



California Independent System  
Operator Corporation

October 23, 2012

The Honorable Kimberly D. Bose  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, DC 20426

**Re: California Independent System Operator Corporation  
Docket No. ER13-\_\_\_\_\_  
Amendment to ISO Tariff**

Dear Secretary Bose:

By this filing, the California Independent System Operator Corporation (“ISO”) respectfully submits revisions to the ISO tariff to clarify the ISO’s role as central counterparty when a utility supplies its own load using resources funded by tax-exempt debt.<sup>1</sup> Under the amendment, the ISO would not be counterparty to such transactions. Instead, the owner of the resource would be transacting with itself. This amendment will ensure that these transactions do not jeopardize the tax-exempt status of the debt used to finance the resource. In addition, the ISO proposes to correct a typographical error.

The ISO requests a ruling within 60 days, and an effective date for the tariff language of November 1, 2012.

## **I. BACKGROUND**

Through Order No. 741,<sup>2</sup> issued on October 10, 2010, the Commission sought to improve the management of risk and the use of credit in organized markets operated by independent system operators and regional transmission organizations. The Commission required independent system operators and regional transmission organizations to implement seven market modifications. This filing concerns one of those modifications: addressing the risk that the organization may not be allowed to use netting and set-offs in bankruptcy proceedings.

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<sup>1</sup> The ISO submits this filing pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d (2006), and Section 35.13 of the Commission’s regulations, 18 C.F.R. § 35.13 (2012).

<sup>2</sup> *Credit Reforms in Organized Wholesale Markets*, 133 FERC ¶ 61,060 (2010), *on reh’g* Order No. 741-A, 134 FERC ¶ 61.126, *reh’g denied*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

In a May 25, 2012, compliance filing, the ISO proposed to address this risk by establishing itself as a central counter party to each scheduling coordinator, congestion revenue rights holder, black start generator, or participating transmission owner for any purchase or sale of any product or service, or for any other transaction, that is financially settled by the ISO under the ISO tariff.<sup>3</sup> In comments on the filing, a number of municipal utilities expressed concern regarding the potential that the ISO's role as a central counterparty could affect the tax-exempt nature of the municipal bonds used to finance their generation assets. They explained that generation developers using such bonds cannot enter into transactions that result in more than ten percent of the power being sold for private use and that the penalty for violating this provision is losing the tax-exempt nature of the interest paid on the bonds. They further contended that, because these market participants are supplying themselves, there is no "sale."<sup>4</sup> The ISO in response expressed its willingness to continue to work with stakeholders to resolve these concerns.<sup>5</sup>

In its order accepting the ISO's compliance filing, the Commission took no action in response to these concerns. It indicated, however, that the ISO, working with its stakeholders, could address this issue in a filing that demonstrates that its new proposal would provide the market the same degree of protection as the counterparty requirement.

The ISO published a paper for stakeholder review describing the amendments related to tax-exempt generation, and held a conference call to discuss those changes. In that process, six stakeholders submitted comments, all of which either support the amendment or do not oppose it.

The ISO Board of Governors approved the amendment during its meeting of September 13, 2012. The memorandum to the Board is included as Attachment C.

As discussed below, the ISO revised the tariff language after the stakeholder process to address additional comments that a stakeholder submitted in recent weeks regarding utilities that serve load outside the ISO balancing authority areas, and to further clarify the language, as discussed below.

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<sup>3</sup> This was one of the options that the Commission set forth in Section 35.47(d) of Title 18, Code of Federal Regulations, promulgated in Order No. 741.

<sup>4</sup> See *Cal. Indep. Sys. Operator Corp.*, 140 FERC ¶ 61,169 at PP 15-16 (2012).

<sup>5</sup> *Id.* at P 19.

## **II. TARIFF REVISIONS**

### **A. Tax-Exempt Generation**

In response to the concerns expressed by municipal utilities, the ISO proposes to revise section 11.29 of the ISO tariff, which establishes the ISO's role as central counterparty, to include the following new language to clarify that there is no sale to the ISO when tax-exempt generation is being used to serve native load:

Bids for Supply submitted by a Scheduling Coordinator for any resource funded by Municipal Tax Exempt Debt are not, and shall not be construed or deemed to be, a sale to the CAISO or other transaction that is financially settled by the CAISO to the extent that the load serving entity that holds entitlements to the resource for which such Bids for Supply are submitted is using its entitlements to serve native load during that interval.

Following that sentence, the ISO would add the following to define more clearly when a resource is being used to serve native load and to exclude any sales of excess energy:

For purposes of this subsection only, a load serving entity is using a resource to serve native load under the following conditions: A) For a Load Serving Entity that is serving demand inside the ISO Balancing Authority Area, if the total MW volume of such Bids for Supply that clear in any settlement interval is less than or equal to the metered CAISO Demand for that settlement interval for the Load Serving Entity that holds entitlements to the resources for which such Bids for Supply are submitted, or B) for load serving entities that serve demand outside of the CAISO Balancing Authority Area by wheeling through or exporting from the CAISO Balancing Authority Area, if the total MW volume of such Bids for Supply that clear in any settlement interval is less than or equal to the total of wheel throughs or exports that are used to serve the native load for the load serving entity that holds entitlements to the resources for which such Bids for Supply are submitted during that settlement interval.

The foregoing language incorporates revisions to the language reviewed by stakeholders to address a concern raised late in the process by load-serving utilities outside the ISO's balancing authority area. At their request, the ISO revised the language to clarify that it applies equally to those load-serving entities, to the extent they use the ISO grid.

Finally, to assure stakeholders that this language does not have other consequences for settlement and credit, the ISO proposes to add:

Nothing in the two preceding sentences shall affect credit requirements under Section 12 of the CAISO Tariff or settlements charges or credits issued pursuant to any section of the CAISO tariff. The details of such Bids for Supply may be

included in Settlement Statements by the CAISO for purposes of calculating settlement charges and credits other than for Supply.

The Commission has accepted an analogous provision proposed by the Midwest Independent System Operator (“MISO”) to protect the tax-exempt status of its participants in an order issued August 8, 2012.<sup>6</sup> MISO had argued that generator self-supply transactions do not have a counterparty for the sale of energy because the market participants are supplying themselves.<sup>7</sup> The Commission concluded that the MISO proposal was reasonable in light of the fact that there is no ambiguity regarding the counterparty for those transactions.<sup>8</sup>

This reasoning is equally applicable to the ISO’s proposed amendment. To the extent a Scheduling Coordinator’s generation that clears the ISO’s markets in a particular settlement interval is greater than that Scheduling Coordinator’s actual demand during the same settlement interval, the Scheduling Coordinator is supplying itself in the same manner as a market participant submitting a generator self-supply transaction in MISO. There is thus no ambiguity regarding the counterparty in such a transaction.

Moreover the ISO’s proposal is narrower than MISO’s. While MISO’s tariff provision applies to all self-supply, the ISO’s proposal is limited to schedules involving tax-exempt generation, because that is the only area in which substantial concerns have been raised.

Additionally, outside bankruptcy counsel has advised the ISO that the netting that occurs with respect to self-supply transactions, which under the ISO’s proposal must be submitted in the same settlement interval, is more akin to recoupment than setoff. Unlike setoff, recoupment neither appears in the Bankruptcy Code nor is subject to the mutuality requirement that concerns the Commission. Recoupment is, instead, an equitable principle, uniformly recognized by bankruptcy courts, that allows a creditor to show that it is not liable for the full amount of the debtor’s claim because of matters that arise out of the same transaction. Self-supply transactions, while possibly involving multiple Bids within the same settlement interval, are by definition part of a single, integrated transaction. As such, recoupment could provide an independent and additional basis for the Commission to conclude that the ISO’s proposed revision would survive a challenge in bankruptcy.

Finally, the ISO’s outside bankruptcy counsel also observed that the proposed amendment will not undermine the independent argument made by the ISO that the Federal Power Act preempts any challenge to netting required by a FERC tariff. For all

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<sup>6</sup> See *Midwest Indep. Transmission Sys. Operator, Inc.*, 140 FERC ¶ 61,116 (2012).

<sup>7</sup> *Id.* at P 12.

<sup>8</sup> *Id.* at P 20.

of these reasons, the ISO believes that its proposed revision to section 11.29 of the ISO's tariff should be approved.

#### **B. Other Clarification of the Central Counterparty Provisions**

In addition, the ISO has a ministerial amendment to the language filed on May 25, 2012. The ISO proposes to correct a typographical error in Section 11.29(b), which currently reads:

The purchase of sale of any products or service, or any other transaction, that is financially settled by CAISO under this CAISO Tariff shall be deemed to occur within the State of California.

To correct the error, the ISO would change the third word in this sentence to "or," so that it reads "purchase *or* sale."

#### **III. EFFECTIVE DATE AND REQUEST FOR WAIVER**

Because the tariff amendments are intended to protect the tax-exempt status of market participants, the ISO asks that FERC waive the 60-day notice requirement and allow the amendment to become effective November 1, 2012.

#### **IV. COMMUNICATIONS**

Please direct communications regarding this filing to the following persons:

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\* Persons designated for service.

#### **V. SERVICE**

The ISO has served copies of this transmittal letter, and all attachments on the California Public Utilities Commission, the California Energy Commission, and all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In

addition, the ISO is posting this transmittal letter and all attachments on the ISO Website.

## VI. ATTACHMENTS

The following documents, in addition to this transmittal letter, support the instant filing:

- |                     |                                                                                 |
|---------------------|---------------------------------------------------------------------------------|
| <b>Attachment A</b> | Revised ISO tariff sheets that incorporate the proposed changes described above |
| <b>Attachment B</b> | ISO tariff revisions shown in black-line format                                 |
| <b>Attachment C</b> | Memorandum to ISO Board of Governors                                            |

## VII. CONCLUSION

For the reasons discussed above, the ISO requests that the Commission approved the ISO's proposed tariff revisions as compliant with Order No. 741.

Respectfully submitted,

*/s/ Daniel J. Shonkwiler*

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**Attachment A – Clean Tariff**

**Amendment to Counterparty Provisions of the ISO Tariff**

**California Independent System Operator**

**Fifth Replacement FERC Electric Tariff**

**October 23, 2012**

**11.29 CAISO as Counterparty; Billing and Payment;**

- (a) The CAISO shall be the contracting counterparty, in its own name and right, to each Scheduling Coordinator, CRR Holder, Black Start Generator, or Participating TO for any purchase or sale of any product or service, or for any other transaction, that is financially settled by the CAISO under the CAISO Tariff, except under the following circumstances:
- (i) The CAISO shall not be the contracting counterparty for transactions that procure Station Power for a Generating Unit located in Mexico or for transactions that procure Energy or Ancillary Services within Mexico; for such transactions, the CAISO will not act as principal but instead as agent for and on behalf of the relevant Scheduling Coordinators.
  - (ii) The provisions of this Section 11.29 will not apply to the billing and payment of transactions associated with Trading Days that occurred prior to September 1, 2012. Billing and payment of such transactions shall be governed by the terms of the tariff effective on the Trading Days.
  - (iii) The CAISO's status as contracting counterparty is not intended to affect the tax-exempt status of transmission facilities or entitlements subject to the CAISO's operational control.

Bids for Supply submitted by a Scheduling Coordinator for any resource funded by Municipal Tax Exempt Debt are not, and shall not be construed or deemed to be, a sale to the CAISO or other transaction that is financially settled by the CAISO to the extent that the load serving entity that holds entitlements to the resource for which such Bids for Supply are submitted is using its entitlements to serve native load during that interval. For purposes of this subsection only, a load serving entity is using its entitlements to a resource to serve native load under the following conditions: A) For a Load Serving Entity that is serving demand inside the ISO Balancing Authority Area, if the total MW volume of such Bids for Supply that clear in any settlement interval is less than or equal to the metered CAISO Demand for that settlement interval for the Load Serving Entity that holds entitlements to the resources for which such Bids for Supply are submitted, or B) for load serving entities that serve demand outside of the CAISO Balancing Authority

Area by wheeling through or exporting from the CAISO Balancing Authority Area, if the total MW volume of such Bids for Supply that clear in any settlement interval is less than or equal to the total of wheel throughs or exports that are used to serve the native load for the load serving entity that holds entitlements to the resources for which such Bids for Supply are submitted during that settlement interval. Nothing in the two preceding sentences shall affect credit requirements under Section 12 of the CAISO Tariff or settlements charges or credits issued pursuant to any section of the CAISO tariff. The details of such Bids for Supply may be included in Settlement Statements by the CAISO for purposes of calculating settlement charges and credits other than for Supply.

- (b) The purchase or sale of any products or service, or any other transaction, that is financially settled by CAISO under this CAISO Tariff shall be deemed to occur within the State of California. To the extent permitted by applicable law, any warranties provided by the sellers to the CAISO of such products or services, whether express, implied or statutory, are hereby passed to the Business Associates who purchase such products or services from the CAISO on a “pass through basis” and to the extent not passed through, any such warranties are hereby assigned by the CAISO to the purchasing Business Associates. Sellers to the CAISO and Business Customers acknowledge that warranties on such products are limited to that offered by the seller to CAISO and will exist, if at all, solely between the seller to the CAISO and the purchasing Business Associate. AS BETWEEN THE PURCHASING BUSINESS ASSOCIATE AND THE CAISO AS COUNTERPARTY, NO EXPRESS OR IMPLIED WARRANTIES ARE MADE BY THE CAISO REGARDING THE PRODUCTS AND SERVICES SOLD BY THE CAISO AS COUNTERPARTY, AND ANY SUCH PRODUCTS AND SERVICES ARE PROVIDED ON AN “AS IS” AND “AS AVAILABLE” BASIS. THE CAISO MAKES NO WARRANTY OR REPRESENTATION THAT THE PRODUCTS OR SERVICES WILL BE UNINTERRUPTED OR ERROR FREE. PURCHASING BUSINESS ASSOCIATES HEREBY WAIVE, AND THE CAISO HEREBY DISCLAIMS, ALL OTHER WARRANTIES, EXPRESSED OR IMPLIED, INCLUDING, WITHOUT LIMITATION, ANY WARRANTY OF

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- (c) The CAISO will calculate for each charge the amounts payable by the relevant Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each Settlement Period of the Trading Day, and the amounts payable to that Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each charge for each Settlement Period of that Trading Day and shall arrive at a net amount payable for each charge by or to that Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each charge for that Trading Day. Each of these net amounts will appear in the Settlement Statements that the CAISO will provide to the relevant Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO.
- (d) The components of the Grid Management Charge will be included in an Initial Settlement Statement T+3B, and any Recalculation Settlement Statement with the other types of charges referred to in Section 11.

**Attachment B – Marked Tariff**

**Amendment to Counterparty Provisions of the ISO Tariff**

**California Independent System Operator**

**Fifth Replacement FERC Electric Tariff**

**October 23, 2012**

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- (c) The CAISO will calculate for each charge the amounts payable by the relevant Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each Settlement Period of the Trading Day, and the amounts payable to that Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each charge for each Settlement Period of that Trading Day and shall arrive at a net amount payable for each charge by or to that Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO for each charge for that Trading Day. Each of these net amounts will appear in the Settlement Statements that the CAISO will provide to the relevant Scheduling Coordinator, CRR Holder, Black Start Generator or Participating TO.
- (d) The components of the Grid Management Charge will be included in an Initial Settlement Statement T+3B, and any Recalculation Settlement Statement with the other types of charges referred to in Section 11.

**Attachment C – Memorandum to ISO Board of Governors**  
**Amendment to Counterparty Provisions of the ISO Tariff**  
**California Independent System Operator**  
**Fifth Replacement FERC Electric Tariff**  
**October 23, 2012**

# Memorandum

**To:** ISO Board of Governors

**From:** Nancy Saracino, Vice President, General Counsel & Chief Administrative Officer

**Date:** September 7, 2012

**Re: Decision on Central Counterparty Exemption for Self-Supply from Tax-Exempt Generation**

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***This memorandum requires Board action.***

## BACKGROUND AND EXECUTIVE SUMMARY

Historically, the ISO has been a pass-through entity with respect to market transactions. Market participants transacted directly with one another, with the ISO serving as an agent. This structure changed as a result of FERC Order No. 741, which imposed several requirements related to the credit practices of ISOs and RTOs. To comply with these requirements, the ISO amended its tariff to make the ISO a central counterparty to market transactions. FERC accepted that filing in an order issued August 31, 2012. As a result, the ISO is now a principal rather than an agent in market transactions – a buyer to every seller, and vice-versa.

Management proposes to provide a limited exception to the new central counterparty structure. This exception is designed to ensure that this structure does not jeopardize the tax-exempt status of bonds that were issued to finance certain generation projects. This amendment was requested by several publicly-owned utilities that are part of the ISO and was raised by Riverside at the July Board meeting. FERC has approved a similar exception for the Midwest ISO.

Management recommends the following motion:

***Moved, that the ISO Board of Governors approves the proposed tariff change to exempt from the central counterparty structure self-supply transactions from generation financed by tax-exempt bonds, as described in the memorandum dated September 7, 2012; and***

***Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change.***

## **DISCUSSION AND ANALYSIS**

During the stakeholder process regarding the ISO's filing to become a central counterparty, several publicly-owned utilities expressed concerns about how the change might affect the tax-exempt status of bonds they had issued to finance generation projects. These generators are intended to supply the customers of the publicly-owned utilities that issue the bonds. Other uses of the generators, known as "private use," are restricted by covenants in the bonds. Although the publicly-owned utilities will continue using these generation projects to serve their own customers, they are concerned that their self-supply schedules might now be considered private use because they would involve a sale of energy to the ISO as a central counterparty in the ISO market. Private use could jeopardize the bonds' tax-exempt status.

Management proposes to amend the tariff to create a limited exception from the central counterparty structure for self-supply from generation funded by tax-exempt debt. This exemption would apply so long as the supply from this generation does not exceed the utility's load during the relevant settlement interval. Generation that exceeds the utility's load would continue to be a transaction with the ISO as a central counterparty. The proposed tariff provision would be similar to one that FERC accepted for the Midwest ISO in an order issued August 8, 2012 to protect the tax-exempt status of its participants. It would not require any changes to the ISO market rules or software, and will not affect settlements or credit requirements.

## **STAKEHOLDER PROCESS**

An explanation of the ISO's proposal, including draft tariff language, was posted for stakeholder review. Six written comments were received from stakeholders, all of which either support the proposal or do not oppose it. Supportive comments were submitted by the California Municipal Utilities Association, the Northern California Power Agency, the Southern California Public Power Authority, the City of Santa Clara, and collectively by the cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside. In addition, Southern California Edison stated that it does not oppose the amendment, provided that it will not affect requirements for collateralization, allocation of default loss, or settlements charges.

Following the written comments, the ISO held a conference call with stakeholders to review the proposal and answer questions. During that call, staff addressed the comment from Southern California Edison by stating explicitly in the draft tariff language that the amendment will not affect calculations of collateral, default loss allocation, or settlements charges.

## **CONCLUSION**

Management requests that the Board approve the proposed tariff amendment as a change that provides assurances for municipal entities that their bond covenants will not be harmed as a result of the central counterparty tariff change.