

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,)	
Complainant,)	
)	
v.)	
)	Docket Nos. EL00-95-000,
All Sellers of Ancillary Services into)	<i>et al.</i>
Markets Operated by the)	
California Independent System)	
Operator Corporation and the)	
California Power Exchange,)	
Respondents.)	
)	
<i>et al.</i>)	

**ANSWER OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO THE EMERGENCY MOTION FOR CLARIFICATION
ON CREDITWORTHINESS ISSUES
OF DYNEGY POWER MARKETING, INC., ET AL.**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("ISO")¹ hereby provides its Answer to the Emergency Motion for Clarification on Creditworthiness Issues ("Motion") of Dynegy Power Marketing, Inc., El Segundo Power LLC, Long Beach Generation LLC, Cabrillo Power I LLC, and Carbrillo Power II LLC (collectively, "Dynegy"), filed on December 22, 2000.

¹ Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, ISO Tariff Appendix A, as filed August 15, 1997, and subsequently revised.

In its Motion, Dynegy requests that the Commission take various actions to protect Generators in light of the financial crises facing Utility Distribution Companies (“UDCs”) in California. In particular, Dynegy asks that the Commission (1) direct the ISO to shorten the period during its settlement process during which amount owed to the ISO must be paid; (2) require the ISO to offset amounts owing to the ISO against amounts owed from the ISO in its billings to Market Participants; (3) affirm the creditworthiness requirements of the ISO Tariff; and (4) rule that the penalties for nondelivery established under Amendment No. 33 to the ISO Tariff are not applicable to a refusal to deliver power to a purchaser that has not complied with the ISO’s creditworthiness requirements. Motion at 4, 7.

The ISO already offsets amounts owed against amounts owing in its invoices. This request therefore does not require Commission action.

The ISO understands the concerns that motivate these requests and, in filing Amendment No. 36 to the ISO Tariff on January 4, 2001, has asked the Commission to provide it with guidance regarding resolution of creditworthiness issues. Creditworthiness issues should, however, be addressed in the Amendment No. 36 proceeding. They are not at issue in the instant proceedings. Moreover, even if the Commission believes it is appropriate to address these issues in this proceeding, Dynegy’s recommendations should be rejected. The first is unworkable at this time and would simply aggravate the current financial crises. The second would create the potential for significant inappropriate cost shifting. Regarding the third, the ISO is concerned that simple reaffirmation of

the creditworthiness standards would present serious risks to the California electricity market and to consumers, but, as indicated above, has sought Commission guidance in this regard. Implementation of the fourth request would defeat the purpose of Amendment No. 33.

DISCUSSION

I. Dynegy's Motion Raises Issues That Are Not Implicated in This Proceeding

Dynegy styles its filing as a "Motion for Clarification on Creditworthiness Issues" of the Commission's December 1 Order. The Commission's December 1 Order, however, did not address or even implicate the creditworthiness requirements of the ISO Tariff. Accordingly, there is nothing in the Commission's order that requires clarification in this regard.

In addition, the Motion requests clarification regarding the penalties included in Amendment No. 33 of the ISO Tariff. The penalties included in Amendment No. 33 are the subject of Docket No. ER01-607, and are not at issue in these dockets. If Dynegy seeks clarification regarding Amendment No. 33, it should do so in Docket No. ER01-607.

II. Dynegy's Requests Are Inappropriate and Counterproductive

The ISO shares Dynegy's concerns about the financial situation facing investor-owned UDCs in California. The combination of soaring wholesale prices and capped retail rates has placed severe stress on those UDCs. Although the Commission, in its November 1, 2000, and December 15, 2000, Orders in this

proceeding,² took significant action to ameliorate the current crisis in California, the impact of the Commission's Orders will not be immediate. Indeed, last week the credit ratings of Southern California Edison ("Edison") and Pacific Gas and Electric Company ("PG&E") were downgraded. Because the immediate crisis is precipitated by the ISO's creditworthiness requirements, the ISO will discuss that issue first.

A. Credit-Worthiness Requirements

The financial straits facing the UDCs severely threaten the continued provision of reliable electric service to Californians. Under Section 2.2.3.2 of the ISO Tariff, a Scheduling Coordinator must maintain an Approved Credit Rating³ or provide the ISO with one of several specified forms of security. In the case of a failure to maintain an Approved Credit Rating, Section 2.2.7.3 of the ISO Tariff requires that the security must be adequate to cover the Scheduling Coordinator's entire outstanding liability to the ISO.

Section 2.2.3.2 further provides, "A Scheduling Coordinator, UDC, or MSS which does not maintain an Approved Credit rating shall be subject to the limitations on trading set out in Section 2.2.7.3." The latter section provides:

Following the date on which a Scheduling Coordinator commences trading, the Scheduling Coordinator shall not be entitled to submit a Schedule to the ISO and the ISO shall reject any Schedule submitted, if at

² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 93 FERC ¶ 61,121; 93 FERC ¶ 61,294 (2000).

³ The Approved Credit Rating is defined in the ISO Tariff as including (1) for the Grid Management Charge, short term taxable commercial paper debt ratings of A1 from Standard and Poor's Corporation, P1 from Moody's Investors Service, or an equivalent rating from certain other agencies; and (2) for other charges, A2 from Standard and Poor's Corporation, P2 from Moody's Investors Service, or an equivalent rating from certain agencies.

the time of submission, the Scheduling Coordinator's ISO Security Amount is exceeded by the Scheduling Coordinator's estimated aggregate liability.

...

Thus, under the ISO Tariff, a downgrade in a Scheduling Coordinator's credit rating coupled with the inability to provide security in the required amount, would preclude the Scheduling Coordinator from scheduling transactions with the ISO.

As a result of the downgraded credit rating, absent Amendment No. 36, Edison and PG&E would be precluded from scheduling on their own behalf. That the California Power Exchange ("PX") is currently the Scheduling Coordinator for the UDCs⁴ does not adequately resolve this problem. The California PX must recover from the UDCs the costs it incurs under the ISO Tariff on their behalf. The ISO's understanding is that it has no source of funding other than the reimbursement from the entities for which it is Scheduling Coordinator and the administrative charges from operating the power exchanges. The UDCs serve the vast majority of the Load in California and, therefore, are responsible for the greater part of the PX's costs. If a UDC can no longer receive credit, the credit rating of the PX will almost certainly fall below the required "Approved Credit Rating." Under such a circumstance, inasmuch as the PX does not have independent ability to provide security for its indebtedness to the ISO – which currently exceeds one billion dollars – it would lose the ability to schedule transactions with the ISO. Because, as noted above, the vast majority of the populace in California depends upon the ability of the investor-owned UDCs to schedule transactions through the California Power Exchange, imposition of the

⁴ In light of the December 15, 2000, Order, it is possible that the UDCs may need to schedule directly in the near future.

trading limitations included in Section 2.2.7.3 would have a devastating impact on California electric consumers.

Under such circumstances, a relaxation of the creditworthiness requirements of the ISO Tariff would seem to be necessary in order to ensure continued electricity service to Californians. On the other hand, as Dynegy suggests in its Motion, such a relaxation could cause Generators to cease voluntarily selling into the California markets. Presumably, in order to keep electricity flowing in California, the ISO could rely upon its authority to call units out-of-market. This authority, while presumably sturdy enough to enable the ISO to meet its responsibility to ensure reliable service, was originally intended for short-term, physical emergencies. Invoking this authority would not address the concerns of Generators such as Dynegy that they might be forced to deliver Energy, perhaps for an extended period, for compensation less than they could expect to receive under viable market conditions.

The creditworthiness provisions of the ISO Tariff, which Dynegy now seeks to have the Commission reaffirm, were the product of intensive negotiations. They were intended to provide Market Participants with the financial security that they consider necessary in order to operate in California markets. These requirements that Scheduling Coordinators provide security were deemed necessary because the ISO is not itself the purchaser of electricity in the ISO's markets and even if it were, as a non-profit public benefit corporation, it lacks the authority and the funds to provide such security itself. Under current circumstances, however, implementation of the measures that the ISO Tariff would require (absent Amendment No. 36) could be expected to

cripple the ability of one or more of the UDCs to serve their customers – which could mean the great majority of California consumers could not be served.

Accordingly, the ISO has filed Amendment No. 36 to the ISO Tariff to provide a temporary exemption from the ISO Tariff for the UDCs and has sought guidance from the Commission regarding the appropriate course of action to resolve the dilemma we have described. The ISO is prepared to take whatever action is necessary to ensure continued service to California consumers during this financial crisis, through further amendment of the Tariff or other appropriate avenues as suggested by the Commission. There is thus no reason for the Commission to take action on Dynegy's request in this proceeding.

B. Payment Calendar

The ISO currently operates under a 75 day payment calendar. This period is largely dictated by the 60 days required to obtain and process meter data on which to base the billing. Dynegy requests that the Commission reduce the payment cycle to 30 days, with the ISO then billing according to estimated charges. Although Dynegy's desire to reduce its exposure to default is understandable, this proposal is not currently practical and would be counter-productive.

First, the ISO cannot estimate amounts owed by the PX with any degree of accuracy. At the moment, and until the market achieves the standard of scheduling 95 percent of its Demand in forward markets that was established in the Commission's December 1, 2000, Order, a significant portion of the costs borne by the PX are Imbalance Energy charges. These charges depend upon

the largely unpredictable scheduling and Generation practices of Market Participants. While the ISO has studied methods to implement a shorter billing cycle, such methods could not be implemented immediately.⁵

More importantly, shortening the payment period could only aggravate the current financial crisis. As noted above, the PX's current obligations to the ISO are in excess of one billion dollars. The current payment cycle allows the UDCs some leeway to work with the California Public Utilities Commission and their creditors to avoid triggering the trading limitations imposed by the ISO Tariff. Shortening the payment cycle may well precipitate the intolerable consequences of a loss of creditworthiness that all are endeavoring to avoid. Moreover, because the payment would of necessity be based on historical estimates and would ignore the potential impact of the Commission's recent actions, it might even include amounts that will not indeed be owed.

Shortening the payment cycle can only exacerbate the current crisis. The Commission should avoid such action.

C. Amendment No. 33 Penalties

Amendment No. 33 to the ISO Tariff provides penalties for Generators that, contrary to their contractual commitments through the ISO's Participating Generator Agreements, refuse to provide Energy when dispatched by the ISO. Dynegy contends that the penalties should not apply when the ultimate

⁵ The ISO has explored these alternatives through a stakeholder process with the Settlements Improvement Team. While substantial progress has been made in developing an approach that could allow for estimated billings, significant issues remain that restrict the value of such a plan and limit stakeholder support.

purchaser of the Energy has not satisfied the creditworthiness provisions of the ISO Tariff.

As noted in the transmittal letter accompanying Amendment No. 33, these penalties were explicitly intended to apply to Generators that, because they believe compensation is inadequate, refuse a Dispatch order when the ISO is acting to avoid or address System Emergencies. The underlying premise is that a Generator's concern about the adequacy of its compensation, whether due to the level of compensation or other factors, is not a sufficient reason to permit interruption of electric service in California.

Dynegy and other Participating Generators are signatories to individual Participating Generator Agreements with the ISO. Those agreements obligate them to comply with the terms of the ISO Tariff. Section 5.6.1 provides that the Generating Units, System Units, and System Resources owned by a Participating Generator are subject to ISO Control during an existing, imminent, or threatened System Emergency. Amendment No. 33 provides the penalties for failure to comply with the obligations imposed by the Participating Generator Agreement.

The implementation of restructuring and market-based rates does not provide public utilities *carte blanche* to ignore the public interest. If Dynegy wishes to continue to reap the apparently significant financial benefits of participation in the California markets, it must bear the costs and risks associated with that participation.

CONCLUSION

For the reasons discussed above, the ISO requests that the Commission reject Dynegy's proposals for shortening the ISO's payment cycles, offsetting credits against debits, and exempting Generators with creditworthiness concerns from the penalties of Amendment No. 33. The ISO also requests that issues concerning the conflict between furthering the purpose of the creditworthiness standards and ensuring the continued provision of electric service to California consumers be addressed in the context of Amendment No. 36 to the ISO Tariff.

Respectfully submitted,

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