



# 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.