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9 System Operator Corporation

10 UNITED STATES BANKRUPTCY COURT
11 NORTHERN DISTRICT OF CALIFORNIA
12 SAN FRANCISCO DIVISION

13 In re) Case No. 01-30923 DM
14)
15 PACIFIC GAS & ELECTRIC) Chapter 11
16 COMPANY, a California)
17 corporation,)
18 Debtor.) STATEMENT BY CALIFORNIA
19) INDEPENDENT SYSTEM OPERATOR
20) CORPORATION IN SUPPORT OF
21) DEBTOR'S MOTION FOR AUTHORITY
22) TO RESUME POWER PROCUREMENT,
23) INCLUDING PROCUREMENT OF THE
24) RESIDUAL NET SHORT POSITION AND
25) TO INCUR POST-PETITION SECURED
26) DEBT RELATED THERETO
27)
28)
29) Date: December 23, 2002
30) Time: 1:30 p.m.
31) Place: 235 Pine St., 22nd Floor
32) San Francisco, CA

33 TO THE HONORABLE DENNIS MONTALI, UNITED STATES BANKRUPTCY
34 JUDGE:

35 The California Independent System Operator
36 Corporation ("ISO") hereby submits its Statement In Support Of
37 Debtor's Motion For Authority To Resume Power Procurement,
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1 Including Procurement Of The Residual Net Short Position And
2 To Incur Post-Petition Secured Debt Related Thereto as
3 follows:
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5 I. SUMMARY

6 This statement is submitted both to clarify certain
7 points of law relating to the Debtor's Motion For Authority To
8 Resume Power Procurement (the "Motion"), and to address points
9 raised in certain oppositions to the Motion filed by Merced
10 Irrigation District ("Merced"), the City of Palo Alto ("Palo
11 Alto"), and the Northern California Power Agency ("NCPA")
12 (collectively, the "Oppositions"). The Oppositions disregard
13 the federal and state regulatory requirements which the Debtor
14 must meet - and appropriately seeks authority to meet - to
15 resume power procurement as prayed in the Motion. The
16 Oppositions argue - without evidentiary support - that the
17 Debtor's Motion is primarily a tactic to further its own self-
18 interest with respect to its present chapter 11 plan
19 confirmation efforts. This misleading and inflammatory
20 argument distracts from the crucial issue to be decided, which
21 is: does the Debtor have the authority to take those actions
22 necessary to meet state regulatory requirements and security
23 thresholds required by the ISO's federal tariff to resume
24 energy procurement to meet its Residual Net Short energy
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1 position? The ISO herein emphasizes the importance of a
2 ruling from this Court either (1) granting the Debtor the
3 authority to post an adequate form of security with the ISO
4 and resume procuring of the Residual Net Short and Ancillary
5 Services or, alternatively, (2) determining that such action
6 is within the ordinary course of business for Debtor and does
7 not require the Court's authorization.

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9 II. THE DEBTOR MUST POST ADEQUATE SECURITY IN ORDER TO
10 QUALIFY AS A SCHEDULING COORDINATOR AND RESUME PROCUREMENT OF
11 ENERGY TO COVER NET SHORT POSITION.

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13 In order to resume the procurement of energy to cover its
14 Residual Net Short position, Debtor is required by the ISO
15 federal Tariff to post adequate security for such procurement
16 transactions since it does not otherwise meet the Approved
17 Credit Rating for Scheduling Coordinators that establish the
18 creditworthiness requirements to participate in the ISO's
19 markets. ISO Tariff Section 2.1.1 provides that Energy and
20 Ancillary Services (essentially, generation capacity that is
21 committed to the ISO to maintain required system reserves)
22 "may be transmitted . . . into, out of or through the ISO
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The "Residual Net Short" is the difference between an energy
provider's gross metered Demand and the resources available to it to meet
that Demand, including its retained generation, any long-term State of
California Department of Water Resources contracts, and any other bilateral
contracts to purchase power. The net short represents the amount of energy
that the energy provider anticipates procuring through the ISO markets.

1 Controlled Grid only if scheduled by Scheduling
2 Coordinator."

3
4 Specifically, the ISO Tariff sets credit requirements for
5 Scheduling Coordinators to ensure, among other things, the
6 financial viability of the ISO markets. ISO Tariff Section
7 2.2.3.2 requires each Scheduling Coordinator either to
8 maintain an Approved Credit Rating or provide in favor of the
9 ISO: (i) an irrevocable and unconditional letter of credit;
10 (ii) an irrevocable and unconditional surety bond; (iii) an
11 irrevocable and unconditional guarantee; (iv) a cash deposit
12 standing to the credit of an interest bearing escrow account
13 maintained at a bank or financial institution designated by
14 the ISO; (v) a certificate of deposit in the name of the ISO;
15 or (vi) a payment bond certificate in the name of the ISO.²

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17 In a series of orders issued during California's energy
18 crisis regarding implementation of the Tariff's credit
19 requirements in these circumstances, the Federal Energy
20 Regulatory Commission ("FERC") commanded that the ISO provide
21 all "third-party suppliers [of Energy and Ancillary Services]
22 assurances of a creditworthy buyer for all energy delivered to
23 loads through the ISO." California Independent System
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² ISO Tariff Section 2.2.7.2 states that the amount to be posted is
intended to cover the entity's outstanding and estimated liability for
either (i) the Grid Management Charge; and or (ii) Imbalance Energy,
Ancillary Services, Grid Operations Charge, Wheeling Access Charge, High
Voltage Access Charge, Transition Charge, Usage Charges and Federal Energy
Regulatory Commission Annual Charges.

1 Operator Corporation, 95 F.E.R.C. P.61,026 at 61,081, 2001
2 FERC LEXIS 779 **6 (April 6, 2001). In its June 13, 2001
3 Order, FERC required "that the ISO obtain prior assurances of
4 payment for all third-party power supplied to [SCE] and PG&E,
5 whether directly or through purchases by DWR . . . on their
6 loads' behalf." California Independent System Operator
7 Corporation, 95 F.E.R.C. P61,391 at 62,459, 2001 FERC LEXIS
8 1377, *22 (June 13, 2001)

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10 Since January 2001 and the adoption by the California
11 Legislature of ABX1-1, the California Department of Water
12 Resources ("DWR") has served as the creditworthy Scheduling
13 Coordinator purchasing and scheduling the Residual Net Short
14 for Debtor's customers. DWR's authority to purchase power
15 under ABX1-1 expires on January 1, 2003. When DWR ceases to
16 purchase and schedule power under ABX1-1, the ISO understands
17 that Debtor will again become the Scheduling Coordinator for
18 all of its own Load, including purchasing and scheduling the
19 energy represented by its Residual Net Short position.
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1 III. FAILURE OF THE DEBTOR TO POST THE REQUISITE SECURITY WILL
2 POTENTIALLY HAVE SUBSTANTIAL ADVERSE IMPACT ON THE ISO'S
3 ABILITY TO ENSURE THAT ENERGY GENERATION WILL MEET THE ENERGY
4 DEMAND; THEREFORE, THE RELIEF REQUESTED IS A SOUND EXERCISE OF
5 BUSINESS JUDGMENT BY THE DEBTOR.
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7 If Debtor does not post the requisite security and
8 qualify under the ISO Tariff as a Scheduling Coordinator for
9 its Net Short Electricity position, and DWR is, by statute, no
10 longer able to fulfill that role, the ISO will have no ability
11 to provide Energy or Ancillary Services to Debtor to cover the
12 Residual Net Short. The ISO cannot, per the FERC Orders
13 discussed above and the ISO Tariff, procure Energy or
14 Ancillary Services on behalf of Debtor's customers.
15

16 Simply stated, if the Debtor does not post the requisite
17 security on a timely basis the ISO may not permit it to serve
18 as a Scheduling Coordinator for its Residual Net Short in
19 accordance with the legal requirements. A timely posting is
20 necessary because the posting must allow a minimum of time for
21 the ISO to make all necessary arrangements for Debtor to begin
22 scheduling in the ISO Day-Ahead Market on December 31, 2002,
23 for purchases to be effected on January 1, 2003. Absent such
24 a timely posting energy providers in the ISO market will not
25 be assured full payment, which would undoubtedly disrupt the
26 ISO's Scheduling process, and could potentially cause a
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1 disastrous loss of confidence in the viability of ISO markets.
2 In accordance with the ISO Tariff, the ISO relies upon the
3 Scheduling process as a principal means to ensure that
4 generation meets demand. If Debtor does not post security,
5 the issues and logistics of otherwise scheduling or accounting
6 for Debtors' Load (approximately 14,000 MW) and resources
7 would severely strain the ISO's ability to match generation
8 and demand to cover Debtor's Residual Net Short in real time.
9 Alternatively stated, if the Residual Net Short for any hour
10 is in the range of 1,000 MW or greater, the reliability of the
11 system could be impaired and load shedding (i.e. outages) in
12 Debtor's service territory could be necessary.

13 This circumstance, contrary to Merced's argument, could
14 lead to blackouts. Accordingly, in the interest of the
15 public, the Debtor, its creditors and security holders, ISO
16 prays for the Court to grant the Motion.
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1 IV. THE ISO REQUESTS THAT THE COURT FIND THAT THE DEBTOR MAY
2 COMPLY WITH THE REGULATORY FRAMEWORK OUTLINED ABOVE IN THE
3 ORDINARY COURSE OF ITS BUSINESS WITHOUT FURTHER ORDER OF THE
4 COURT PURSUANT TO 28 U.S.C. § 959(b).
5

6 In the alternative, the ISO believes that the Debtor's
7 resumption of energy procurement to cover its Residual Net
8 Short position and posting of security with the ISO are within
9 the ordinary course business. As set forth in 28 U.S.C. §
10 959(b), the Debtor:

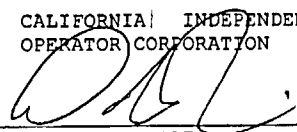
11 "shall manage and operate the property, in
12 his possession . . . according to the
13 requirements of the valid laws of the
14 State in which such property is situated .
15 . . ."

16 Because the resumption of energy procurement is a
17 regulatory obligation of the Debtor, the ISO believes that the
18 Court's authorization to take those actions necessary to
19 comply with those regulations is unnecessary. Given the
20 rubric of the bankruptcy laws, however, the ISO recognizes the
21 appropriateness to request express authority from the Court in
22 an abundance of caution.
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1 V. ALTERNATIVELY, IF THE COURT FINDS THAT THE MOTION
2 REQUESTS RELIEF OUTSIDE THE ORDINARY COURSE OF THE DEBTOR'S
3 BUSINESS, IF THE DEBTOR DEMONSTRATES THAT MOTION SHOULD BE
4 GRANTED PURSUANT TO 11 U.S.C. §§ 363(B) AND 364.
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6 For the reasons stated in Sections II and III, above, the
7 Motion should be granted pursuant to 11 U.S.C. §§ 363(b) and
8 364 with respect to the resumption of energy procurement and
9 incurring post-petition debt to meet the security requirements
10 described above.

11 Dated: December 17, 2002 CALIFORNIA INDEPENDENT SYSTEM
12 OPERATOR CORPORATION

13
14 By: 
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