

Background

Docket No. ER03-552-000, et al. (Creditworthiness)

2. On February 21, 2003, as amended on March 9, 2003, the NYISO filed revisions to its Tariffs to specify the creditworthiness requirements for customers participating in the NYISO-administered markets. NYISO states that the proposed creditworthiness requirements protect against losses attributable to non-payment by a NYISO customer without creating barriers to entry or unduly burdening customers in these markets. The NYISO explains that the revisions have been designed with the understanding that the customers who will be subject to the requirements are also those for whose benefit the requirements have been designed, since they ultimately have to cover the bad debts of other customers. The NYISO is filing these provisions to provide a detailed description of its creditworthiness requirements, as was previously required by the Commission.¹

3. Under the proposed revisions in Attachment W, the NYISO would determine a customer's projected financial obligation to the NYISO market and determine whether to extend unsecured credit toward that obligation based on the customer's creditworthiness. If a customer does not have unsecured credit, or to the extent that a customer's financial obligation exceeds its unsecured credit, it must provide collateral to the NYISO.

4. The NYISO proposes to calculate an "Operating Requirement" that reflects the nonpayment exposure attributable to each customer based on the customer's activity in each of the NYISO's markets.² A customer's Operating Requirement has four parts: an Energy and Ancillary Services Component (an estimate of a customer's daily financial obligations in the Energy and Ancillary Services markets and its ability to meet those obligations); a UCAP Component (calculated as the sum of all amounts then owed for UCAP purchases); a TCC Component (reflecting credit requirements for primary holders of Transmission Congestion Charges); and a Bid Component (based on a customer's

¹See New York Independent System Operator, Inc., et al., 98 FERC & 61,282 at 62,217 (2002) (March 2002 Order).

²Every customer participating in any of the NYISO-administered markets, including sellers, will be subject to the proposed creditworthiness requirements. Assuming a seller is a net supplier of energy, the Energy Component of its Operating Requirement would be zero. Under normal circumstances, therefore, the seller would be required to demonstrate creditworthiness or provide collateral only in the event that its Operating Requirement reflected activities in other markets that require it.

requested amount of authorization to bid in UCAP and TCC auctions and the maximum amount that the customer may be required to pay for UCAP purchased in the auction on its behalf). The estimated daily payment obligation for the Energy and Ancillary Services Component would be calculated as the higher of (1) the greatest daily average amount that the customer owed to the NYISO for Energy and Ancillary Services during any month in the prior same-season Capability Period, or (2) the daily average amount owed by the customer in the prior ten days. The estimated daily payment obligation would be multiplied by 45 or 90 days, depending on whether the customer is "Investment Grade" and on whether it has signed a prepayment agreement. For purposes of determining Operating Requirements, the NYISO proposes that customers not be permitted to net or pool the credit requirements of their accounts if customers operate in more than one of the NYISO-administered markets. Pooling of credit requirements would also not be permitted if NYISO customers operate in multiple ISO/RTO systems.

5. The amount of a customer's Operating Requirement is then used to determine the total amount of unsecured credit and, if necessary, collateral that the customer is required to provide. A customer deemed to be Investment Grade will be eligible to receive unsecured credit up to 7.5 percent of its tangible net worth, subject to a 20 percent "Market Concentration Cap." This amount may be adjusted upward by up to 10 percent or downward by up to 100 percent based on the NYISO's assessment of the customer's liquidity and other creditworthiness aspects that NYISO says it is uniquely qualified to assess. Investment Grade customers may also enter into pay down agreements under which they can pay down the amount by which their Operating Requirement exceeds their unsecured credit, in lieu of providing collateral that would otherwise be required. Permissible forms of collateral include cash deposits, acceptable letters of credit, and acceptable affiliate guarantees.

6. Under the proposal, the NYISO may declare a customer in default if it fails to make timely payment or fails to comply with the NYISO's creditworthiness requirements. Once the NYISO serves notice, the customer will have two business days within which to cure a nonpayment default and three business days within which to cure a creditworthiness default. If the default is not cured within the period, the NYISO would be able to immediately terminate service to the customer under the OATT, the Services Tariff, or both, upon notice to the Commission.

7. The NYISO also proposes to expand the financial reporting requirements for customers to allow it to timely assess and respond to changes in a customer's creditworthiness. The creditworthiness requirements for virtual transactions are not proposed to be changed.

8. The NYISO explains that it has worked with Market Participants and independent credit experts for nearly two years to develop a comprehensive financial assurance policy, including creditworthiness provisions. At the time of the February 21 and March 9 filings, the Board had not approved the entire package of proposed revisions, so the NYISO states that it made the creditworthiness filings pursuant to its authority to file changes to its tariffs unilaterally under section 206 of the Federal Power Act (FPA) as opposed to FPA Section 205.³ The requested effective date was ninety days after a final order approving the revisions.

9. On June 26, 2003, NYISO submitted a notice that the proposed creditworthiness provisions should be treated as if they had been filed under Section 205 of the FPA. NYISO states that its Board has denied an appeal of the Management Committee's vote in support of the rest of the comprehensive financial assurance package (working capital and bad debt loss allocation provisions). Since both the Board and the Management Committee have now approved the entire financial assurance package, it is no longer necessary for the Commission to review the filing under Section 206.⁴ NYISO explains this filing now has all of the approvals required for consideration under Section 205 and should be treated as a Section 205 filing on and after June 26, 2003.

10. On July 8, 2003, the Commission issued a data request to the NYISO requesting additional information that would help Commission staff with its analysis of this filing. The NYISO submitted its answers on July 23, 2003.

Docket Nos. ER03-984-000 and ER03-984-001 (Other Aspects of Comprehensive Financial Assurance Policy)

11. On June 26, 2003, the NYISO filed proposed revisions that would enhance the NYISO's rules governing the allocation of new working capital contributions⁵ and bad

³The NYISO explains that, pursuant to section 19.01 of the ISO Agreement, it is permitted to unilaterally file changes to its tariffs under section 206 of the FPA in the event it has not obtained all necessary stakeholder or Board approvals.

⁴See Filing of Tariff Revisions Regarding the Allocation of New Working Capital Contributions and Bad Debt Loss Costs, Docket No. ER03-984-000 (June 26, 2003).

⁵Working capital contributions are used to offset temporary imbalances in cash flow. The working capital fund contributes to the liquidity, stability, and efficiency of NYISO's markets.

debt losses among NYISO customers. The NYISO states that now, new working capital contribution and bad debt loss costs are allocated solely to loads based on the megawatt hours of energy that they withdraw. The proposed revisions would allocate these costs to all customers, including loads and suppliers, in proportion to the dollar volume of their transactions in the NYISO-administered spot markets. Customers that are more active in the NYISO markets and thus benefit more from the liquidity that the working capital fund and bad debt loss rules bring would thus have greater financial obligations. The NYISO believes that this will be a more equitable cost allocation. It proposes to allocate new working capital contributions based on "dollar volume," which would reflect the size of a participant's transactions, as measured in dollar terms. Under the proposal, each customer's percentage of the NYISO's total working capital collection in a given month would be the sum of its gross accounts receivable and payable, divided by the sum of the NYISO's gross accounts receivable and payable, in that month. This method ensures that each participant pays its fair share of working capital contribution costs, so that those who derive greater financial benefits from the markets' liquidity will make larger working capital contributions.

12. The NYISO clarifies that it is not proposing to retroactively revisit earlier working capital contributions. NYISO states that a retroactive adjustment would require suppliers to pay a large portion of the tens of millions of dollars previously collected under the existing allocation rules. Moreover, the Board did not believe that it would be appropriate to impose such retroactive costs on suppliers at this time and the NYISO stakeholders concluded that the dollar volume allocation methodology should only be applied prospectively.

13. The NYISO states that virtual transactions would be excluded from this working capital calculation because they are subject to more stringent creditworthiness rules than physical transactions. The NYISO believes that these rules prevent virtual transactions from burdening the regular working capital fund.

14. Under the proposed revisions to Section 3.0 of Attachment U, the NYISO seeks to adopt new bad debt loss recovery rules. Currently, when a bad debt loss occurs, the NYISO recovers the balance it is owed from its non-defaulting customers on the basis of each remaining transmission customer's load ratio share during the month of service that the bad debt loss originated. Suppliers currently have no responsibility to pay for bad debt losses. The NYISO and a majority of its stakeholders believe that it would be more equitable to assign costs to all Market Participants based on the volume of their transactions in the NYISO markets.

15. The revisions define steps that the NYISO would ordinarily follow to recover debts in the event of a default. First, the NYISO would seek to draw upon the entire amount of collateral provided by the defaulting customer. If the NYISO were unable to recover the entire debt this way, it would then seek to draw upon the customer's contribution to the working capital fund. If that did not cover the debt, the NYISO would make a claim against any available loss protection insurance according to its terms. Finally, any remaining losses would be allocated to all customers using a dollar volume methodology. Each customer would be required to pay a percentage of the bad debt losses that occurred in a given month equal to the sum of its gross accounts receivable and payable divided by the NYISO's gross accounts receivable and payable for that month. The NYISO could deviate from the above-mentioned sequence if it determines that an alternative approach would be more likely to minimize or avoid the loss.

16. The NYISO further proposes to modify Attachment U to clarify that the NYISO will not be required to await the final outcome of any insurance claim before allocating losses to customers. Any losses recovered through insurance or from a defaulting customer will be allocated to customers previously charged for the loss in proportion to their original allocation of the loss. Finally, the NYISO proposes to clarify in its Tariffs that the dollar volume methodology for allocating bad debt loss costs trumps other NYISO cost recovery rules.

17. The NYISO states that virtual transactions would be excluded from this bad debt loss procedure, since they are already subject to special bad debt cost allocation rules.

18. Finally, the NYISO proposes to revise Section 3.A of OATT Rate Schedule 1 to expressly establish the NYISO Board's authority to procure credit insurance. The NYISO believes that credit insurance helps protect NYISO Market Participants against losses attributable to defaults by customers. The NYISO feels that its Board has always been authorized to procure such insurance but in order to eliminate ambiguity, it proposes this clarification to the Tariffs.

19. The NYISO requests that the tariff revisions in Docket Nos. ER03-984-000 and ER03-984-001 become effective on the first calendar day of the first month after the customer creditworthiness provisions pending in Docket No. ER03-552-000, et al., become effective. The NYISO states that this effective date will make it administratively and technically easier for the NYISO to implement them at approximately the same time. Moreover, this effective date would be consistent with the will of the NYISO

stakeholders who approved the creditworthiness, working capital, and bad debt loss provisions as a single package (the comprehensive financial assurance policy).

Notice of Filing, Interventions and Protests

Docket No. ER03-552-000, et al. (Creditworthiness)

20. Notices of the NYISO's filing and amendment were published in the Federal Register, 68 Fed. Reg. 10,224 and 13,291 (2003), with motions to intervene and protests due on or before March 27, 2003. Timely motions to intervene raising no substantive issues were filed by the New York State Public Service Commission, Mirant Corporation, and Morgan Stanley Capital Group, Inc. The Long Island Power Authority and LIPA (LIPA) filed a timely joint motion to intervene and comments in support of the filing. Timely motions to intervene and protests or comments raising concerns were filed by Advantage Energy, Inc. (Advantage); the City of Jamestown Board of Public Utilities (Jamestown); Consolidated Edison Company of New York, Inc. (Con Edison); the Energy Cooperative of New York, Inc. (ECNY); Multiple Intervenors;⁶ the New York Transmission Owners⁷ (NY Transmission Owners); the NRG Companies (NRG); the National Energy Marketers Association (NEM); and Reliant Resources, Inc. (Reliant).

21. On April 11, 2003, the NYISO filed a limited answer. NRG opposed NYISO's answer, contending that the pleading confused rather than clarified the issues in the proceeding, and requesting that the Commission deny the answer as it applies to NRG's comments. Multiple Intervenors also filed to oppose NYISO's answer, with similar arguments, and also asserted that the answer failed to cure the allegedly defective initial filing.

22. Notice of the NYISO's June 26 letter converting its filing to a Section 205 filing was published in the Federal Register, 68 Fed. Reg. 41,122 (2003), with comments due

⁶Multiple Intervenors represents approximately 55 large commercial and industrial energy consumers with facilities located throughout New York State.

⁷The New York Transmission Owners include Central Hudson Gas & Electric Corp., Consolidated Edison Company of New York, Inc., LIPA, New York Power Authority, New York State Electric & Gas Corp., Orange and Rockland Utilities, Inc., Rochester Gas and Electric Corp., and Niagara Mohawk Power Corp.

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on or before July 17, 2003. The NY Transmission Owners filed a timely motion to intervene and comments raising concerns. Multiple Intervenors filed a timely motion to intervene and a motion to consolidate the proceedings with Docket Nos. ER03-984-000 and ER03-984-001. The NY Municipals⁸ filed a timely motion to intervene, comments in support of the filing, and a motion to consolidate the proceedings with Docket Nos. ER03-984-000 and ER03-984-001.

23. Notice of the NYISO's July 23 response to the data request was published in the Federal Register, 68 Fed. Reg. 41,122 (2003), with comments due on or before August 13, 2003. Timely motions to intervene and comments were filed by the NY Transmission Owners, Con Edison and Orange and Rockland Utilities (O&R), Advantage, ECNY, and Leveraged Energy Purchasing Corporation (LepCorp).

Docket Nos. ER03-984-000 and ER03-984-001 (Other Aspects of Comprehensive Financial Assurance Policy)

24. Notice of the NYISO's filing was published in the Federal Register, 68 Fed. Reg. 40,653 (2003), with motions to intervene and protests due on or before July 17, 2003. Timely motions to intervene raising no substantive issues were filed by KeySpan-Ravenswood, LLC and Reliant Resources, Inc. The NY Transmission Owners filed a timely motion to intervene and comments raising concerns. Multiple Intervenors filed a timely motion to intervene and a motion to consolidate the proceedings with Docket No. ER03-552-000, et al. The NY Municipals filed a timely motion to intervene, comments in support of the filing, and a motion to consolidate the proceedings with Docket No. ER03-552-000, et al. Con Edison and Orange & Rockland Utilities (O&R) filed a timely motion to intervene and a supplemental protest to NYISO's filing. ECNY filed a late motion to intervene and comments.

25. On August 1, 2003, as corrected on August 6, 2003, the NYISO filed an answer.

⁸ The NY Municipals include the Village of Bergen, City of Jamestown Board of Public Utilities, Town of Massena, Village of Rockville Centre, Salamanca Board of Public Utilities, Village of Sherburne, City of Sherrill Power & Light, and the Village of Solvay.

Discussion

A. Procedural Matters

26. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. ' 385.214 (2003), the timely, unopposed motions to intervene of the entities that filed them make them parties in the proceedings in which they were filed. We will grant ECNY's late motion to intervene in Docket No. ER03-984-000 given its interest in the proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay. Although Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. ' 385.213 (2003), generally prohibits an answer to a protest, we will accept the NYISO's answers because, contrary to protesters' assertions,⁹ they assist our understanding of the issues raised in this proceeding. We will, however, reject NRG's and Multiple Intervenors's responses in Docket No. ER03-552-000 as impermissible answers to answers.

27. NY Transmission Owners, NY Municipals, and Multiple Intervenors argue that the proceedings in Docket Nos. ER03-552-000, et al. and ER03-984-000 and ER03-984-001 should be consolidated since they are the comprehensive financial assurance policy that the NYISO Management Committee approved as a single package. NYISO states in its transmittal letter that even though these dockets complement each other, they should be considered on their own and not consolidated.

28. The Commission typically consolidates proceedings only for purposes of hearing and decision.¹⁰ As we are not setting either of these proceedings for hearing, there is no need to formally consolidate the dockets. We are persuaded, however, that the two cases should be considered simultaneously, and we are conditionally accepting both for filing in this order. Accordingly, we will deny the motions for consolidation, but our action should satisfy the concerns of the parties requesting consolidation.

⁹Because the NYISO is not proposing to modify the tariff provisions that are the subject of NRG's comments in Docket No. ER03-552-000, NRG's concern about NYISO's interpretation of those sections has no bearing on this proceeding.

¹⁰ See, e.g., Arizona Public Service Company, 90 FERC ¶ 61,197 (2000).

B. Creditworthiness Provisions

29. We note that this filing is one of several that have recently been made by ISOs and RTOs to revise the credit or collateral requirements for participation in the markets run by these organizations. While we recognize that the RTOs and ISOs have approved these filings through their stakeholder processes and will give such approval some deference, we nevertheless must address each filing on its merits and be able to find the proposal just and reasonable. In reviewing these filings, we must balance the goals of allowing the ISOs and RTOs to reduce their risk of exposure in the event of default while at the same time ensuring that the credit or collateral requirements are not so stringent that they unnecessarily inhibit access to the marketplace. To permit the Commission to balance these interests, it is incumbent for the ISOs and RTOs to include in their filings support for their proposals, including a full justification for their proposed credit or collateral provisions, and an explanation of why they reflect an appropriate balance. As discussed below, we find that NYISO has not adequately provided such a justification for certain aspects of its filing.

30. Moreover, we are interested in exploring whether there are additional ways of decreasing NYISO's proposed upfront collateral requirements through the use of more flexible settlement options. Such options could include faster procedures for clearing bids, more frequent billing and payment by customers that do not have investment grade debt, as well as any other proposals that would improve credit exposure protection while enhancing non-discriminatory market access. We will direct NYISO to explore through its stakeholder process whether additional changes should be made to the settlement or credit procedures and to file revised tariff provisions or a report on the results of these discussions within 180 days of the date of this order.

31. Based on this balancing of interests, the Commission finds NYISO's proposed revisions to its creditworthiness requirements, as conditioned below, to be reasonable, and will accept them effective 90 days after the date of issuance of this order. We direct the NYISO to submit a compliance filing within 30 days of the date this order is issued to comply with the modifications discussed below.

1. NYISO's Process

32. Several parties note that the filing is just a portion of NYISO's comprehensive financial assurance policy that was approved at a February 20, 2003 Management Committee meeting, and they urge the Commission to hold the filing in abeyance until it is supplemented by a FPA Section 205 filing that includes the entire package, to condition

acceptance on NYISO filing the entire package, or to reject the filing. These arguments have been rendered moot, since NYISO has now filed the entire comprehensive financial assurance policy, and we are considering all elements of the policy simultaneously.

33. Multiple Intervenors state that the NYISO has not met its FPA Section 206 burden to prove that the existing tariff provisions are unjust and unreasonable. The Commission will also reject this argument as moot, since NYISO has converted this filing to an FPA Section 205 filing.

2. Non-Investment Grade Customers

34. Section III. B. (I) of proposed Attachment W describes the calculation of the Energy Component of a customer's Operating Requirement. The amount of the Energy Component depends on whether the customer is Investment Grade. If a customer is Investment Grade, it must provide 45 days of security; if the customer is Non-Investment Grade or is unrated, it must provide 90 days of security.

35. NEM states that the 90-day requirement is a barrier to entry for small Market Participants that are Non-Investment Grade or unrated who could be precluded from participating in NYISO-administered markets because they may be unable to post the amount of security required. NEM urges the Commission not to impose creditworthiness standards that could force small entities to over-collateralize.

36. Advantage raises the same issue, and states that NYISO's proposed revisions are unduly discriminatory against Non-Investment Grade customers because only Investment Grade customers have the option to enter into a pay-down agreement in lieu of providing collateral.¹¹

37. LepCorp states that the entities it represents, which are large industrial, educational and commercial end users, present less risk than larger Load Serving Entities and marketers, because these end users account for a small portion of the NYISO market and have not been responsible for bad debt losses in the past. LepCorp states that the NYISO should develop additional alternatives, such as the prepayment option. LepCorp recommends that the NYISO perform a thorough analysis of the various customer groups and determine which ones have historically presented the highest incidence of default resulting in bad debt losses. With this information, the NYISO could formulate credit

¹¹ Section V.B. of proposed Attachment W.

policies that provide an even greater degree of protection without overly burdening those that are less risky.

38. In its answer, NYISO states that the different requirements for differently situated customers accurately reflect the different risks of loss posed by each. According to the NYISO, an Investment Grade customer, by virtue of its demonstrated financial strength, poses less risk of nonpayment than does a Non-Investment Grade or unrated customer. The NYISO also states in its response to the data request that the 90 days accounts for the amount of exposure that the NYISO incurs in the approximately 45 day service, billing, and payment cycle. Moreover, the 90 days accounts for additional unknown exposure attributable to true-ups and other corrections to initial invoices that may be incurred as much as 36 months after the customer's initial invoice.

39. We conclude that NYISO's proposal to require 90 days of security for Non-Investment Grade and unrated customers has not been justified. Although those customers generally present greater risks than Investment Grade customers, NYISO has much less than 90 days of exposure in the event of a default. It is at most 48 days¹² from the first date of service before a customer must pay its bill; then, a customer has two days after receiving written notice from the NYISO to cure a default. If the customer does not cure the default within that time, the NYISO is able to immediately terminate service to the customer.¹³ Thus, the number of days of customer nonpayment could total roughly 50. It is reasonable for the NYISO to ensure adequate collateral to cover the period from default to termination of service, but requiring some 40 additional days of security is excessive. Based on the principle that the amount of security should reflect the actual non-payment exposure from default to termination of service, there is no basis for using any different time period for investment grade customers. Therefore, the process for determining the amount of security should be the same for all customers. NYISO then takes into account its customers' investment grade rating when it determines the amount of unsecured credit that is afforded these customers. Accordingly, we will require the

¹²This number is derived from the fact that Section 7.1(ii) of the OATT and Section 7.2 B of the Services Tariff state that customers must pay their invoices by the first business day after the 15th day of the month that the invoice is rendered. Thus, it could be up to 48 days if the 15th day falls on a non-business day.

¹³See Section 7.3 of Original Volume No. 1, and 7.5 of Original Volume No. 2. No party objects to the 2 or 3-day period after which the NYISO may terminate service in the event of a default (Sections 7.3(B) and 7.5(B), respectively).

NYISO to file revised tariff sheets to provide for a justifiable amount of collateral for all customers.

40. We find that the NYISO has not adequately explained why it allows only Investment Grade customers to pay down their security requirements, and we do not know of any reason why Non-Investment Grade and unrated customers should not be afforded this option. Therefore, we will grant Advantage's protest in this regard and require the NYISO to file revised tariff sheets to extend this option to all customers.

41. LepCorp's concern about overburdening large end users should be alleviated when the NYISO submits a compliance filing with the justifiable amount of collateral indicated above. However, LepCorp's desire for the NYISO to perform a thorough analysis does not present a concrete enough proposal for the Commission to require any further action on NYISO's part. LepCorp may pursue this issue in the formal NYISO stakeholder process if it so desires.

42. The Commission believes that it is necessary to strike a reasonable balance between the needs of a company or an ISO/RTO to protect itself against credit risks, while at the same time not unnecessarily restricting entry into the market. Therefore it is necessary to require only enough collateral to protect the company from the risk of on-payment of its customers. As explained above, since the maximum period between the time a customer incurs a charge and the time the NYISO is able to terminate service to the customer is approximately 50 days, the NYISO would be protected against credit risk of Non-Investment Grade or unrated customers if it obtains approximately 50 days of collateral. To require more than that would unnecessarily restrict entry into the market. Our approach here is consistent with that which we have approved for the natural gas industry.¹⁴

¹⁴ See, e.g., Northern Natural Gas Company, 37 FERC ¶61,272 at 61,822 (1986). In Northern Natural, the Commission held that the pipeline could require up to three months of collateral (prepayment) from a shipper to cover the non-payment exposure faced by the pipeline. Although the length of the non-payment exposure for the NYISO is less than that for Northern Natural, principally due to the NYISO's ability to terminate service within a few days after the due date of its billing, the principle underlying the determination of the appropriate length of the collateral period is similar.

3. Market Concentration Cap

43. Section IV.B., Market Concentration Cap (Cap) of the proposed Attachment W puts an upper limit on the amount of unsecured credit a customer can have:

A Transmission Customer's Unsecured Credit shall not exceed twenty (20%) percent of the total amount of the ISO's accounts receivable in the ISO-administered markets in the month during the previous calendar year in which the sum of the following is highest: (i) one and one half times the Energy and Ancillary Services purchases in the ISO markets, (ii) amounts then-owed (billed and unbilled) for UCAP purchased in the ISO-administered auctions, and (iii) total TCC auction sales. The ISO may adjust this market concentration cap to reflect changes in prevailing Energy prices."^{15]}

44. Con Edison believes that the Cap is unduly discriminatory because the Cap affects only Con Edison. It proposes that this provision be replaced with a provision that links the absolute maximum amount of unsecured credit to a Market Participant's credit rating.

45. The NYISO states that the Cap protects against losses of a magnitude that would be very difficult for the remaining customers to absorb.¹⁶ In addition, the NYISO explains that ISO-NE and PJM use comparable Caps in their respective markets. According to NYISO, the Cap acts as an outside limit on the amount of unsecured credit that may be granted to any customer, not just to Con Edison. Moreover, the NYISO will apply the Cap to the amount of unsecured credit to be granted to a customer, which takes into account the customer's credit rating and financial resources.¹⁷ In its response to the data request, the NYISO states that Con Edison would be eligible for approximately \$350 million in unsecured credit, which is roughly 29 percent of the total NYISO-administered market volume if no Cap were in place.

¹⁵Proposed Substitute Sheet No. 728 under FERC Electric Tariff Original Volume No. 1 and Proposed Substitute Sheet No. 500 under FERC Electric Tariff Original Volume No. 2.

¹⁶Transmittal Letter at 9, n.22.

¹⁷See Answer at 7.

46. We agree with the NYISO. The NYISO has a duty to maintain the liquidity of the New York energy markets. The 20 percent Cap helps the NYISO achieve this goal by preventing any one customer from receiving unsecured credit in an amount so large that losses attributable to that customer could not be absorbed by the remaining NYISO customers. Even though this provision only affects Con Edison at this time, that does not make it unduly discriminatory, since only Con Edison is large enough to have its potential default overwhelm the other customers in the NYISO markets. Moreover, NYISO's Cap is similar to those used by PJM and ISO-NE.¹⁸

4. Netting

47. The NYISO proposes to preclude a customer from netting its accounts in different markets in determining its Operating Requirement. For example, if a customer holds a positive position in one NYISO market and a negative position in another, it cannot net its positions to reduce its creditworthiness requirement. NYISO states that in order to secure each customer's obligations, it must separately consider the customer's participation in each of the markets that it administers to determine the amount of credit support required. This separate consideration is necessary, according to the NYISO, because a customer's position in one market could deteriorate over time, the customer could discontinue its activity in one market, or the customer may be able to reject certain contracts that it has entered into with the NYISO in a bankruptcy proceeding, leaving an unsecured obligation to the NYISO. In addition, the NYISO states that if a customer operating in both these markets were to declare bankruptcy, certain revenue streams may be considered post-petition revenue and thus would not be available for netting. In its answer, the NYISO states that netting positions between other ISO/RTO systems also should not be permitted.

48. In its response to the data request, the NYISO explains further its concerns with netting positions within the NYISO administered markets. Specifically, the NYISO states customers can incur relatively long-term obligations in the markets for transmission congestion contracts (up to five years) and installed capacity (up to six months), while a customer's obligations in the energy transactions markets extend out only one day. The NYISO further explains that the risk of netting customer positions across markets for purposes of determining creditworthiness requirements is exacerbated by the fact that a customer may be permitted to reject certain contracts while assuming others in the event of a bankruptcy.

¹⁸See Restated New England Power Pool Agreement, Attachment L, Section II.2.a and Section III.D, and PJM Credit Policy, at II (B) at www.pjm.org.

49. Reliant states that not allowing participants to net across markets is too conservative because it restricts entry into the marketplace. Reliant proposes two alternatives. First, the NYISO could track the positions of Market Participants at regular intervals, thereby substantially minimizing the risk of undetected decay of the participant's financial condition or its potential flight from the market. Second, the NYISO could adopt an approach that would prorate a participant's position on a percentage basis so that a customer with, for example, a 75 percent positive position in one market and a 25 percent negative position in another, could be deemed creditworthy.

50. NEM states that there is a pancaking problem for entities that do business in multiple ISO/RTO systems. For example, an entity that does business in both PJM and the NYISO is responsible for two security deposits. NEM suggests that entities should be permitted to net their positions among ISO/RTOs, claiming that it is expensive for small entities to post multiple security deposits. Advantage raises similar concerns, and urges the NYISO to consider "pooling" the security deposit requirements or permitting the netting of import transactions.

51. The Commission finds that NYISO has not adequately justified its proposed prohibition against netting across NYISO-administered markets. According to NYISO, it must carefully monitor its markets to ensure that customers do not accrue unsecured obligations in excess of allowable amounts. The NYISO's credit department will monitor the financial positions and total outstanding exposure of each of its customers on a daily basis, and determine whether the customer will be required to provide additional collateral as security for its obligations. If so, the NYISO will require additional collateral from the customer to secure its outstanding obligations.¹⁹ The Commission believes that the risk that a customer's position in one market could change or deteriorate over time without being detected by the NYISO is not affected by netting across markets. Netting will also facilitate the entry of smaller Market Participants. Therefore, we direct the NYISO to file revised tariff sheets to allow for netting within the NYISO markets.

52. NYISO's concerns stated in its response to the data request are not persuasive. As stated above, it is highly unlikely that a customer's position could deteriorate without the NYISO detecting it, whether the position is in the short-term or long-term markets. Netting will also not be a problem in the event of a bankruptcy since the NYISO can draw upon posted collateral, working capital, or letters of credit. We believe these three

¹⁹ Id. at 8.

alternatives are enough to protect the NYISO while at the same time preventing participants from having to over-collateralize.

53. However, we agree with the NYISO's explanation regarding the issues raised by NEM and Advantage. The NYISO's creditworthiness requirements are based on the activity of customers in the NYISO-administered markets. The NYISO states that obligations incurred in other markets, such as PJM, are not accounted for by or reflected in the NYISO's creditworthiness requirements because the NYISO is not responsible for obligations incurred in other ISO/RTO systems. The Commission agrees with the NYISO that netting between other ISO/RTO systems could leave the NYISO with inadequate security if a customer defaults on obligations in more than one market.

5. Surety Bonds

54. ECNY objects to the fact that the NYISO proposes to eliminate a surety bond as an acceptable form of collateral. ECNY believes that this could significantly affect the participation of independent energy service companies within the NYISO markets. In its comments to the response to the data request, ECNY states that the New York Public Service Commission Uniform Business code lists Surety Bonds issued by a bank, insurance company or other financial institution as an acceptable security instrument to provide to a distribution utility in New York State from an energy service company.

55. Advantage states that it had a surety bond posted with the NYISO under the existing creditworthiness requirements, and that the surety instrument provided that the surety would pay the beneficiary upon demand and seek demonstration of the validity of the claim later. Advantage believes this “pay now, fight later” arrangement should alleviate the NYISO’s concern.

56. Advantage further states that the failure to allow surety bonds as an acceptable form of financial security is prejudicial and discriminatory toward unrated market participants. In addition, Advantage states that often letters of credit cost more to obtain than security bonds, and create a further barrier to entry for smaller participants.

57. The NYISO explains in its answer that the surety bond is a less reliable form of security than cash collateral, a letter of credit, or an acceptable parental guaranty, and thus does not offer the NYISO adequate protection against customer nonpayment. The NYISO states that it has accepted surety bonds as collateral in the past entirely at its discretion, as its current provisions do not provide for the use of surety bonds. The current provisions

state that a customer may supply a letter of credit or a parental guaranty as security to support its obligations to the NYISO. In its proposed revisions, the NYISO carries these terms over and indicates clearly that existing surety bonds will have to be replaced with an acceptable form of collateral no later than March 21, 2004. In the response to the data request, the NYISO states that surety bonds typically require the beneficiary to demonstrate the validity of its claim before the surety is required to make payment. This requirement leads to litigation and difficulties in enforcing payment from the surety. The NYISO further explains that the stakeholder working group voted to disallow surety bonds as an acceptable form of collateral because of perceived deficiencies with this form of collateral.

58. As noted above, the Commission believes that it is necessary to strike a reasonable balance between the needs of the market participants and the need for an ISO/RTO to protect itself against credit risks, while at the same time not unnecessarily restricting entry into the market. Therefore, the Commission agrees with NYISO that surety bonds without a "pay now/fight later" provision is not a sufficiently reliable form of security to offer NYISO adequate protection against customer nonpayment. Alternatively, surety bands with a "pay now/fight later" provision would seem to alleviate NYISO's concerns with surety bonds as an adequate form of security and, at the same time, not increase costs or create unnecessary barriers to entry for smaller market participants. We find that surety bonds with a "pay now/fight later" provision is a sufficiently reliable form of security for small market participants. ^{20/}

6. Unclear Terms and Conditions

59. Two provisions of proposed Attachment W are unclear. First, Article IV.C., Determination of Unsecured Credit, states: "The Credit Assessment shall be conducted according to an established methodology that shall be publicly available on the ISO's website, as it may be amended from time to time."²¹ The phrase "established methodology" is not definitive. Second, Article II.C. states: "The ISO shall determine an Equivalency Rating in accordance with a methodology that shall be commercially

²⁰ A small market participant is defined as a customer purchasing \$5 million or less in NYISO-administered markets each month.

²¹ Proposed Substitute Sheet No. 729 under FERC Electric Tariff Original Volume No. 1 and Proposed Substitute Sheet No. 501 under FERC Electric Tariff Original Volume No. 2.

available."²² Advantage protests this provision, stating that the NYISO has not provided an objective standard for measuring an Equivalency Rating for "unrated" customers.

60. We will require the NYISO to include in its tariff (rather than on its website) clear descriptions of the methodologies it will use to conduct its Credit Assessments and Equivalency Ratings. The NYISO must make these revisions in a compliance filing.²³

C. Working Capital and Bad Debt Loss Requirements

61. The Commission finds NYISO's proposed revisions to its working capital and bad debt losses requirements and its clarification regarding credit insurance, as modified below, to be just and reasonable, and will accept them effective the first calendar day of the first month after the customer creditworthiness provisions in Docket No. ER03-552-000, et al., become effective. We direct the NYISO to submit a compliance filing within 30 days of the date this order is issued to comply with the modifications discussed below.

1. Credit Insurance

62. The NY Transmission Owners state that the Commission should reject NYISO's proposal to revise Section 3.A of its OATT Rate Schedule 1²⁴ to authorize the Board to procure credit insurance. They argue that the credit insurance provisions were not considered or approved by the Management Committee. Moreover, the NY Transmission Owners state that these credit insurance revisions did not go through the stakeholder process, which is necessary to support a Section 205 filing.

63. In its transmittal letter, the NYISO explains that it feels the Board has always been authorized to procure credit insurance and is just making this revision to clarify the

²²Proposed Substitute Sheet No. 722 under FERC Electric Tariff Original Volume No. 1 and Proposed Substitute Sheet No. 494 under FERC Electric Tariff Original Volume No. 2.

²³The Commission has stated that all terms and conditions of jurisdictional transactions are required to be on file with the Commission, including creditworthiness provisions. See March 2002 Order, 98 FERC at 62,217.

²⁴Proposed First Revised Sheet No. 234 under FERC Electric Tariff Original Volume No. 1, Schedule 1.

Board's authority.²⁵ Moreover, the NYISO explains in its answer that credit insurance was approved by the NYISO Management Committee on February 20, 2003. The NYISO submits two attachments that show the meeting materials, which state: "the NYISO Board of Directors shall have the authority to procure credit insurance, as it may deem reasonably necessary, to protect against losses attributable to nonpayment by NYISO Customers."

64. The Commission finds that the credit insurance revision is just and reasonable. We are not persuaded by the NY Transmission Owners' assertions the revision did not go through the proper stakeholder process. Section 3.A. of NYISO's OATT Rate Schedule 1 specifically states that the NYISO is able to recover costs associated with the operation of the New York State Transmission System. These costs include insurance expenses. Thus, it appears that recovering insurance expenses is already allowed by the OATT, and the NYISO was just clarifying its ability to recover credit insurance costs as well. Since recovering "insurance expenses" was already a term and condition of the OATT,²⁶ the NYISO did not have to go through the normal stakeholder process. In any event, it appears that the NYISO went through the normal stakeholder process, since the attachments it submitted in its answer clearly show that the NYISO introduced the credit insurance provision to the Management Committee.

2. Current Working Capital

65. As described above, NYISO proposes to modify its current working capital contribution provisions by allocating the costs for new contributions to all customers, including loads and suppliers, and by changing from a load ratio share methodology to a dollar-volume allocation. NYISO reasons that all market participants benefit from having the working capital fund; thus, all should pay their fair share. Likewise, the dollar volume allocation methodology ensures that those parties who derive greater financial benefits from the markets' liquidity will make proportionally larger contributions to the working capital fund.

66. Con Edison and O&R generally support the new working capital provisions. However, they are concerned that this proposal does not adjust the cost responsibility for NYISO's current \$47 million balance of working capital. The NYISO only proposes to

²⁵Transmittal Letter at 8.

²⁶First Revised Sheet No. 234 under FERC Electric Tariff Original Volume No. 1, Schedule 1.

apply its new dollar volume methodology to incremental working capital that the NYISO may seek to collect in the future as a result of a loss. Con Edison and O&R argue that this proposal does not rectify the inequities reflected in the current balance, since the load serving entities will continue to be responsible for carrying the majority of current working capital. They request that the Commission require the NYISO to modify the working capital contribution formula by providing that, within one year, there be a reallocation of existing working capital based upon the same formula that is to be applied to new working capital contributions. In their response to the data request, Con Edison and O&R assert that working capital contributions should be considered as part of a Market Participant's overall Creditworthiness Requirements.

67. The NYISO states that these revisions should only be applied prospectively; asserting that a retroactive adjustment would require suppliers to pay a large portion of the amount collected under the existing allocation rules. NYISO states that the Board did not believe it would be appropriate to impose such retroactive costs on suppliers at this time and that the majority of stakeholders want the dollar volume methodology applied prospectively.

68. We agree with Con Edison and O&R that the proposed revisions should be applied to the NYISO's entire working capital balance. The NYISO has not shown why all Market Participants should not pay for their fair share of the NYISO's current working capital requirements. The filing demonstrates that the new dollar volume methodology is superior to the existing allocation because it provides for more equitable cost allocations by ensuring all market participants including suppliers pay their fair share of working capital contribution costs. NYISO has tariff provisions providing procedures for adjusting annually each customer's respective contribution to the working capital fund; these procedures may be used to calculate all market participants' required allocations. Therefore, we will direct the NYISO to revise its tariff sheets to provide that annual working capital contribution adjustments related to existing working capital contributions, as well as those made after the effective date of this filing, will be conducted using the new dollar volume methodology.²⁷

²⁷ This change will not constitute an impermissible retroactive rate change. The entire balance of the Working Capital Fund is used for the NYISO's current (and future) needs, not to cover past cash flow imbalances.

3. Unclear Terms and Conditions

69. The NY Transmission Owners note that the NYISO uses the term “ordinarily” three times on proposed First Revised Sheet No. 707 in describing the steps it may take to recover the amount of a bad debt loss and that it reserves the right to employ other undefined tactics to recover amounts attributable to a bad debt loss. The NY Transmission Owners believe that these tariff provisions are confusing and ambiguous. They also want a typographical error corrected on this sheet and some grammatical errors corrected on proposed Original Sheet No. 716A.

70. We find that the terms and conditions on Sheet No. 707 are clear and do not need any further revisions. The steps outlined in Sheet No. 707 follow a logical path and are clear in their terms and conditions. The NYISO’s use of the word “ordinarily” only emphasizes what it will do under normal circumstances, but it can deviate from the outlined steps if the deviation would minimize or avoid a bad debt loss.

71. However, we will require the NYISO to correct the typographical and grammatical errors on Sheet No. 707 and 716A in a compliance filing.

The Commission orders:

(A) NYISO's filing in Docket No. ER03-552-000, et al., is hereby conditionally accepted to become effective as requested 90 days from the date of this order, subject to Ordering Paragraph (C), as discussed in the body of this order.

(B) NYISO’s filing in Docket Nos. ER03-984-000 and ER03-984-001 is hereby conditionally accepted to become effective as requested on the first calendar day of the first month after the provisions in Docket No. ER03-552-000, et al., become effective, subject to Ordering Paragraph (C), as discussed in the body of this order.

(C) The NYISO is hereby ordered to submit a compliance filing within 30 days of the date of this order reflecting the modifications discussed in the body of this order.

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(D) The NYISO is hereby ordered to submit revised tariff provisions or a report on the results of additional stakeholder discussions within 180 days of the date of this order, as discussed in the body of this order.

By the Commission. 28/

(S E A L)

Magalie R. Salas,
Secretary.

²⁸ Action in this proceeding was required on September 19, 2003. On that day, however, all Federal Government offices in the Washington, D. C. metropolitan area, including the offices of the Federal Energy Regulatory Commission, were officially closed.