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March 29, 2004

The Honorable Magalie R. Salas, Esq.
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

New York Independent System Operator, Inc.'s
Report in Docket Nos. ER03-552-000 and ER03-984-000 et al.
Regarding Potential Settlement and Customer Credit Enhancements

Dear Ms. Salas,

In its September 22, 2003, *Order Conditionally Accepting Tariff Revisions*¹ (“September 22 Order”), the Commission conditionally accepted revisions to the New York Independent System Operator, Inc.’s (“NYISO’s”) Open Access Transmission Tariff (“OATT”) and Market Administration and Control Area Services Tariff (“Services Tariff”) regarding customer credit requirements. In the September 22 Order, the Commission noted its interest in “whether there are additional ways of decreasing NYISO’s proposed upfront collateral requirements through the use of more flexible settlement options,” stating that 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.” The Commission directed the NYISO to explore through its stakeholder process whether changes to the NYISO’s settlement or credit procedures should be made and to submit a report on the results of that stakeholder process or to file revised tariff provisions within 180 days of the September 22 Order.² The NYISO respectfully submits this report as directed by the Commission in the September 22 Order.

The NYISO continues to believe that its overall approach to addressing customer credit risk is sound and that it appropriately protects the NYISO and its customers against credit risk

¹ 104 FERC ¶ 61,311 (Sept. 22, 2003).

² *Id.*

without creating undue barriers to entry into the markets it administers. The NYISO remains very interested, however, in exploring ways to further refine and improve its settlement systems and credit requirements to minimize the burden of those requirements on customers. In accordance with the Commission's direction, the NYISO has worked and will continue to work with stakeholders to examine possible means by which the NYISO's settlement systems and customer credit requirements can be tailored to reduce both the credit risk faced by the NYISO and the resulting credit requirements for customers.

This report outlines the NYISO's activities since the Commission's issuance of the September 22 Order to: (i) explore potential enhancements to the NYISO scheduling and settlement systems that could reduce customer collateral requirements, (ii) revise its tariffs to reduce customer collateral requirements, and (iii) engage stakeholders regarding ways to further reduce customer credit requirements without incurring undue credit risk. This report also describes the NYISO's plans to continue these efforts, working with stakeholders, in hopes of lowering the credit and collateral requirements for participation in the NYISO-administered markets.

A. Potential Settlement and Scheduling Enhancements

1. Enhanced Settlement System. The NYISO is committed to improving its current settlement system and has included the deployment of a state-of-the-art settlement system as a major objective in its strategic plan.³ In its evaluation of the costs, benefits, and feasibility of an enhanced settlement system, the NYISO met with representatives of the New York Mercantile Exchange ("NYMEX") to discuss how features of NYMEX's settlement process might be adapted for application to the NYISO markets. Separately, the NYISO has hired an outside consultant to examine means by which the NYISO might improve its settlement system. The NYISO expects to release the consultant's report in April, share its own evaluation of the report's premises and conclusions, and solicit stakeholder input about the desirability and feasibility of implementing the consultant's recommendations.

2. Changes in Bilateral Scheduling. The NYISO scheduling system currently requires a customer to identify a generation source as well as a sink when scheduling a bilateral transaction. This prevents parties from entering into financial bilateral transactions whereby the buyer receives a specified price for energy under the contract and the supplier agrees to pay the

³ *New York Independent System Operator Strategic Plan, 2004-2008*, available at http://www.nyiso.com/services/documents/misc_pdf/strategic_plan.pdf.

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market price for the energy.⁴ To approximate this type of transaction, purchasing customers currently must buy energy through the NYISO energy markets while entering into a contract for differences with a supplier to achieve a fixed price for energy. This requires the purchaser to provide credit support to the NYISO for the energy purchase and also to the supplier to support the contract for differences. The credit support provided to the NYISO would be unnecessary if the purchaser and the marketer were permitted to schedule the transaction directly with the NYISO as a bilateral contract.⁵

At the request of stakeholders, the NYISO is beginning to explore a proposal that would allow customers to schedule bilateral contracts without identifying a specific generation source. If adopted, this proposal would significantly reduce the purchasing customer's credit requirement with the NYISO. The NYISO will determine the timeline for development of a concept of operations for the bilateral scheduling proposal and will report back to stakeholders by the end of next month.

3. True-Ups to Settlements. In October 2001, the NYISO moved from a 24 month to a 12 month true-up period before final bills are issued, and the NYISO is exploring options to further shorten this true-up period. In addition, the NYISO Board of Directors has directed NYISO staff to examine measures to enhance the NYISO settlement process by improving initial bill accuracy to minimize subsequent true-ups. These measures could reduce customer credit requirements to the extent that true-up liabilities affect customers' collateral requirements.

B. Changes Following the September 22 Order

1. Changes Pursuant to FERC Orders. The NYISO has, since the September 22 Order, and in compliance with that and subsequent Commission orders, filed two changes to its tariffs that lower customer credit requirements. First, the NYISO filed changes to permit netting of a customer's positions by allowing the customer to treat as cash collateral the amount that is

⁴ The supplier may then separately bid a generation unit into the NYISO markets to supply the energy, thereby effectively fixing the cost of energy under its financial bilateral supply contract, or it may choose to pay market prices for that energy.

⁵ If the parties were permitted to schedule the transaction as a bilateral contract, then the credit impact of the energy purchase from the NYISO would fall on the marketer, which is often better positioned for it due to greater available unsecured credit or a net sales position in the NYISO-administered markets.

owed to it after the NYISO makes payment for services provided in the previous month.⁶ In addition, the NYISO has made a separate compliance filing that is currently pending before the Commission to reduce the collateral requirement of a customer entering into a prepayment agreement with the NYISO by reducing the customer's Operating Requirement to only 10 days worth of energy and ancillary services, plus an estimate of the customer's liabilities to true up past bills.⁷

2. Aggregated Treatment of Municipals. The NYISO tariffs provide that a municipal electric system shall be granted a starting point of \$1 million in the determination of unsecured credit that it will receive.⁸ Thirty four of New York's municipal electric systems are members of a joint action agency, the New York Municipal Power Agency ("NYMPA"), which handles all of the bidding, scheduling, and settlements for its members in the NYISO-administered markets. Therefore, the benefit of the provision described above was not available to these municipal electric systems as intended because NYMPA, rather than its constituent members, is the NYISO's customer. Through its stakeholder process, the NYISO has developed tariff revisions that will extend to NYMPA a starting point for determining its unsecured credit of up to the amount that would have been granted to its various members. The NYISO's stakeholders have approved these proposed revisions. The NYISO Board of Directors is scheduled to review them at its April meeting.

C. Additional Stakeholder Review

In February and March, the NYISO sent email notices to stakeholders soliciting input regarding potential improvements to its customer credit policies. At the March 16, 2004, stakeholder meeting of the Scheduling & Pricing Working Group, the NYISO reviewed the changes described above and again solicited customer input regarding potential improvements to its settlement systems and customer credit requirements. In response, several customers have submitted comments and proposals for consideration. The NYISO is currently evaluating the input received from customers and will soon schedule a meeting to discuss the suggestions submitted and any further customer input with all interested stakeholders. Following that meeting and any subsequent stakeholder meetings, the NYISO plans to file resulting tariff changes, as appropriate.

⁶ *Compliance Filing of New York Independent System Operator, Inc. in Docket Nos. ER03-552-003, et al. and ER03-984-003* (Oct. 23, 2003).

⁷ *Compliance Filing of New York Independent System Operator, Inc. in Docket No. ER03-984-004* (Jan. 7, 2004).

⁸ See Services Tariff, Attachment K, Section IV.C.(ii); OATT, Attachment W, Section IV.C.(ii).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (2001).

Dated at Washington, D.C. this 29th day of March 2004.

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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

New York Independent System Operator, Inc.) Docket No.

NOTICE OF FILING

Take notice that on March 29, 2004, the New York Independent System Operator, Inc. (“NYISO”) submitted a report regarding potential settlement and customer credit enhancements.

Any person desiring to be heard or to protest this filing should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission’s Rules of Practice and Procedure (18 CFR §§ 385.211 and 385.214). Protests will be considered by the Commission to determine the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. All such motions or protests should be filed on or before the comment date, and, to the extent applicable, must be served on the applicant and on any other person designed on the official service list. This filing is available for review at the Commission or may be viewed on the Commission’s website at www.ferc.gov, using the FERRIS link. Enter the docket number excluding the last three digits in the docket number filed to access the document. For assistance, call (202) 502-8222 or TTY, (202) 208-1659. Protests and interventions may be filed electronically via the Internet in lieu of paper. *See*, 18 CFR 385.2001(a)(1)(iii) and the instructions on the Commission’s website under the “e-filing” link. The Commission strongly encourages electronic filings.

Comment Date:

Magalie R. Salas, Esq.
Secretary