Credit Policy Task Force Meeting
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Purchase of Receivables As An Alternative Form of "Acceptable Collateral"
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This memorandum presents a proposal for an alternative security mechanism that reflects changes in the developing competitive retail market and the need to mollify the heavy security burden that is currently borne by Load Serving Entities ("LSE").

There is an increasing trend in New York whereby local distribution utilities purchase the accounts receivable without recourse of ESCOs[1] participating in utility consolidated billing programs.[2] A utility that offers purchase of receivables without recourse ("POR") sends payments to an ESCO at predetermined intervals for amounts billed less any agreed upon discount, and has no right to seek reimbursement from the ESCO of any unpaid amounts. The utility's obligation to purchase the receivables are codified in contractual documents executed by the ESCO and the utility, and are also incorporated in the utility's tariffs filed with and approved by the Public Service Commission. Therefore, the utility's obligation to pay and the ESCO's right to receive payment from the utility are both contractual obligations supported by law and the utility tariff.

Currently, POR programs are available in the service territories of the following electric distribution utilities: Consolidated Edison of New York, Inc.; Central Hudson Gas & Electric Corporation; Rochester Gas and Electric Corporation, New York State Electric and Gas, Niagara Mohawk Power Corp., and Orange and Rockland Utilities, Inc.

The ESCO's right of payment from the utility is supported and, in fact, securitized by an entity that is deemed an "Investment Grade Customer" pursuant to the credit standards of the NYISO.[3] Thus, an LSE that participates in a POR program obtains and is able to use an investment grade asset—the right of payment from the utility—regardless of its individual financial condition.

In view of these factors, Econnergy proposes that the NYISO allow its credit standards to include the pledge or assignment by an LSE of its right of payment under a POR program as "Acceptable Collateral" that can support the LSE's credit obligation to the NYISO.[4] The value attributed to this collateral would be in proportion to the level of the ESCO's accounts receivable in the service territory of the utility that implements a POR program.

Currently, the NYISO views the following instruments, among others, as "Acceptable Collateral": Letter of Credit; Affiliate Guarantee; and Surety Bonds.[5] In reality all three of these

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[1] The terms LSE and ESCO are used interchangeably in this memorandum as an ESCO will also be viewed as an LSE by the NYISO.

[2] See, Cases 03-G-1671 and 03-S-1672 – Consolidated Edison Company of New York, Inc. – Gas and Steam Rates, *Joint Proposal*, dated May 28, 2004; Cases 03-E-0765 and 03-G-0766 – Rochester Gas and Electric Corporation – *Joint Proposal on Purchase of Accounts Receivable,* dated August 20, 2005, mimeo at 3); Cases 00-E-1273 and 00-G-1274 – Central Hudson Gas & Electric Corporation, *Results of Retail Access Collaborative*, dated July 29, 2004.

[3] See, NYISO, FERC Electric Tariff, Original Volume No. 2, Attachment K, First Revised Sheet No. 493-94.

[4] See, *Id*., First Revised Sheet No. 503-504A

[5] The NYISO also accepts the posting of cash and netting of accounts receivables to a Market Participant as "Acceptable Collateral" under its tariffs.

instruments constitute an agreement by an investment grade institution to pay a certain sum to the NYISO in the event of a default by the LSE. In the case of the Affiliate Guarantee, the affiliate of the LSE guarantees that it will secure the LSE's credit obligation in the event of a default. Similarly, with a Surety Bond, a third-party institution that is adequately rated, agrees to pay on demand a sum sufficient to meet the LSE's credit obligation.

From this perspective, it becomes evident that the ESCO's pledge of its right of payment from the utility is entirely consistent with, and substantially similar to, these existing forms of collateral. Under the POR, the utility, an independent investment grade third-party institution, has effectively guaranteed that it will on a pre-determined basis pay the ESCO a sum of money equivalent to its receivables which are billed to the customer by the utility.[6] The utility is obligated to pay this sum of money to the ESCO or to the ESCO's assignee. Once this right of payment is assigned or pledged to the NYISO (in a form acceptable to the NYISO), an instrument is established under which an investment grade institution will pay a certain sum to support the LSE's credit obligation.

The efficacy of this credit instrument is under girded by a number of additional important factors. First, the existing POR programs have now been in place for a considerable period of time and are operating effectively, efficiently and without any material problems. Second, it is probable that by the end of this year, every electric utility in New York will have either implemented or agreed to establish a POR program for ESCOs operating on its system. Third, all of the Billing Services Agreements related to POR allow the ESCO to assign the right of payment to a third party. Fourth, FERC has continued to exhibit interest in providing for credit mechanisms that help spur competitive choice while protecting the ISO security requirements.

Adoption of this proposal will serve the best interests of all concerned parties. As the NYISO is well aware, all players in the energy industry are currently concerned over the rapid increase in the level of credit obligation and its impact upon the ability of LSEs to expand and bring competitive choice to a large body of consumers.[7] The NYISO is, of course, concerned about the exposure of its members to a defalcation by any one energy provider. It is therefore necessary to balance these concerns in a reasonable and prudent manner. The instant proposal fully meets these goals. The pledging of the right of payment allows the LSE to use an existing asset to securitize its NYISO credit obligation at no additional cost and without incurring the cost or burden associated with obtaining a Letter of Credit or a Surety Bond. The NYISO's credit related concerns are also fully addressed, as the entity guaranteeing payment is an investment grade institution that is a known entity to the NYISO, the payment will be made by the utility regardless of the actions by or the financial condition of the LSE and the NYISO can be assured that payment will be made as required.

[6] The timing of the payment stream may differ among utilities. RG&E will remit payment 20 days after each bill is issued; Central Hudson will issue payments twice each month.

[7] See, Electric Creditworthiness Standards, FERC Docket No. AD4-8-000, Notice of Technical Conference and Request for Written Comments on Credit-Related Issues for Electric Transmission Providers, Independent System Operators, and Regional Transmission Organizations, dated May 28, 2004.