



290 Washington Ave. Ext • Albany, NY 12203

July 21, 2005

The Honorable Magalie R. Salas
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 NYISO Settlement and Customer Credit Policies

Dear Ms. Salas,

As required by the Commission, the NYISO submitted a report on March 29, 2004¹ ("March 29 Report") regarding potential settlement and customer credit enhancements, including netting of purchase and sales accounts. In its June 2, 2004 *Order Conditionally Accepting Compliance Filings*² ("June 2 Order"), the Commission accepted the March 29 Report, but ordered the NYISO to submit, within 180 days of the June 2 Order, a subsequent status report on its work with stakeholders to review the NYISO's creditworthiness standards and settlement policies. The NYISO submitted a report as required by the Commission on November 30, 2004³ ("November 30 Report") in which it stated that the Netting Bilaterals Project "purportedly would reduce the need for customers engaging in certain transactions to provide collateral to the NYISO to cover market energy purchases while also providing collateral to counterparties to cover contracts for differences."⁴

Strategic Energy, L.L.C. ("Strategic Energy") filed a Motion to Intervene on January 7, 2005 ("January 7 Motion")⁵ pursuant to Rule 214 of the Rules and Regulations of the Federal Energy Regulatory Commission regarding the implementation of the Netting Bilaterals Project. In the January 7 Motion, Strategic Energy petitioned the Commission to set a specific timetable for implementing the project.

¹ *New York Independent System Operator, Inc.'s Report in Docket Nos. ER-03-552-000 and ER03-984-000 et al. Regarding Potential Settlement and Customer Credit Enhancements (March 29, 2004)*. This report was in compliance with the Commission's September 22, 2003, *Order Conditionally Accepting Tariff Revisions* ("September 22 Order").

² 107 FERC ¶ 51,243 (June 2, 2004).

³ *New York Independent System Operator, Inc.'s Report in Docket Nos. ER-03-552-000 and ER03-984-000 et al. Regarding NYISO Settlement and Customer Credit Policies (November 30, 2004)*.

⁴ November 30 Report, P. 3.

⁵ *Motion to Intervene and Comments of Strategic Energy, L.L.C. Dated January 7, 2005*.

The Commission, in its March 23, 2005 Letter Order⁶ ("March 23 Order"), accepted the November 30 Report for "informational purposes" and declined Strategic Energy's request to set a specific timetable for implementing the Netting Bilaterals Project. However, the Commission required the NYISO to submit within 120 days a status report on its progress regarding the implementation of the Netting Bilaterals Project. The NYISO respectfully submits this report as directed by the Commission in the March 23 Order.

This report describes: (i) the NYISO's efforts to determine the feasibility and priority of the Netting Bilaterals Project, and (ii) the form of netting currently available to NYISO customers as a means of satisfying customer credit requirements. As explained below, the NYISO views the Netting Bilaterals Project as a potential improvement to its market structures, but has determined that it is not a project that merits the resources that would be required to implement it at this time.

I. Priority of the Netting Bilaterals Project

In response to the March 23 Order urging the NYISO to implement the Netting Bilaterals Project as soon as possible, the NYISO has worked through its Project Prioritization Team ("PPT") to determine the relative priority of the Netting Bilaterals Project's to NYISO stakeholders. The PPT, which consists of the elected chairs of the three main Market Participant governance committees and the chair of the Budget, Standards, and Performance Subcommittee, advises the NYISO on the relative priority of the various projects under consideration and provides the NYISO with the stakeholders' perspective on the value of projects under consideration. It has advised that the project is not a high priority for Market Participants.

Furthermore, while the Netting Bilaterals Project may be a market enhancement, it appears that the form of netting it would provide would benefit only a small number of Market Participants. In addition to the conclusion drawn by the PPT, this is evidenced by the fact that out of approximately 278 Market Participants that participate in the NYISO markets, Strategic Energy is the only Market Participant that filed a motion to intervene with FERC in support of the Netting Bilaterals Project. As the Commission is aware, the NYISO operates under rigorous budget and human resources limitations. In determining project priority, the NYISO governance process must weigh budget and resource impacts, against a project's impact on the market as a whole.

Nevertheless, the NYISO respects the Commission's position that the NYISO should implement the Netting Bilaterals Project as soon as possible, and, in accordance with the Commission's concerns addressed in its November 19, 2004 policy statement, the NYISO has reviewed the project on several occasions. After careful consideration the project was placed in the Group 2 level on the 2005 queue. The Netting Bilaterals Project was moved from the Group

⁶ Letter Order accepting New York Independent System Operator, Inc.'s status report on its work with the stakeholders etc under ER03-552-000 et al. (Commissioner Brownell's concurring statement attached).

3 level where “no work was planned in 2005,” to the Group 2 level which is “the non-priority list where some work may be undertaken in 2005 if possible using baseline resources.”⁷

The NYISO has included the Netting Bilaterals Project among those projects it is evaluating. As projects of a higher priority to the market are completed and NYISO resources become available, the NYISO will take up the Netting Bilaterals Project. The NYISO cannot predict at this time, precisely when efforts to complete the Netting Bilaterals Project may begin but because of finite budget and resources, we do not believe those efforts can begin before 2006.

II. Available Netting Mechanism

The form of netting already allowed by the NYISO is broader in scope than what would be made available through the Netting Bilaterals Project. The NYISO Market Administration and Control Area Services Tariff (“Services Tariff”) and Open Access Transmission Tariff (“OATT”) establish that “[u]pon written notice to the ISO, a Customer may elect to treat as cash collateral the amount that the ISO determines will be owed to the Customer as of the day after the next regular monthly payment to the Customer and that will be payable to the Customer in the following regular monthly payment.”⁸ This allows a Customer that is an overall net seller in the NYISO markets to treat a portion of its net position as cash collateral to satisfy any collateral requirement that it may have as a result of its participation in a given NYISO market. Furthermore, netting to determine the amount of a customer’s creditworthiness requirements could leave the NYISO with inadequate security to protect against the credit risk posed by some customers.⁹

The form of netting currently allowed in the NYISO markets is available to any net seller, while the Netting Bilaterals Project would benefit only a Market Participant that engages in a particular transaction structure whereby the Market Participant purchases energy from the NYISO markets and hedges those purchases with bilateral transactions that the Market Participant elects to register with the NYISO. As such, the Netting Bilaterals Project is best viewed as a proposed market structure with credit implications, rather than a credit mechanism as described by Strategic Energy.

⁷ See NYISO Project Prioritization Team, Meeting Notes and 2005 Proposed Project Rankings (November 4, 2004), available at

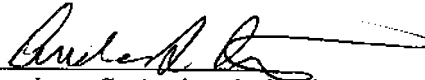
https://mdex.nyiso.com/Committees?id=104&com=Project%20Prioritization%20Team&dir=49bd70_ffbd1dd2ea_-7f8e0a03015f

⁸ Services Tariff at Attachment K, Section A, V. “Netting of Accounts Receivable,” Original Sheet Nos. 504-504A.

⁹ Allowing a more extensive form of netting exposes the NYISO to additional risk in the case of a bankruptcy. As discussed in NYISO’s report of July 23, 2003, the risks inherent in netting Market Participant positions across markets for purposes of determining creditworthiness requirements is exacerbated by the fact that, in the event of a bankruptcy, there is the possibility that a Market Participant may be permitted to reject certain contracts while assuming others. This would leave the NYISO without adequate security for the rejected contracts and would likely result in bad debt losses that would have to be borne by other NYISO Market Participants. *New York Independent System Operator, Inc.’s Response to Date Requests Regarding Proposed Customer Creditworthiness Requirements in Dockets Nos. ER03-552-003 and ER03-984-001* (July 23, 2003).

The NYISO continues to examine possible means by which to improve and refine its settlement systems and credit requirements in order to better serve customers. As stated in the November 30 Report, the NYISO has recently implemented a number of changes that benefit customers by reducing the credit requirements for participation in the NYISO-administered markets.¹⁰ As explained above, while the NYISO views the Netting Bilaterals Project as a potential enhancement to its market structures, it is one that the NYISO's Market Participants have indicated not to be a high priority relative to other projects under consideration and development.

Respectfully submitted,



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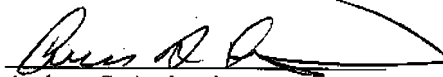
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¹⁰ November 30 Order, P. 2-4

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served the foregoing document on the official service list compiled by the Secretary in this proceeding. I have also electronically served this document on the official representative of each of its customers, on each participant in its stakeholder committees, on the New York State Public Service Commission, and on the electric utility regulatory agencies of New Jersey and Pennsylvania.

Dated at Albany, New York this 21st day of July, 2005.



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