UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Credit and Capital Issues Affecting the	)	
Electric Power Industry	)	**Docket No. AD09-2-000**

COMMENTS OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

The New York Independent System Operator, Inc. ("NYISO")[1] hereby submits these comments in response to the Technical Conference on Credit and Capital Issues Affecting the Electric Power Industry held by the Federal Energy Regulatory Commission ("Commission") on January 13, 2009. These comments pertain to the Commission's review of "Credit Issues in Short-term Electricity Markets."

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[1] Capitalized terms that are not otherwise defined herein shall have the meanings specified in the NYISO's tariffs.
[2] The NYISO respectfully requests waiver of 18 C.F.R. § 385.203(b)(3) (2008) to permit service on counsel for the NYISO in both Washington, D.C. and Richmond, Virginia.

II. Introduction

In the wholesale electricity markets administered by ISOs/RTOs, when an ISO/RTO extends credit to a market participant the default risk is shared collectively by all other market participants. As a result, if collateral posted by a defaulting market participant to meet its ISO/RTO credit requirements is insufficient to cover its payment obligations then the remaining market participants must collectively cover any shortfall because bad debt losses are mutualized. After the significant payment defaults in the fall of 2007 in the financial transmission rights market administered by PJM Interconnection, L.L.C. ("PJM")[3], many ISOs/RTOs began reevaluating the adequacy of their credit policies to ensure their policies minimize credit risk and default exposure, and, in turn, minimize potential mutualized losses. Some market participants have expressed concern about potential extraordinary mutualized losses resulting from the failure of a major market participant operating on the basis of unsecured credit.

At the same time, the 2008 collapse of Lehman Brothers, bailout of AIG, buyout of Merrill Lynch, and other related financial market crises have resulted in a tightening of the credit markets and a decrease in the amount of credit available to many market participants. Some market participants are concerned that ISOs/RTOs will revise their credit policies to require excessive levels of credit support and thereby hinder the competitiveness of the wholesale electricity markets by limiting access to, and reducing the liquidity of, these markets.

III. Comments

A. Active Approach to Credit Risk Management

The NYISO has a history of working closely with its market participants through its unique shared governance process to develop credit policies that provide appropriate safeguards

[3] The payment defaults required PJM to mutualize approximately $70 million in bad debt losses to its market participants. *See PJM*. "2007 Annual Report." [Online] 27 January 2009. < http://www.pjm.com/about-pjm/who-we-are/annual-report.aspx?p=1>.

against bad debt losses without imposing undue barriers to market entry. In 2003, the NYISO submitted proposed tariff provisions to the Commission that established detailed creditworthiness requirements for customers participating in the NYISO-administered markets.[4] Those tariff provisions reflected the results of almost two years of collaborative effort by the NYISO, its market participants, and credit experts.

Since the 2003 Credit Filing, the NYISO has continued to use its stakeholder process to work with its market participants and refine and improve its credit requirements to ensure its tariffs strike the appropriate balance between minimizing the risk of bad debt losses and maintaining open and accessible markets. As the wholesale power markets have evolved over the past decade and historical market data has become available for analysis, the NYISO has adjusted its market-specific credit requirements to better align them with the risks associated with its markets. Through this approach the NYISO has sought to develop credit requirements that do not under- or over-collateralize market risks.

For example, in late 2007 and early 2008, after extensive discussions with market participants, the NYISO revised its credit requirements for participating in the TCC market to more appropriately match the credit requirements with the credit risks present in the TCC market.[5] The revised credit requirements were based upon the results of an analysis of the historical TCC auction prices and the actual payments owed to the NYISO by holders of different types of TCCs. Upon implementation of these revisions/changes, a majority of TCC auction participants experienced a reduction in their TCC credit requirements.

The NYISO similarly revised its credit requirements for participating in the Virtual Transaction market after gaining three years of experience administering that market. The three

[4] *New York Independent System Operator, Inc.'s Filing of Tariff Revisions Regarding Customer Creditworthiness Requirements*, Docket No. ER03-552-000 (February 21, 2003) ("2003 Credit Filing").
[5] *See New York Independent System Operator, Inc.*, 122 FERC ¶ 61,124 (2008) and 123 FERC ¶ 61,090 (2008).

years of Virtual Transaction market data indicated that the NYISO was over-collateralizing for the credit risks present in the Virtual Transaction market. The NYISO market participants unanimously voted to reduce the collateral required for participating in the Virtual Transaction market from seven days of collateral to four days of collateral.[6]

In addition, over the past few years the NYISO has collaborated with market participants to shorten the timeframe for finalizing customer invoices from 36 months to 8 months.[7] The shortened timeframe provides NYISO customers with greater financial certainty and limits the exposure of the NYISO and its market participants to customer defaults and bad debt losses.

B. Continued Evolution of Credit Risk Management Tools

One of the lessons the NYISO and other ISOs/RTOs have learned from the recent financial challenges is that ISOs/RTOs need tools that allow them to respond quickly and predictably in the event leading financial metrics indicate a decline in the creditworthiness of a market participant. As ISOs/RTOs have developed transparent and predictable credit practices they have relied heavily on the credit ratings assigned to market participants by the rating agencies. The historic failure of the rating agencies, however, to forecast the collapse of large investment grade entities (e.g., Bear Stearns, Enron, Lehman Brothers) demonstrates the inadequacy of credit assessment tools that determine counterparty credit risk based upon lagging indicators of creditworthiness.

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[6] *New York Independent System Operator, Inc.'s Filing of Tariff Revisions to Allow an Additional Form of Collateral and Reduce the Collateral Required in the Virtual Transactions Market*, Docket No. ER05-941-000 (May 5, 2005); *see also New York Independent System Operator, Inc.*, 113 FERC ¶ 61,319 (2005) (ordering the NYISO to further reduce the collateral required from four to two days of collateral).

[7] *See FERC Letter Order Accepting Tariff Revisions Regarding the Shortening of NYISO's Customer Settlement Cycle*, Docket No. ER09-193-000 (Dec. 10, 2008); *see also FERC Letter Order Accepting Tariff Revisions Regarding the Shortening of NYISO's Customer Settlement Cycle*, Docket No. ER07-156-000 (Dec. 18, 2006), and *FERC Letter Order Accepting Tariff Changes to Time Allowed for Settlement Adjustments and Billing Challenges*, Docket No. ER02-2652-000 (Oct. 30, 2002).

Over the last several years the NYISO has continued to refine its market-specific credit requirements, as described earlier, but has not revisited its policies for evaluating and monitoring the creditworthiness of its market participants since 2003. The NYISO is currently working with its market participants through the Credit Policy Task Force ("CPTF")[8] to develop credit tools that assess a market participant's creditworthiness, and allow for adjustments to a market participant's credit limit, based on leading financial metrics (e.g., stock volatility, expected default frequency, liquidity). The NYISO expects to make a filing with the Commission to address these issues later this year.

1. Shortened Billing Periods

In 2004, the Commission encouraged ISOs/RTOs to consider adopting shortened billing periods to minimize the time between when a cost is incurred by a market participant and when the market participant ultimately pays the ISO/RTO for that cost.[9] At that time, the NYISO convened a working group of market participants to discuss the various issues associated with shortening of the settlement cycle through a transition from monthly to weekly invoicing. While there was widespread recognition by market participants of the benefits arising from a shortened settlement cycle (e.g., the reduction in aggregate bad debt loss exposure and credit requirements), concerns regarding the technical feasibility of the proposal ultimately prevented a consensus on whether the NYISO should shorten its settlement cycle.

In June 2008, in conjunction with the planned redesign of its invoicing software, the NYISO reopened discussions with market participants regarding shortening of its settlement cycle. The NYISO has proposed transitioning from monthly to weekly invoicing for hourly

[8] The CPTF is a special working group of market participants composed of credit experts. The NYISO originally created the CPTF when developing the credit policies embodied in the 2003 Credit Filing, and reconstituted the CPTF in 2007 when reevaluating the TCC credit requirements.

[9] *See Policy Statement on Credit-Related Issues for Electric OATT Transmission Providers, Independent System Operators and Regional Transmission Organizations*, 109 FERC ¶ 61,186 (2004).

market services[10] by 2010. At the request of market participants, the NYISO commissioned a cost-benefit analysis of the financial impact on market participants of a move from monthly to weekly billing. The NYISO presented the results of this study to its market participants on January 16, 2009. The analysis indicated that shortening the settlement cycle would result in an estimated annual net financial benefit to the NYISO marketplace in excess of $31M annually and have positive financial implications for over 70% of the NYISO's market participants. The largest financial benefit to a single market participant is estimated to be $4.5M annually, while the largest financial cost to a single market participant is estimated to be $1.7M annually.

The NYISO plans to continue working closely with market participants to reach a consensus regarding the steps required to thoughtfully transition to a shorter settlement cycle while remaining sensitive to the fact that the transition to weekly invoicing will entail certain costs.

2. Additional Tools to Reduce Credit Risk

The financial market turmoil in 2008 highlighted the challenges to ISOs/RTOs in assessing counterparty credit risk, and demonstrated how critically important it is for ISOs/RTOs to have credit provisions in their tariffs that will allow them to respond quickly and appropriately to declines in the creditworthiness of market participants. In addition to the NYISO's proposal to transition from monthly to weekly invoicing, the NYISO and the CPTF are in the process of evaluating and discussing further mechanisms through which the NYISO can reduce credit risk and bad debt loss exposure in an effective and efficient manner. These proposals include revising the credit assessment mechanism to account for leading indicators of credit risk, setting a fixed cap on the amount of unsecured credit the NYISO may extend to any one market

[10] Hourly market services include those market services/products for which the market price varies hour-by-hour (e.g., Energy and Ancillary Services, Virtual Transactions, and TCC rents).

participant, and revising the creditworthiness provisions applicable to certain governmental entities to better align the NYISO's credit requirements with the unique risk profile and legal status of those customers.

Once the NYISO has developed, with input from the CPTF, the enhancements that it believes will best protect the NYISO-administered markets without unduly burdening any sector of market participants, then the NYISO will present these proposed enhancements to the full body of market participants and work to develop a consensus approach. This collaborative process ensures that the viewpoints of all NYISO market participants are carefully considered when developing solutions to the challenges encountered in the NYISO-administered wholesale electric market.

IV. Conclusion

The NYISO's credit policies are carefully tailored to strike an important balance between protecting against bad debt losses while not unduly restricting access to the NYISO-administered markets. ISO and RTO tariffs must maintain the appropriate balance between these two fundamental principles to ensure the long-term viability of robust, competitive wholesale electricity markets. It is also essential that ISO and RTO credit provisions include reasonable procedures for addressing the heightened credit risk that arises with the financial deterioration of a market participant to enable ISOs/RTOs to minimize potential bad debt losses.

The NYISO is confident that the Commission's recognition of these facts, and its timely review of the impact of the current financial market volatility on the industry, will result in policies that enable the continued development and long-term success of the wholesale electricity markets.

Respectfully submitted,

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