132 FERC ¶ 61,046
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

ISO New England Inc. and New England Power Pool Docket No. ER10-942-000

ORDER ACCEPTING IN PART AND REJECTING IN PART PROPOSED TARIFF REVISIONS

(Issued July 15, 2010)

1. On March 26, 2010, ISO New England Inc. (ISO-NE) and the New England Power Pool (NEPOOL) Participants Committee (jointly, Filing Parties), submitted for filing, pursuant to section 205 of the Federal Power Act (FPA),[1] proposed amendments (Amendments) to the ISO New England Financial Assurance Policy (Financial Assurance Policy) and ISO New England Billing Policy (Billing Policy)(collectively, Policies).[2] The Filing Parties assert that the proposed revisions are intended to increase the efficiency of the New England energy markets by further limiting the Pool's exposure in case of payment default by an ISO-NE Market Participant[3] and by making other changes, including: (i) providing for twice-weekly, rather than weekly, settlement for certain charges; (ii) eliminating the use of unsecured credit for ISO-NE Market Participants that do not serve retail load at government-established rates and increasing unsecured credit for certain entities; (iii) reallocating the costs of defaults where unsecured credit is still used; (iv) segregating the billing and collateralization of transmission charges from other

[1] 16 U.S.C. § 824d (2006).

[2] Capitalized terms used but not defined are intended to have the meaning given to such terms in the ISO-NE Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3, Second Restated NEPOOL Agreement, and the Participants Agreement.

[3] An ISO-NE Market Participant is intended to refer specifically to those Market Participants operating in the energy markets within the ISO-NE Regional Transmission Organization.

ISO charges; (v) improving the quality of security that is provided pursuant to the Policies; and (vi) eliminating third-party credit protection.

2. For the reasons discussed below, we accept in part the Filing Parties' proposed tariff changes to become effective, as requested, on or after December 1, 2010, with sixty days' notice to be provided by ISO-NE to all Governance Participants and to the Commission. We also reject in part certain of ISO-NE's proposals, as discussed below. Finally, we grant the requested waiver of the notice provisions of 18 C.F.R. § 35.3 (2010), which generally provide that the tariff changes may not be posted more than 120 days before they are to become effective.

## I. <u>Background</u>

3. The Filing Parties state that one of ISO-NE's primary responsibilities as the regional transmission organization (RTO) for New England is to ensure the efficient administration of its wholesale electricity markets, which includes maintaining sufficient funds to clear transactions in a timely manner.[4] The Filing Parties contend that this responsibility is complicated by the fact that the generators, suppliers, and retail load serving entities (LSEs) in New England are largely unaffiliated, such that wholesale power market transactions often involve transfers of funds between distinct entities rather than merely between one part of an organization and another part.

4. The Filing Parties state that, in the early days of ISO-NE's operation, its credit policies and risk management mechanisms required that uncovered payment defaults be socialized among those ISO-NE Market Participants with settlement activity during the billing period in which the default occurred.[5] The Filing Parties further state that, since June 2004, when ISO-NE was billing all markets monthly, when the bid to payment cycle for energy market obligations was more than 50 days, and when unsecured credit limits were capped at $125 million for each qualified participant, the Filing Parties have subsequently worked together to reduce credit risk in the markets and ISO-NE now maintains weekly billing for hourly energy markets, a 14-day average bid to payment cycle for energy market obligations, and a maximum unsecured credit limit of $75 million per qualified participant.

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[4] Transmittal Letter at 3.

[5] *Id.* at 3-4.

## II. ISO-NE Proposal and Discussion

### A. The Amendments Generally

#### 1. Proposal

5. The Filing Parties state that the Amendments to the credit and risk management practices will further reduce the financial assurance burden on ISO-NE's Market Participants and the risks to the New England electricity markets posed by payment defaults.[6] The Filing Parties remain concerned that the risks and costs of a payment default where unsecured credit is used are socialized among ISO-NE Market Participants, thereby providing ISO-NE Market Participants with the opportunity and incentive to behave in ways that increase the risks associated with a default. The Filing Parties assert that the Amendments are intended to: (i) reduce the magnitude of the default risk and the amount of financial assurance required by further shortening the billing and payment cycle; (ii) minimize the use of unsecured credit and, where it is used, reallocate the costs of a payment default among those parties using unsecured credit; and (iii) improve the quality of the security by enhancing the requirements associated with letters of credit and proof of financial viability. Each of these issues is discussed in more detail below.

#### 2. Procedural Matters

6. Notice of ISO-NE's filing was published in the *Federal Register*, 75 Fed. Reg. 18,493 (2010), with protests and interventions due on or before April 16, 2010. Motions to intervene were timely filed by BP Energy Company (BP); Consolidated Edison Solutions, Inc. and Consolidated Edison Energy, Inc. (jointly, ConEd); Constellation Energy Commodities Group, Inc. and Constellation New Energy, Inc. (jointly, Constellation); Energy America, LLC (Energy America); Exelon Corporation (Exelon); Hess Corporation (Hess); Northeast Utilities Service Company[7] (NU); NRG Companies; PSEG Companies[8] (PSEG); and Shell Energy North America (US), L.P. (Shell). A motion to intervene out-of-time was submitted by Integrys Energy Services, Inc. (Integrys). Comments in support were filed by the Supporting T&D Companies.[9]

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[6] *Id.* at 4.

[7] NU consists of Connecticut Light and Power Company, Western Massachusetts Electric Company, and Public Service Company of New Hampshire.

[8] The PSEG Companies are PSEG Energy Resources & Trade LLC and PSEG Power Connecticut LLC.

[9] The Supporting T&D Companies are NSTAR Electric Company, National Grid, United Illuminating Company, and the Northeast Utilities Companies.

Protests and comments were submitted by BP, ConEd, Shell, and the New England Credit Policy Coalition[10] (Coalition Members). On May 3, 2010, ISO-NE, NEPOOL, and the Supporting T&D Companies filed motions for leave to answer and answer to protests. On May 13, 2010, the Coalition Members filed an answer to the answers of ISO-NE, NEPOOL, and the Supporting T&D Companies. On May 18, 2010, Integrys filed an answer to the answers of ISO-NE and NEPOOL.

7. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2010), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. In addition, given its interest, the early stage of the proceeding, and the absence of undue prejudice or delay, we grant the unopposed late-filed intervention submitted by Integrys.

8. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We will accept the answers filed by ISO-NE, NEPOOL, the Supporting T&D Companies, the Coalition Members, and Integrys because they have provided information that assisted us in our decision-making process.

### 3. Prejudging the Final Rule in the Credit Reforms NOPR

#### a. Protests and Comments

9. The Coalition Members state that they do not oppose most of the Amendments, but they do oppose making significant changes to the ISO-NE Financial Assurance Policy while the Commission is conducting a generic rulemaking regarding credit standards in ISO and RTO markets. Therefore, the Coalition Members argue that the Commission should dismiss the Amendments without prejudice pending the issuance of the Final Rule in the Credit Notice of Proposed Rulemaking (Credit Reforms NOPR),[11] at which time the Filing Parties may re-submit the Amendments.[12]

10. The Coalition Members also argue that since the Amendments do not conform in all respects to the proposed regulations in the Credit Reforms NOPR, the Commission should dismiss the Amendments as premature or should defer action until after the

[10] The New England Credit Policy Coalition is composed of BP, ConEd, Constellation, Energy America, Exelon, Hess, PSEG, and Shell.

[11] *Credit Reforms in Organized Wholesale Electric Markets*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,651 (2010).

[12] New England Credit Policy Coalition protest at 2-3 (Coalition Protest).

issuance of a Final Rule in the Credit Reforms NOPR. For example, in the Credit Reforms NOPR, the Commission proposes to require that each ISO and RTO include in the credit provisions of its tariff, revisions to reduce the extension of unsecured credit to no more than $50 million per market participant and eliminate all unsecured credit for FTR markets. The Coalition Members state that the Amendments would establish higher credit limits for ISO Charges and ISO Transmission Charges for the Municipal Market Participants and T&D Companies that have continued access to unsecured credit than are proposed in the Credit Reforms NOPR.[13]

11. The Coalition Members also argue that the Amendments pre-judge certain issues upon which the Credit Reforms NOPR has solicited comments.[14] The Coalition Members assert that it would be disruptive to the market for the Commission to approve revisions to the ISO-NE Policies in the very near term because they will likely change once the Commission's Final Rule in the Credit Reforms NOPR proceeding is issued.[15] The Coalition Members note that in the past, the Commission has declined to consider individual tariff filings, or has deferred action on such filings until the Commission has issued its Final Rule in that proceeding.[16] Therefore, the Coalition Members state that the Commission should either dismiss the proposal or hold this proceeding in abeyance pending the issuance of the Final Rule on the Credit Reforms NOPR.[17]

12. The Supporting T&D Companies filed comments in support of the Amendments to the ISO-NE Policies as filed in this proceeding.[18] The Supporting T&D Companies

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[13] *Id.* at 9-10.

[14] The Coalition Members express concern regarding the Filing Parties' decision to submit the Amendments now, while the rulemaking is pending, and argue that this may be an attempt to "get in under the wire" before a Final Rule is issued. The Coalition Members note that this concern is highlighted by the Filing Parties' request that the Commission act now on the Amendments despite that the tariff changes would not become effective until December 1, 2010, at the earliest.

[15] Coalition Protest at 11.

[16] *Id.* at 11 & n.15 (citing, among other orders, *Demand Response Compensation in Organized Wholesale Energy Markets*, FERC Stats. & Regs. ¶ 32,656, at P 23 (2010) and *Southern Co. Services, Inc.*, 98 FERC ¶ 61,328, at P 25, *clarified*, 99 FERC ¶ 61,069, *reh'g denied*, 99 FERC ¶ 61,204 (2002)).

[17] *Id.* at 12.

[18] Supporting T&D Companies Comments at 1.

state that the Amendments reasonably refine the Policies in an effort to further curtail potential instances of payment defaults in the ISO-NE energy markets and to further limit the impact that such defaults have on ISO-NE Market Participants.[19] The Supporting T&D Companies state that the Amendments will: (i) decrease the percentage of the total financial assurance currently met using unsecured credit; (ii) minimize mandatory risk-sharing among all ISO-NE Market Participants; and (iii) increase the assurance that ISO-NE will be able to settle the markets in the event of a payment default.[20]

13. Specifically, the Supporting T&D Companies support the Amendments to eliminate the use of unsecured credit in most instances, and retain the use of unsecured credit for certain entities under certain narrow circumstances. The Supporting T&D Companies also support tightening the requirements that entities must meet in order to qualify for unsecured credit, eliminating the use of unsecured credit for FTRs, and using corporate guarantees as financial assurance in all cases.[21]

### b. <u>Answers</u>

14. ISO-NE states that there is no compelling reason to defer consideration of the Amendments pending the issuance of a Final Rule in the Credit Reforms NOPR proceeding because: (i) the Amendments are consistent with the Credit Reforms NOPR; (ii) the Amendments reflect preparation and consideration, followed by the normal NEPOOL stakeholder process, which began long before the issuance of the Credit Reforms NOPR, resulting in the Amendments which were supported by a majority of NEPOOL participants; and (iii) the Coalition Members mischaracterize Commission precedent regarding deferral of action on individual tariff filings when a rulemaking has been initiated.[22] ISO-NE further states that the Commission has often cited its judicially upheld and broad discretion to act in a case-by-case manner rather than through a rulemaking process.[23] ISO-NE states that if the Credit Reforms NOPR proceeding ultimately results in a Final Rule that is at odds with the Policies and Amendments, it will work with its stakeholders to develop and file any required changes.[24]

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[19] *Id.* at 8.

[20] *Id.* at 10.

[21] *Id.* at 8-9.

[22] ISO-NE Answer at 5, 10-11.

[23] *Id.* at 11.

[24] *Id.* at 9.

15. NEPOOL asserts that the Amendments reflect the regional variations that are appropriate for New England, in turn lessening the risk of nonpayment across a broad range of possible scenarios and thus assuring the liquidity of the markets.[25] NEPOOL states that the only issue before the Commission in this proceeding is whether the Amendments as filed are just and reasonable[26] and urges the Commission to deny protesters' requests to dismiss the Amendments.

#### c. <u>Commission Determination</u>

16. The Commission has the discretion to determine how best to address the issues before it.[27] Because we are able to make determinations based on the record in this proceeding, we believe it is appropriate to do so now, rather than wait until after a Final Rule is issued in the Credit Reforms NOPR proceeding, as suggested by some parties. We will therefore evaluate the Amendments under the just and reasonable standard of section 205 of the FPA. Although we see no need to wait until the issuance of a Final Rule and instead will address the filing before us, the Filing Parties may nevertheless be required, if necessary, to make further revisions as a result of the Final Rule.

## B. <u>Shortening the Billing and Payment Cycle</u>

### 1. <u>Amendments</u>

17. The Filing Parties propose to reduce the billing and payment cycle for Hourly Charges to twice-weekly, with all Non-Hourly Charges continuing to be billed and settled on a monthly basis. The Filing Parties state that this will result in: (i) lower financial assurance requirements; (ii) a reduction in the amount of unsecured credit outstanding within the Pool at any time, with a corresponding reduction in the potential exposure of a defaulting entity; (iii) a reduction in the amount of outstanding unbilled settlements; and

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[25] NEPOOL Answer at 5.

[26] *Id.* at 6.

[27] *See, e.g., Mobil Oil Exploration v. United Distrib. Cos.*, 498 U.S. 211, 230 (1991) ("An agency enjoys broad discretion in determining how to handle related, yet discrete, issues in terms of procedures . . . [such as] where a different proceeding would generate more appropriate information and where the agency was addressing the question.") (citations omitted); *Tennessee Gas Pipeline Co v. FERC*, 972 F.2d 376, 381 (D.C. Cir. 1992) ("The agency is entitled to make reasonable decisions about when and in what type of proceeding it will deal with an actual problem"); *Nader v. FCC*, 520 F.2d 182, 195 (D.C. Cir. 1975) ("[T]his court has upheld in the strongest terms the discretion of regulatory agencies to control the disposition of their caseload.").

(iv) earlier identification of possible defaults.[28] The Filing Parties further argue that, since this proposal will reduce the total outstanding liability of participants in the ISO-NE energy markets, it will therefore reduce the exposure for non-payment of Hourly Charges.

### 2. Protests and Comments

18. Protests to the twice-weekly settlement structure for Hourly Charges were filed by BP, ConEd, and Shell. Protesters argue that the Amendments will not provide sufficient incremental value to justify the expense of moving to a more frequent cycle.[29] Protesters cite various issues with the Amendments.

19. Shell states that allowing ISO-NE to circumvent the Commission's consideration of the billing cycle issue in the Credit Reforms NOPR will add to the confusion in the marketplace about credit policies, for all markets, now and in the future. Shell advocates for a uniform approach which is not unduly burdensome on ISO-NE Market Participants that operate in multiple markets.[30]

20. ConEd states that moving to a more frequent settlement cycle will increase the cost of working capital for LSEs because of the lag between their RTO payments and their customer receipts.[31] Further, ConEd argues that a shortened settlement cycle can introduce a disincentive for generation owners to enter into bilateral agreements with LSEs, since a generation owner might prefer to receive twice-weekly payments, with the corresponding reduction in working capital requirements, instead of the usual monthly payments in a bilateral contract.[32] Finally, ConEd states that twice-weekly settlements will, at a minimum, double the administrative cost of settling the market, with extra costs coming from changes to internal systems, processing of an additional invoice per week, and further reconciling of estimated data.[33]

21. BP states that requiring the settlement of Hourly Charges twice-weekly will: (i) increase the danger of payment default; (ii) limit the time to validate and reconcile

[28] Transmittal Letter at 9.

[29] Shell Protest at 2; ConEd Protest at 2; and BP Protest at 4.

[30] Shell Protest at 3.

[31] ConEd Protest at 3.

[32] *Id.*

[33] *Id.*

data before billing and the required payment of bills; and (iii) limit the time to dispute possible billing inaccuracies.[34] BP further contends that twice-weekly billing and settlement is likely to cause more uncertainty regarding bills and that the likely negative outcomes outweigh any gains its imposition may provide.

### 3. Answers

22. In response, ISO-NE argues that the concern that twice-weekly settlements pose an increased danger of payment defaults is unfounded, since the settlements in each case will be smaller and the grace period between bill issuance and payment due date has not been changed.[35] ISO-NE further argues that the Amendments do not short-change the time needed to validate and reconcile data before billing and payment, because data have been, and under the Amendments will continue to be, validated and reconciled on a daily basis.[36] Finally, ISO-NE argues that the Amendments do not alter the time limits governing ISO-NE Market Participants' submission of billing disputes.[37]

23. NEPOOL states that twice-weekly billing would reduce credit risk in the markets and the need for financial assurance in the first instance. NEPOOL points out that the interval between receipt of invoice and payment has not changed and any ISO-NE Market Participant will retain the right to contest the amount due (after paying such invoice).[38]

### 4. Commission Determination

24. The Commission accepts the Filing Parties' proposed tariff revisions to further shorten the cycle for billing and payment of Hourly Charges from once each week to twice each week, to become effective on or after December 1, 2010. We believe these revisions are just and reasonable as they will reduce credit risk by reducing the total outstanding liability of participants in the ISO-NE energy markets by, in turn, reducing the exposure to non-payment of Hourly Charges. Twice-weekly billing will also reduce credit requirements by lowering the amount of charges outstanding that are used in the

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[34] BP Protest at 4.

[35] ISO-NE Answer at 26.

[36] *Id.*

[37] *Id.*

[38] NEPOOL Answer at 6.

calculation of financial security requirements for ISO-NE Market Participants.[39] For these reasons, we reject the various arguments of the protesters that shortening the billing and payment cycle is not just and reasonable. Specifically, we disagree with BP, ConEd, and Shell that the proposal does not provide sufficient incremental value to justify the expense of moving to a more frequent cycle.

25. We disagree with Shell's assertion that accepting these changes before the issuance of a Final Rule in the Credit Reforms NOPR proceeding will add to confusion in the marketplace about credit policies. Shorter settlement periods have been Commission policy since 2004.[40] This change is also consistent with industry practice to move toward shorter settlement periods.[41] As explained above, should the Credit Reforms NOPR proceeding conclude that a different settlement schedule is more appropriate, the Filing Parties will be expected to revise the Policies to make them consistent with the Final Rule.

26. We also find unsupported ConEd's arguments that administrative costs will be doubled. Although the number of transactions to be processed will likely double, ConEd has not shown how this automatically translates into a doubling of administrative costs. For example, ConEd does not assert that it would have to double the number of personnel necessary to process the additional transactions, or that any other cost would double. We also reject as unsupported ConEd's assertion that moving to a twice-weekly billing cycle will introduce a material disincentive for generation owners whose bilateral agreements with LSEs are typically settled monthly. ConEd incorrectly compares monthly with twice-weekly settlement, when the comparison should be between weekly and twice-weekly settlement, as that is the revision that the Filing Parties are proposing in this proceeding. Any material effect on a generator's working capital requirements was more likely to have occurred when ISO-NE moved from monthly to weekly settlement in 2004, and ConEd has failed to show that there was such an effect for that shortening of the settlement cycle. In short, we find that the Filing Parties have justified this modification as reasonable, in light of all relevant factors.

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[39] Fifth Rev. Sheet No. 64A and Fourth Rev. Sheet Nos. 64B and 64C of Section I, Exhibit IA of the ISO-NE FERC Electric Tariff No. 3, General Terms and Conditions.

[40] *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186, at P 21 (2004) (*Creditworthiness Policy Statement*).

[41] *New England Power Pool*, 107 FERC ¶ 61,201, at P 10-12 (2004); *PJM Interconnection, LLC*, 127 FERC ¶ 61,017, at P 4 (2009); *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 FERC ¶ 61,163, at P 473 (2004).

27. Finally, we reject BP's arguments that the Amendments will increase the danger of payment default, limit the time to validate and reconcile data, and limit the time to dispute possible billing inaccuracies. We agree with the Filing Parties that moving to twice-weekly billing will reduce settlement amounts and thereby lower the risk of a payment default. We also concur with the Filing Parties that the Amendments neither change current practices, where data are validated and reconciled on a daily basis before billing and payment, nor does it alter the time limits governing the submission of billing disputes by an ISO-NE Market Participant, and thus no additional payment default risks are created.

### C. Separate Financial Assurance Requirements for ISO Charges and Transmission Charges

#### 1. Amendments

28. The Filing Parties propose to separately account for and collateralize charges related to market activity (i.e., ISO Charges) and charges that essentially reflect an administrative billing and collection function of ISO-NE on behalf of Transmission Owners (i.e., Transmission Charges).[42] The Filing Parties state that this distinction will: (i) allow the imposition of different credit limit calculations for these different types of charges; and (ii) facilitate the proper allocation of payment defaults associated with the use of unsecured credit. In addition, the Filing Parties state that they have made a number of conforming revisions to the Billing Policy.[43]

#### 2. Protests and Comments

29. No protests or comments were filed on this issue.

#### 3. Commission Determination

30. The Commission accepts the Filing Parties' proposed tariff revisions that account for and collateralize ISO Charges and Transmission Charges separately, to become effective on or after December 1, 2010. We agree with the Filing Parties that these revisions are just and reasonable as they will allow the imposition of different and more

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[42] *See generally* Section 2 of the revised Billing Policy. The separation creates two categories of charges: Transmission Charges, collected under Schedule 1 (Scheduling and Dispatch Surcharge), Schedule 8 (Through or Out Service Revenues), and Schedule 9 (Regional Network Service); and ISO Charges, including all amounts billed by the ISO that are not Transmission Charges, as defined in (1) above.

[43] Transmittal Letter at 10.

appropriate credit limit calculations for charges for administrative activities, i.e., the Transmission Charges, compared to charges for various market activities, i.e., the ISO Charges. In the ISO-NE markets, the monthly Transmission Charges are often paid to different parts of the same companies – such as a distribution company paying itself or its affiliated transmission company – and these payments have no real relationship to ISO Charges which generally involve transactions among unaffiliated entities. We agree that the revisions to separately collateralize these two different types of charges will facilitate the proper allocation of payment defaults associated with the use of unsecured credit.

31. As explained below, we also will require the Filing Parties to implement separate accounting and collateralization in a manner such that the combined credit limits for ISO Charges and Transmission Charges do not exceed the existing credit limits of the ISO-NE Market Participants.

### D. Elimination of Unsecured Credit

#### 1. Amendments

32. The Filing Parties propose to largely eliminate the use of unsecured credit, except for certain LSEs, and, for such entities, only with respect to their native load obligations.[44] The Filing Parties assert that such entities are entitled to recover those costs through government-established rates and therefore have a different risk profile than the rest of the market. In addition, the proposal eliminates the use of unsecured credit for all FTRs, without exception. The Filing Parties argue that the elimination of unsecured credit will reduce credit risk in the markets and reduce the inefficiencies associated with the broad socialization of the risks and costs of uncovered payment defaults. The Filing Parties note that allowing ISO-NE Market Participants to satisfy their financial assurance requirements with unsecured credit can lead to: (i) greater risk-taking; and (ii) the "sleeving" of bilateral transactions, which shifts the risks associated with bilateral contracts to the Pool of ISO-NE Market Participants.[45]

33. The Filing Parties therefore propose to continue to allow the use of unsecured credit by three types of entities that are Qualifying and only in relation to their native load service: (i) Municipal Market Participants; (ii) Transmission and Distribution (T&D) Companies; and (iii) Non-Market Participant Transmission Customers (collectively, Qualifying Distribution LSEs).[46] The Filing Parties state that the Qualifying Distribution

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[44] *Id.* at 5.

[45] *Id.* at 11-12.

[46] *Id.* at 12-13.

LSEs are those entitled to recover their costs for native load service through governmentally-established retail rates, meaning they are able to provide a form of financial security that is unavailable to other participants, and that either have an Investment Grade Rating or satisfy a Credit Threshold. The Filing Parties also state that ISO-NE will calculate a Market Credit Limit and a Transmission Credit Limit for each qualifying entity. The Filing Parties further state that the unsecured Market Credit Limit will apply to ISO Charges while a separate unsecured Transmission Credit Limit will apply to Transmission Charges.

34. The Filing Parties also propose to change the limits on unsecured credit. Generally, the Market Credit Limit[47] for a Municipal Market Participant with an Investment Grade Rating will be limited to $25 million while the Market Credit Limit for a T&D Company or a Non-Market Participant Transmission Customer will be limited to $50 million if Rated and $25 million if Unrated. Similarly, the Transmission Credit Limit[48] for a Rated Municipal Market Participant will be equal to $25 million and the Transmission Credit Limit for a T&D Company or a Non-Market Participant Transmission Customer will be limited to $50 million if Rated and $25 million if Unrated. The Market Credit and Transmission Credit Limits for non-Qualifying ISO-NE Market Participants will be $0, and those participants must provide the same collateral as other ISO-NE Market Participants without unsecured credit.[49]

### 2. <u>Protests, Comments and Answers</u>

#### a. <u>Credit Policy</u>

35. NEPOOL states that the proposed revisions significantly reduce the amount of unsecured credit that is used to meet financial assurance requirements, arguing that these changes minimize the risks among all ISO-NE Market Participants and increase assurances that ISO-NE will be able to settle its markets in the event of a payment default.[50]

36. The Coalition Members contend that the proposed elimination of unsecured credit will adversely affect consumers through increased costs due to reduced market liquidity, diminished competition, and an overall reduction in market efficiency. Additionally, the

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[47] *Id.* at 14.

[48] *Id.* at 15.

[49] *Id.* at 14-15.

[50] NEPOOL Answer at 5.

Coalition Members argue that higher costs will reduce infrastructure investment in New England as the increased collateral costs will reduce rates of return and drive capital to other markets where transaction costs relative to potential gains are more favorable.[51]

37. The Coalition Members assert that the proposal to eliminate unsecured credit is directly at odds with Commission policy, in that the Commission, they assert, has acknowledged the simplicity of eliminating unsecured credit as a means of reducing risk, but has concluded that the cost to the market of such an approach is prohibitive.[52] The Coalition Members note that the Commission has previously rejected arguments that ISOs and RTOs should go as far as ISO-NE has in the Amendments and eliminate the use of unsecured credit.[53] The Coalition Members further state that the survey of the other organized markets by Dr. Carr, their witness, demonstrates that other ISOs and RTOs evaluate a market participant's creditworthiness based on credit ratings and other relevant data, and do not apply characteristics-based thresholds to deny unsecured credit to otherwise qualified entities.[54] The Coalition Members assert that based upon Dr. Carr's survey of the use of unsecured credit in other ISOs and RTOs, the Amendments would result in ISO-NE becoming an outlier with respect to credit policy.

38. The Coalition Members state that while they support the elimination of unsecured credit in the FTR market, the Filing Parties fail to justify the elimination of unsecured credit in the ISO-NE energy market. The Coalition Members argue that the Filing Parties have not identified a single default in these energy markets or any comparable defaults in other energy markets that would support elimination of unsecured credit in the energy market. The Coalition Members argue that if, during this period of unprecedented financial stress, the Filing Parties cannot identify a single instance in which the current credit policy has failed to protect ISO-NE Market Participants from credit defaults, then

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[51] Coalition Protest at 34.

[52] *Id.* at 15 (citing *Creditworthiness Policy Statement*, 109 FERC ¶ 61,186 at P 19).

[53] *Id.* at 15 & n.24 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 128 FERC ¶ 61,093, at P 19 (2009) (*MISO Order*); *California Indep. Sys. Operator Corporation*, 126 FERC ¶ 61,285, at P 37, *corrected*, 127 FERC ¶ 61,118 (2009) (*CAISO Order*)).

[54] Dr. Scott Carr testimony at 5-7 (First Carr Affidavit). The First Carr Affidavit was included as part of the Coalition Protest.

there appears to be no justification for the extraordinary credit policy changes contained in the Amendments.[55]

39. The Coalition Members argue that there is no risk posed by creditworthy Competitive LSEs[56] that justifies elimination of unsecured credit to entities that meet the stringent creditworthiness criteria contained in the current Financial Assurance Policy. The Coalition Members argue that evidence of defaults in the FTR market does not support new remedies in the separate and unrelated energy market, absent specific evidence of defaults in the energy market.[57]

40. The Coalition Members also contest the Filing Parties' concerns about the potential "sleeving" of bilateral transactions. The Coalition Members argue that the Filing Parties constructed a wholly speculative scenario to illustrate their concerns, but failed to identify a single instance in which any element of the sleeving scenario had actually occurred.[58] The Coalition Members contend that the downward trend in internal bilateral transactions could be caused by the implementation of weekly settlements because they create incentives for suppliers to favor settlements in the ISO-NE energy markets, which generally involve payments on a bi-weekly or monthly basis, over bilateral transactions which settle monthly.

41. In its May 13, 2010 answer, ISO-NE contests the Coalition Members' argument that eliminating the use of all unsecured credit is contrary to Commission policy. ISO-NE states that there is no general Commission policy prohibiting the elimination of unsecured credit.[59] Specifically, ISO-NE argues that the policy statement, to which the Coalition Members refer, the Creditworthiness Policy Statement, is six years old and does not reflect interim reforms. ISO-NE argues that in the statement, the Commission recognized the benefits of requiring full collateralization, and expressly stated that the only reason not to impose such a requirement is that the costs of doing so appeared to be excessive at that time:

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[55] *Id.* at 24.

[56] The Competitive LSEs are those entities who currently qualify to use unsecured credit in the energy market that under the proposed revisions would be excluded from continuing to do so because they do not serve retail load at government-established rates.

[57] *Id.* at 27 (citing *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006)).

[58] *Id.* at 24-25.

[59] ISO-NE Answer at 11.

> While requiring all market participants in ISOs/RTOs to be fully collateralized would eliminate the mutualized credit risk, the Commission believes that such a goal would impose significant costs on market participants and, in turn, would represent a serious barrier to entry into the markets…[T]he Commission believes that there are less burdensome ways to reduce credit exposure and minimize the mutualized default risk in ISO/RTO markets and encourages them to adopt such measures.[60]

Subsequently, the New England region adopted a series of reforms designed to shorten the settlement periods and reduce the risk of defaults. ISO-NE asserts that these reforms reduced, to a manageable level, the cost of achieving the benefits recognized in the *Creditworthiness Policy Statement*, and that moving to twice-weekly settlements will yield further similar benefits.[61]

42. ISO-NE argues that the Coalition Members incorrectly relied on the *MISO Order* and *CAISO Order*.[62] ISO-NE states that in the *MISO Order* the Commission rejected on purely procedural grounds a proposal to eliminate the use of unsecured credit, because it was not made through a filing under FPA section 205 or 206, but in a protest that constituted a collateral attack on earlier orders. Similarly, ISO-NE notes that in the *CAISO Order*, the Commission rejected a protest because it was a collateral attack, rather than a proposal by a market operator to eliminate unsecured credit.

43. ISO-NE states that the Coalition Members' protest regarding surveys on the unsecured credit policies of other regions has no value as to the acceptability of the unsecured credit proposals in this filing. ISO-NE notes that the Commission has long recognized the acceptability of regional differences among ISOs and RTOs,[63] and New England has often taken a leading role on credit issues.[64]

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[60] *Id.* at 12 & n.24 (citing *Creditworthiness Policy Statement*, 109 FERC ¶ 61,186 at P 19).

[61] *Id.* at 12.

[62] *Id.* at 13-14 (citing *MISO Order*, 128 FERC ¶ 61,093 at P 19; *CAISO Order*, 126 FERC ¶ 61,285).

[63] *Id.* at 14 & n.29 (citing *Southwest Power Pool, Inc.*, 128 FERC ¶ 61,114, at P 5 (2009)).

[64] *Id.* at 14 & n.30 (citing *New England Power Pool*, 107 FERC ¶ 61,201 at P 1).

44. ISO-NE contests the Coalition Members' argument that there simply is not a high enough risk of default to warrant implementing the proposed amendment to limit those who receive unsecured credit. ISO-NE notes that the Commission has approved countless filings made pursuant to section 205 of the FPA to improve regional markets in various ways without requiring a showing of actual harm, and potential harm has been sufficient support for a preventative tariff change.[65]

### b. Costs and Benefits of Eliminating Unsecured Credit

45. The Coalition Members argue that the Filing Parties have failed to show a nexus between extending unsecured credit to Competitive LSEs and defaults in the energy market that would justify selectively imposing the additional costs of full collateralization on the competitive suppliers. The Coalition Members state that the Commission has previously rejected attempts to impose additional burdens where no such nexus exists.[66] The Coalition Members state that the Amendments do not account for the fact that many companies now receiving unsecured credit are large, sophisticated firms, with substantial financial strength and liquidity, that are capable of minimizing credit and default risks through forward trading, hedging, and other risk-management techniques.[67]

46. The Coalition Members also argue that in order to impose significant additional costs on ISO-NE Market Participants, there must be a nexus between those costs and any claimed benefits.[68] The Coalition Members assert that the cost of eliminating unsecured credit is substantially greater than the benefit, i.e., the avoided cost of potential defaults.[69] Specifically, the Coalition Members argue that based upon a study by Dr. Carr,[70] the additional annual cost would be approximately $7.7 million, while the benefit of eliminating unsecured credit for Competitive LSEs would only be $50,000. Using an

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[65] *Id.* at 16-18 & n.44 (citing *ISO New England Inc.*, 125 FERC ¶ 61,355, at P 33 (2008)).

[66] Coalition Protest at 28 (citing *PJM Interconnection, LLC*, 108 FERC ¶ 61,116, at P 6 (2004)).

[67] *Id.* at 29-30.

[68] New England Credit Party Coalition Answer at 6 & n.14 (citing *PJM Interconnection, LLC*, 108 FERC ¶ 61,116 at P 6) (Coalition Answer).

[69] Coalition Protest at 32-33.

[70] First Carr Affidavit at 12-13.

ISO-NE Study,[71] Dr. Carr estimates that the Competitive LSEs would need an additional $256 million in collateral (based on peak unsecured credit market levels) at an annual cost rate of 3.0 percent of the collateral value. Dr. Carr also assumes that firms would post collateral in excess of their expected peak requirements as protection against unexpectedly high prices or demand.[72] Dr. Carr's $50,000 risk-avoidance benefit was derived by multiplying the average level of unsecured credit in ISO-NE's Study of $89.6 million, by the Moody's forecasted 2010 one-year Credit Loss Rate for investment grade debt of 0.06 percent.

47. In its answer, ISO-NE argues first that the Carr Affidavit overstates the amount and cost of additional required collateral that would be needed.[73] ISO-NE asserts that the cost of additional collateral should be based on the approximately $79.8 million[74] of average daily outstanding unsecured credit for the 7.0 percent (i.e., 30) of the ISO-NE Market Participants that would have been affected for 2009, rather than the $256 million used by Dr. Carr. ISO-NE further asserts that the cost rate for the additional collateral would be more in the range of 0.75 to 1.25 percent, as this is the historical rate for standby letters of credit that would replace the $79.8 million of unsecured credit, rather than the 3.0 percent used by Dr. Carr. Thus, according to ISO-NE, the cost of the proposed elimination of unsecured credit would be approximately $600,000 to $1,000,000, rather than the $7.7 million asserted by the Coalition Members.

48. ISO-NE also argues that Dr. Carr's estimate of only a $50,000 expected financial risk-avoidance benefit is too low. First, ISO-NE asserts that it is inconsistent to use average unsecured credit market levels in the determination of the benefit, while using peak levels in the determination of the cost of eliminating unsecured credit. Second, ISO-NE asserts that the Credit Loss Rate used by Dr. Carr was too low as most of the Competitive LSEs are rated Baa and the Moody's Credit Loss Rate for Baa entities is nearly twice as high as that used by Dr. Carr. Additionally, ISO-NE notes that the annual premiums on its existing competitively bid unsecured credit insurance policy are many times higher than the $50,000 in expected financial risk-avoidance benefit claimed in the

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[71] An ISO-NE presentation titled "Costs and Benefits of ISO-NE's Proposed Financial Assurance Term Sheet" dated March 6, 2009 (ISO-NE Study) *available on* ISO-NE's web site at http://www.iso-ne.com/committees/comm_wkgrps/prtcpnts_comm/prtcpnts/mtrls/2009/mar62009/3-09_npc_presentation_6.pdf.

[72] First Carr Affidavit at 12-13.

[73] ISO-NE Answer at n.56.

[74] *Id.* at 21-23.

First Carr Affidavit in order to cover a similar level of risk.[75] Further, ISO-NE states that the First Carr Affidavit ignores the hard-to-estimate costs of the damage to market efficiency and confidence that a major default would entail, such as the default in PJM by the Lehman Brothers Commodities Services equaling $17 to $18 million.[76]

49. In response to ISO-NE's criticisms, Dr. Carr asserts[77] that it is appropriate to base the amount of additional collateral needed on an adjusted peak study amount even though the computation of benefits is based on the study's average amount. Dr. Carr states that if a firm only posted sufficient collateral to cover its average requirements, the firm's collateral would be less than its actual requirements about half of the time and ISO-NE would find this practice unacceptable. Dr. Carr asserts that if a company finds itself under-collateralized in ISO-NE, it must either immediately post additional collateral, which could be very expensive, or suffer severe consequences. Dr. Carr further asserts that the 0.75 to 1.25 percent range for the issuance cost for standby letters of credit may reflect past collateral costs and does not accurately reflect current and/or forecasted costs of providing new collateral. Dr. Carr explains that his use of 3.0 percent is a reasonably conservative estimate.[78]

50. Finally, Dr. Carr counters ISO-NE's argument that the Credit Loss Rate was too low by asserting that his assumed 0.06 percent value already anticipates that a large proportion of the affected firms will hold a Baa rating.[79] In response to ISO-NE's assertion that its existing credit insurance policy carries with it annual premiums many times greater than the $50,000 expected financial risk-avoidance benefit, the Coalition Members state that the expected value of future credit losses represents but one component of the premium that ISO-NE pays for default insurance. The Coalition Members assert that this premium additionally includes underwriting and servicing costs, profits, costs of funding reserves, and other items.[80]

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[75] *Id.* at 24.

[76] *Id.* at 24-25.

[77] Dr. Scott Carr testimony at 7-8 (Second Carr Affidavit). The Second Carr Affidavit was included as part of the Coalition Answer.

[78] *Id.* at 7 & n.18.

[79] *Id.* at 6-7 & n.16

[80] *Id.* at 8.

### c. <u>Preferential Treatment</u>

51. The Coalition Members protest the Filing Parties proposal to retain unsecured credit for Qualifying Distribution LSEs. The Coalition Members argue that the elimination of credit from some, but not all, ISO-NE Market Participants will skew the market significantly by imposing additional costs only on competitive suppliers, an outcome that will undermine competition to the detriment of consumers. The Coalition Members argue that while the Qualifying Distribution LSEs may avoid higher collateral costs under the Amendments, their customers will pay such costs through higher energy prices while also continuing to bear the risk of potential defaults, an outcome that provides no identifiable customer benefit. The Coalition Members further contend that the selective imposition of higher collateral costs will, in the long run, undermine the competitive restructuring of the power industry which has taken place across New England over the past decade.[81]

52. The Coalition Members also contend that the elimination of unsecured credit for a subset of ISO-NE Market Participants is unduly discriminatory. They assert that the Commission's *Creditworthiness Policy Statement* explained that a credit policy should be transparent and fairly and uniformly applied. They further assert that the Commission has consistently held that it is not just and reasonable to adopt a credit policy that addresses only a subset of market participants, nor is it appropriate for a credit policy to discriminate against entities seeking credit based on their corporate form.[82] The Coalition Members argue that although the Amendments were approved with substantial stakeholder support, this does not make the Amendments any less discriminatory. The Coalition Members also state that the Filing Parties' assertion that the Qualifying Distribution LSEs are uniquely creditworthy, solely because they have the ability to seek to recover higher costs through regulated rates, is unsupported and does not ensure that they will be adequately protected from market volatility.

53. In its answer, ISO-NE contests the Coalition Members' reliance on a quotation from the Commission's *Creditworthiness Policy Statement*: "that a credit policy should be transparent and fairly and uniformly applied."[83] ISO-NE argues that this statement

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[81] Coalition Protest at 35-36.

[82] *Id*. at 21 & n.44 (citing *PJM Interconnection, LLC*, 122 FERC ¶ 61,279, at P 58 (2008); *Southwest Power Pool, Inc.*, 116 FERC ¶ 61,162, at P 18 (2006), *reh'g granted*, 118 FERC ¶ 61,035 (2007)).

[83] ISO-NE Answer at 15 & n.32 (citing *Creditworthiness Policy Statement*, 109 FERC ¶ 61,186 at P 12).

did not address the acceptability of a credit policy that objectively distinguishes among classes of market participants based on their collective characteristics. ISO-NE notes that this statement says no more than that the unsecured credit policies should be applied transparently, fairly and uniformly to the members of the classes of market participants that are still permitted to use unsecured credit.[84]

54. In addition, ISO-NE argues that preserving a limited use of unsecured credit by certain types of ISO-NE Market Participants (i.e., Qualifying Distribution LSEs), while eliminating its use by other ISO-NE Market Participants (i.e., Competitive LSEs), is not unduly discriminatory. Specifically, ISO-NE argues: (i) the Commission has not prohibited the application of credit policies that distinguish between various classes of market participants based on objective distinctions; (ii) the Coalition Members inappropriately characterize the risk of organized market defaults by investment-grade entities as low; and (iii) the Coalition Members inappropriately dispute that the types of ISO-NE Market Participants being permitted to continue to use limited amounts of unsecured credit present a lower risk of default.[85]

55. ISO-NE further states that the differentiation in credit requirements between unregulated energy ISO-NE Market Participants (i.e., Competitive LSEs) and Qualifying Distribution LSEs is justified and does not constitute undue discrimination. Specifically, ISO-NE states that load-serving ISO-NE Market Participants with state-regulated rates, if they begin to experience financial difficulty, tend to decline in strength more slowly and transparently than unregulated entities, and in a manner that can be accommodated by the markets through imposing more security requirements as strength decreases. Moreover, ISO-NE states that the First Carr Affidavit points out[86] that Moody's one-year corporate default rate forecast for the "Utilities: Electric" category is 0.4 percent (mostly regulated public utilities), while the default rate forecast for the "Energy: Electricity" category is 2.0 percent (mostly unregulated electric producers/marketers). ISO-NE notes that the latter category has a forecasted default rate five times higher.[87] ISO-NE asserts that while municipal entities are not immune to default, since 1934 only 614 cases have been filed by municipal entities under the provisions of the Bankruptcy Code (Chapter 9)

[84] *Id.* at 15.

[85] *Id.* at 6-7.

[86] *Id.* at 20 & n.49 (citing First Carr Affidavit at n.20).

[87] *Id.* at 18-20.

addressing municipal bankruptcies, versus more than 60,000 business bankruptcy filings overall in 2009 alone.[88]

56. In its answer, NEPOOL avers that permitting a small and financially unique subset of ISO-NE Market Participants to use unsecured credit in a narrow set of circumstances would not upset the goals of minimizing the risks among all ISO-NE Market Participants and increase assurances that ISO-NE will be able to settle its markets in the event of a payment default. In support, NEPOOL states that the risk of default is materially different for certain municipal utilities and transmission owners that serve native load because they recover their costs through cost-of-service rates that provide a form of financial security, and therefore the Amendments merely reflect that difference.[89]

57. In their answer, the Supporting T&D Companies state that the difference in treatment between T&D Companies and Competitive LSEs with regard to the use of unsecured credit is justified given that T&D Companies pose a lower risk of payment default than these Competitive LSEs in the ISO-NE markets. The Supporting T&D Companies argue that this is due to the fact that T&D Companies can recoup their ISO-NE costs incurred in providing state-mandated service from their retail customers. The Supporting T&D Companies note that T&D Companies have cost recovery mechanisms that allow for the pass-through of wholesale power costs to their retail customers.[90]

58. The Supporting T&D Companies also argue that Competitive LSEs will not be at a cost disadvantage in the competitive retail market. Specifically, the Supporting T&D Companies state that in fulfilling their provider of last resort (POLR) obligations, T&D Companies do not compete with ISO-NE Market Participants for retail customers. The Supporting T&D Companies state that the Competitive LSEs are the wholesale market suppliers for the T&D Companies' basic service obligations. As such they argue that the basic service prices of the T&D Companies include the credit costs of the Competitive LSEs, and therefore the Competitive LSEs will not be at a cost disadvantage in the competitive retail market.[91]

59. Further, the Supporting T&D Companies argue that even if a T&D Company does not transfer competitive retail suppliers' credit costs to the T&D Company's retail

[88] *Id.* at 20-21.

[89] NEPOOL Answer at 5.

[90] Supporting T&D Companies Answer at 5.

[91] *Id.* at 6.

customers, Competitive LSEs continue to have cost advantages since they have no obligation to serve and thus can selectively choose customers with lower credit risks, whereas T&D Companies have to make their load available to all customers regardless of credit risk, load profile, location, or other considerations. The Supporting T&D Companies assert that at the end of the day, the Amendments do not put Competitive LSEs at a disadvantage, but rather balance respective risks by giving T&D Companies the tools to manage their state-mandated load obligations in a least-cost manner.[92]

60. The Supporting T&D Companies argue that the Coalition Members disregard in their protest that in the rare case of utility bankruptcies, outstanding bills of the type at issue here still get completely paid in the end, even if by the new utility that might result from the bankruptcy.[93] The Supporting T&D Companies state that utilities may not be immune from credit problems or bankruptcies, but there are characteristics unique to utilities that operate to protect their creditors. Further, the Supporting T&D Companies maintain that the utility infrastructure continues to exist as do the ratepayers in the franchised service territory. Thus, the risk of ISO-NE charges remaining unpaid in the event of a bankruptcy is completely different for an electric utility with POLR obligations as compared to other competitive suppliers. Therefore, the Supporting T&D Companies argue that different treatment for T&D Companies and Competitive LSEs is not unreasonable, nor unduly discriminatory, and should be accepted by the Commission.[94]

61. In response to these answers, the Coalition Members argue that the Qualifying Distribution LSEs may present different credit risks, but are not uniquely creditworthy, and relying on an entity's status as the sole factor to determine whether to extend unsecured credit is unjust, unreasonable and unduly discriminatory. Additionally, the Coalition Members state that while it is true that other ISOs/RTOs consider the status of a market participant and its ability to collect revenues through state-approved rates in making creditworthiness determinations, no ISO/RTO has gone as far as ISO-NE proposes and made the status of an entity the sole determining factor as to whether the entity qualifies for unsecured credit.[95]

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[92] *Id.*

[93] *Id.* at 7 & n.18 (citing *In re Public Service Company of New Hampshire*, 110 P.U.R. 4th 259, 108 B.R. 854 (1989)).

[94] *Id.* at 7.

[95] Coalition Answer at 7.

62. The Coalition Members note that even though the 0.4 percent value may be a reasonable default rate estimate for investment grade regulated utilities, the large number of speculative grade firms in the unregulated electricity sector implies that the 2.0 percent value is not a reasonable estimate for the Competitive LSEs.[96] The Coalition Members also contend that ISO-NE's argument that an investment-grade rating for a municipal entity may be more reassuring than for other types of entities because investment grade municipals had only 614 bankruptcy filings since 1934 versus more than 60,000 business bankruptcies in 2009, is meaningless because ISO-NE does not indicate how many, or how few, of these bankruptcies involved investment grade firms.[97]

### 3. **Commission Determination**

63. At the outset, we note that the Commission has long held that reducing mutualized default risks in ISOs/RTOs is an important goal.[98] Thus, among other things, the Commission has supported shortening settlement periods and netting obligations owed by and to individual market participants whenever possible.[99] Similarly, the Commission has supported reducing the amount of unsecured credit available to market participants in certain cases where the additional costs imposed would not create a barrier to entry.[100]

64. Against this backdrop, the Commission will accept the Filing Parties' proposed tariff revisions that eliminate the use of unsecured credit for FTRs for all ISO-NE Market Participants. No party protests this proposal and, due to the unique characteristics and risks inherent in the FTR market, we believe it is just and reasonable to eliminate the use of unsecured credit for FTRs. Specifically, FTRs are unique due to their value being derived from unforeseeable events, including unplanned outages and unanticipated weather conditions. Additionally, FTRs are relatively illiquid, adding to the inherent risk in their valuation.[101]

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[96] Second Affidavit of Scott Carr at 4.

[97] *Id.*

[98] *Creditworthiness Policy Statement*, 109 FERC ¶ 61,186 at P 17-20.

[99] *Id.* P 20-30.

[100] *See PJM Interconnection, LLC*, 127 FERC ¶ 61,017 at P 35; *accord New York Indep. Sys. Operator*, Docket No. ER09-1612-000 (Nov. 4, 2009) (unpublished letter order).

[101] *PJM Interconnection, LLC*, 127 FERC ¶ 61,017 at P 36.

65. However, we also find, as explained below, that the Filing Parties have not shown that the Competitive LSEs are more likely to default in comparison to Qualifying Distribution LSEs (i.e., the entities that serve native load at government-established retail rates). We cannot find, on the basis of the record before us, that the Filing Parties' proposal to selectively eliminate unsecured credit is not unduly preferential and unduly discriminatory.

66. Over the past quarter century, a few regulated utilities have sought bankruptcy protection resulting from stranded costs related to nuclear facilities and wholesale power contracts, debts incurred as part of restructuring, and extraordinary storm restoration costs. In several cases, the regulated utility was rated investment grade within one year prior to default, and in one case, it was rated investment grade at the time of default.[102] Additionally, during 2007, several Midwestern utilities that were rated investment grade were close to default as a result of a dispute with the state government concerning the pass-through of wholesale power costs under electric restructuring.[103] In several of these situations, regulated utilities defaulted or were at risk of defaulting with respect to their native load, sometimes in a very rapid manner, when involved in rate disputes with state regulators or when faced with statute changes by state legislatures. While we agree with the Filing Parties that the risks of an unforeseen bankruptcy for the Qualifying Distribution LSEs are very low, we do not believe that the Filing Parties have demonstrated that such entities are immune from these same risks just noted and therefore deserve a carve-out as a separate class of entity allowed the continued use of unsecured credit.

67. Further, we do not accept ISO-NE's argument that the Competitive LSEs are far more likely to default than Qualifying Distribution LSEs and therefore their activity in the energy markets should be fully collateralized. We agree with the Coalition Members that ISO-NE has not demonstrated that the cited 2.0 percent one-year default rate

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[102] *See* "Special Comment: Default, Recovery, and Credit Loss Rates for Regulated Utilities, 1983-2008" (May 2009) at www.moodys.com. This utility was rated A2 one year prior to and Baa3 at the time of its January 2001 default when the company was unable to recover high market-price wholesale power costs against the legislatively frozen electric rates. Another western utility was rated A2 six months before it defaulted in April 2001 for the same reasons. A southeastern utility was rated Baa3 one month before defaulting in September 2005 due to costs associated with Hurricane Katrina. A northwestern utility was rated Baa2 one year prior to defaulting in September 2003 because of debts incurred as the result of a diversification strategy.

[103] *Id.* All of the regulated utilities involved were rated investment grade during this regulatory dispute.

forecasted by Moody's for the "Energy: Electricity" sector is more representative of the Competitive LSEs than the 0.4 percent rate for the "Utilities: Electric" sector, as most of the Competitive LSEs are either regulated utilities that serve native load in distribution territories located outside New England's energy markets or are major oil companies that have affiliates serving competitive electricity markets. Thus, we agree that the Competitive LSEs, all rated investment grade, should have a default rate more like the 0.4 percent rate for the "Utilities: Electric" sector. In fact, several of the Competitive LSEs have higher credit ratings and more liquid balance sheets than the Qualifying Distribution LSEs who would continue to have access to unsecured credit under the Amendments. Finally, we agree with the Coalition Members that ISO-NE's comparison of the number of bankruptcy filings by municipal entities versus those of businesses is not informative because the number of business bankruptcies statistic may include both investment grade and speculatively-rated entities, and ISO-NE does not allow unsecured credit for speculative entities.

68. Similarly, we find that the Supporting T&D Companies have not adequately shown that their POLR obligations uniquely justify allowing them unsecured credit while simultaneously eliminating it for the Competitive LSEs that do not serve native load. While it is true that the T&D Companies will continue to own the infrastructure to provide distribution service to native load customers in jurisdictions where retail choice is available, there is the risk that customer migration to Competitive LSEs may result in unrecoverable stranded wholesale power purchase costs. In addition, the Supporting T&D Companies have not provided examples or otherwise shown that, in the case of a utility bankruptcy, the utility's outstanding obligations would be completely paid in full due to their ability to request a rate increase. Therefore, we find that the Filing Parties have not demonstrated that their proposal to continue the use of unsecured credit in the energy markets only for the Qualifying Distribution LSEs is not unduly discriminatory or preferential. Given our rejection of the selective elimination of unsecured credit for Competitive LSEs, we need not address the Coalition Members' assertions that the Filing Parties have not supported the elimination of unsecured credit in the energy markets. As explained above, should the Credit Reforms NOPR proceeding reach different outcomes with respect to the use or elimination of unsecured credit, the Filing Parties will be expected to revise the Policies to make them consistent with the Final Rule.

69. We also reject as unsupported, the Filing Parties' proposal to increase the total unsecured credit limit from $75 to $100 million for certain T&D Companies that are entitled to recover costs through government-established retail rates, by providing up to $50 million of unsecured credit for ISO Charges and up to $50 million for Transmission Charges. The Filing Parties have not provided any support for this increase. While we are not opposed to the creation of separate Market and Transmission Credit Limits, we cannot find, on the record before us, that it would be just and reasonable for the combined unsecured credit limit of these entities to increase to as much as $100 million.

70. While we will not accept the Filing Parties' proposal to largely eliminate unsecured credit, we note that in this order we are accepting their proposals to separate ISO Charges and Transmission Charges and reallocate the costs of payment defaults associated with unsecured credit. We expect that these proposals, along with our rejection of both increased unsecured credit limits for T&D Companies and the proposed elimination of third-party credit insurance, will ameliorate the Filing Parties' concern over mutualization of unsecured credit risk among ISO-NE Market Participants. To the extent that the Filing Parties remain concerned with the risk from unsecured credit among ISO-NE Market Participants, we encourage the Filing Parties to submit an alternative proposal that seeks to reduce unsecured credit levels in a not unduly discriminatory manner.

### E. Reallocation of the Costs of Payment Defaults Associated with Unsecured Credit

#### 1. Amendments

71. The Filing Parties also propose to change how the cash shortfalls associated with payment defaults are allocated where unsecured credit is used.[104] Specifically, except in limited circumstances, the costs associated with a default by an Unsecured Municipal Market Participant will be shared by other Unsecured Municipal Market Participants, and the costs associated with a default by an Unsecured Non-Municipal Market Participant will be socialized to other Unsecured Non-Municipal Market Participants. Further, there will no longer be any default allocations to those ISO-NE Market Participants that choose to forgo the use of unsecured credit by meeting their financial assurance requirement with secured collateral. Finally, any defaults will not be socialized across the two participant types, unless that default exceeds the defaulting participant's applicable credit limit, and only at that point would the payment default be socialized among all ISO-NE Market Participants with settlement activity for the billing period at issue.

#### 2. Protests and Comments

72. No protests were filed on this issue. The Supporting T&D Companies support the provision that revises the default cost allocation methodologies such that any shortfalls caused by a payment default by an ISO-NE Market Participant using unsecured credit will be allocated first to the same-type resources also using unsecured credit, up to the credit limit for the defaulting ISO-NE Market Participant.[105]

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[104] Transmittal Letter at 6.

[105] Supporting T&D Companies Comments at 9-10.

### 3. Commission Determination

73. The Commission accepts the Filing Parties' proposed tariff revisions modifying the allocation of payment defaults, to become effective on or after December 1, 2010, finding them to be just and reasonable. These revisions will better associate payment defaults that may arise when an ISO-NE Market Participant's payment obligation exceeds its collateral with those of other, similar ISO-NE Market Participants that use unsecured credit. The revisions will also enable ISO-NE Market Participants to control their exposure to defaults through an annual election process whereby ISO-NE Market Participants may forgo the use of unsecured credit. Although the Commission has not authorized elimination of all unsecured credit, all groups of ISO-NE Market Participants will be covered by the two defined participant types, Unsecured Municipal Market Participants and Unsecured Non-Municipal Market Participants.

## F. Improvements to the Quality of Security Provided, and Other Changes

### 1. Amendments

74. The Filing Parties propose to revise the term Investment Grade Rating in two ways. First, the Filing Parties propose to eliminate the possible use of senior secured debt ratings for an ISO-NE Market Participant that does not have a corporate rating or a rating for its senior unsecured debt. Second, the Filing Parties propose to use the lowest credit rating when there is more than one available. The Filing Parties state that using the lowest credit rating is a more conservative approach because it is based on the most pessimistic of major ratings.[106] The Filing Parties also seek to eliminate the use of corporate guarantees as financial assurance in all cases.[107]

75. The Filing Parties propose to require each bank issuing a letter of credit be on ISO-NE's "List of Eligible Letter of Credit Issuers." The Filing Parties state that the list will be updated no less than once quarterly. The Filing Parties also state that, in order to be included on the "List of Eligible Letter of Credit Issuers," a bank must either be a bank organized under the laws of the United States or any state thereof, or be the United States branch of a foreign bank, and must either: (i) be recognized by the Chicago Mercantile Exchange (CME) as an approved letter of credit bank; (ii) have a minimum long-term debt rating of an "A-" by Standard and Poor's, or "A3" by Moody's, or "A-" by Fitch, and have its letter of credit confirmed by a bank that is recognized by CME as an

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[106] Transmittal Letter at 15-16.

[107] *Id.* at 16.

approved letter of credit issuer; or (iii) have a minimum long-term debt rating consistent with (ii) above and be approved by the ISO in its sole discretion.[108]

76. The Filing Parties state that, if an entity on the "List of Eligible Letter of Credit Issuers" fails to satisfy any of the eligibility criteria, the applicable ISO-NE Market Participant will have five business days to replace the letter of credit with a letter of credit from an entity satisfying those criteria or provide other financial assurance satisfying the requirements of the Financial Assurance Policy. The Filing Parties further state that, if a letter of credit issuer is removed from the CME list of approved letter of credit banks, ISO-NE, in its sole discretion, may extend the cure period to twenty business days.[109] Additionally, the Filing Parties propose that no entity may issue or confirm letters of credit under the Financial Assurance Policy in an amount exceeding either: (i) $100 million in the aggregate for any single ISO-NE Market Participant; or (ii) $150 million in aggregate for a group of affiliated entities.[110] The Filing Parties note that once the proposed changes go into effect the financial assurance requirements for Municipal Market Participants will be the same as the financial assurance requirements for Non-Municipal Market Participants.

77. In addition, the Filing Parties state that the proposed changes will require Municipal Market Participants to abide by the currently existing provisions that require entities seeking to become ISO-NE Market Participants to submit proof of financial viability. Specifically, the Filing Parties state that Municipal Market Participants will be required to submit various financial statements and references, where such data is available.[111]

### 2. **Protests and Comments**

78. No protests or comments were filed on this issue.

### 3. **Commission Determination**

79. The Commission will accept the Filing Parties' proposed tariff revisions regarding tightening financial assurance requirements, to become effective on or after December 1, 2010, as we find they will reasonably reduce credit risk. We thus will accept the proposed

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[108] *Id.* at 18.

[109] *Id.* at 18.

[110] *Id.* at 19.

[111] *Id.*

tariff revisions as just and reasonable, including: (i) revising the definition of Investment Grade; (ii) imposing new requirements on a bank to be eligible to provide a letter of credit, including placing new limits on the amount of financial assurance that may be provided through letters of credit from a single entity; and (iii) extending certain existing financial assurance and suspension provisions to Municipal Market Participants.

80. The Commission will also accept the Filing Parties' proposed tariff revisions to entirely eliminate corporate guarantees as financial assurance as a reasonable way to further reduce the risk of default.

## G. Elimination of Third-Party Credit Protection

### 1. Amendments

81. The Filing Parties propose to allow ISO-NE to discontinue purchasing third-party credit protection, which reimburses ISO-NE and its stakeholders for losses that may accrue as a result of a payment default by an Investment Grade Rated ISO-NE Market Participant utilizing a credit limit. The Filing Parties state that the revised default allocation provisions, as described above, will obviate the need for this insurance.[112]

### 2. Protests and Comments

82. No protests or comments were filed on this issue.

### 3. Commission Determination

83. In light of our denial of the selective elimination of unsecured credit in the energy markets, the Commission will not accept the Filing Parties' proposed tariff revisions that would allow ISO-NE to discontinue purchasing third-party credit protection, as we believe that this insurance may continue to be necessary.

The Commission orders:

(A) ISO-NE's proposed tariff revisions are hereby accepted in part, to become effective, as requested, on or after December 1, 2010, and rejected in part.

[112] *Id.*

(B) ISO-NE is hereby directed to submit revised tariff sheets, reflecting the proposed revisions accepted herein, as discussed in the body of this order.

By the Commission. Commissioner Moeller is concurring with a separate statement attached. Commissioner LaFleur voting present.

( S E A L )

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

| | | |
|---|---|---|
| ISO New England Inc. and<br>New England Power Pool | )<br>) | Docket No. ER10-942-000 |

(Issued July 15, 2010)

MOELLER, Commissioner, *concurring*:

The Filing Parties have worked extensively to develop amendments to ISO-NE's Financial Assurance and Billing Policies and I am generally supportive of such efforts to minimize risk exposure in the organized markets. The fact that the proposal was strongly supported (81.88%) in the NEPOOL Participants Committee demonstrates that consensus exists to minimize both financial assurance burdens on market participants as well as the risk associated with payment defaults.

In the accompanying decision, however, we reject a key provision of the Filing Parties' proposal involving the elimination of unsecured credit to market participants who do not have native load obligations. For the reasons stated in the Order, we determine this provision to be unduly preferential and unduly discriminatory largely because the determinative factor is based on a general assumption that load-serving entities are "safer bets" than other market participants, rather than a reliance on objective and not unduly discriminatory criteria to separate the two (or more) risk pools.

I recognize the difficult position that the Filing Parties find themselves in attempting to balance efforts to minimize risk exposure with the need to establish reasonable credit and collateral policies. This is a delicate task that calls for a delicate solution and, as stated in the Order, the Filing Parties are encouraged to reconsider criteria by which to design a proposal that could pass muster and accomplish its goal (*i.e.*, to reduce or eliminate unsecured credit to participants with greater risk exposure.)

Finally, I disagree with those parties who argue that a filing utility must demonstrate actual harm before it can propose tariff changes that are intended to prevent harm. We should not be required to stand by and wait for an actual instance of market default before taking preventative measures. That argument is simply not compelling.

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Philip D. Moeller
Commissioner