123 FERC ¶ 61,090
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

New York Independent System Operator, Inc. Docket Nos. ER08-778-000
ER08-778-001

ORDER ACCEPTING REVISIONS TO CREDIT REQUIREMENTS

(Issued April 28, 2008)

I. Summary

1. On April 2, 2008, as amended on April 4, 2008, the New York Independent System Operator, Inc. (NYISO) submitted, pursuant to section 205 of the Federal Power Act (FPA),[1] revised tariff sheets[2] to Attachment W of its Open Access Transmission Tariff (OATT) and Attachment K of its Market Administration and Control Area Services Tariff (Services Tariff) to modify the credit requirements for holding Transmission Congestion Contracts (TCCs). NYISO seeks waiver to permit the proposed revisions to become effective April 29, 2008.[3] Waiver of the 60-day notice requirement is granted and NYISO's tariff sheets are accepted for filing, effective April 29, 2008, as requested.

II. NYISO's Filing

A. Background

2. NYISO states that the customers seeking to participate in its TCC markets must satisfy credit requirements for (i) submitting bids to purchase TCCs (bidding requirement), and (ii) holding TCCs awarded through a TCC auction (holding requirement). The bidding requirement is designed to ensure that a customer has sufficient credit to cover the

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[1] 16 U.S.C. § 824d (2000).

[2] *See* Appendix for list of tariff sheets.

[3] NYISO also requests waiver of 18 C.F.R. § 385.203(b)(3) (2007) to permit service on more than two persons, which is granted.

cost of any TCCs awarded to it.[4] The holding requirement is designed to ensure that the customer awarded the TCCs has sufficient credit to make payments due during the term of the TCCs. NYISO states that currently it determines a customer's holding requirement based on the market clearing price and duration of the TCC.

3. NYISO and its stakeholders have determined, based on a month-by-month analysis of historical TCC auction and payment data from the Spring of 2002 through the Spring of 2006, that for low positive, zero and negatively priced TCCs, the current holding requirement calculation does not require enough credit to adequately cover the actual payments that a customer may owe during the term of the TCC. NYISO asserts that the analysis of the historical relationship between TCC auction prices and payments owed to NYISO by holders of negatively priced TCCs, zero or positively priced TCCs with low positive market clearing prices, revealed that, at times, the required payments differed significantly from the auction price, with a few historical instances in which the differences were in excess of $20,000/MW up to almost $50,000/MW. The analysis identified this significant limitation to the current method for determining the holding requirement, which, in effect, assumes that the required payments will be the inverse of the auction price with no margin for uncertainty. Conversely, the analysis also revealed that some high-priced positive TCCs have historically had such a high probability of substantial positive values that the holding of those TCCs should provide a credit offset against the credit requirement for holding other low positive, zero or negatively priced TCCs. NYISO states that based on these findings, NYISO and its stakeholders have concluded that requiring security in excess of the current holding requirement amount is prudent and reasonable for the purchase of TCCs with negative, zero or low positive prices in the TCC auctions.

4. NYISO asserts that the new holding requirement calculation is the outcome of an analysis of historical auction data and lengthy discussions with NYISO stakeholders over the spring and summer of 2007. NYISO compared historical holding requirements to the actual payments[5] due to NYISO on the TCCs awarded in past auctions. To develop a formula for calculating the new holding requirement NYISO analyzed the dispersion of actual payments around the expected level. Under the proposed formulas the required credit coverage will depend upon the expected level of payments for each TCC and the projected dispersion of actual payments around the expected level. The larger the credit

[4] NYISO revised its bidding requirement on December 14, 2007 in Docket No. ER08-334-000 (December 14 Filing).

[5] Actual payment due to NYISO for a positively priced TCC is the clearing price of the TCC while actual payment to NYISO for the negatively priced TCC is the day-ahead congestion cost associated with the TCC.

margin, the smaller the likelihood of undersecured TCC payments. Under the new holding requirement calculation, the required credit coverage is largest for TCCs with large negative prices in the auction and smallest for TCCs with high positive prices in the auction. As a result of the increase in the holding requirement for low positive, zero, and negatively priced TCCs and the decrease in the holding requirement for high positive priced TCCs, the actual credit requirement for Market Participants under the new holding requirement calculation may either increase or decrease depending upon the mix of positive, zero, and negatively priced TCCs held by an individual Market Participant.

B. Proposed Tariff Revisions

5. NYISO states that its proposed revisions will replace the current calculation used to determine a customer's holding requirement with a formula developed through the NYISO's analysis of TCC auction data from the Spring of 2002 through the Spring of 2006.

6. NYISO explains that the new TCC holding requirement calculation sets the holding requirement based upon a credit margin calculation, which is derived from TCC path specific characteristics (e.g., whether the TCC sinks in Zone J or in Zone K, the TCC auction price, the term of the TCC, the month of the year in the case of monthly TCCs, and the season in the case of six-month TCCs). This credit margin is designed to result in a 3 percent probability that the payments due to NY1SO over the term of a monthly or six-month TCC will exceed the credit requirement for the individual TCC and a 5 percent probability in the case of one-year TCCs. These probabilities are a parameter set by NYISO and its stakeholders in developing the credit coverage margin but do not guarantee the actual probability of uncollateralized payments due from Market Participants, which will also depend on the monthly sequence of payments, the composition of the portfolio of TCCs held, and the other credit coverage of the Market Participant.

7. NYISO states that the proposed tariff revisions were the product of extensive analysis and discussions with NYISO's Credit Policy Task Force and Market Issues Working Group, and will better align the credit requirements for TCC holders with the expected payment obligations of the TCCs they hold. NYISO asserts that the proposed tariff revisions will improve the credit requirements for participation in the TCC markets by more closely aligning the credit requirements for TCC holders with their potential payment obligations.

III. Notice of Filing and Responsive Pleadings

8. Notices of NYISO’s filings were published in the *Federal Register*, 73 Fed. Reg. 19,210 (2008), with comments, interventions, and protests due on or before April 17, 2008. Coral Power, L.L.C. and DC Energy, LLC filed motions to intervene in this

proceeding. The New York Transmission Owners[6] filed a motion to intervene and comments in support of the NYISO filing. On April 16, 2008, EPIC Merchant Energy, LP (EPIC) submitted a motion to intervene, request for emergency action and a protest. On April 17, 2008 EPIC filed a supplemental protest. On April 21, 2008, NYISO filed a request for leave to answer and an answer to EPIC's protests.

9. EPIC argues that NYISO's proposal is a violation of the filed rate doctrine and the prohibition against retroactive ratemaking which does not allow the NYISO to change the rates applicable to already settled market transactions. EPIC states that NYISO has informed Stakeholders that it intends to apply the new collateral calculation to all TCCs currently held by Market Participants including existing TCC positions that were purchased by Market Participants in prior TCC auctions. EPIC states that NYISO informed EPIC on April 15, 2008 that it must post an additional $3.8 million in collateral on or before April 29, 2008 which, EPIC asserts, is unreasonable and harmful to EPIC's trading activities.

10. EPIC requests that the Commission act immediately to clarify that the NYISO is not permitted to impose additional collateral requirements on TCC transactions that were entered into prior to the effective date of any new TCC credit requirements that may be approved in this proceeding.

11. EPIC argues that NYISO's proposal is flawed because it relies on TCC auction market clearing prices to determine the appropriate collateral requirements applicable to cleared TCC positions. EPIC explains that auction clearing prices are not a suitable proxy for the risk posed by TCC transactions, since they ignore key factors such as: (1) historical Day-Ahead settlement prices along the specific path; and (2) historical volatility along the path. EPIC provides two examples that demonstrate how paths with the same auction clearing price may present very different risks to the market, but would be assigned the same collateral requirements under the NYISO's proposal. Further, according to EPIC, relying on auction clearing prices assumes that the bids placed by Market Participants accurately reflect the actual value or potential liability represented by a specific TCC purchase; however, defaults usually occur when a Market Participant misjudges the potential value or liability associated with a particular TCC path. While EPIC states that it supports the effort to modernize the NYISO's TCC credit requirements, NYISO's proposal does not represent a path-specific analysis of credit risk and is not

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[6] The New York Transmission Owners include Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., Long Island Power Authority, New York Power Authority, New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation d/b/a National Grid, Orange and Rockland Utilities, Inc., and Rochester Gas and Electric Corporation.

based on historical Day-Ahead settlement prices, even though these factors provide a far more accurate estimate of potential liability. EPIC contends that NYISO's proposal will result in a many-fold increase in Market Participant's collateral requirements based on an auction clearing price that does not reflect actual risk to the market.

12. EPIC argues that NYISO's proposal is against the Commission's credit policies to balance the need to protect the market from the risk of default against the benefits of increased trading, market liquidity and market entry. EPIC asserts that NYISO's proposal does not meet the Commission's standard that credit provisions should allow "the ISOs and RTOs to reduce their risk exposure in the event of default while at the same time ensuring that the credit or collateral requirements are not so stringent that they unnecessarily inhibit access to the marketplace."[7]

13. EPIC states that NYISO has provided no data justifying its proposal or even any explanation of its new collateral requirements. EPIC requests that the Commission direct NYISO to (1) provide a detailed explanation of its collateral formula; (2) analyze the effect of the new requirements on Market Participants; and (3) provide evidence demonstrating that the changed requirement will actually reduce the risk of default.

14. The New York Transmission Owners support the NYISO's modification of credit requirements for TCC holders as a way to better protect consumers from the risk of a payment default.

15. In its answer, NYISO explains that in 2005 it hired an outside consultant to review the effectiveness of the credit requirements for participation in the NYISO-administered TCC markets, and the consultant's results were presented to the Market Participants. NYISO then worked in close collaboration with its Market Participants to develop improvements to the TCC credit requirements and the result was the Enhanced Holding Requirement, which NYISO intended to apply to existing TCCs.

16. NYISO argues that applying the Enhanced Holding Requirement to unexpired TCCs as of the effective date of the tariff revisions is a prospective application of the revised requirement to future TCC payment obligations. According to NYISO, there is good cause to prospectively apply the Enhanced Holding Requirement because NYISO and its Market Participants remain at risk on existing TCCs for the unexpired term of each TCC. Contrary to EPIC's belief that TCC holders would be harmed by the Enhanced Holding Requirement, NYISO states that most TCC holders will benefit from the requirement because it ensures that TCC customers that hold high risk TCC positions would have the financial capacity to meet the potential future payment obligations. In

[7] *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,309 at P 19 (2003).

addition, NYISO maintains that it is not increasing rates in an attempt to recoup past unrecovered costs and so the revisions are not considered retroactive ratemaking. NYISO states that a change in collateral requirements does not result in additional revenue to the NYISO or any other party because any additional collateral collected would be returned to the customer, at the customer's request, upon expiration of the TCC as long as the customer does not default on its future TCC payment obligations, and NYISO would pay interest on cash collateral to the customer monthly. Also, NYISO explains that the purpose of the proposed revisions is to protect against nonpayment default on future TCC settlements.

17. NYISO argues that its tariffs provided notice to EPIC that its credit requirements are subject to revision by the NYISO.[8] NYISO explains that regardless of whether the Commission determines that the Enhanced Holding Requirement should apply to existing TCCs, the NYISO already possesses the tariff authority to revise EPIC's credit requirements when there is a material adverse change to the risk of nonpayment. However, rather than evaluating and revising individual Market Participants' credit requirements, the NYISO has pursued the development of the Enhanced Holding Requirement in an open and transparent manner.

18. According to NYISO, all Market Participants received substantial advance notice regarding the increase in the holding requirement for high risk TCC positions, which is another indication that the rule against retroactive ratemaking would not apply. NYISO states that it first informed Market Participants of the need to revise TCC collateral requirements for both bidding on and holding TCCs at the Credit Policy Task Force meeting on April 2, 2007. Since then, NYISO held extensive discussions with its Market Participants, including EPIC, on the development of the revisions to the TCC collateral requirements. Contrary to EPIC's argument that it has no way of anticipating the credit required to hold their existing TCC transactions, NYISO argues that it provided its Market Participants with the means to calculate the credit requirements under the proposed new holding requirement approximately one year ago through a spreadsheet. NYISO states that it also informed Market Participants of the applicability of the Enhanced Holding Requirement to existing TCCs at the October 1, 2007, Market Issues Working Group meeting.

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[8] NYISO cites to its Market Services Tariff at Attachment K, § IX and its OATT at Attachment W, § IX, which state in relevant part "…the amount of a Customer's Operating Requirement shall be subject to change, at the discretion of the ISO, in the event that there is a material adverse change affecting the risk of nonpayment by the Customer."

19. NYISO asserts that the application of the Enhanced Holding Requirement to existing TCCs was endorsed by the Market Participants at the October 10, 2007, Business Issues Committee meeting. NYISO states that the Enhanced Holding Requirement was again supported by the Market Participants at the October 24, 2007, Management Committee meeting. NYISO asserts that EPIC failed to vote in opposition to the Enhanced Holding Requirement at the meetings of the Business Issues Committee and Management Committee and it subsequently failed to appeal the vote of the Management Committee to the NYISO's Board of Directors. As such, NYSO contends that EPIC's motion constitutes an attempted end-run around a robust stakeholder process in which EPIC had ample opportunity to address the concerns that it raises now for the first time in its "emergency" motion and protest.

20. NYISO states that after it submitted its December 14 Filing to modify its tariff's credit requirements for submitting bids and offers in TCCs auctions, several Market Participants requested that the Commission direct the NYISO to implement the Enhanced Holding Requirement tariff revisions expeditiously in order to protect Market Participants from the risks of future payment defaults.

21. NYISO states that if the Commission were to accept EPIC's interpretation of the rule against retroactive ratemaking it would establish a precedent prohibiting, or at a minimum, substantially delaying the implementation of, prospectively effective tariff revisions that could in some way affect the value of existing TCCs. NYISO explains that under such a rule an ISO or RTO's ability to institute market improvements and customer protections, e.g., a revised bid cap or anti-market manipulation measure, would be limited to the extent that they might have some adverse effect on the value of existing TCCs or FTRs.

22. NYISO contends that the harmful impact of a ruling in EPIC's favor will only be magnified as long-term firm transmission rights become more prevalent in ISO/RTO markets. Finally, NYISO states that the increase in ISO/RTO operating expenses as a result of the complexity of the calculations that would be necessary to simultaneously administer multiple credit requirements according to the date the Market Participant purchased the TCC or FTR highlights another of the potentially significant negative consequences that could result from the Commission adopting EPIC's reasoning.

IV. Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the timely, unopposed motions to intervene serve to make the

entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the NYISO's answer because it has provided information that assisted us in our decision-making process.

B. <u>Commission Determination</u>

24. The Commission will grant waiver of our filing requirements and accept NYISO's proposed revisions to its credit requirements for holding TCCs effective April 29, 2008, as proposed. Based on our review, the Commission finds that NYISO's revisions to its credit requirements are just and reasonable as they will better protect the NYISO's stakeholders from credit risk while not unduly impairing trading in NYISO's TCC market.

25. NYISO's analyses show that its current credit requirements for negative priced TCCs, as well as zero or low positively priced TCCs, have resulted in instances in which there have been significant differences between the required payments for TCCs and the amounts of required collateral, and that this has led to significant under-collateralizations. NYISO's analyses also show that some high-priced positive TCCs have been over-collateralized. NYISO's instant proposal is designed to better protect against both under- and over-collateralizations. The proposed formulas result in a 3 percent probability that the payments due to the NYISO over the term of a monthly or six-month TCC will exceed the credit requirement for the individual TCC and a 5 percent probability that the payments due to the NYISO over the term of a yearly TCC will exceed its credit requirement. In other words, NYISO's proposed revisions should more closely align the collateral requirements for TCC holders with their actual payment obligations to NYISO.

26. We reject EPIC's assertion that the NYISO proposal is flawed because it relies on TCC auction market clearing prices to determine the appropriate collateral requirements applicable to cleared TCC positions. Although NYISO uses auction prices in the formulas, it adjusts them to take into account the historical differences between auction prices and actual payment obligations to NYISO. Specifically, NYISO analyzed the dispersion of actual payments around the expected levels on the TCCs awarded in auctions from the Spring of 2002 through the Spring of 2006 in designing the formulas it is proposing for the new holding credit requirement. NYISO's proposal is carefully designed to result in a 97 percent probability (for monthly and six-month TCCs) and a 95 percent probability (for one-year TCCs) that the credit requirement will be adequate to protect NYISO stakeholders against the risk of default. Thus, the Commission believes that NYISO's proposal is an improvement over its current collateral requirement and should better protect Market Participants against the risk of defaults. The NYISO should

continue to monitor its credit requirements to ensure they balance the protection of its Market Participants against the risk of defaults while not unduly impeding market liquidity.

27. The Commission disagrees with EPIC that NYISO's proposal is a violation of the filed rate doctrine and the prohibition against retroactive ratemaking. NYISO has proposed a change in rates that applies prospectively to the positions held by the parties. The filed rate doctrine:

> forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. In other words, the doctrine bars the Commission from imposing after-the-fact increases, such as surcharges, on gas already purchased.[9]

The rule against retroactive ratemaking, which derives from the filed rate doctrine, "prevents utilities from collecting revenues to compensate for [prior over- or] under-recoveries . . . ."[10]

28. NYISO's filing does not violate the filed rate doctrine because the NYISO will be charging, from the effective date of the tariff change, the just and reasonable tariff rate for collateral on file. The filing is not retroactive ratemaking since the NYISO is not seeking to recover past losses through a current rate; instead it is revising its collateral requirements to apply prospectively to future payment obligations associated with unexpired TCCs that exist at the effective date of the tariff changes. This is entirely appropriate as there continues to be a credit risk associated with the unexpired term of each TCC.

29. EPIC cites no provision in the NYISO's tariff that prevents the NYISO from filing to change the rate applicable to collateral for the TCC market. In fact, section 14.4 of NYISO's Market Services tariff specifically permits the NYISO to file to make changes to

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[9] *Public Utilities Comm'n of California v. FERC*, 988 F.2d 154, 160 (D.C. Cir. 1993), *quoting Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981).

[10] *Id.* at 161, *quoting Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986).

its rates terms and conditions of service, including the TCC market at issue here.[11] EPIC and other customers, therefore, took service with knowledge that the NYISO could make a section 205 filing, as it did here, to revise collateral requirement. Just like any other rate change, the NYISO can apply such a revision prospectively, once the Commission determines the revision is just and reasonable.[12]

The Commission orders:

(A) The revisions are hereby accepted and made effective April 29, 2008.

(B) Waiver of the 60-day prior notice requirement is granted.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

[11] Section 14.4 of NYISO's Market Services tariff specifically permits the NYISO to file to make changes to its rates, terms and conditions of service applicable to the TCC market at issue here.

[12] The NYISO's filing to change the rate for collateral requirements under an existing TCC contract is no different than the clear right of a utility (that has reserved its section 205 filing rights) to file to change the just and reasonable transmission rate applicable to an existing 20-year transmission contract.

APPENDIX

New York Independent System Operator, Inc.
FERC Electric Tariff
Original Volume No. 2
Services Tariff, Attachment K

Tariff Sheets Accepted Effective April 29, 2008

Second Revised Sheet No. 497
Original Sheet No. 497A

New York Independent System Operator, Inc.
FERC Electric Tariff
Original Volume No. 1
OATT, Attachment W

Tariff Sheets Accepted Effective April 29, 2008

Second Revised Sheet No. 725
Original Sheet No. 725A