

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**California Independent System            )           Docket Nos. ER06-613-004  
Operator Corporation                    )           and ER07-1077-000**

**ANSWER TO MOTIONS TO INTERVENE AND COMMENTS, AND MOTION  
FOR LEAVE TO ANSWER AND ANSWER TO PROTEST, OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

On June 22, 2007, as clarified on June 29, 2007, the California Independent System Operator Corporation (“CAISO”) submitted an amendment to the ISO Tariff in the captioned proceedings governing the credit requirements for Congestion Revenue Rights (the “June 2007 CRR Credit Policy Amendment” or “Amendment”).<sup>1</sup> The Commission established a July 13, 2007 comment date for the CAISO’s June 22, 2007 filing (“June 22 CAISO Filing”), and a July 20, 2007 comment date for the CAISO’s June 29, 2007 filing (“June 29 CAISO Filing”). In response, a number of parties submitted motions to intervene.<sup>2</sup> Of those parties, only Southern California Edison Company submitted comments and only the Northern California Power Agency submitted a protest.

The CAISO does not object to any party’s motion to intervene. However, pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18

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<sup>1</sup> Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff, and in the Amendment as clarified by the CAISO’s June 29, 2007 filing in this proceeding.

<sup>2</sup> Timely motions to intervene were filed by the following parties: the Alliance for Retail Energy Markets; California Electricity Oversight Board; Modesto Irrigation District; Northern California Power Agency (“NCPA”); Southern California Edison Company (“SCE”); Transmission Agency of Northern California; Western Area Power Administration; and Williams Power Company, Inc. Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. filed a motion to intervene out of time, as did Golden State Water Company.

C.F.R. § 385.213, the CAISO files its answer to SCE's comments, and pursuant to Rules 212 and 213 of the Commission's Rules, 18 C.F.R. §§ 385.212, 385.213, the CAISO respectfully requests leave to file an answer, and files its answer, to NCPA's protest.<sup>3</sup> For the reasons explained below, the Commission should accept the Amendment as filed.

## I. ANSWER

### A. The Vast Majority of Stakeholders Either Support or Do Not Oppose the CAISO's CRR Credit Requirements.

The Commission has emphasized that it gives weight to the input provided by stakeholders regarding proposals by an Independent System Operator ("ISO") or Regional Transmission Organization ("RTO") to modify its credit requirements.

As the Commission has stated, such an ISO or RTO:

does not have the same financial stake in the creditworthiness criteria as the members of the [ISO or RTO] do, in that all members may be exposed to uplift caused by the default of any one member. Therefore, it is appropriate that the Commission consider stakeholder support, especially on matters related to credit.<sup>4</sup>

Moreover, the Commission has explained that "no decision on the creditworthiness criteria is based solely on a stakeholder vote, but for criteria that

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<sup>3</sup> The CAISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to the protest. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. See, e.g., *Entergy Services, Inc.*, 116 FERC ¶ 61,286, at P 6 (2006); *Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,124, at P 11 (2006); *High Island Offshore System, L.L.C.*, 113 FERC ¶ 61,202, at P 8 (2005).

<sup>4</sup> *Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,053, at P 177 (2005). See also *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186, at P 32 (2004) ("Credit Policy Statement") ("[B]ecause the risk of default in ISOs/RTOs involves each member sharing a portion of a default, the Commission encourages, to the extent practicable, each ISO/RTO to improve its credit practices through its stakeholder processes . . .").

are otherwise acceptable to the Commission, we do consider the level of stakeholder support when making a decision.”<sup>5</sup>

As the CAISO explained in detail in Appendix C to the Amendment, it conducted an extensive, months-long stakeholder process concerning Congestion Revenue Right (“CRR”) credit policy issues. This process was part of the CAISO’s larger stakeholder process on CRR-related issues. However, only two stakeholders submitted filings that are critical of the Amendment.<sup>6</sup> Therefore, in deciding whether to approve the Amendment as just and reasonable, the Commission should give significant weight to this large degree of stakeholder approval of, or at least lack of opposition to, the Amendment.

**B. The Commission Should Reject the Suggestion That CRR Credit Requirements Based on Actual CRR Auction Results Should Be Limited By Data From LMP Simulations.**

SCE argues that the CRR Auction Price component of the credit requirements for holding allocated CRRs should be subject to a limit of plus or minus 20 percent of the CAISO’s calculation of “Expected Congestion Revenue” as determined through the CAISO’s Locational Marginal Price (“LMP”) simulations.<sup>7</sup> SCE has failed to demonstrate that the CAISO’s proposal is not just and reasonable or that SCE’s proposed limit is needed.

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<sup>5</sup> *Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,053, at P 177.

<sup>6</sup> NCPA mistakenly asserts that “[a]pparently, even larger LSEs [Load-Serving Entities] see significant downside potential with the CAISO collateral proposal.” NCPA at 11 n.16. Contrary to NCPA’s assertion, only SCE, alone among the larger LSEs, filed comments in this proceeding that are critical of the Amendment.

<sup>7</sup> SCE at 2-6.

As explained in the Declaration of Dr. Scott M. Harvey of LECG on file in this proceeding, SCE's assertion appears to be based on a mistaken belief that the CAISO will be, or should be, calculating expected CRR Congestion revenues based on the CAISO's LMP simulations.<sup>8</sup> Dr. Harvey has substantial experience with the credit requirements for other ISOs and RTOs with financial transmission rights and has provided advice to the CAISO as part of the development of the Amendment.

First, as Dr. Harvey notes, future CRR Congestion revenues will always be unknown at the time of a CRR Auction. Although it is true that there will be additional uncertainty at the time of the initial auction, as there will be no history of actual CRR Auction results or actual LMPs produced in a functioning market, the auction price is the best measure of expected Congestion revenues. This is true because CRR Congestion revenues will be reflected in large part in market outcomes, *i.e.*, the value that Market Participants assign to CRRs by bidding in the competitive auction.

Moreover, the LMP simulations that SCE wishes to rely upon are not forecasts of future CRR prices. Dr. Harvey explained that the CAISO will actually be using its simulations of past Congestion patterns to assess the potential variability of CRR payments, not to estimate the prospective level of those payments, and the variability component will be used to calculate the Credit Margin applicable to any CRR. Contrary to SCE's assertion, these simulations

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<sup>8</sup> June 22 CAISO Filing, Attachment D, Declaration of Dr. Scott M. Harvey, at P 46 n.11. *See also* SCE at 4 ("There is no reason to believe that the market's collective best guess of the value [of the CRR] will be any better or worse than the CAISO's best guess based upon LMP studies.").

were never intended to be the CAISO's "best guess" of the future value of a CRR. A consideration of the inputs into these simulations reveals why the simulations are not a reliable indicator of future CRR values. The CAISO's historic simulations are based on historical transmission conditions, historic fuel prices (not the fuel prices expected at the time of the CRR Auction), historic demand levels and patterns (not the demand levels and patterns that are expected to prevail in the future), and historic generation assets. Market Participants can factor the results of the CAISO's simulations into their CRR Auction bids, but the simulations themselves – which are based on historic data rather than projections of future inputs – do not provide an assessment of expected future CRR payments.<sup>9</sup> Therefore, contrary to what SCE contends, a calculation of expected CRR Congestion revenues based on the CAISO's LMP simulations would not provide a better measure of expected Congestion revenues than the CRR Auction Price.

The Commission also should reject SCE's proposal to introduce an unjustified restriction on the amount of credit that a CRR Holder must provide because such a proposal may result in CRR Holders being under-secured.<sup>10</sup> It would be inappropriate for the Commission to permit Market Participants to be able to use a restriction on their credit requirements, such as SCE's proposal, to shield themselves from providing appropriate credit support for CRRs. As the Commission stated in its order approving the CAISO's Long Term CRR proposal,

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<sup>9</sup> June 22 CAISO Filing, Attachment D, Declaration of Dr. Scott M. Harvey, at P 46 n.11.

<sup>10</sup> See Section I.D.1, below, for further discussion of the need for CRR Holders in the CAISO's markets to provide sufficient security to cover the full extent of their projected risk.

*California Independent System Operator Corp.*, 120 FERC ¶ 61,023 (2007) (the “Long Term CRR Order”), Market Participants are expected to exercise due caution in requesting CRRs – particularly Long Term CRRs – at the outset:

[W]e expect that the first few years of MRTU will provide valuable experience, and, accordingly, we would expect market participants to consider the newness of the market when making their initial long-term CRR nominations. In addition, the “go slow” approach that we have accepted above for the release of long-term CRRs provides LSEs with a further means to gain experience with the long-term CRR allocation process.<sup>11</sup>

SCE’s true concern appears to be that the initial CRR Auctions will produce irrational results and that the credit requirements for holding allocated CRRs – which are based on the outcome of those CRR Auctions – will therefore be too high.<sup>12</sup> SCE provides no evidence to support this concern, nor can it as it is nothing more than a speculation. More importantly, based on the experience of other ISOs and RTOs, there is no reason to believe that the CRR Auction will produce irrational results. In developing the rules for its CRR Auctions, the CAISO has taken into account years of experience of other ISOs and RTOs with LMP-based markets. The terms and conditions of the CAISO’s CRR Auctions themselves have also been litigated extensively before this Commission in a series of orders over many years. Moreover, even if SCE’s concerns about the initial CRR Auction were justified, there is no reason to believe that LMP

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<sup>11</sup> Long Term CRR Order at P 168. Like the Commission in the Long Term CRR Order, the CAISO believes that Market Participants will have sufficient information to fully participate in the initial CRR allocation and also that Market Participants should exercise due caution in requesting CRRs, especially at the outset. There is nothing contradictory in these views, contrary what NCPA claims. See NCPA at 17.

<sup>12</sup> See SCE at 5 (“an illiquid market or a market subject to manipulation may produce clearing prices that are not indicative of expected congestion payments”).

simulations based on historic data would be a better predictor. Thus, there is no evidence that the CAISO's proposal is not reasonable or that SCE's proposed limit is justified.

**C. The Commission Should Reject NCPA's Arguments in the Instant Proceeding that Constitute An Improper Collateral Attack on Commission Findings in the Long Term CRR Proceeding.**

The Commission routinely rejects arguments made by parties that are collateral attacks on directives issued in other Commission proceedings.<sup>13</sup> In the instant proceeding, NCPA concedes that it protests and seeks revision of the Amendment for reasons "which have been previously aired in more piecemeal fashion in prior pleadings."<sup>14</sup> NCPA also concedes – as it must – that in Docket Nos. ER07-869, *et al.* (the "Long Term CRR proceeding"), the Commission approved the CAISO's proposal to implement Long Term CRRs and found the proposal to be in compliance with the requirements of the Commission's Order Nos. 681 and 681-A.<sup>15</sup> NCPA's protest in the instant proceeding: (1) rehashes

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<sup>13</sup> See, e.g., *North American Electric Reliability Council*, 119 FERC ¶ 61,060, at P 222 (2007) ("We reject each of these protests as a collateral attack of the *ERO Certification Order*."); *Alliant Energy Corporate Services, Inc.*, 111 FERC ¶ 61,025, at P 14 (2005) ("Many of the arguments in Wisconsin TDUs' request for rehearing represent a collateral attack on the TEMT provisions that were considered and accepted by the Commission in another proceeding, and as a result we reject them."); *Dominion Transmission, Inc.*, 106 FERC ¶ 61,257, at P 11 (2004) ("The Commission denies the protest filed by NYSEG and RG&E. The protest constitutes a collateral attack on the Commission's January 29 Order on rehearing and clarification, where the Commission considered and rejected substantially similar arguments in that proceeding.")

<sup>14</sup> NCPA at 3 (citation omitted).

<sup>15</sup> NCPA at 8 & n.9 (citing Long Term CRR Order). See also *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 Fed. Reg. 43564 (Aug. 1, 2006), FERC Stats. & Regs. ¶ 31,226 ("Order No. 681"), *order on reh'g*, Order No. 681-A, 117 FERC ¶ 61,201 (2006) ("Order No. 681-A"). *Inter alia*, Order Nos. 681 and 681-A gave transmission providers the flexibility to propose designs for long-term firm transmission rights that reflect regional preferences and accommodate their regional market designs, while also ensuring that the objectives of Congress expressed in Section 217(b)(4) of the Federal Power Act ("FPA") (16 U.S.C. § 824q(b)(4) (2006)) are met. Order No. 681-A at P 2.

arguments that the Commission rejected in the Long Term CRR Order and (2) otherwise improperly makes arguments in an attempt to overturn relevant findings that the Commission made in the Long Term CRR Order. The Commission should reject these arguments by NCPA as an improper collateral attack on findings in the Long Term CRR Order. These NCPA arguments amount to a procedurally defective request for rehearing of the Long Term CRR Order under the guise of a protest of the Amendment.

NCPA argues in this proceeding that the risks presented by the credit requirements proposed in the Amendment are much greater for small LSEs than for large LSEs, and that “if the CAISO’s overall LTCRR [Long Term CRR] mechanism is to truly accomplish the goals of the statute [*i.e.*, Section 217(b)(4) of the FPA], the credit requirements associated with it cannot be so onerous as to prevent smaller LSEs from making use of it.”<sup>16</sup> NCPA fails to mention the fact that previously, in the Long Term CRR proceeding, it similarly argued that “the risks associated with long-term CRRs are much greater for smaller entities like NCPA” and that “the disproportionate risk on small LSEs vitiates their ability to use the long-term CRRs to hedge existing resources and plan new ones and thus fails to meet the anticipated goal of the statute.”<sup>17</sup> In response to these arguments, the Commission stated that it found “*no reason to conclude that the long-term CRR proposal exposes smaller LSEs to disproportionately greater*

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<sup>16</sup> NCPA at 8, 11,14-15, 20-21.

<sup>17</sup> Long Term CRR Order at P 165. Indeed, some of the arguments that NCPA made in the Long Term CRR proceeding are expressed in exactly the same words as NCPA employs in the instant proceeding. Compare the Protest and Motion to Intervene of the Northern California Power Agency, Docket Nos. ER07-475-000 and ER07-475-001 (Feb. 23, 2007), at 12, with the instant NCPA filing at 11.

*financial risks. Instead, we find that the rules established under the long-term CRR proposal treat all LSEs alike.*<sup>18</sup> Therefore, the Commission has already considered and rejected NCPA's arguments that small LSEs are exposed to disproportionately greater financial risks associated with Long Term CRRs than large LSEs.

NCPA also argues that small LSEs cannot rely on the "generalization that they can be safe" from exposure to the risk of negatively-valued CRRs and the associated credit requirements "by designating CRRs from their baseload resources to their loads."<sup>19</sup> NCPA states that "[t]he generalization appears to have been adopted by the Commission, in the LTCRR Order at P 248," and then NCPA makes an argument in an attempt to refute this Commission finding.<sup>20</sup> NCPA's citation to the Long Term CRR Order leaves no doubt that NCPA's protest is a collateral attack on that Order.

In addition, NCPA argues that small Market Participants "are negatively affected by the relative lack of data on LMP prices and CRR values" and that "only limited studies have been done based on the recent results of the CRR 'dry run' to determine the value and availability of CRRs."<sup>21</sup> NCPA made the exact same arguments, using these exact same words, in a filing in the Long Term

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<sup>18</sup> Long Term CRR Order at P 168 (emphasis added).

<sup>19</sup> NCPA at 14-15 (citation omitted). The Commission made its finding in paragraph 248 of the Long Term CRR Order in response to requests for rehearing by parties that included NCPA. Long Term CRR Order at P 242.

<sup>20</sup> NCPA at 15 n.24.

<sup>21</sup> *Id.* at 15. See also *id.* at 16 (providing an example that purportedly illustrates NCPA's argument).

CRR proceeding.<sup>22</sup> In the Long Term CRR Order, the Commission noted NCPA's arguments but found once again that there was "no reason to conclude that the long-term CRR proposal exposes smaller LSEs to disproportionately greater financial risks" and that the Commission need not address concerns "about the data and the assumptions used in [the CAISO's] studies."<sup>23</sup> The Commission should not reverse these findings in the instant proceeding.

Further, NCPA argues that, prior to the CRR allocation, LSEs will not have sufficient information to determine the values for Long Term CRRs and the credit required to hold them. In making this argument, however, NCPA states that "[t]he Commission's observation that through the stakeholder process LSEs will have sufficient information to participate in the initial CRR allocation . . . *appears to presuppose that the Commission will accept the [Amendment] without modification*, though NCPA does not believe that is what the Commission could have intended to imply."<sup>24</sup> Plainly, NCPA's argument is undermined by the Commission statement cited by NCPA, which NCPA acknowledges "appears to presuppose" that the Commission will accept the Amendment without modification. NCPA is correct. The Commission's prior findings are conclusive and NCPA's present protest constitutes a collateral attack on those findings.

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<sup>22</sup> Compare the Protest and Motion to Intervene of the Northern California Power Agency, Docket Nos. ER07-475-000 and ER07-475-001 (Feb. 23, 2007), at 12-13, with the instant NCPA filing at 13. In the cited portions of these two filings, all of the words starting with the phrase "Small entities such as NCPA" and ending with the phrase "explain these differences" are exactly the same.

<sup>23</sup> Long Term CRR Order at PP 166, 168.

<sup>24</sup> NCPA at 17-18 (citing *California Independent System Operator Corp.*, 119 FERC ¶ 61,244, at P 6 (2007) (emphasis added)). The Commission reiterated this same observation in the Long Term CRR Order (at paragraph 105).

NCPA then repeats arguments relating to the purported advantages of requiring the development of “options Long Term CRRs,” which NCPA favors but the Commission declined to require in the Long Term CRR Order. NCPA argues in the instant proceeding that, “in order to site a generator in a beneficial location,” it “would have to undertake multiple years of LTCRR obligations payments and the corresponding . . . collateral requirements just to ensure that it has access to the associated hedging instruments for transmission access when the generator comes on line.”<sup>25</sup> NCPA made this very same argument in the Long Term CRR proceeding, and the Commission rejected this argument.<sup>26</sup> Moreover, NCPA reiterates its request that the Commission require the CAISO to provide “options Long Term CRRs.”<sup>27</sup> In the Long Term CRR proceeding, the Commission rejected a similar request by NCPA and other parties, finding that the CAISO’s proposal to offer obligations Long Term CRRs (at least initially) satisfies the requirements of Order No. 681.<sup>28</sup>

For the reasons explained above, the Commission should reject these NCPA arguments as an improper collateral attack on the Long Term CRR Order.

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<sup>25</sup> NCPA at 21.

<sup>26</sup> See Long Term CRR Order at PP 224, 226. Also, compare the Protest and Motion to Intervene of the Northern California Power Agency, Docket Nos. ER07-475-000 and ER07-475-001 (Feb. 23, 2007), at 15-16, with the instant NCPA filing at 20-21. As this comparison makes clear, many of the arguments in the cited portions of these two NCPA filings are worded exactly the same.

<sup>27</sup> NCPA at 24, 27.

<sup>28</sup> Long Term CRR Order at PP 224, 226.

**D. The CAISO Has Shown That the Credit Requirement for Holding Long Term CRRs Are Just and Reasonable.**

In the Amendment, the CAISO proposes a credit requirement for holding a Long Term CRR that is equal to: (i) the negative of the most recent CRR Auction Price of a CRR with the same source and sink as the Long Term CRR but with only a one-year term, multiplied by the number of years remaining in the term of the Long Term, plus (ii) the Credit Margin calculated for the one-year CRR multiplied by the square root of the number of years remaining in the term of the Long Term CRR.<sup>29</sup> NCPA protests this credit requirement and argues that the credit requirement should be based on the current year's estimated liability only, rather than the remaining term of the Long Term CRR.<sup>30</sup> NCPA also provides an example that purportedly shows that the CAISO's proposed credit requirement will be onerous for small LSEs such as NCPA.<sup>31</sup> The Commission should reject NCPA's arguments and find that the CAISO's proposed credit requirement is just and reasonable.

**1. The CAISO's Proposed Credit Requirement for Long Term CRRs Properly Correlates with the Projected Risk Posed by the Holding of Long Term CRRs.**

In the Credit Policy Statement, the Commission explained that ISOs and RTOs must establish credit requirements that balance two competing goals. On the one hand, ISOs and RTOs must "implement their credit policies in a manner created to limit, as much as possible, the risk of credit defaults," because in an

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<sup>29</sup> See the June 29 CAISO Filing, at page 2 of the transmittal letter and at Attachment A (Section 12.6.3.3).

<sup>30</sup> NCPA at 24-25.

<sup>31</sup> *Id.* at 10.

ISO or RTO the risk of default is mutualized (*i.e.*, the default risk exposure caused by undercapitalized market participants in the ISO or RTO is socialized among the non-defaulting market participants), and thus “the level of exposure faced by ISOs/RTOs can significantly affect market development by dampening the willingness of various entities to participate in ISO/RTO markets that inadequately mitigate mutualized risks.”<sup>32</sup> On the other hand, the credit requirements of ISOs and RTOs should not be so conservative as to “represent a serious barrier to entry into the markets.”<sup>33</sup>

Commission orders issued subsequent to the Credit Policy Statement make it clear that the credit requirements of an ISO or RTO must be sufficient to cover the risk of credit defaults. As the Commission has explained:

It is crucial to the long-term success of the market that the level of collateral required to conduct market activities correlate with the exposure to risk. Financial exposure without corresponding collateral to draw upon in the event that it is needed is a detriment to the overall viability of the market.<sup>34</sup>

Further, the Commission has found that it is reasonable for an ISO or RTO to require “traders in its markets [to] post sufficient collateral to cover the full extent of their projected risk.”<sup>35</sup>

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<sup>32</sup> Credit Policy Statement at PP 17-19. As the Commission noted, “ISOs/RTOs are not generally capitalized sufficiently to absorb the impact of defaults by market participants on an outstanding obligation.” *Id.* at P 17.

<sup>33</sup> *Id.* at P 19.

<sup>34</sup> *Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,250, at P 31 (2005).

<sup>35</sup> *PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,088, at P 21 (2006).

The CAISO's proposed credit requirement for holding a Long Term CRR satisfies these Commission directives because the purpose of the credit requirement is to cover the full extent of the risk of credit default over the entire term of the Long Term CRR. In the event of a default involving a Long Term CRR, the CAISO may choose to resell it in the subsequent monthly auctions, but it may not be possible for a Long Term CRR to be fully liquidated at the auction. If the Long Term CRR is not resold in an auction, the financial loss includes not only the current period Congestion revenue payments of the defaulting holder of the Long Term CRR, but also the Congestion revenue payments due *for all the years in the remaining term of the defaulted Long Term CRR*. Therefore, credit requirements covering only the current year would not provide appropriate credit support for holding a Long Term CRR. Instead, the credit requirement for holding a Long Term CRR must cover the risk of credit default over the Long Term CRR's entire term.<sup>36</sup> As explained by Dr. Harvey, Long Term CRRs with negative or low positive prices might not only turn out to require payments by the CRR Holder, but might also provide counterflow to other Long Term CRRs awarded in the CRR allocation process and a default by the CRR Holder would make the remaining CRRs infeasible, producing a shortfall in the CAISO's CRR settlements. Therefore, Dr. Harvey concluded, it is desirable to require credit support for the holding of Long Term CRRs with negative or low positive prices that covers potential payment obligations beyond the first year.<sup>37</sup>

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<sup>36</sup> Transmittal Letter for June 22 CAISO Filing at 10.

<sup>37</sup> June 22 CAISO Filing, Attachment D, Declaration of Dr. Scott M. Harvey, at PP 61-63.

The CAISO considered a number of alternatives for calculating the credit requirements for holding a Long Term CRR and ultimately chose a moderately conservative approach given the initial uncertainty as to the volatility of CRR payment obligations. As Dr. Harvey explained, “it will obviously be several years before any empirical data are available to assess the actual variability of returns and quite a number of years before there is data covering multiple periods.”<sup>38</sup> Therefore, it is prudent to establish a moderately conservative credit requirement.

In contrast, basing the credit requirement for holding a Long Term CRR only on the current year’s estimated liability, as NCPA proposes, would fail to provide any protection against the risk of credit default beyond the first year of the term of the Long Term CRR. This would clearly violate the Commission’s requirement that ISO and RTO market participants post sufficient security to cover the full extent of their projected risk. The likely result of adopting NCPA’s proposal would be that mutualized default risk would be inadequately mitigated. NCPA provides no evidence suggesting that its proposal would provide sufficient protection against mutualized default risk as required by the Commission.

Finally, credit requirements for CRRs are determined on a portfolio basis, so that positively valued CRRs will offset negatively valued CRRs.<sup>39</sup> LSEs with a portfolio of CRRs – some positive and some negative – may, in fact, not face significant credit requirements.

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<sup>38</sup> *Id.*, Attachment D, Declaration of Dr. Scott M. Harvey, at P 60.

<sup>39</sup> See proposed Section 12.6.3.1(b) (stating that the credit requirements applicable to CRRs will be determined on a portfolio basis). CRRs with low positive values will also have credit requirements if the values are not high enough to cover the Credit Margin.

## **2. NCPA Exaggerates the Amount of Credit Required to Hold Long Term CRRs Under the CAISO's Proposal.**

NCPA provides an example that purportedly shows that the CAISO's proposed credit requirement for the holding of Long Term CRRs will be onerous for small LSEs because "the potential charges associated with a negatively valued LTCRR could be very large."<sup>40</sup> As explained in Section I.C, above, the Commission has already considered and rejected NCPA's arguments that small LSEs are exposed to disproportionately greater financial risks than large LSEs by Long Term CRRs, and thus has already rejected NCPA's position that small LSEs are exposed to disproportionately greater risks relating to Long Term CRRs. This alone should be reason enough for the Commission to disregard the arguments made by NCPA that are based on its example in the instant proceeding. However, the Commission should also reject NCPA's arguments because NPCA is exaggerating the amount of security required under the CAISO's proposal.

Pursuant to Section 12.1 of the ISO Tariff (as modified in the Amendment), each Market Participant is required to secure its financial transactions with the CAISO, including its CRR obligations, by maintaining an Aggregate Credit Limit that is at least equal to the Market Participant Estimated Aggregate Liability ("EAL"). The Aggregate Credit Limit is the sum of two components: the Unsecured Credit Limit (*i.e.*, the amount of credit) and the Financial Security Amount (*i.e.*, the amount of collateral, such as a cash deposit, a payment bond certificate, *etc.*). Each Market Participant will likely choose to

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<sup>40</sup> NCPA at 10.

maintain its Aggregate Credit Limit using credit to the extent possible, and to rely on collateral as little as possible. Under the ISO Tariff, the maximum Unsecured Credit Limit for a Market Participant is \$250 million,<sup>41</sup> and even for a smaller LSE such as NCPA the Unsecured Credit Limit can be a substantial amount (e.g., \$10 million or more).

The example provided by NCPA of its potential collateral requirement due to acquiring a Long Term CRR is based on assumptions that are extreme and are thus very unlikely to be borne out in real life. NCPA's example assumes a single Long Term CRR that is the only Long Term CRR in NCPA's portfolio and thus cannot be offset by other CRRs in the portfolio. NCPA has sources at both trading hubs and generators. Therefore, it is very unlikely that NCPA would nominate only a single Long Term CRR. NCPA's example also incorrectly assumes that its Long Term CRR has a negative price for each hour of each year, and thus is for both the on-peak and off-peak periods throughout the year. Long Term CRRs are defined for on-peak and off-peak periods separately. It is very unlikely that they would have a single price. With all of the information available to it, NCPA should be able to estimate the value of the Long Term CRRs it would nominate. There is no reason for NCPA to nominate a single negatively valued CRR. Further, although NCPA concedes that "[t]he Credit Margin introduces a measure of probability of a change in value beyond the expected value," NCPA states that it is deliberately ignoring the probability that the Long Term CRR in its example will have a change in value; instead, NCPA

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<sup>41</sup> ISO Tariff, § 12.1.1.

simply assumes that its Long Term CRR will be subject to the largest possible credit requirement.<sup>42</sup> Thus, NCPA assumes the extreme, worst-case scenario with regard to the Long Term CRR in its example. This scenario is extremely unlikely to occur. Even if NCPA is concerned that it will occur, the obvious solution for NCPA is to be cautious in deciding to hold Long Term CRRs and to mitigate its risk as discussed in Section I.B, above.

Also, NCPA argues that small LSEs cannot rely on the “generalization that they can be safe [from exposure to the risk of negatively-valued CRRs and the associated credit requirements] by designating CRRs from their baseload resources to their loads,” because “[t]his generalization overlooks the possibility that generation resources can become unavailable for long periods of time due to forced outages or other reasons.”<sup>43</sup> Here, NCPA is confusing the concept of a negatively-priced CRR, which will entail a negative CRR Auction price and increased credit requirements, and a negatively-valued CRR due to a temporary cause such as a Forced Outage, which does not necessarily lead to a negative CRR Auction price and increased credit requirements. Therefore, NCPA overstates the risk of exposure to higher CRR credit requirements due to the unavailability of generation resources.<sup>44</sup>

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<sup>42</sup> NCPA at 10 n.13.

<sup>43</sup> *Id.* at 14-15.

<sup>44</sup> Further, as explained in Section I.C, above, this NCPA argument constitutes a collateral attack on the Long Term CRR Order.

For the reasons explained in this Section I.D, NCPA fails to provide a sufficient basis for the Commission to find that Market Participants' EALs should not be required to cover their Long Term CRRs for the full term of those CRRs.

## II. CONCLUSION

For the reasons explained above, the Commission should accept the Amendment (as clarified by the CAISO on June 29, 2007) as filed.

Respectfully submitted,

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Dated: July 30, 2007

## CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon the parties listed on the official service lists in the captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 30<sup>th</sup> day of July, 2007.

/s/ Sidney M. Davies  
Sidney M. Davies