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VIA ELECTRONIC FILING

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket Nos. ER06-700-____

Dear Secretary Salas:

Attached please find the Request for Rehearing of the California Independent System Operator Corporation, submitted today in the captioned docket.

Please contact the undersigned with any questions regarding this matter.

Respectfully submitted,

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System Operator Corporation

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

**California Independent System) Docket Nos. ER06-700-____
Operator Corporation)**

**REQUEST FOR REHEARING OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

The California Independent System Operator Corporation (“CAISO”),¹ pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 825l(a) (2000), and Rule 713 of the Federal Energy Regulatory Commission’s (the “Commission” or “FERC”) Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2006), submits this request for rehearing of the Commission’s “Order Conditionally Accepting Tariff Revisions Governing Credit Policy,” 115 FERC ¶ 61,170, issued in the above-captioned proceeding on May 12, 2006 (“Credit Policy Order”).

I. STATEMENT OF ISSUES

In accordance with Rules 203(a)(7) and 713(c)(2), 18 C.F.R. §§ 385.203(a)(7), 385.713(c)(2), the CAISO provides this Statement of Issues.

1. Whether the Commission’s Credit Policy Order imposes an undue burden on the CAISO that is not supported by the record and does not reflect reasoned decision-making insofar as it: (i) requires the CAISO to file the eight-step process for calculating a Market Participant’s unsecured credit limit as part of the ISO Tariff; and (ii) requires the CAISO to file the remaining provisions of the Credit Policy & Procedures Guide (“Credit Guide”) as an attachment to the ISO Tariff.

¹ Capitalized terms not otherwise defined herein have the meanings set forth in Appendix A to the ISO Tariff.

2. Whether the Commission's rule of reason requires the CAISO to file the eight-step process as part of the ISO Tariff or to file the rest of its Credit Guide as an attachment to the ISO Tariff.
3. Whether the Commission should, at a minimum, permit the CAISO to add further detail regarding its credit policies to the ISO Tariff instead of requiring the CAISO to include the eight-step process or the rest of the Credit Guide as part of the ISO Tariff.

II. BACKGROUND

The CAISO filed on March 7, 2006, as clarified and corrected on March 14, 2006, amendments to modify the credit requirements and procedures set forth in Section 12 of the ISO Tariff ("March 2006 Credit Policy Amendments"). The March 2006 Credit Policy Amendments revised Section 12 to change certain creditworthiness requirements. The main purpose of the amendments was to replace unlimited credit status for entities with an "Approved Credit Rating" with a credit scoring system, whereby each entity would receive a specific unsecured credit limit up to a cap of \$250 million. Section 12, as revised by these amendments, references the Credit Guide, which is posted on the ISO Home Page. The Credit Guide provides affected parties with "further detailed information regarding credit-related provisions described in Section 12 of the ISO Tariff,"² including the description of the eight-step process for determining Unsecured Credit Limits, which is based on an assessment of qualitative and quantitative factors. The Credit Guide, as revised from time to time, has been posted on the ISO Home Page since 2003.

On May 12, 2006, the Commission issued the Credit Policy Order. The Commission found the tariff revisions proposed in the March 2006 Credit Policy

² Credit Guide at 5.

Amendments to be “generally reasonable,” but held that it was necessary to include in Section 12 of the ISO Tariff the eight-step process used to calculate a Market Participant’s or FTR Bidder’s Unsecured Credit Limit.³ The Commission stated that “[t]he CAISO’s proposed revisions to section 12 of its tariff are . . . incomplete without this information.”⁴ In addition, the Commission directed the CAISO to file the remaining provisions of the Credit Guide as an attachment to the ISO Tariff and indicated that the CAISO could explain what provisions of the Credit Guide, if any, it recommends removing from the tariff.⁵ The Commission also required the CAISO to file sample calculations showing how Unsecured Credit Limits will be determined for all types of Market Participants as part of the Credit Guide.⁶

III. REQUEST FOR REHEARING

A. The Credit Policy Order Imposes an Undue Burden on the CAISO.

1. The CAISO’s Flexibility to Balance Qualitative and Quantitative Factors in Determining Credit Risk Will Be Significantly Impaired by the Credit Policy Order.

Requiring the CAISO to file the eight-step process for determining Unsecured Credit Limits as part of the ISO Tariff and other provisions of the Credit Guide as an attachment to the ISO Tariff unnecessarily and

³ Credit Policy Order at PP 20, 22. The CAISO’s credit requirements apply to both Market Participants and FTR Bidders. Throughout the instant filing, references to “Market Participants” are references to both Market Participants and FTR Bidders, unless otherwise specifically stated or the context indicates otherwise.

⁴ Credit Policy Order at P 21.

⁵ *Id.* at P 22.

⁶ *Id.* at P 36.

inappropriately limits the CAISO's flexibility to modify the eight-step approach and those other provisions based on experience.⁷

The eight-step process is one of many appropriate ways the CAISO could have chosen to balance qualitative and quantitative factors in determining the Unsecured Credit Limit of a Market Participant. Although the CAISO spent considerable effort to develop the formulaic approach to balancing those factors that is embodied in the eight-step process,⁸ and believes that it is an appropriate starting point for determining Unsecured Credit Limits, the CAISO developed the eight-step process fully expecting that this process would need to be revised and refined based on experience.

The development of the eight-step process was part of a paradigm change from the previous credit provisions of the ISO Tariff, under which the CAISO did not assess the credit of Market Participants that had "Approved Credit Ratings," to a regime under which the CAISO determines Unsecured Credit Limits for every Market Participant that applies for unsecured credit. Despite over two years of effort, including an extensive stakeholder process,⁹ the CAISO

⁷ The CAISO acknowledges that the Commission has indicated that the CAISO has the opportunity argue in its compliance filing that certain provisions of the Credit Guide should not be included in the ISO Tariff. Credit Policy Order at P 22. On its face, however, the Credit Policy Order requires the filing of the entire Credit Guide as part of the ISO Tariff.

⁸ Steps 1 through 7 of the eight-step process are applied according to mathematical formulas set forth therein. Step 8 of the eight-step process is a mathematical formula for adjusting credit limits downward that is applied based on the CAISO's review of the qualitative and quantitative credit strength indicators set forth in Section A-2.3 of the Credit Guide. See Credit Guide at 10-16. The CAISO will apply the qualitative and quantitative credit strength indicators set forth in Section A-2.3 in the same manner to each Market Participant.

⁹ These extensive efforts are described on pages 2 to 4 of the transmittal letter for the March 2006 Credit Policy Amendments. The CAISO was also mindful of the need to satisfy the Commission's credit requirements in as cost-effective manner as possible, given the Commission's concern about ISO/RTO costs.

reasonably foresaw that the detailed business rules and procedures implementing the new credit requirements would inevitably need to be modified subsequent to their implementation. Importantly, the CAISO expected that it would have the flexibility to revise and refine the eight-step process by modifying the Credit Guide (not the ISO Tariff), without having to make a filing pursuant to Section 205 of the Federal Power Act (“FPA”).

In developing these changes, the CAISO reviewed Commission directives regarding credit limits. The consideration of a multitude of factors in determining credit limits is consistent with the Commission’s *Policy Statement on Electric Creditworthiness*¹⁰ and also with the recently issued *Notice of Proposed Rulemaking, Preventing Undue Discrimination and Preference in Transmission Service* (“OATT Reform NOPR”).¹¹ The *Policy Statement on Creditworthiness* states that “OATT Transmission Providers, ISOs, and RTOs must consider both qualitative and quantitative measures in their assessment of the credit risk of a party and post the criteria they use to determine these factors.”¹² Moreover, the Commission has recognized the importance of balancing various factors in determining credit limits, stating that “[e]ffective credit policies contain balance in their rules between participants large and small, balance between the need to ensure maximum participation through extension of credit and minimal amounts

¹⁰ *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 (2004) (“*Policy Statement on Creditworthiness*”).

¹¹ *Notice of Proposed Rulemaking, Preventing Undue Discrimination and Preference in Transmission Service*, 115 FERC ¶ 61,211 (2006).

¹² *Policy Statement on Creditworthiness* at P 13 (internal citations omitted).

of uplift through default, and balance between the length of the billing cycle and the amount of exposure in the market.”¹³

The usefulness of an approach that considers both quantitative and qualitative factors in determining credit limits, such as the eight-step process, depends on the CAISO having the ability to modify that approach in a timely manner as the CAISO identifies improvements that should be made and as conditions in the market and the industry evolve.¹⁴ The same is true of other provisions of the Credit Guide.¹⁵

By posting the Credit Guide on the ISO Home Page, the CAISO is able to efficiently refine the procedures it uses for making assessments of credit risk based on qualitative and quantitative factors and the tools the CAISO uses for assessing compliance with credit requirements and to adapt these procedures and tools to meet specific circumstances (e.g., refined scoring approaches for non-profit entities, updates of various factors used in the eight-step process such as default probability as to rating agency ratings, the need to recalibrate the limits contained in the eight-step process in light of changing market conditions, *etc.*), while still ensuring that there is transparency as to how the CAISO will implement the Commission-approved credit provisions of the ISO Tariff.

¹³ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 at P 430 (2004).

¹⁴ As discussed in Section III.A.1.a, below, in addition to improvements that can be made as a result of experience, the eight-step process itself requires periodic updates of certain inputs.

¹⁵ See Section III.A.1.b, below. In its compliance filing in this proceeding, the CAISO will describe in detail which provisions in the Credit Guide should not be included in the ISO Tariff.

The requirement to move the Credit Guide to the ISO Tariff (either in the text of Section 12 or as a filed attachment to the Tariff) will not improve the transparency of the CAISO's detailed procedures, but it will limit the ability of the CAISO to make timely revisions to the Credit Guide. Once the Credit Guide is part of the ISO Tariff, changes to the Credit Guide would not only be presented for stakeholder review and comment in the normal course of business, but then once the stakeholder process is complete, these changes must be approved by the CAISO Board of Governors and then must be submitted for Commission approval under Section 205 of the FPA. Such a Section 205 filing will require 60 days' advance notice unless the Commission grants a waiver of the prior notice requirement and approves the filing more quickly pursuant to a CAISO request for expedited consideration. The Commission has indicated that it will expedite the issuance of orders in order to correct a market flaw that will "materially adversely impact the market."¹⁶ Changes to the CAISO's credit policies are unlikely to meet this threshold. Accordingly, even a widely-supported update to the tools and detailed procedures in the Credit Guide could take many months to implement as a result of the requirement to move the Credit Guide to the ISO Tariff.

In contrast, the CAISO has made revisions to the Credit Guide in due course following stakeholder discussions concerning substantive proposed changes, and has also updated the Credit Guide periodically to reflect how the

¹⁶ *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,009 (2005).

CAISO has implemented ISO Tariff provisions related to credit.¹⁷ Major revisions were made on August 13, 2004 and May 6, 2005, following stakeholder processes, in addition to the recent March 2006 revisions to the Credit Guide to reflect the corresponding amendments to the ISO Tariff.

As noted above, the CAISO anticipates that more frequent updates to the Credit Guide may be appropriate as both the CAISO and Market Participants gain experience with the eight-step approach and identify improvements that could be implemented. Each revised version of the Credit Guide (including a brief description of the revision history) is posted on the ISO Home Page,¹⁸ thus ensuring transparency as to how the CAISO is implementing the Commission-approved credit provisions of the ISO Tariff. The CAISO offers the following three examples of provisions of the Credit Guide that may need to be updated on a timely basis to illustrate how the new filing requirements imposed by the Credit Policy Order will inappropriately limit the CAISO's flexibility to update the Credit Guide:

a. The Eight-Step Process To Determine Unsecured Credit Limits Is Designed To Be Updated On an Ongoing Basis.

The Commission expressly directed the CAISO to move the eight-step process for determining Unsecured Credit Limits from Section A-3 of the Credit Guide to Section 12 of the ISO Tariff.¹⁹ The eight-step process, however,

¹⁷ For example, the CAISO developed the "Scheduling Coordinator Aggregate Liability Estimate" or "SCALE" tool through an open and transparent process with stakeholder advice and comment.

¹⁸ See Credit Guide at 2.

¹⁹ Credit Policy Order at P 22.

contains a number of details such as numerical parameters that are more appropriately included in the Credit Guide rather than the ISO Tariff, in order to permit the CAISO to fine-tune such details as needed without first having to receive approval of filings made pursuant to Section 205 of the FPA.

For example, Steps 2 and 5 of the eight-step process contain these kinds of details. Step 2 includes a table of Agency Rating Default Probabilities. The current version of the Credit Guide notes this table is required to be updated each January 31st.²⁰ In fact, the source data for this table will need to be updated more frequently, a fact the CAISO has learned after finalizing the contract with Moody's KMV subsequent to FERC's approval of the March 2006 Credit Policy Amendments. For example, the five-year median default probability for Moody's and Standard & Poor's long-term credit rating classes is based on data that is updated monthly by Moody's KMV. Accordingly, it will be appropriate for the CAISO to update this table as frequently as every month, rather than just once per year as noted in the table presently. If the CAISO were required to update this table through a Section 205 filing, there would be a minimum of a 60-day lag in the CAISO's ability to use the updated information. That approach would be unworkable.

Step 5 of the eight-step process lists a Base Default Probability "which currently equals 0.06 percent" and the Maximum Tangible Net Worth Percentage allowed by the CAISO, "which currently equals 7.5 percent." These percentages also should be updated to reflect changing market conditions. The CAISO

²⁰ Credit Guide at 13.

developed the eight-step process with the intention of periodically reviewing the overall credit limits resulting from the mechanical formulas, and to periodically recalibrate factors such as the 0.06 percent Base Default Probability and the 7.5 percent Maximum Tangible Net Worth Percentage. Moreover, Step 5 indicates that Scheduling Coordinators with a Combined Default Probability greater than 0.5 percent will receive zero percent of their Tangible Net Worth. The CAISO anticipates that this limit may need to be reviewed periodically to ensure that it does not unduly restrict credit limits, particularly in changing market conditions. In general, Market Participants could be subject to adverse consequences if the CAISO does not have the flexibility to change, with changing market conditions, the factors that directly affect the amount of unsecured credit they will receive.

In addition, the CAISO may need to make changes relating to its use of a software tool under Step 3 of the eight-step process. Step 3 concerns the calculation of a Market Participant's Moody's KMV Default Probability. The CAISO has a concern, which is not supported by any specific evidence, that the application of Step 3 to certain private entities may yield results that are too conservative. If it turns out that Step 3 yields results that are too conservative, the CAISO will make the necessary changes.

These examples demonstrate that the eight-step process is too detailed to be included in the ISO Tariff, given the fact that many elements of the eight-step process are based on numerical parameters that will need to be fine-tuned over time. Requiring the CAISO to make a Section 205 filing every time it needs to fine-tune these numerical parameters is unreasonable and will impose an undue

and unnecessary burden on the CAISO and the Commission with serious consequences for the CAISO's Market Participants.

b. The Tools to Determine Whether Market Participants Have Posted Adequate Security Should Be Refined Over Time.

Similarly, the CAISO firmly believes that the tools that the CAISO uses to help it to determine whether Market Participants have posted adequate security (and/or have sufficient Unsecured Credit Limits) to cover their Estimated Aggregate Liability ("EAL") should not be included as part of the ISO Tariff.

The CAISO has a settlement timeline that is currently longer than the settlement timelines of peer ISO/RTOs. Specifically, at any given date, between 65 and 95 days worth of unsettled transactions are outstanding. Accordingly, entities that do not receive unsecured credit must post collateral to cover their outstanding obligations. The CAISO strives to balance two important objectives: ensuring that sufficient collateral is available in the event of a default and avoiding burdening entities with unnecessary collateral requirements in excess of their actual liabilities. These objectives are best achieved through the development of a reasonably accurate liability estimate, and this process has proven to require continual refinement due to the need to refine how the CAISO estimates a Market Participant's liability for the time period for which it does not have complete settlements data (*i.e.*, the time period 30-50 days from the date of the transaction). The CAISO has attempted to use available information to calculate an accurate liability estimate, and has striven to improve these estimates over time.

The currently posted version of the Credit Guide reflects the use of the SCALE tool for estimating financial liabilities. SCALE was a prototype system built to more accurately estimate Scheduling Coordinator liabilities based on limited settlements and operational data for this 30-50 day period. The CAISO intended to transition to a new liability estimation tool with the deployment of its new Settlements and Market Clearing system initially scheduled for implementation in early 2006. As the CAISO explained in its May 31, 2006, motion in this proceeding, that system has been delayed, and, in the meantime, the CAISO has also encountered problems with the continued availability and accuracy of the SCALE tool as a result of other changes in the CAISO's markets and the need to update inputs to the SCALE tool.²¹ As a result, SCALE is not currently operative, and the CAISO has used a simpler but less accurate (as compared to SCALE when it was working properly) approach to estimating liabilities based on available settlements data that it used prior to SCALE. The CAISO is currently developing a written description of this process for inclusion in the Credit Guide to reflect this change. The CAISO is currently proceeding on parallel paths to fix SCALE and to implement and communicate the use of a revised version of the simpler approach and will be discussing this with stakeholders in the near future.

Even when the SCALE tool was operative, the CAISO did not use the results of SCALE or any other tool as the definitive number establishing a Market Participant's Estimated Aggregate Liability. Rather, the CAISO uses the results

²¹ Motion for Extension of Time to Submit Compliance Filing, Docket No. ER06-700-000 (May 31, 2006), at 4-5.

of such tools to make an initial compliance assessment. For example, when the SCALE tool was being utilized, the CAISO would contact the Scheduling Coordinator if the SCALE results showed that the Scheduling Coordinator may not have sufficient security to cover its EAL. The CAISO would request additional collateral based on this liability estimate, but provided the Market Participant with the opportunity to present evidence to justify a different liability estimate, through an appeal/dispute procedure.²² Indeed, the Market Participant itself often has more actual information for the 30-50 day period than the CAISO has. Accordingly, the Scheduling Coordinator and the CAISO, working together, often come to an agreed-upon estimate of the EAL that is different from what SCALE may have produced. Such discussions at times also led the CAISO to revise the formulas and assumptions used in the SCALE tool. Experience has shown that any tool used to produce the EAL needs to be revised on an ongoing basis to provide for as accurate an estimate as possible.

For example, in addition to seasonal adjustments, implementation of the CAISO's "Phase 1B" market design on October 1, 2004, caused the SCALE results to be inaccurate, requiring the tool to be adjusted accordingly. Requiring the description of the tool to be included in the ISO Tariff needlessly burdens the CAISO and the Commission and will institutionalize inaccurate results due to the lag required to file and get approval of any tariff amendment to revise the tools for determining EAL included in the Credit Guide.

²² See Credit Guide at 24-25.

c. The Credit Guide Will Need To Be Updated To Reflect Entity-Specific Issues.

In the Credit Policy Order, the Commission encouraged the CAISO to work with its stakeholders to develop an alternative means of calculating Unsecured Credit Limits for non-profit entities to be included in the Credit Guide, and directed the CAISO to submit an informational filing within 60 days regarding the progress made on this effort.²³ This example illustrates the CAISO's need to address entity-specific factors, such as non-profit status in applying its credit provisions. The Commission's *Policy Statement on Creditworthiness* referenced the examples of municipalities and cooperatives to emphasize the importance of balancing such entity-specific factors.²⁴ The CAISO envisions that unique needs of individual Market Participants will require enhancements to the Credit Guide. As explained above, however, the requirement to file the Credit Guide as part of the ISO Tariff will significantly limit the CAISO's flexibility to develop and implement such enhancements and to modify them based on experience.

2. The Requirement to File the Credit Guide as Part of the ISO Tariff Is Contrary to the Commission's Recognition That Filing of Detailed Credit Procedures May Create An Undue Administrative Burden.

As explained above, requiring the CAISO to file every change made to its Credit Guide is impractical and will create an undue administrative burden. In considering whether to require transmission providers "to incorporate the creditworthiness and security methodologies into their OATTs," the Commission

²³ Credit Policy Order at P 35.

²⁴ *Policy Statement on Creditworthiness* at P 14.

has recently recognized that “[t]here is a balance here between the *burden...of adding these methodologies to...OATT[s] and the need for Commission review and approval if methodologies frequently change.*”²⁵ The Commission has chosen the wrong balance in the instant case by requiring the CAISO to file its Credit Guide as part of the ISO Tariff. The Commission has placed on the CAISO the burden of filing the Credit Guide as an attachment and explaining “what provisions, if any, it recommends removing from the tariff.”²⁶

In the OATT Reform NOPR, the Commission specifically states that it will allow creditworthiness provisions to be “supplemented with a credit guide or manual to be posted on OASIS.”²⁷ The CAISO’s current posting of its Credit Guide is consistent with the approach promulgated in the NOPR. However, the Commission has required the CAISO to satisfy a higher standard by requiring the CAISO to file its Credit Guide as part of its Tariff.

Requiring the CAISO to file the Credit Guide for approval under Section 205 of the FPA is contrary not only to the approach proposed in the OATT Reform NOPR but also to the approach described in the Commission’s *Policy Statement on Creditworthiness*. The CAISO developed and filed its March 2006 Credit Policy Amendments based on this understanding. In the *Policy Statement on Creditworthiness*, the Commission emphasized the importance of the development of creditworthiness requirements specific to individual ISOs and

²⁵ OATT Reform NOPR at P 456 (emphasis added).

²⁶ Credit Policy Order at P 22.

²⁷ OATT Reform NOPR at P 455.

RTOs “because of the greater variability and difficulty required to measure the credit exposure of providing these additional services.”²⁸ These difficulties and the accompanying need for stakeholder input in order to account for regional variations are but another example of why filing the Credit Guide as part of the ISO Tariff would constitute an undue burden. The Commission has imposed an acknowledged burden on the CAISO without providing a reasoned basis for deviating from both its established and proposed policies.

The filing of the Credit Guide and the concomitant filing of changes will stifle the ability of the CAISO to improve the application of its Commission-approved credit requirements as needed and to make necessary adaptations in a timely manner. As an example, the evaluation, documentation, internal review process, and reporting of how qualitative factors will affect the credit limits will likely necessitate detailed consideration, documentation, and, in all likelihood, subsequent revisions. Additional details about how Step 8 of the eight-step process will be developed as the CAISO implements the policy.

The CAISO has considered its new approach to evaluating Market Participant credit requirements for nearly two years and received significant stakeholder feedback, but there is no substitute for experience. The CAISO expects that experience will yield information about the new credit requirements that the CAISO would intend to use to make improvements to the detailed tools and procedures set forth in the Credit Guide. The Commission has recognized in the past that “[t]he credit policies of other established energy markets have

²⁸ *Policy Statement on Creditworthiness* at P 2.

undergone continual refinements to better reflect the needs of all affected parties."²⁹ The Commission should adopt an approach in the instant proceeding that allows the CAISO to make such refinements to its Credit Guide as appropriate.

3. Market Participants Are Adequately Protected by the Transparency of the CAISO's Credit Procedures.

The CAISO recognizes that the Commission has a legitimate interest in ensuring that credit requirements are applied in an open and transparent manner.³⁰ The provisions of the Credit Guide are already completely transparent to all parties because they are posted on the ISO Home Page. Filing these provisions as part of the ISO Tariff will delay updates to the Credit Guide without improving the transparency of the provisions of the Guide.

In addition, a stakeholder process has been used to develop the current Credit Guide, and the CAISO will continue to include stakeholders in the process of developing revisions in the future. The Commission has stated that it "values the stakeholder process to determine regional creditworthiness requirements. Because credit is a collective market mechanism, in that all Market Participants share in the extension of credit and therefore share in the losses, significant weight should be given to the outcome of the stakeholder process."³¹ The

²⁹ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 at P 432 (2004).

³⁰ See *Policy Statement on Creditworthiness*, Brownell dissenting ("I believe establishing mandatory electric creditworthiness principles will promote consistent practices across markets and utilities and provide customers with an objective and transparent creditworthiness evaluation").

³¹ *Midwest Independent Transmissions System Operator, Inc.*, 109 FERC ¶ 61,285, at P 356 (2004), *order on reh'g*, 111 FERC ¶ 61,053, *reh'g denied*, 111 FERC P 61,053 (2005)

CAISO conducted stakeholder meetings on November 13, 2003, November 30, 2004 and April 26, 2005 to discuss possible changes to its credit policies. The CAISO posted the comments and questions from stakeholders as well as written responses that the CAISO provided to each of them, on the ISO Home Page. The CAISO is committed to the principles of transparency and non-discrimination contained in the *Policy Statement on Creditworthiness* and Market Participants have the ability to raise concerns regarding the Credit Guide.

One reason why filing of more detailed credit revisions as part of a tariff might be required is due to concerns that the transmission provider might be applying credit requirements in a discriminatory manner.³² The basis for that concern is not present in the current case. Indeed, the Commission has recognized the CAISO's independence from Market Participants, ensuring that the CAISO is free from incentives to apply its Tariff in an unduly preferential or discriminatory manner.³³ Nothing in the Credit Policy Order suggests that the Commission has concerns about the discriminatory application of the CAISO's credit requirements. Moreover, as the Commission itself noted in the Credit Policy Order, if a customer believes that discrimination has taken place, the appropriate remedy is to file a complaint pursuant to Section 206 of the FPA.³⁴ Given that Market Participants are adequately protected, and no Market

(internal citation omitted); see also *Policy Statement on Creditworthiness* at P 32 ("the Commission encourages, to the extent practicable, each ISO/RTO to improve its credit practices through its stakeholder process").

³² See *Policy Statement on Creditworthiness*, Commissioner Brownell dissenting.

³³ *California Independent System Operator Corp.*, 112 FERC ¶ 61,010 at P 1 (2005).

³⁴ Credit Policy Order at P 32.

Participant has filed a complaint pursuant to Section 206, there is no need for the Commission to require the CAISO to file the Credit Guide as part of the ISO Tariff.

B. The Rule of Reason Does Not Require Filing of the Eight-Step Process in the ISO Tariff or the Credit Guide as an Attachment to the ISO Tariff.

The Commission's "rule of reason" is grounded in Section 205(c) of the FPA and applies to "an infinitude of practices affecting rates and service."³⁵ In *City of Cleveland*, the District of Columbia Circuit found that "[t]he statutory directive [of section 205(c)] must reasonably be read to require the recitation of only those practices that affect rates and service *significantly*, that are realistically *susceptible* of specification, and that are not so generally understood in any contractual arrangement as to render recitation superfluous."³⁶

1. The Level of Detail in the Credit Provisions of the ISO Tariff Satisfies the Rule of Reason.

The level of detail found in Section 12 of the ISO Tariff, a level of detail that has only been increased by the March 2006 Amendments, satisfies the rule of reason and therefore does not need to be augmented. The March 2006 Amendments revised Section 12 of the CAISO tariff to change certain creditworthiness requirements, steps, and circumstances, but did not eliminate any subject addressed in the previously effective version of the ISO Tariff or otherwise decrease the level of detail in the credit provisions of the ISO Tariff.

³⁵ *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985)

³⁶ *Id.* (emphasis in original).

None of these changes should have affected the Commission's application of the rule of reason.

The Credit Guide has *never* heretofore been a part of the ISO Tariff, consistent with the *Policy Statement on Creditworthiness*, which specifically states that ISOs and RTOs are expected to post their credit policies and practices either in their tariffs or on their websites.³⁷ Ever since 2003, the CAISO has made the Credit Guide available on the ISO Home Page. Given that the CAISO has only increased the level of information available to Market Participants, there is no basis for the Commission now to claim that the Credit Guide must now be filed to satisfy the "rule of reason."

There is no evidence that the CAISO's current creditworthiness requirements have affected market participation or liquidity levels in the market, and certainly improvements in these requirements and increased transparency will not have any such deleterious effect. Indeed, the Commission explicitly found that "[c]onsistent with the *Policy Statement* CAISO considered qualitative and quantitative factors in setting the unsecured credit limits for rated entities"³⁸ yet still held that the Credit Guide must be filed to supplement the approved credit provisions of the ISO Tariff. Therefore, the Commission's application of the rule of reason should be revised on rehearing.

³⁷ *Policy Statement on Creditworthiness* at P 12 (2004) ("the term 'reasonable credit review procedures' . . . include[s] the posting by . . . ISOs, and RTOs on their OASIS sites, to the extent that they have not already...incorporated such requirements in their tariffs . . .").

³⁸ Credit Policy Order at P 20.

2. The Commission Has Not Explained What Rendered the Level of Detail in the Previously-Approved Credit Provisions of the ISO Tariff Unjust and Unreasonable.

The Commission has never found the level of detail in the previously-effective credit provisions of the ISO Tariff to be unjust and unreasonable under Section 206 of the FPA. These credit provisions of the ISO Tariff have been accepted in past orders of the Commission.³⁹ As noted above and in the CAISO's prior filings in this proceeding, the March 2006 Credit Policy Amendments only maintained or increased the level of detail in the credit provisions of the ISO Tariff. In essence, the Credit Policy Order, in requiring that the Credit Guide be filed as an attachment to the ISO Tariff, implicitly found that the previously-approved level of detail in the CAISO Tariff was no longer just and reasonable. The Commission did not point to any change in circumstances to justify this change in the application of its rule of reason.

The CAISO submitted the March 2006 Credit Policy Amendments in its filing under Section 205 of the FPA, not in response to a Commission finding that the CAISO's existing credit provisions were unjust or unreasonable. In contrast, the Commission has found that the existing level of detail in the credit provisions of other ISO tariffs was unjust and unreasonable. In *Outback Power Marketing*,⁴⁰ the Commission found PJM's existing tariff to be unjust and unreasonable under Section 206 of the FPA because PJM's tariff did not contain creditworthiness provisions. PJM was then ordered to include its creditworthiness standards into

³⁹ See *California Independent System Operator Corp.*, 101 FERC ¶ 61,241 (2002), *reh'g denied*, 105 FERC ¶ 61,322 (2003).

⁴⁰ *Outback Power Marketing, et al.*, 104 FERC ¶ 61,079 (2003).

its tariff. In comparison, the Commission did not find the level of detail in the previously-approved ISO Tariff to be unjust and unreasonable. Without such a finding, the Commission's unexplained change in the application of its rule of reason is not reasoned decision-making.⁴¹

C. At a Minimum, the Commission Should Permit the CAISO to Add More Detail to the ISO Tariff Regarding the Credit Scoring Process Without Adding Provisions of the Credit Guide That Were Never Designed To Be Included in the ISO Tariff.

For the reasons explained in this Section III, the CAISO should not be required to file the eight-step process in the ISO Tariff or file the other detailed provisions of the Credit Guide as part of the ISO Tariff. Rather, the CAISO should be permitted to keep the Credit Guide out of the ISO Tariff and to update the Credit Guide without making a filing pursuant to Section 205 of the FPA. The CAISO does believe, however, that it can develop additional detail concerning its credit policies that could be added to the ISO Tariff without filing the eight-step process in its entirety or the other detailed provisions of the Credit Guide as part of the ISO Tariff. For example, the CAISO would consider adding a description of the eight-step process to the ISO Tariff while keeping the numbers-heavy details of the eight-step process solely in the Credit Guide. Adding further detail to the ISO Tariff might allay any concerns that the ISO Tariff contains an insufficient amount of information, while at the same time permitting the CAISO the flexibility to update the Credit Guide as discussed above. As an alternative to being required to include the Credit Guide in the ISO Tariff, the CAISO therefore

⁴¹ See *Atlantic City Electric Co., et al. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002) ("The courts have repeatedly held that FERC has no power to force public utilities to file particular rates unless it first finds the existing filed rates unlawful.").

requests that the Commission modify the Credit Policy Order and permit the CAISO to make such a filing rather than adding the eight-step process and other provisions of the Credit Guide to the ISO Tariff. The CAISO intends to make a similar proposal in the compliance filing it will submit in this proceeding.

IV. CONCLUSION

For the foregoing reasons, the CAISO respectfully requests that the Commission grant rehearing of the Credit Policy Order and eliminate the requirement that: (i) the CAISO file the eight-step process for calculating a Market Participant's Unsecured Credit Limit as part of the ISO Tariff; and (ii) the CAISO file the remaining provisions of the Credit Guide as an attachment to the ISO Tariff. In the alternative, the CAISO respectfully requests that the Commission permit the CAISO to add further detail regarding its credit policies to the ISO Tariff instead of requiring the CAISO to include the eight-step process or the rest of the Credit Guide as part of the ISO Tariff.

Respectfully submitted,

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Dated: June 12, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, 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 12th day of June, 2006.

/s/ Sidney M. Davies
Sidney M. Davies