

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

California Independent System) Docket No. ER09-589-000
Operator Corporation)

**ANSWER TO MOTIONS TO INTERVENE AND COMMENTS, MOTION TO FILE
ANSWER, AND ANSWER TO PROTESTS, OF THE CALIFORNIA
INDEPENDENT SYSTEM OPERATOR CORPORATION**

The California Independent System Operator Corporation (“ISO” or “CAISO”)¹ hereby files its answer to the motions to intervene and comments submitted in this proceeding in response to the ISO’s January 29, 2009 submittal of changes to the credit policy provisions of the CAISO Tariff.² The ISO also hereby submits a motion to file an answer and its answer to the protests submitted in this proceeding.³

¹ Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the CAISO Tariff (also known as the Market Redesign and Technology Upgrade or MRTU Tariff), and except where otherwise noted, references to section numbers are references to sections of the CAISO Tariff.

² The following entities filed motions to intervene, comments, and/or protests in this proceeding: the California Department of Water Resources State Water Project; Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California; City of Los Angeles Department of Water and Power (“LADWP”); City of Santa Clara, California and the M-S-R Public Power Agency; Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy South Bay, LLC (collectively, “Dynegy”); J.P. Morgan Ventures Energy Corporation and BE CA LLC (together, “J.P. Morgan”); Mirant Energy Trading, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC; Modesto Irrigation District (“MID”); NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, and Long Beach Generation LLC (collectively, “NRG”); Powerex Corp. (“Powerex”); Reliant Energy, Inc.; Sacramento Municipal Utility District; Southern California Edison Company (“SCE”); Transmission Agency of Northern California; and Western Power Trading Forum (“WPTF”).

³ The ISO submits this filing pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213 (2009). The ISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to the protests. 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).

The ISO does not object to any of the motions to intervene. It notes that a number of the parties that submitted comments and protests state that they support many of the ISO's proposed tariff changes.⁴ Indeed, adverse comments were generally limited to arguments that the ISO had not gone far enough in one direction or another or had failed to propose specific changes to the ISO's default cost allocation provisions. The general support for the tariff amendment suggests that for the most part parties believe the ISO has been successful in modifying its credit policy in a way that balances the diverse views of stakeholders on credit-related issues. While the ISO recognizes that it cannot possibly satisfy all parties on all such matters, it appreciates the parties' general support and addresses in this answer the limited set of issues they do raise.

I. Answer

A. The Commission Should Approve the ISO's Proposal to Lower the Maximum Unsecured Credit Limit to \$150 Million.

Some parties oppose the ISO's proposal in the tariff amendment to lower the maximum Unsecured Credit Limit ("UCL") for any Market Participant from \$250 million to \$150 million. They argue that the ISO ought to reduce the maximum UCL to a level significantly below \$150 million or, alternatively, that the ISO ought to stop providing unsecured credit to Market Participants.⁵ The Commission should reject these parties' arguments and approve the ISO's proposal.

⁴ J.P. Morgan at 5, 16, 18-19; LADWP at 3; NCPA at 3; NRG at 2; Powerex at 5; SCE at 2; WPTF at 1-2.

⁵ J.P. Morgan at 5-6, 7-10; NRG at 3-4; Powerex at 7-13 and Powerex affidavits cited therein.

As the ISO explained in the transmittal letter for its filing (at 4), the reduction of the maximum UCL to \$150 million represents a compromise between the different views of stakeholders on this issue, and also represents an appropriate step toward a more conservative credit policy in response to recent defaults.⁶ In order to address concerns like these, the ISO has gradually reduced the maximum UCL over the past few years, and plans to continue to do so after MRTU start-up. Prior to the ISO's submittal in 2006 of revisions to its credit policy in Docket No. ER06-700, there was no maximum limit on the amount of unsecured credit that a creditworthy Market Participant could receive.⁷ Then, following discussions with stakeholders, the ISO proposed to reduce the maximum UCL to \$250 million, a dollar level that the Commission approved as being "proof of reduced mutualized default risk."⁸ For the reasons explained in the tariff amendment submitted in the instant proceeding, the ISO now proposes to lower the maximum UCL to \$150 million. The ISO expects that, following the start of its Payment Acceleration program, which it anticipates will occur within a few months after MRTU start-up, the ISO will make another tariff amendment to lower the maximum UCL to \$50 million in order to reflect the shortened Payment

⁶ Further, the ISO explained that it made its proposal after considering the maximum unsecured credit limits established by its peer Independent System Operators ("ISOs") and Regional Transmission Organizations ("RTOs"), the historical Estimated Aggregate Liabilities of Market Participants in comparison to their maximum Unsecured Credit Limits in recent years, and how Estimated Aggregate Liabilities may change as a result of the implementation of MRTU. Transmittal letter for tariff amendment at 4.

⁷ See page 5 of the transmittal letter for the ISO's March 7, 2006 tariff amendment in Docket No. ER06-700-000 (explaining that, under the Simplified and Reorganized ("S&R") tariff in effect at that time, Market Participants "that have an Approved Credit Rating (as defined in the S&R Tariff) generally obtain unlimited unsecured credit in the CAISO markets").

⁸ *California Independent System Operator Corp.*, 115 FERC ¶ 61,170, at P 32 (2006) ("2006 Credit Policy Order"). The Commission explained that "[t]he default risk is mutualized if one market participant defaults and it falls upon the remaining market participants to make up the shortfall." *Id.* at P 32 n.14.

Acceleration settlement cycle.⁹ Each of these gradual reductions of the maximum UCL is appropriate, given the circumstances of the time, in order to balance (1) the ability of creditworthy Market Participants to obtain unsecured credit and thus more fully participate in ISO markets against (2) the goal of minimizing mutualized default risk. By contrast, the extreme reductions in the maximum UCL that parties propose do not reflect this balance of considerations and are inappropriate.

These parties also appear to fail to appreciate that the \$150 million UCL level the ISO proposes is the maximum possible, not the UCL that every Market Participant that applies for one will in fact receive. The ISO determines each Market Participant's UCL based on a case-by-case application of the calculation steps and the qualitative and quantitative credit strength indicators set forth in the tariff.¹⁰ Pursuant to this individualized review, the ISO frequently assigns UCLs to Market Participants that are well below the maximum UCL permitted by the tariff or are zero.¹¹ Moreover, the ISO has proposed other tariff revisions in this proceeding that further reduce risk to Market Participants. These tariff revisions include the calculation of a Market Participant's UCL using the lowest credit agency issuer rating when two or more such issuer ratings are available; use of the lowest equivalent long-term rating when only a short-term rating is available;

⁹ Transmittal letter for the ISO's tariff amendment at footnote 7.

¹⁰ See Sections 12.1.1, 12.1.1.1, 12.1.1.1.1, 12.1.1.1.2, and 12.1.1.2.

¹¹ For example, in 2008, Lehman Brothers Commodity Services, Inc. ("Lehman Brothers") defaulted on its obligation to post an additional Financial Security Amount in response to an ISO request. Lehman Brothers had no unsecured credit but instead could only rely on the Financial Security it had previously provided to the ISO. Soon after Lehman Brothers defaulted on its obligation, the ISO terminated Lehman Brothers' Scheduling Coordinator Agreement and the Commission accepted the ISO's notice of termination. See Docket No. ER09-22-000.

and exclusion of certain assets from the calculation of Tangible Net Worth. J.P. Morgan, Powerex, and WPTF express support for these changes.¹²

The parties that advocate a maximum UCL significantly below \$150 million cite the lower maximum unsecured credit limits employed by other ISOs and RTOs.¹³ However, this difference in limits is justified because the settlement cycle under MRTU will initially be much longer than the settlement cycles that other ISOs and RTOs employ.¹⁴ As explained above, after Payment Acceleration is implemented, the MRTU settlement cycle will be shortened and for that reason the ISO plans to further reduce the maximum UCL.¹⁵ NRG urges a slightly different approach and requests that the Commission require the ISO to modify Section 12.1.1 to state that the maximum UCL is \$50 million for any individual Market Participant and is \$150 million for any group of affiliated Market Participants.¹⁶ The Commission should reject this NRG request. As the ISO previously explained in the Docket No. ER06-700 proceeding, it does not generally group all affiliated entities and restrict them to a single Unsecured Credit Limit. However, the ISO does consider, pursuant to Section 12.1.1.4, the creditworthiness and financial condition of a Market Participant's Affiliates when

¹² J.P. Morgan at 15-16; Powerex at 5; WPTF at 1-2.

¹³ J.P. Morgan at 9-10; NRG at 3-4; Powerex at 9-10.

¹⁴ See the memorandum providing an overview of the ISO's proposed credit policy changes from the ISO's Chief Financial Officer and Treasurer to the ISO Governing Board dated December 8, 2008, at page 3 ("Memorandum"). The Memorandum is available on the ISO's website at <http://www.caiso.com/2098/2098b3f758490.pdf>.

¹⁵ Powerex (at 12-13) proposes that, if the ISO does not eliminate the use of unsecured credit entirely, it should reduce the maximum UCL to a level no higher than \$25 million, and once the ISO implements Payment Acceleration, it can increase the maximum UCL to the \$50 million level the ISO currently envisions. Powerex at 12-13. Powerex's proposal is wrongheaded. As explained above, the current MRTU settlement cycle will be shortened once Payment Acceleration is implemented. Therefore, employing a maximum UCL under the current settlement cycle that is greater than the maximum UCL that will apply after the shorter settlement cycle under Payment Acceleration goes into effect, is justified.

¹⁶ NRG at 4-5.

determining whether and the extent to which the Market Participant is entitled to a UCL. Specifically, Section 12.1.1.4 states that the ISO “may determine that the maximum Unsecured Credit Limit specified in Section 12.1.1 applies to the combined activity of such Affiliates.”¹⁷ The Commission found the approach reflected in Section 12.1.1.4 to be reasonable in Docket No. ER06-700¹⁸ and should continue to do so here.

Parties’ arguments that the ISO should be required to eliminate the availability of unsecured credit at this time are without merit. In its *Policy Statement on Electric Creditworthiness*, the Commission specifically rejected the notion that ISOs and RTOs should be precluded from extending unsecured credit: “While requiring all market participants in ISOs/RTOs to be fully collateralized would eliminate the mutualized default risk, the Commission believes that such a goal would impose significant costs on market participants and, in turn, would represent a serious barrier to entry into the markets.”¹⁹ So far from forbidding ISOs and RTOs to extend unsecured credit to qualifying market participants, the Commission provided direction in the *Policy Statement* on the required transparency and content of an ISO’s or RTO’s unsecured credit

¹⁷ Motion for Leave to File Answer and Answer to Protests, Answer to Motions to Intervene and Comments, and Answer to Request for Order Requiring Supplemental Filing, of the California Independent System Operator Corporation, Docket No. ER06-700-000 (Apr. 12, 2006), at 21. The language from Section 12.1.1.4 quoted above was instead contained in proposed Section 12.1.1.1 at the time the ISO filed its April 2006 answer in Docket No. ER06-700.

¹⁸ See 2006 Credit Policy Order at P 34.

¹⁹ *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186, at P 19 (2004) (“*Policy Statement*”).

policies.²⁰ The ISO's own credit policies are fully in compliance with the Commission's requirements.²¹

Further, every ISO and RTO currently offers unsecured credit to qualifying market participants. Powerex argues that "the trend in organized markets appears to be away from extending any unsecured credit."²² The only ISO- or RTO-related support that Powerex provides for this argument is that "ISO New England, Inc. ('ISO-NE') has recently indicated it is considering eliminating unsecured credit entirely." As shown in the citations that Powerex provides, ISO-NE made these statements during the technical conference the Commission recently held in Docket No. AD09-2-000 to discuss "Credit and Capital Issues Affecting the Electric Power Industry." If Powerex seeks to modify the Commission's existing policy authorizing the use of unsecured credit by ISOs and RTOs, it should pursue such a change in the general Docket No. AD09-2-000 proceeding, not in the instant proceeding. The ISO recognizes that the subject was discussed at the Docket No. AD09-2-000 technical conference and that the Commission's policy may very well change in the future. However, to suddenly eliminate the use of unsecured credit now, in the instant proceeding, would be a jarring and unwarranted disruption of the ISO's current credit policy, on which Market Participants rely.

²⁰ See *id.* at PP 10-15.

²¹ See *California Independent System Operator Corp.*, 119 FERC ¶ 61,053, at P 37 (2007) ("Consistent with our grant of rehearing on this issue above, we find that the CAISO's alternative compliance filing has struck a reasonable balance by describing the CAISO's credit practices in the tariff and providing additional details in the Credit Guide, which it will post on the CAISO website."); *California Independent System Operator Corp.*, 126 FERC ¶ 61,099, at P 26 (2009) ("We find the CAISO's creditworthiness provisions are consistent with the principles of Order No. 890 and accept the CAISO's demonstration that these provisions have been incorporated into the MRTU tariff, as directed in the May 16 Order.").

²² Powerex at 9-10 (emphasis omitted).

At the other end of the spectrum from the parties contending that the maximum UCL should be lower than \$150 million or should be zero, SCE argues that the maximum UCL should be kept at the current \$250 million level until the ISO implements its Payment Acceleration initiative, when the maximum UCL should be reduced to \$150 million. SCE's argument is based on the possibility of increases in Estimated Aggregate Liabilities and thus of more frequent collateral requests after MRTU start-up.²³ As noted above, however, the ISO proposed to lower the maximum UCL to \$150 million after specifically taking into account how Estimated Aggregate Liabilities may change once MRTU goes into effect.²⁴ The Commission should accept the ISO's proposal for the reasons the ISO has explained and should reject SCE's unjustified alternative proposal.

B. The Commission Should Accept the ISO's Proposal to Give Market Participants Three Business Days to Satisfy an ISO Request for Additional Financial Security.

J.P. Morgan, Powerex, and WPTF support the ISO's proposal to reduce the time period for satisfying an ISO request for additional Financial Security from five Business Days to three Business Days.²⁵ MID, on the other hand, argues that the ISO's proposal leaves too little time to comply with an ISO request and asks the Commission to direct the ISO to maintain the current five Business Day

²³ SCE at 3-4.

²⁴ See *supra* note 6.

²⁵ J.P. Morgan at 17; Powerex at 5; WPTF at 1-2. J.P. Morgan goes on to state that, while it supports the ISO's proposal, it would prefer a further reduction of the time period to one or two Business Days. J.P. Morgan at 17-18. The ISO believes that the Commission should accept the ISO's proposed reduction of the time period to three Business Days as being sufficient in this proceeding. Section 205 of the Federal Power Act ("FPA") only requires a public utility (in this case, the ISO) to show that its own proposed tariff change is just and reasonable, not that the public utility's proposed tariff change is superior to all alternatives. See, e.g., *ISO New England Inc. and New England Power Pool*, 124 FERC ¶ 61,298, at P 49 (2008) (citing Commission and court precedent).

time period.²⁶ The Commission should reject MID's arguments. MID states that it typically requires "roughly two business days to respond to a request by the CAISO to post additional Financial Security."²⁷ Thus, MID will typically have a whole extra Business Day in which to provide any additional Financial Security the ISO requests. That cushion should be more than sufficient to permit MID to make a timely posting. Further, the ISO's proposal allows Market Participants at least as much time as other ISOs and RTOs allow when they request that their market participants provide additional financial security.²⁸ The proposed time period of three Business Days is reasonable because, as the ISO has explained in this proceeding, it is the result of benchmarking the ISO's credit policy against the policies of other ISOs and RTOs and will provide a targeted and effective enforcement tool by mandating more timely posting of Financial Security.²⁹ Therefore, the Commission should accept the ISO's proposal.

C. The Commission Should Not Consider Issues Regarding the Allocation of Payment Defaults as They Are Outside the Scope of the Instant Proceeding.

A number of parties request that the Commission either direct the ISO to revise the existing methodology under its tariff for allocating the costs of payment defaults or establish an investigation on the issue pursuant to Section 206 of the

²⁶ MID at 5-6.

²⁷ *Id.* at 5.

²⁸ See PJM Interconnection, L.L.C., FERC Electric Tariff, Sixth Revised Volume No. 1, at Seventh Revised Sheet No. 523K (requiring the posting of additional financial security within two business days); Midwest Independent Transmission System Operator, Inc., FERC Electric Tariff, Third Revised Volume No. 1, at Second Revised Sheet No. 1221 (requiring the posting of additional financial security within two business days if the request is made before noon Eastern Daylight Time and within three business days if the request is made after noon Eastern Daylight Time); New York Independent System Operator, Inc., FERC Electric Tariff, Original Volume No. 2, at First Revised Sheet No. 504B (requiring the posting of additional financial security by 4:00 p.m. of the next business day).

²⁹ Transmittal letter for tariff amendment at 5; Memorandum at 5.

FPA.³⁰ This request is procedurally inappropriate and should be rejected. As the parties acknowledge, the ISO's tariff amendment does not contain any proposed revisions regarding payment default allocation. Thus, the parties' requests go beyond the scope of the instant proceeding. If a party wishes to raise the issue of payment default allocation, it should do so through the ISO stakeholder process. As explained in the Memorandum, ISO management has committed to continued evaluation of this contentious issue and recommends that it be further discussed in a stakeholder process that is likely to commence after MRTU start-up.³¹ Alternatively, a party could file with the Commission a complaint pursuant to Section 206 of the FPA to seek revisions to the tariff language. Given these possible avenues for raising the issue, the Commission need not and should not address it in the instant proceeding.

Further, the resolution of any issues regarding payment default allocation should in no way be tied to the implementation of MRTU.³² In January, the ISO submitted a filing in the MRTU proceeding that certifies the ISO's readiness to implement MRTU on March 31, 2009, provided that certain milestones and assumptions are satisfied.³³ The implementation of MRTU, and the satisfaction of the requisite milestones and assumptions, are unrelated to the question of

³⁰ Dynegy at 2; J.P. Morgan at 6, 11-15; Powerex at 13-19 and Powerex affidavits cited therein; WPTF at 2-8.

³¹ Memorandum at 1-2, 6.

³² *Cf.* Powerex at 18-19 (requesting that the Commission require tariff changes to be made prior to or as soon as possible after MRTU implementation); WPTF at 2 (requesting that the Commission address issues regarding payment default allocation prior to MRTU implementation).

³³ MRTU Readiness Certification, Docket No. ER06-615-038 (Jan. 16, 2009). *See also* Answer to Comments, Motion to File Answer, and Answer to Protests, of the California Independent System Operator Corporation, Docket No. ER06-615-038 (Feb. 18, 2009) (ISO answer to comments and protests regarding MRTU readiness certification).

whether the existing tariff provisions concerning payment default allocation should be modified.

II. Conclusion

For the reasons explained above, the Commission should accept the tariff revisions as submitted by the ISO in this proceeding.

Respectfully submitted,

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Dated: March 6, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing documents upon all of the parties listed on the official service list for the above-referenced 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 Washington, D.C. this 6th day of March, 2009.

/s/ Bradley R. Miliauskas
Bradley R. Miliauskas