UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Credit Reforms in Organized Wholesale Electric Markets	**)** **)**	**Docket No. RM10-13-000**

COMMENTS OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

The New York Independent System Operator, Inc. ("NYISO"),[1] by counsel, respectfully submits these comments in response to the Federal Energy Regulatory Commission's ("Commission's" or "FERC's") Notice of Proposed Rulemaking ("NOPR") on Credit Reforms in Organized Wholesale Electric Markets.[2] The NYISO submits these comments in conjunction with (i) the joint comments submitted by the ISO/RTO Council ("IRC Comments"), which the NYISO joined in as a member of the IRC and incorporates by reference here, and (ii) the Northeast ISO comments ("Northeast ISO Comments") that the NYISO submitted in conjunction with PJM Interconnection, LLC and ISO New England Inc., and incorporates by reference here.

The NYISO strongly supports the Commission's objective in the NOPR to establish broad credit standards for organized wholesale electric markets that will reduce market participant exposure to excessive mutualized losses without negatively impacting market liquidity.

1 Capitalized terms that are not otherwise defined herein shall have the meanings specified in Article 1.0 of the NYISO's Open Access Transmission Tariff and Article 2 of the NYISO's Market Administration and Control Area Services Tariff.
2 Notice of Proposed Rulemaking on Credit Reforms in Organized Wholesale Electric Markets, 130 FERC ¶ 61,055, Docket No. RM10-13-000, January 21, 2010.

I. THE NYISO LARGELY SUPPORTS THE COMMISSION'S TARGETED CREDIT REFORMS

In the NOPR, the Commission proposes to standardize certain ISO/RTO credit practices by requiring each ISO/RTO to adopt tariff provisions to implement the following seven targeted credit reforms: (i) a seven day invoicing period with no more than an additional seven days for payment; (ii) a $50 million cap per market participant on unsecured credit; (iii) a prohibition on the use of unsecured credit in financial transmission rights ("FTR") markets; (iv) an explicit right for the market operator to offset market participant obligations; (v) specification of minimum participation criteria for unsecured credit eligibility; (vi) specification of circumstances that justify the use of a "material adverse change" as a basis for requiring additional collateral from a market participant; and (vii) a maximum time period of two days for a market participant to post additional collateral after request by the market operator.[3]

The NYISO agrees with the Commission that appropriate standardization of general ISO/RTO credit practices will "enhance certainty and stability in the markets and, in turn, ensure that costs associated with market participant defaults do not result in unjust and unreasonable rates."[4] With one potential exception concerning the ability to offset market obligations, the NYISO largely supports the credit reforms proposed by the Commission in the NOPR. At the same time, the NYISO respectfully requests that any final rule incorporate the enhancements to the proposed regulations suggested in this filing, in the IRC Comments, and in the Northeast ISO Comments.

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3 NOPR, at PP 13-31.
4 NOPR, at P 10.

II. SPECIFIC COMMENTS ON FIVE OF THE SEVEN MAJOR CREDIT REFORMS PROPOSED IN THE NOPR

A. Shortening the Settlement Cycle

As a matter of sound credit policy, the NYISO supports shortening settlement cycles to help protect consumers by mitigating bad debt loss exposure. As recognized by the Commission in its 2004 Policy Statement on Electric Creditworthiness:

> The size of credit risk exposure is, in large part, a function of the length of time between completion of the various parts of electricity transactions, i.e., the provision of service, the billing for service, and the payment for service. […] Accordingly, the Commission believes that ISOs/RTOs can minimize the exposure period and significantly reduce the credit risk to all market participants by reducing the time between when a cost is incurred and when payment is ultimately received by an ISO/RTO (i.e., shortening the settlement period).[5]

While the NYISO has experienced a relatively low incidence of defaults and bad debt losses, the NYISO has seen large defaults occur suddenly in other ISOs/RTOs, and has itself seen companies with investment grade ratings become financially distressed or go bankrupt virtually overnight. The NYISO's positive track record to date should not create a false sense of security regarding the likelihood of future bad debt losses.

Two years ago, the NYISO initiated discussions with market participants about weekly invoicing.[6] Last year, market participants voted on, and ultimately rejected, a proposal to transition from monthly to weekly invoicing. Market participants initially voted on weekly invoicing as part of a package of credit enhancements designed to reduce the NYISO's bad debt loss exposure, and later as a stand-alone proposal.[7] Under the weekly invoicing proposal, the

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5 *See Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 at P. 21 (2004).
6 *See Weekly Billing Presentation*, NYISO Billing & Accounting Working Group Meeting Presentation (March 25, 2008). < http://www.nyiso.com/public/webdocs/committees/bic_bawg/meeting_materials/2008-03-25/Weekly_Billing_Presentation_March_2008_v2.pdf>
7 Over 90% of NYISO stakeholders voted in favor of the revised package of credit enhancements, which excluded weekly invoicing, and agreed to revise the NYISO's tariffs to (i) change its methodology for assessing market participant creditworthiness, (ii) require on-time payments for six months as a prerequisite to qualifying for unsecured credit, (iii) set a fixed cap on the amount of unsecured credit that the NYISO may grant to a market participant, (iv) provide an alternative mechanism for public power entities to obtain unsecured credit, (v) eliminate the use of unsecured credit in the TCC market, (vi) reduce

NYISO would have billed approximately 90% of the dollar-volume of market transactions weekly, including charges relating to Energy and Ancillary Services, Virtual Transactions, and TCC Congestion Rents. In response to market participant feedback, the NYISO refined the elements of the weekly invoicing proposal numerous times. Accordingly, the NYISO had agreed to (i) reduce its working capital fund by $13.5 million to provide market participants with an immediate cash injection to offset potential implementation costs, (ii) allow municipalities and state agencies, other than the New York Power Authority ("NYPA") and the Long Island Power Authority ("LIPA"), to continue paying for their services monthly because certain legal restrictions sometimes make it difficult for these agencies to gain access to short-term capital, and (iii) continue issuing month-end invoices to resettle prior weekly activity in that respective month, thereby minimizing the impact of weekly invoicing on market participants' existing systems and processes.[8] In the event the Commission issues an order requiring ISOs/RTOs to adopt shortened settlement cycles, the NYISO respectfully requests that the Commission's regulation include sufficient discretion for the NYISO to permit municipalities and state agencies, other than NYPA and LIPA, to defer payment on weekly invoices until month end for the reason noted above.

The NYISO discussed weekly invoicing with market participants during at least twelve meetings, and during innumerable one-on-one conversations with stakeholders, prior to finalizing the proposal ultimately voted on by the Management Committee. The NYISO also commissioned a consulting firm[9] to perform an analysis of the costs and benefits to market

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default cure periods, and (vii) provide the NYISO with additional tariff authority to address credit concerns.

8 *See Enhancements to NYISO Creditworthiness Policies*, NYISO Management Committee Presentation, pp. 30-50 (June 24, 2009). <http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2009-06-24/agenda_04_062409_MC_Presentation_on_Creditworthiness_Enhancements.pdf> ("MC Presentation").

9 Market Reform, LLC is a boutique consulting firm that specializes in advising on the energy industry and energy marketplaces (e.g., spot, derivative, physical, financial, wholesale and retail). Market Reform is the same company that performed PJM's Credit and Clearing Analysis Project that the Commission refers to in paragraph 14 of the NOPR.

participants resulting from a transition to weekly invoicing (the "Cost-Benefit Study"). The Cost-Benefit Study quantified the costs and benefits for each individual market participant related to (i) a change in float, (ii) a change in collateral costs, (iii) a change in the costs to cover expected losses, and (iv) a change in the costs to cover potential losses in excess of expected losses.[10]

The Cost-Benefit Study did not include potential increases in market participant administrative costs (e.g., personnel and software costs) because those costs vary by market participant and the data necessary to calculate those costs is not readily available to the NYISO. Nevertheless, it is unlikely market participants would incur significant administrative costs because (i) market participants already receive and review invoicing data daily, (ii) many market participants already participate in other markets that settle weekly, and (iii) at least one market participant budgeted, in a recent rate filing, for only a marginal increase in administrative costs in the event the NYISO transitioned to weekly invoicing. Likewise, the Cost-Benefit Study did not include the potential benefit of a reduction in energy prices resulting from suppliers receiving faster payments and offering energy at lower prices because those benefits are difficult to quantify with precision.

The NYISO presented the results of the Cost-Benefit Study to market participants in January 2009.[11] The results are based upon NYISO market pricing and settlement data, as well as market participant credit and financial information, during the time period from November 1, 2007 through October 31, 2008. These indicative results will vary in accordance with current market data and information. The analysis, after carving out the impact on municipalities and

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10 The consultant based its analysis on each market participant's (i) daily settlement data, (ii) credit requirements, (iii) amount of unsecured credit, and (iv) estimated cost of capital for the period from November 1, 2007 through October 31, 2008. *See Weekly Billing Cost-Benefit Analysis*: *Summary of Results*, NYISO Credit Policy Working Group Meeting Presentation by Market Reform (January 16, 2009). <http://www.nyiso.com/public/webdocs/committees/bic_spwg_cptf/meeting_materials/2009-01-16/NYISO_Weekly_Billing_CBA_Summary_of_Results_Final.pdf>

state agencies, showed that the annual, net financial benefit to the NYISO marketplace would equal approximately $32 million, comprised of approximately $23 million in net cash flow benefits and $9 million in net risk avoidance benefits.

Specifically, the analysis indicated that approximately 75% of market participants would experience net benefits totaling around $38 million annually, and the other 25% of market participants would experience net costs totaling around $6 million annually. A greater number of LSEs would experience net costs than those with net benefits, and a greater number of suppliers and power marketers would experience net benefits than those with net costs. The largest, net financial benefit to any single market participant would equal approximately $4.5 million annually. The largest, net financial cost to any single market participant would equal approximately $1.7 million annually, with the average, net cost to any single market participant equaling approximately $170,000 annually.[12]

A frequent topic of discussion with market participants related to the appropriate allocation of the costs and benefits associated with weekly invoicing. Many LSEs asserted that a transition to weekly invoicing would result in an inequitable transfer of wealth from consumers to suppliers. The suppliers disagreed, asserting that the LSEs are holding money owed to them. The suppliers also stressed that weekly payments by LSEs would reduce the amount at risk for loss. Nevertheless, in an effort to address the concerns expressed by LSEs, the NYISO and its market participants considered various proposals to implement weekly invoicing that would reallocate certain financial benefits from suppliers to LSEs. Market participants, however, could not reach a consensus regarding any of the proposed alternatives. As a result, when market

11 Id.
12 *See MC Presentation* at pp. 30-50.

participants voted on weekly invoicing, the proposal did not include a mechanism for shifting costs or benefits from one sector of market participants to another.

When PJM Interconnection LLC ("PJM") made a filing with the Commission requesting permission to invoice weekly, its members also debated the issue of the appropriate allocation of costs and benefits. One PJM member asserted that the Commission's approval of weekly invoicing "results in generators receiving a windfall at the expense of LSEs and end-use consumers."[13] In rejecting this argument, the Commission responded as follows:

> Although the switch to weekly billings may result in increased working capital costs to LSEs, PJM correctly concludes that LSEs continue to be beneficiaries of the extension of trade credit, even under a shortened settlement cycle. Therefore, there is no basis for requiring a generator to pay interest on its receipts of weekly settlements. Additionally, we agree with PJM that a regulated utility's lead-lag working capital allowance should take into account the accelerated payments under weekly billing. Moreover, any adverse effect from the shortened billing cycle is outweighed by the overall credit risk-mitigation benefits of accelerated settlements, including reductions in the magnitude of defaults and reduced member financial assurance requirements.[14]

Despite the NYISO's participation in exhaustive deliberations with market participants and extensive efforts to address market participant concerns through refinement of the weekly invoicing proposal, the NYISO's Management Committee rejected weekly invoicing at its June 24, 2009 meeting, with 43% of the Management Committee voting in favor, and 57% against, the proposal.[15]

The Independent Power Producers of New York, Inc. ("IPPNY")[16] appealed the Management Committee's decision to the NYISO's Board of Directors ("Board").[17] IPPNY

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13 PJM Interconnection, LLC, 127 FERC ¶ 61,017 at p. 5 (2009).
14 Id.
15 The vote split along stakeholder lines with generators and other suppliers voting in favor of weekly invoicing while transmission owners, public power entities, and end-users voted against the proposal.
16 IPPNY is a not-for-profit trade association representing more than 100 companies involved in the development and operation of electric generation facilities and the marketing and sale of electric power in New York. IPPNY member HQ Energy Services US did not join in the appeal.
17 *See IPPNY−Appeal 07-09-09*, Appeals to the Board (June 24, 2009). <http://www.nyiso.com/public/markets_operations/committees/appeals/index.jsp> (the "IPPNY Appeal").

requested that the Board unilaterally file a weekly invoicing proposal with the Commission. IPPNY asserted that the implementation of weekly invoicing was long overdue, would reduce bad debt loss exposure in the NYISO-administered markets by 68%, and that stakeholders had fully vetted all weekly invoicing issues over the preceding 15 months. IPPNY further asserted that if the NYISO did not shorten its invoicing cycle to match that of its neighboring ISOs/RTOs then market participants could exploit the float provided by the NYISO's monthly invoicing cycle to satisfy their obligations in markets with shorter invoicing cycles.

The New York State Department of Public Service ("NYPSC"), the Transmission Owners, the City of New York, Gateway Energy Services Corporation, Multiple Intervenors,[18] and a group of end-use sector stakeholders[19] each filed motions in opposition to IPPNY's appeal.[20] The opponents of weekly invoicing countered with concerns that weekly invoicing could (i) have much broader implications than credit, (ii) increase costs to LSEs, and (ii) adversely impact the New York retail access market. The opponents also asserted that the seven credit enhancements approved by the Management Committee at the June 24 meeting would adequately mitigate bad debt loss exposure.[21]

After hearing oral arguments, in deference to the governance process and in an attempt to foster a compromise among stakeholders, the Board deferred ruling on IPPNY's appeal, stating:

> After carefully considering the parties' papers and arguments, the Board is not convinced that a compromise solution is unattainable.[22]

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18 Multiple Intervenors is an unincorporated association of approximately 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State. Multiple Intervenors participates in the NYISO stakeholder process through four of its members: (i) Alcoa, Inc., (ii) IBM Corporation, (iii) Occidental Chemical Corp. and (iv) Wegmans Food Markets, Inc.

19 The end-use sector stakeholders include: Memorial Sloan Kettering Cancer Institute, Fordham University, Mount Sinai Medical Center, Continuum Health Partners, New York University and American Sugar Refining, Inc.

20 *See Motions in Opposition to IPPNY Appeal*. Appeals to the Board (June 24, 2009). <http://www.nyiso.com/public/markets_operations/committees/appeals/index.jsp>

21 *See* Footnote 7, supra.

22 See NYISO Board of Directors Decision. Appeals to the Board (June 24, 2009). <http://www.nyiso.com/public/markets_operations/committees/appeals/index.jsp>

In remanding the issue to market participants for mediation, led by a neutral with significant FERC dispute resolution experience, the Board noted:

> Indeed, no party has argued that weekly invoicing completely lacks merit. Rather, the source of disagreement among the parties seems to surround the magnitude of benefits to the NYISO markets as a whole and the appropriate allocation of the costs and benefits of weekly invoicing.[23]

Mediation proceedings began in September 2009 and continued for five months. The NYISO and all sectors of market participants actively participated in these proceedings. The mediator held two open plenary sessions and engaged in numerous one-on-one meetings with market participants and the NYPSC. The mediation process, however, failed to result in a consensus proposal for weekly invoicing or any alternative proposal to shorten the NYISO's invoicing and settlement cycle. As a result, the Board concluded the mediation in February 2010, deferred action on the IPPNY appeal, and issued a second decision in this matter stating:

> After carefully considering the parties' current positions on this matter, the Board is not convinced that continuation of the mediation process would lead to a consensus resolution of the issue in the near future. In addition, FERC has recently issued a Notice of Proposed Rulemaking ("NOPR") entitled "Credit Reforms in the Organized Wholesale Electricity Markets." Among other things, the NOPR proposes to amend FERC's regulations to address the settlement cycles of ISOs and RTOs. As this element of the rulemaking is directly relevant to the central issue of the mediation and IPPNY's appeal, the Board believes that it is appropriate to delay further action on this matter until the conclusion of the FERC proceeding which may render moot the issues raised in this appeal.[24]

In the event the Commission issues an order requiring ISOs/RTOs to adopt shortened settlement cycles, the NYISO respectfully requests that the Commission provide ISOs/RTOs with sufficient notice prior to the effective date of any regulation. In the NOPR, the Commission also recognizes that "software adjustments may be necessary" for ISOs/RTOs to implement

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23 Id.
24 See NYISO Board of Directors Decision Concluding Stakeholder Mediation and Continuing Deferral of Action. Appeals to the Board (June 24, 2009). <http://www.nyiso.com/public/markets_operations/committees/appeals/index.jsp>

shortened settlement periods."[25] Consistent with this acknowledgement, the NYISO notes that it would need approximately nine to twelve months from the date of any Commission order requiring shortened invoicing cycles to finish implementing its enhanced invoicing software. One key benefit of the NYISO's redesigned invoicing software is its flexibility to support invoicing cycles of varying duration. With sufficient notice, the NYISO expects to be able to comply with Commission's proposed August 2011 deadline for shortening settlement cycles, should the Commission so order.

B. Use of Unsecured Credit

As indicated in the IRC Comments, the NYISO supports the Commission's proposal to "[l]imit the amount of unsecured credit extended to any market participant to no more than $50 million"[26] in those ISO/RTO markets that invoice weekly. The NYISO also believes that any final rule instituting a cap on the amount of unsecured credit should allow for ISOs/RTOs to establish limited exceptions to the cap, where appropriate.

For example, the amount of unsecured credit available to any one NYISO market participant is currently capped at $150 million, subject to an exception for Investment Grade customers that (i) have a legal right to recover costs for supplying Energy, Capacity, and Ancillary Services to end-users, and (ii) use their unsecured credit to fulfill Native Load Credit Requirements only. In such case, the qualifying Investment Grade customer could receive unsecured credit in an amount up to $250 million. In the event the NYISO transitions from monthly to weekly invoicing, the NYISO and its stakeholders have previously considered reducing the cap on unsecured credit to $50 million, with the cap for Investment Grade customers qualifying for the limited exception set at $85 million.

25 NOPR, at P 15.
26 See NOPR at p. 29, Proposed Section 35.47(a) of the Commission's regulations.

The NYISO's current tariff provisions also permit market participants to agree to an indexing methodology that would require the NYISO to adjust the dollar cap on unsecured credit annually in accordance with fluctuations in specified market factors (e.g., price and demand) as set forth in ISO Procedures. The NYISO respectfully requests that any final rule include sufficient flexibility to allow the NYISO to continue recognizing the two limited exceptions, described above and supported by NYISO stakeholders, to any dollar cap on the amount of unsecured credit available to a market participant.

C. Use of Material Adverse Change to Request Additional Collateral

As established in the IRC Comments, the NYISO supports the enumeration, in ISO/RTO tariffs, of items that may constitute a material adverse change so long as it is clear that such a list is not exhaustive (i.e., that the ISO/RTO may consider changes that are not enumerated). The NYISO also recommends that any final rule on this issue allow each ISO/RTO to customize the list of material adverse changes that it includes in its tariffs.

The NYISO, much like other ISOs/RTOs, require market participants, in general, to have an investment grade credit rating to qualify for unsecured credit. The amount of unsecured credit potentially available to an investment grade market participant equals a percentage of its tangible net worth (i.e., 0-7.5%) and is subject to the NYISO's concentration cap. This amount is termed the "starting point" for determining a market participant's unsecured credit. After calculating the starting point, the NYISO performs a credit assessment of the market participant using a credit assessment tool set forth in its tariffs. Based on the results of the credit assessment, the NYISO will either grant the market participant unsecured credit in the amount of its starting point or adjust the starting point downward from 20-100%. A market participant that is subject to a 100% reduction in unsecured credit is not eligible for restoration unless the market participant has two consecutive quarters of financial performance that would otherwise qualify it for unsecured credit.

The NYISO's use of a credit assessment tool to adjust the amount of unsecured credit available to a market participant differentiates the NYISO's practices regarding adjustments to unsecured credit from the practices of most other ISOs/RTOs. The NYISO and its market participants spent approximately one year developing the currently effective version of the credit assessment tool to ensure that the tool evaluates each market participant's financial position using a combination of traditional financial ratios and market-based ratios that are typically leading indicators of financial deterioration. This methodology allows the NYISO to promptly identify and appropriately adjust the amount of unsecured credit extended to a market participant based on early signs of the market participant's financial distress. The financial metrics and weightings underlying the credit assessment tool are set forth in the NYISO's tariffs. This transparency allows market participants to predict potential decreases in unsecured credit and plan ahead in the event credit support is required.

Even with this credit assessment tool, it is very important that the NYISO maintain its authority to adjust a market participant's credit requirements, or amount of unsecured credit, in the event of a material adverse change. Without this authority, the NYISO may be unable to protect against significant losses when circumstances arise that indicate a market participant is experiencing severe financial distress but such circumstances are not reflected in the market participant's credit rating, or are not sufficiently accounted for by the credit assessment tool.

D. Financial Transmission Rights Markets

The NYISO agrees with the Commission's proposed regulation to "[e]liminate unsecured credit in the financial transmission rights[27] market."[28] The NYISO revised its tariffs, effective

27 In the NYISO marketplace, "financial transmission rights" are known as Transmission Congestion Contracts (TCCs).
28 See NOPR at p. 29, Proposed Section 35.47(c) of the Commission's regulations.

November 12, 2009, to disallow the use of unsecured credit to meet TCC credit requirements. TCCs, unlike other market products, have lengthy periods of forward exposure that could subject market participants to potentially excessive bad debt losses. For example, if an initially creditworthy market participant relies on unsecured credit to support its projected TCC payment obligations, then later experiences severe financial distress and defaults, this bad debt loss is mutualized among market participants.

The NYISO, however, exempts Fixed Price TCCs from the TCC collateralization requirement. Fixed Price TCCs are less risky than other TCC instruments because Fixed Price TCCs are available only to hedge physical load obligations. As such, the congestion resulting from a Fixed Price TCC is offset by the opposite congestion of the physical energy flow associated with the load serving obligation. The NYISO respectfully requests that the final rule on the elimination of unsecured credit in FTR markets include the flexibility necessary to allow the NYISO to continue to exempt Fixed Priced TCCs from its TCC collateralization requirement.

E. Ability to Offset Market Obligations

The NYISO seeks clarification regarding the Commission's proposed regulation that each ISO/RTO have tariff provisions that "[a]llow it to offset market obligations owed to market participants against market obligations owed by market participants."[29] To the extent that the Commission is proposing that each ISO's/RTO's tariff include an explicit right to setoff market participant obligations, the NYISO supports this proposal. If the proposed regulation, however, would require the NYISO to "take title"[30] in each market transaction to address the risk that a bankruptcy court would potentially prohibit an ISO/RTO from netting payments owed to a market participant against payments owed by that market participant, the NYISO respectfully

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29 See NOPR at p. 29, Proposed Section 35.47(d) of the Commission's regulations.
30 NOPR at P 15.

submits that less complicated alternatives exist to address such risk.

While the NYISO does not oppose other ISOs/RTOs adopting practices to take title in market transactions, the NYISO is concerned that a Commission mandate could negatively affect the NYISO's non-profit tax status and potentially impose significant tax, accounting, regulatory and administrative costs, and reporting burdens, on the NYISO. For example, Section 3.04(g) of the ISO/TO Agreement prohibits the NYISO from having "a financial interest in any commercial transaction involving the use of the NYS Power System or any other electrical system . . . ." Under Section 6.14 of that Agreement, Section 3.04(g) may only be amended with the unanimous consent of the parties, i.e., the NYISO and its member transmission owners, or if the Commission were to make an express finding "that such change is required under the public interest standard under the Mobile-Sierra doctrine."

1. The Mirant Bankruptcy

In the NOPR, the Commission expresses concern that in the event of a bankruptcy proceeding, an ISO/RTO that does not take title in the underlying contract position of the market participant may not have the right to net payments owed to the market participant against payments owed by the market participant. The NOPR states that this practice became an issue for the California Independent System Operator ("CAISO") during the *Mirant* bankruptcy and concludes that "[b]ecause CAISO had not 'taken title' of the transactions, CAISO could not net payments owed to Mirant against payments owed by Mirant."[31] The NYISO respectfully submits that the language quoted in the preceding sentence is inaccurate because it suggests that the bankruptcy court ruled on the issue of ISO/RTO title to transactions and setoff when, in fact,

31 NOPR at P 15 (citing Memorandum by Wachtell, Lipton, Rosen & Katz to PJM regarding Setoffs and Credit Risk of PJM in Member Bankruptcies at 7, 10-11 (Mar. 17, 2008) (found on Dec. 31, 2009 at http://www.pjm.com/~/media/committees-groups/committees.crmsc/20080423/20080423-wachtell-netting-memo.ashx (hereinafter the "Wachtell Memo")).

the bankruptcy court in *Mirant* did not rule on the merits of Mirant's argument because the case settled.[32]

In the *Mirant* case, Mirant claimed entitlement to certain refund obligations arising from the California power crisis of 2000. Following its bankruptcy filing, Mirant objected to CAISO's attempt to setoff against its refund obligations to Mirant certain debts arising from ordinary course transactions in the market that Mirant owed CAISO.[33] Based on the different nature of these two types of obligations, Mirant argued that the court should deny CAISO's setoff claim for lack of mutuality.[34] As noted above, the bankruptcy court did not rule on the merits of this argument.

Notably, Mirant may have lacked conviction in the merits of its own argument because it chose to settle its case. Under the terms of the settlement agreement, Mirant's receivable was assigned to litigation adversaries to satisfy claims of overcharging customers by Mirant during the power crisis.[35] Had the court ruled on the issue in Mirant's favor, the receivable would have benefited all creditors, not just the litigation adversaries. While the reasons Mirant settled cannot be known for certain, for the bankruptcy court to authorize the settlement, Mirant and its unsecured creditors may have perceived the likelihood of Mirant winning its argument to be remote.

To date, the NYISO has found no case law supporting the proposition that a creditor must be a central counter-party in a transaction, or "take title," in order to setoff payment obligations. Such a requirement was not established in the *Mirant* case. In fact, the bankruptcy court in *Mirant* entered a stipulated order that allowed CAISO to net Mirant's ordinary course credits and

32 Wachtell Memo at P 11.
33 Wachtell Memo at P 10.
34 The Bankruptcy Code only preserves the right of setoff where the debt obligations are mutual. See 11 U.S.C. § 553(a).
35 *See Order on Settlement Agreement*, 111 FERC ¶ 61,017 (April 13, 2005) ¶ 7; accord January 14, 2005 Press Release of Governor Schwarzenegger, available at http://gov.ca.gov/press-release/2348/.

debits for the pre-petition trade months. The NYISO submits that the netting of market obligations that arise in the ordinary course poses significantly less risk of a successful challenge to mutuality than the unique facts of *Mirant*.

2. Risks Posed to the Ability to Setoff Market Obligations

The NYISO does not believe that there is substantial risk that a bankruptcy court would prohibit an ISO/RTO from applying amounts owed to a market participant against amounts owed to the ISO/RTO where its tariff specifically establishes a contractual obligation of payment to the ISO/RTO, and conversely an obligation of payment by the ISO/RTO to the market participant. This contractual obligation likely establishes the mutuality required to setoff market obligations under the terms of the Bankruptcy Code.

Moreover, in considering whether to permit setoff, a bankruptcy court may, for public policy reasons, defer to the Commission-approved tariff provisions of the ISO/RTO that allow it to net market participant obligations and uphold setoff. The NYISO has found at least one case where a bankruptcy court acknowledged the jurisdictional grant to the Commission in this marketplace, and refused to disturb an order of the Commission.[36] Therefore, a bankruptcy judge may consider the public interest of providing energy services at a reasonable cost to end-use consumers in determining whether to enforce an ISO's/RTO's setoff rights. The inability of an ISO/RTO to setoff market obligations in connection with a series of major defaults would implicate this public interest.

The NYISO also believes that a bankruptcy court could potentially uphold the netting of market obligations by an ISO/RTO under the doctrine of recoupment, particularly netting within one market, and therefore circumvent a challenge for lack of mutuality. Unlike with setoff,

36 *See In re NRG Energy Inc*., Case No. 03-3754-RCC, 2003 U.S. Dist. LEXIS 11111 (S.D.N.Y. 2003) (commenting on the bankruptcy's court decision to permit rejection of a power services agreement, but not to disturb the Commission's order that a

mutuality is not a requirement for recoupment. In general, recoupment applies to allow for the netting of obligations arising out of a single transaction, but may also apply to a set of transactions arising under a single contract.[37] To the extent that a single market agreement governs a set of transactions that are periodically netted between an ISO/RTO and a market participant, a bankruptcy court may permit recoupment, thereby avoiding the requirement of mutuality. In such a case, a bankruptcy court would likely enforce the netting provisions of the ISO's/RTO's tariff.

3. Becoming a Central Counter-Party, or "Taking Title," Is Not the Only Solution to Preserving Ability to Setoff Market Obligations

The NYISO has found no case law holding that taking title is a prerequisite to satisfying the mutuality requirement necessary to effect setoff. In discussing setoff rights, the applicable sections of the Bankruptcy Code provide that there must be mutual debts, which are defined as liabilities on a claim or rights to payment.[38] Rights to payment arise from any number of types of contracts, not necessarily those that provide for the transfer of title. While not free from uncertainty, the NYISO believes that a bankruptcy court likely would adhere to the language of the Bankruptcy Code and focus on whether a payment obligation exists between the parties, without specifically requiring that both parties take title in the transaction.

The NYISO submits that the thrust of the risk to mutuality identified in the Wachtell Memo is the ambiguity in the identity of the party to which the payment obligation is owed rather than the exclusion of the ISO from the chain of title in the transactions. As such, the NYISO believes the Commission's proposed regulations should require that the credit provisions in ISO/RTO tariffs specify that the market participant owes each/all of its payment obligations to

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bankrupt power marketer continue to provide services to a customer).

37 *See In re McMahon*, 129 F.3d 93, 96 (2d Cir. 1997) (applying NY law).

38 Section 553 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., addresses setoff. Sections 101(12) and 101(5) of the Bankruptcy Code provide the definition of "debt" and "claim," respectively.

the NYISO. The NYISO also believes that amending credit provisions in tariffs to strengthen setoff rights by providing for the periodic netting of obligations would also significantly reduce the risk that a bankruptcy court would refuse to recognizes an ISO's/RTO's right to setoff.

III. CONCLUSION

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission consider these comments and act or elect not to take action in accordance with the NYISO's comments above and the IRC Comments incorporated herein by reference.

Respectfully submitted,

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March 29, 2010