

# MEMORANDUM

**TO:** NEPOOL Budget and Finance Subcommittee  
**FROM:** Paul N. Belval, NEPOOL Counsel  
**DATE:** May 7, 2008  
**RE:** Clean-up Changes to Financial Assurance Policies

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At its May 12 teleconference meeting, the NEPOOL Budget and Finance Subcommittee will be asked to recommend to the NEPOOL Participants Committee that it approve changes to the ISO New England (“ISO”) Financial Assurance Policies (the “Policies”) to address some minor issues in the Policies. The proposed revisions are described below. The proposed changes to the Financial Assurance Policy for Market Participants, Exhibit IA to the ISO Tariff, are included in Attachment 1 to this memorandum, and that Attachment is marked to show the changes from the currently effective Policy. In the interest of efficiency, we have not yet prepared the conforming changes to the other Policies. If the Subcommittee recommends the proposed revisions to the Participants Committee, we will include the conforming revisions to those other Policies in the materials to be provided to the Participants Committee.

Commercial/Non-Commercial Capacity. The FCM-related provisions in the Policies currently distinguish between “Existing Capacity” and “New Capacity,” as defined in the Market Rules. Existing Capacity generally has less stringent financial assurance requirements than New Capacity, and, as a result of changes approved recently by the Commission, an award of Existing Capacity in the FCM is not terminated for a Financial Assurance Default. The Market Rules provide that a Resource can only be treated as “New Capacity” in one Forward Capacity Auction, and if a Market Participant were to be awarded an offer for New Capacity in a Forward Capacity Auction and have its New Capacity award terminated for failure to satisfy its obligations (including under the Policies), it will be treated as “Existing Capacity” in the next Forward Capacity Auction. As a result of the interplay of these provisions, a Market Participant offering New Capacity in the FCM that fails to meet its obligations could be treated more favorably under the Policies than a similarly situated Market Participant that has satisfied its obligations.

Since this is not likely the result intended for those provisions, the proposed revisions to the Policies switch from distinguishing between “Existing Capacity” and “New Capacity” to distinguishing between “Commercial Capacity” and “Non-Commercial Capacity.” Commercial Capacity is generally the capacity of a Resource that has been declared commercial and successfully tested for its capacity rating by the ISO and has not elected to be treated as New Capacity in connection with a new investment in the Resource. Non-Commercial Capacity, conversely, is the capacity of a Resource that has not been declared commercial and has not successfully tested for its capacity rating by the ISO or has elected to be treated as New Capacity in connection with a new investment in the Resource. The provisions that had applied to “Existing Capacity” previously would apply to “Commercial Capacity,” and the provisions that had applied to “New Capacity” previously would apply to “Non-Commercial Capacity.”

Application Fee. Language is being added to the Policies to clarify that the ISO will not begin reviewing the credit application and related materials for a new Market Participant until that Market Participant pays its application fee to the ISO.

Return of Financial Assurance. The Policies are being revised to provide that, if a Market Participant voluntarily terminates or is terminated, the ISO may retain a portion of its financial assurance that would be needed for obligations or liabilities that the ISO knows about but which have not yet been settled in the ISO's Settlement System. This would avoid a situation where a terminated Market Participant can have its financial assurance returned simply because a known liability has not yet worked its way through that Settlement System.

90 Percent Test/100 Percent Test. The Policies are being revised to clarify that a Market Participant whose Obligations equal 90 percent of its Credit Test Amount also bears the consequences of its Obligations equaling 80 percent of its Credit Test Amount, and a Market Participant whose Obligations equal 100 percent of its Credit Test Amount also bears the consequences of its Obligations equaling 80 percent and 90 percent of its Credit Test Amount. This addresses situations in which a Market Participant's Obligations increase very quickly or its available financial assurance decreases very quickly.

Elimination of U.S. Treasury Obligations. The proposed changes eliminate U.S. Treasury obligations as an acceptable form of financial assurance under the Policies. Since those obligations were added as a form of financial assurance, no entity has posted U.S. Treasury obligations under the Policy. Moreover, with the recent introduction of investment accounts through BlackRock, Inc. for the maintenance of cash deposits, the use of U.S. Treasury obligations for financial assurance seems less attractive. Eliminating those obligation as a form of financial assurance will permit the ISO to reduce the fees it pays to [Key Bank] to make that option available.

Letter of Credit Changes. The Policies are being revised to (1) no longer permit unaffiliated entities to act as account parties on letters of credit for Market Participants, (2) provide that the available amount of the letter of credit is reduced by any draws, whether or not they are reimbursed, (3) update the reference to the Uniform Customs and Practice for Documentary Credits to reflect a revision released last year, and (4) add a notice address for the ISO.

If the Budget and Finance Subcommittee recommends these changes, they will be addressed by the Participants Committee at its June 6 meeting.