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August 31, 2010

BY ELECTRONIC FILING

Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: ISO New England Inc. and New England Power Pool; Docket No. ER10-942-001; Motion for Leave to Answer and Answer of ISO New England Inc.

Dear Ms. Bose:

Enclosed for electronic filing in the referenced docket is the Motion for Leave to Answer and Answer of ISO New England Inc.

If there are any questions concerning this filing, please call me at (202) 661-2212.

Very truly yours,

/s/ Howard H. Shafferman

Howard H. Shafferman
Counsel for ISO New England Inc.

Enclosures

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

**ISO New England Inc. and
New England Power Pool**

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Docket No. ER10-942-001

**MOTION FOR LEAVE TO ANSWER AND ANSWER
OF ISO NEW ENGLAND INC.**

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.212 and § 385.213 (2010), ISO New England Inc. (the “ISO” or “ISO-NE”) submits this Motion for Leave to Answer and Answer to the August 16, 2010 rehearing request (the “Rehearing Request”) of the New England Credit Policy Coalition (the “Coalition”) of the July 15, 2010 order¹ accepting in part and rejecting in part the March 26, 2010 filing of proposed credit reform-related tariff amendments submitted by the ISO and the New England Power Pool (“NEPOOL”) Participants Committee in this proceeding (the “Credit Reform Amendments”).

I. MOTION FOR LEAVE TO ANSWER

Because an answer is not normally permitted in response to a rehearing request,² the ISO moves, pursuant to Rule 212 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.212 (2009), for leave to accept this answer. Although the Commission’s rules do not normally permit answers to rehearing requests, the Commission often waives this prohibition for good cause shown.³ The Commission has found good cause, for instance, when an answer

¹ *ISO New England Inc. and New England Power Pool*, 132 FERC ¶ 61,046 (2010) (the “Order”).

² *See* 18 C.F.R. §§ 385.213(a)(2), 385.713(d)(1) (2010).

³ *See, e.g., Dominion Cove Point LNG, LP*, 118 FERC ¶ 61,007 at P 10 (2007).

provides information that assists the Commission in its decision-making process,⁴ narrows or clarifies important issues,⁵ or responds to a rehearing request that raises an issue of fact.⁶ This answer satisfies this test for good cause.⁷ Specifically, the ISO submits this brief answer because the Rehearing Request is procedurally improper, and mischaracterizes the Order and its context.

II. ANSWER

A. Introduction and Background

The Rehearing Request challenges the Commission's decision to accept the proposal of the ISO and NEPOOL to eliminate corporate guarantees as a form of financial assurance in the New England markets.

As detailed below in this Answer, the Commission was correct in accepting the elimination of corporate guarantees. Doing so is an appropriate, non-discriminatory, and well-justified means of reducing the use of unsecured credit, and thereby reducing the concomitant default risk exposure of New England Market Participants.⁸ Because the elimination is applied even-handedly to all sectors of the New England electric marketplace, it does not bear the infirmity perceived by the Commission in the other credit reform proposals.

In sum, the Rehearing Request should be rejected because:

⁴ See, e.g., *id.*; *PSEG Power Connecticut, LLC*, 113 FERC ¶ 61,210 at P 17 (2005).

⁵ See, e.g., *Consumers Energy Co.*, 110 FERC ¶ 61,317 at P 13 n.16 (2005); *Sound Energy Solutions*, 107 FERC ¶ 61,263 n.37 (2004).

⁶ See, e.g., *SFPP, L.P.*, 117 FERC ¶ 61,275 at P 2 (2006).

⁷ See, e.g., *PSEG Power Connecticut, LLC*, 113 FERC ¶ 61,210 at PP 10 & 17 (accepting an answer to respond to a misleading rehearing request); *Northwest Pipeline Corp.*, 95 FERC ¶ 61,029 at p. 61,092 (2001) (same).

⁸ Capitalized terms not otherwise defined herein have the meanings ascribed thereto in the ISO New England Inc. Transmission, Markets and Services Tariff.

- it is procedurally improper due to the Coalition’s failure to raise its arguments below;
- the elimination of corporate guarantees does not selectively eliminate unsecured credit or “target” any sector of New England Market Participants; and
- the elimination was both supported and justified.

More generally, the Rehearing Request appears to presume that the Commission views as suspect any reduction in unsecured credit. That is not correct, for the Commission is clearly supportive of such efforts, as indicated in the Commission’s recent notice of proposed rulemaking on credit reforms in wholesale electric markets:

To promote confidence in the markets, the Commission proposes reforming credit practices of the organized wholesale electric markets to limit potential future market disruptions and to dampen the possible ripple effect of such disruptions. These reforms include shortening settlement periods and reducing the amount of unsecured credit, as described below. The Commission believes that these reforms, if adopted, will enhance certainty and stability in the markets and, in turn, ensure that costs associated with market participant defaults do not result in unjust or unreasonable rates.⁹

Indeed, the only portion of the Credit Reform Amendments that the Commission found unacceptable were the elements that proposed an *uneven* reduction in unsecured credit.

Accordingly, the Commission’s acceptance of the elimination of corporate guarantees is not some sort of aberration, but advances the stated policy goals of the Commission.

B. The Rehearing Request Should Be Rejected as Procedurally Improper

The Coalition rightly anticipates¹⁰ an attack on the fundamental flaw of the Rehearing Request: namely, that the Coalition failed to raise the arguments made in the Rehearing Request

⁹ See *Credit Reforms in Organized Wholesale Electric Markets*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,651 at P 10, 75 Fed. Reg. 4310 (January 21, 2010).

¹⁰ See Section III.C of Rehearing Request.

in its April 16, 2010 protest (the “Coalition Protest”) or in its May 13, 2010 answer to the answer of ISO and NEPOOL (the “Coalition Answer”). This flaw is fatal, and for that reason alone, the Commission should reject the Rehearing Request.

The Commission has repeatedly dismissed rehearing requests in which new issues and arguments are raised for the first time. As the Commission stated in *Northeast Utilities Service Co. and Select Energy, Inc. v. ISO New England Inc. and New England Power Pool*:¹¹

The Commission has repeatedly looked with disfavor on parties raising new issues and arguments for the first time on rehearing.¹²

This clear precedent should be applied to dismiss the Rehearing Request.

The Coalition *did not even mention*, much less protest, the elimination of corporate guarantees in the Coalition Protest or the Coalition Answer. The Coalition Protest, in fact, specifically states that

...the Coalition Members support or do not oppose most of the specific revisions to the [ISO’s Financial Assurance Policy (“FAP”)] and the Billing Policy contained in the [Credit Reform] Amendments.¹³

The Coalition protested only those elements of the Credit Reform Amendments that had an allegedly selective or discriminatory element. As stated in the Coalition Protest, the Coalition urged the Commission:

¹¹ 109 FERC ¶ 61,204 (2004).

¹² See, e.g., *New York Independent System Operator, Inc.*, 95 FERC ¶ 61,347 (2001), citing *Baltimore Gas & Electric Company, et al.*, 91 FERC ¶ 61,270 at 61,922 (2000); see also *Philadelphia Electric Company*, 58 FERC ¶ 61,060 at 61,133 & n. 4 (1992) (footnotes as in original).

¹³ Coalition Protest, at 2.

to reject the aspects of the Proposed [Credit Reform] Amendments that would eliminate the availability of unsecured credit for all but *a discrete group of state-regulated load-serving entities*....¹⁴

By contrast, as reflected in the filing letter accompanying the Credit Reform Amendments,¹⁵ and in the Order itself,¹⁶ the proposal to eliminate corporate guarantees was not among the protested aspects of the amendments, as it did not exclude from its coverage those “state-regulated load-serving entities” allegedly favored by other elements. Rather, an *across-the-board elimination* – that applies regardless of the type of entity – was proposed by the ISO and NEPOOL and accepted by the Commission.

In light of the clear statements in the Coalition Protest, the Coalition’s instant argument¹⁷ that its opposition to eliminating corporate guarantees was somehow subsumed in its arguments against the “selective elements” must be rejected. Nor can this defect in the Rehearing Request be cured or papered over by belated and unsupported assertions – the introduction of which, even if the assertions rose to the level of actual evidence, is not permitted at the rehearing stage¹⁸ –

¹⁴ Coalition Protest, at 2-3 (emphasis added). In a similar vein, the Coalition Protest also stated: “*The dispute in this case is not whether unsecured credit should be reduced or not; rather, the dispute is whether a reduction in unsecured credit should be implemented in a fair and even-handed manner that allows creditworthy parties continued access to a reasonable amount of unsecured credit, or whether such reductions should be accomplished in a discriminatory fashion that applies different standards to equally creditworthy parties.*” *Id.* at 3 (emphasis added). Further, the Carr Testimony accompanying the Coalition Protest was limited to “an assessment of one element of ISO-NE’s and NEPOOL’s proposal, which would *selectively reduce* the unsecured credit that it extends to its members.” Carr Affidavit at 1.

¹⁵ See ISO/NEPOOL filing letter at 16 (stating that the amendments “eliminate the use of corporate guarantees for the provision of financial assurance in all circumstances, even where the use of unsecured credit will still be permitted.”)

¹⁶ See Order, at P 80 (accepting tariff revisions “to *entirely eliminate* corporate guarantees.” (emphasis added)).

¹⁷ See Rehearing Request, at 3, 11-12.

¹⁸ See, e.g., *New York Independent System Operator, Inc.*, 112 FERC ¶ 61,283 at P 35 n. 20 (2005) (“parties are not permitted to raise new evidence on rehearing. To allow such evidence would allow impermissible moving targets”), citing *Entergy Nuclear Operations, Inc., Entergy Nuclear Indian Point 2, L.L.C., Entergy Nuclear Indian Point 3, L.L.C. v. Consolidated Edison Company of New York, Inc.*, 112 FERC ¶ 61,117 at P 39 (2005); see also *Ocean State Power II*, 69 FERC ¶ 61,146 at 61,548 n. 64 (1994) (“The Commission generally will not consider new
(continued...)”)

about the allegedly disproportionate effect of the elimination of guarantees upon a subset of load-serving entities (“LSEs”).¹⁹ The Coalition may not, in sum, attempt to shoehorn the elimination of guarantees into its protest of the “selective” elements of the Credit Reform Amendments filing.

Having failed to make the requisite arguments below, the Coalition must fail in its attempt to overturn the Commission’s decision regarding the across-the-board elimination of corporate guarantees. As discussed in Section II.D below, this well-supported decision accepted just and reasonable tariff provisions.

C. The Rehearing Request’s Assertions that Corporate Guarantees are Selectively Eliminated and that the Elimination “Targets” Certain Entities Are Incorrect and Should Be Rejected

The Rehearing Request makes the startling assertions – instantly identifiable as incorrect from the filing letter, the text of the Credit Reform Amendments and the Order – that the elimination of corporate guarantees was selective and “targets” one segment of Market Participants.²⁰ The Rehearing Request uses these assertion as a springboard to the conclusion that the elimination of corporate guarantees must therefore be rejected as unduly discriminatory.

The Commission should reject both assertions and the associated conclusion. As explained above, the proposal to eliminate corporate guarantees is in no way selective; nor does it “target” a particular sector of Market Participants. It applies to *all* Market Participants, and does not carve out the state-regulated LSEs that would have been permitted to continue use of

(...continued)

evidence on rehearing, as we cannot resolve issues finally and with any efficiency if parties attempt to have us chase a moving target”).

¹⁹ See Rehearing Request, at 5-7.

²⁰ Rehearing Request, at 11-12, 5.

unsecured credit. Indeed, the Rehearing Request even cites the statement included in the filing letter for the Credit Reform Amendments that corporate guarantees were to be eliminated “even in the narrow circumstances where unsecured credit may still be used.”²¹

The Coalition seeks to circumvent this inconvenient reality by making unsupported allegations about the differing impacts of guarantee elimination on certain LSEs (such as the Coalition members) compared with certain other, state-regulated, Market Participants that are LSEs.²² This approach is apparently intended to bootstrap the across-the-board elimination of guarantees into alignment with the “selective elements” of unsecured credit elimination that the Commission found unacceptable. The Rehearing Request also uses figures that exaggerate the cost of letters of credit as an alternative to guarantees.

This approach is unavailing, in several respects. First, mere allegations of disparate impact are no basis for the Commission to overturn its acceptance of the elimination of corporate guarantees as somehow discriminatory. As discussed in Section III.B., even if the allegations rose to the level of evidence, the evidence would not be admissible at the rehearing stage.

Second, the Rehearing Request is incorrect in stating that “the proposed elimination of corporate guarantees targets one segment of market participants, the ‘Competitive LSEs’ identified in the ... Order that rely on corporate guarantees to meet their creditworthiness requirements” and in citing footnote 56 of the Order as somehow signifying a Commission recognition that Competitive LSEs rely on guarantees. A conclusory misstatement cannot (if so intended) overcome the absence of evidence of disparate impact. Further, footnote 56 simply defines “Competitive LSEs” for purposes of the Order as those who would not qualify for

²¹ Rehearing Request, at 7.

continued use of unsecured credit under the “selective” elements included in the Credit Reform Amendments, and makes no reference at all to guarantees, much less to their use by Competitive LSEs or any other particular group of Market Participants. Accordingly, no finding of a disparate impact of guarantee elimination is available in the Order or the existing record for overturning the Commission’s correct ruling.

Third, the allegations of a disproportionate financial impact on non-state-regulated LSEs (through costs of letters of credit that would be used in place of corporate guarantees) cannot withstand scrutiny. The Coalition apparently seeks to create the impression that all non-state-regulated LSEs are similarly situated in their use of corporate guarantees as a form of unsecured credit, and that the non-state-regulated LSEs are the only group of Market Participants that uses guarantees. Neither impression would be correct. There are non-state-regulated LSEs (of which the Coalition Members are only a subset) that currently qualify for use of unsecured credit but do not use corporate guarantees. More importantly, however, almost every other sector of New England Market Participant – from generators to state-regulated LSEs – includes entities that currently utilize guarantees, so non-state-regulated LSEs (or the subset that participates in the Coalition) are not being singled out.²³

Fourth, the Coalition continues to overstate, as it did in the Coalition Protest and affidavit, the costs for Market Participants that would need to replace guarantees with letters of

(...continued)

²² Rehearing Request, at 5-7.

²³ As noted in the Ludlow/Iafrati Testimony accompanying the filing of the Credit Reform Amendments (p. 8, line 20 through p. 9, line 2), “approximately 80% of financial assurance requirements in New England are secured. Of the approximately 20% that are currently satisfied through unsecured credit, 53% are satisfied through guarantees from affiliates that are not Market Participants.”

credit,²⁴ by characterizing those costs as constituting three percent of face value and as having a total annual cost of \$7.7 million. A more realistic, and far lower, level of such costs was previously estimated in the ISO's answer to the Coalition Protest, and is incorporated by reference here;²⁵ and a Market Participant can avoid letter of credit costs altogether by posting cash collateral in an account that accrues interest for the Market Participant. Moreover, the cost figure developed in the Coalition Protest affidavit was correlated with the proposed elimination of unsecured credit pool-wide (with the proposed exceptions), rather than with the elimination of corporate guarantees. Because, under the Order, credit limits will remain in place after the elimination of guarantees, permitting reliance on unsecured credit such as reliance on investment grade credit ratings, the cost of letters of credit to replace guarantees pool-wide will obviously be less than that estimated by the Coalition.

In sum, because the elimination of guarantees is neither selective nor targeted by type of entity, and because the Coalition's attempt to make disparate impact claims are not credible, the Commission should deny rehearing.

D. The Rehearing Request's Argument that the Elimination of Guarantees Was Insufficiently Supported Should Be Rejected

The Rehearing Request argues that the proposal to eliminate corporate guarantees was inadequately supported,²⁶ and that the Order identified no basis on which the elimination should be accepted, "simply stating in conclusory fashion that the proposal was a 'reasonable way to further reduce the risk of default.'"²⁷

²⁴ Rehearing Request, at 8.

²⁵ See ISO answer to Coalition Protest, at 21-23.

²⁶ Rehearing Request, at 8.

²⁷ Rehearing Request, at 9.

The Commission should reject this argument. The ISO's supporting basis for guarantee elimination was clear and obvious from the Ludlow/Iafrati Testimony accompanying the initial filing, and based on common sense: default risk increases with the introduction of another obligor that the ISO is not in a position to monitor. Specifically, the ISO stated in testimony, by way of justification:

Indeed, corporate guarantees are an even more attenuated form of security than the extension of unsecured credit to the Market Participant itself, and introduce, at a minimum, increased contract, legal, and bankruptcy risk. Furthermore, when the guarantor is not a Market Participant, the ISO's ability to monitor the default risk of that entity is diminished. For these reasons, it is appropriate to eliminate the use of corporate guarantees for the provision of financial assurance in all circumstances, even where the use of unsecured credit will still be permitted.²⁸

Oddly, the Rehearing Request offers no direct rebuttal to the ISO's testimony about attenuation and the inability to monitor default risk of a non-Market Participant, but nonetheless calls the guarantee-elimination proposal "unsupported." And, as noted above, neither the Coalition Protest nor the Coalition Answer challenged this testimony.

Similarly puzzling is the Coalition's statement²⁹ that it does not see the connection between a reduction in contract, legal and bankruptcy risk and a reduction in the risk of default. The connection is, of course, self-evident, as the former set of risks go hand-in-hand with default risk.

²⁸ See Credit Reform Amendments filing, Attachment 3 (Ludlow/Iafrati Testimony), at 20, lines 11-17.

²⁹ Rehearing Request, at 9 (noting that the ISO/NEPOOL filing of the Credit Reform Amendments "asserted, without support or explanation, that eliminating corporate guarantees would reduce 'contract risk, legal risk, and bankruptcy risk' but, importantly, did *not* claim that eliminating corporate guarantees would reduce the risk of default." (footnote omitted)).

The weakness of the Coalition’s argument is epitomized, though, by the Rehearing Request’s related statements that: (i) corporate guarantees *reduce* risk by providing another creditworthy party against whom to present a claim in the event of default; and (ii) a corporate guarantee is similar to a letter of credit.³⁰ On the first point, the Coalition ignores the obvious rebuttals that: (a) a default by a *subsidiary/affiliate* of a guarantor will weaken the parent and could thereby reduce the likelihood of recovery under the guarantee, and (b) conversely, the bankruptcy of a parent makes the guarantee worthless. The second point – that the guarantee is similar to a letter of credit – ignores the interdependency of the parent and subsidiary/affiliate described above. If a Market Participant’s letter-of-credit bank becomes uncreditworthy, it does not mean that the Market Participant’s default risk has increased: the latter simply replaces the letter of credit with one issued by a creditworthy bank. Further, banks are strictly regulated as to the maximum amounts of letters of credit, whereas a parent entity is subject to no such regulation regarding the amount it may guarantee for its subsidiary/affiliate.³¹

For the foregoing reasons, then, the Commission should reject the argument that the elimination of guarantees was unsupported by the ISO and NEPOOL. The Commission is well-justified in standing by its conclusion – in response to the support supplied by ISO and NEPOOL

³⁰ Rehearing Request, at 9-10.

³¹ The Rehearing Request’s assertion (at p. 10) that “all” of the state-regulated load serving utilities operating in New England accept corporate guarantees for their load auction is not supported by an affidavit, and is irrelevant. The ISO acknowledges that unsecured credit, such as guarantees, can play an appropriate role in bilateral trades (such as are structured through the load auctions), because a party can take steps to fully understand the credit risks posed by the counterparty and can make profit maximization and cost minimization decisions that best fit its corporate strategy, including the ability to hedge its counterparty credit exposure. However, the spot market is a vastly different context, as it does not offer individualized creditworthiness due diligence opportunities or the negotiation of varying price, terms and conditions based on creditworthiness levels. Accordingly, what is permitted in the bilateral trading context has no relevance in this proceeding.

– that the elimination of guarantees was “a reasonable way to further reduce the risk of default.”³²

³² Order, at P 80.

III. CONCLUSION

WHEREFORE, for the foregoing reasons, the ISO respectfully requests the Commission to accept this answer and deny the Rehearing Request.

Respectfully submitted,

/s/ Kerim P. May

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August 31, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in these proceedings.

Dated at Washington, D.C. this 31st day of August, 2010.

/s/ Pamela S. Higgins _____
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