UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Credit Reforms in Organized Wholesale Electric Markets	))))	**Docket No. AD20-6-000**

COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON ENERGY TRADING INSTITUTE REQUEST FOR TECHNICAL CONFERENCE AND PETITION FOR RULEMAKING

The California Independent System Operator Corporation (CAISO) submits these comments in response to the December 16, 2019, petition filed by the Energy Trading Institute (ETI) requesting the Commission to schedule a technical conference and open a rulemaking to update credit and risk management rules in the markets operated by Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) (ETI Filing).[1] As discussed below, the CAISO and other ISOs and RTOs previously responded to the ETI Filing through the comments of the ISO/RTO Council (IRC). The CAISO and other IRC members generally support efforts to ensure effective credit policies are in place for organized electricity markets, but do not support the relief ETI seeks. In these comments, the CAISO highlights certain considerations specific to the CAISO credit requirements and CAISO markets that reinforce why the Commission should decline to undertake the procedures proposed by ETI or

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[1] The CAISO submits these comments pursuant to Rule 211 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.211), and the notice issued in this proceeding on February 11, 2020. The CAISO separately submitted a motion to intervene in the proceeding on January 3, 2020.

establish new "one-size-fits-all" credit rules. The ETI Filing does not even mention the CAISO's credit policy, and ETI fails to show that any of the issues it raises apply to the CAISO or its markets. The CAISO's markets are unlikely to face the types of significant risks ETI cites, such as those associated with the 2018 financial default of GreenHat Energy, LLC (GreenHat), discussed in more detail below. The Commission has approved a number of enhancements to the CAISO markets that minimize credit risks.

Rather than the technical conference and rulemaking proposed by ETI, a more appropriate forum for ETI to voice any region-specific proposals for enhancing the CAISO credit policy is the CAISO's standing Credit Working Group. Although ETI has not chosen to participate in this working group to date, the CAISO stands ready to consider any issues ETI may raise in its Credit Working Group.

I. Comments

A. The IRC Response Provides the Most Effective and Efficient Approach to Addressing the Issues Raised by ETI

The CAISO previously joined other ISOs and RTOs[2] in filing the January 24, 2020 motion for leave to respond and response of the IRC to the ETI Filing (IRC Response). Although the IRC Response stated it is important to ensure that effective credit policies are in place in organized electricity markets, it did not support ETI's request that the Commission immediately initiate a process aimed

[2] ISO New England Inc., Midcontinent Independent System Operator, Inc., New York Independent System Operator, Inc., PJM Interconnection, L.L.C. (PJM), and Southwest Power Pool, Inc.

at standardizing ISO and RTO credit rules.[3] The IRC explained that the Commission should instead allow ISOs and RTOs to implement credit practices that best meet the specific needs of their respective markets. The IRC stated that some of those credit practices are already in place while others are being revised pursuant to ongoing ISO/RTO stakeholder processes and filings currently before the Commission.[4] The IRC stated that, at a minimum, ISOs and RTOs should be given time to gain experience with the revised credit practices recently approved by the Commission or currently under development before the Commission takes any steps towards standardization.[5] The IRC noted that its proposed approach is consistent with federal court guidance that "[i]n matters of administrative regulation, a month of experience may be worth a year of hearings."[6]

B. The Specific Risks ETI Cites Are Inapplicable to the CAISO

The CAISO continues to believe the IRC Response describes the appropriate way to address any concerns with ISO and RTO credit practices. The CAISO files these comments solely to address CAISO-specific matters. Notably, the ETI Filing does not raise any issues regarding the CAISO's credit policy or identify credit risks anticipated in the CAISO markets. Indeed, the ETI Filing only mentions the CAISO in passing, noting the CAISO took part in the

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[3] IRC Response at 3-4.

[4] *Id.* at 4-5.

[5] *Id.* at 5-6. On February 10, 2020, ETI filed a motion for leave to respond and response to the IRC Response.

[6] *Id.* at 4 (quoting *Pub. Serv. Comm'n for the State of N.Y. v. FPC*, 516 F.2d 746, 751 (D.C. Cir. 1975) (internal quotation marks omitted)).

discussions that ultimately resulted in the credit practice requirements set forth in Commission Order No. 741.[7]

The concerns expressed by ETI about ISO/RTO credit policies do not involve issues with the CAISO's credit policy or the CAISO markets. Rather, ETI asserts that a technical conference and rulemaking are needed due to the 2018 financial default of GreenHat and the evolution of the ISO/RTO markets since the issuance of Order No. 741.[8] ETI then suggests possible improvements to ISO/RTO credit and counterparty practices and procedures and raises potential questions for discussion at its requested technical conference.[9] These are inapplicable to the CAISO.

The GreenHat default involved risks that either are not applicable to or considerably lower in the CAISO. GreenHat defaulted on its financial obligations associated with a portfolio of sizable financial transmission rights (FTR) positions it acquired primarily through long-term auctions and that would remain open for a period of approximately three years. Starting in 2018, FTR positons were settled without payment from GreenHat in every hour of every day through May 31, 2021.[10] According to the GreenHat Report, which independent consultants

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[7] ETI Filing at 2 n.4 (discussing background on *Credit Reforms in Organized Wholesale Elec. Mkts.*, Order No. 741, FERC Stats. & Regs. ¶ 31,317, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320, *order on reh'g*, 135 FERC ¶ 61,242 (2011) (collectively, Order No. 741)). ETI's February 10, 2020 response does not mention the CAISO at all.

[8] ETI Filing at 1-4.

[9] *Id.* at 4-20 and appendix A.

[10] *PJM Interconnection, L.L.C.*, 165 FERC ¶ 61,188, at P 6 & n.7 (2018); Report of the Independent Consultants on the GreenHat Default, at 10-11 and appendix A at 7 (Mar. 26, 2019) (GreenHat Report), available at https://www.pjm.com/-/media/library/reports-notices/special-reports/2019/report-of-the-independent-consultants-on-the-greenhat-default.pdf. FTRs acquired through the long-term auction allowed GreenHat to maintain open positions for up to four years.

prepared at the request of PJM, a significant contributing factor in the GreenHat default was that PJM's credit policy assessed credit requirements for FTRs based entirely on historical information, which was reevaluated annually.[11] These circumstances do not exist in the CAISO.

The equivalents of FTRs under the CAISO market design are congestion revenue rights (CRRs). The CAISO tariff rules make it impossible for CRR positions acquired by market participants through a CRR auction to remain open for a period anywhere close to three years. The only types of CRRs available in the CAISO's auction are (1) monthly CRRs and (2) seasonal CRRs that have a term of three months.[12]

Low positive and negatively valued FTRs (*i.e.*, such CRRs in the CAISO) are the most risky instruments in organized energy markets. For all entities other than federal agencies, the CAISO credit policy determines credit requirements for a CRR auction for low and negatively valued CRRs based on the product of the CRR bid value and a credit margin.[13] Further, the CAISO determines credit

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GreenHat Report, appendix at 7. GreenHat acquired a relatively small portion of its FTR portfolio through PJM's annual auction for 2018 and bilateral transactions. GreenHat Report at 10-11.

[11] *Id.* at 13, 15, 18-19, and appendix A at 11-12. To address issues raised by the GreenHat default, PJM took actions that included seeking and obtaining Commission approval of revisions to the credit policy contained in the PJM tariff*.* *See, e.g.*, 165 FERC ¶ 61,188, at PP 33-38.

[12] CAISO tariff, sections 36.2.5 – 36.2.7, 36.13 *et seq.* The CAISO market design also includes long-term CRRs, which have a term of ten years, but long-term CRRs are not available through the CRR auction. *Id.*, section 36.2.7. They are only available through the CRR allocation process to load-serving entities that serve load internal to the CAISO balancing authority area (*id.*, section 36.8 *et seq.*) and to project sponsors of merchant transmission facilities that turn such facilities over to CAISO operational control and do not recover the cost of the transmission investment through a regulatory cost recovery mechanism (*id.*, section 36.11). GreenHat was not a load-serving entity or a project sponsor.

[13] Specifically, the maximum credit exposure of a positively valued CRR bid is the maximum value of the bid quantity (expressed in megawatts (MW)) multiplied by the sum of the bid price corresponding to the bid quantity and the credit margin of the CRR within the range of the minimum and maximum bid quantities submitted by the bidder. The maximum credit exposure of

requirements to hold CRRs acquired in an auction based on the most recent auction price for the CRR or the historical expected value of the CRR, whichever is lower, plus the credit margin for the CRR.[14] The CAISO reevaluates the credit requirements for holding CRRs, and adjusts those credit requirements accordingly, not less than monthly.[15] The CAISO may adjust the credit requirements for holding CRRs with terms of one year or less, which include all CRRs acquired in an auction, at the CAISO's discretion to account for changes in the monthly auction prices for CRRs and changes in the historical expected values for CRRs, or more frequently than monthly if the CAISO finds that actual or anticipated market conditions indicate that CRR credit requirements may be inadequate to cover the financial risk of the CRRs.[16] At the time of the GreenHat default, PJM used only historical values to set credit requirements.

In sum, these components of the CAISO market design serve to reduce the risk presented by the GreenHat default.[17] ETI fails to allege, much less demonstrate, that the issues it raises are relevant to the CAISO markets.

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a negatively valued CRR bid is the maximum bid quantity (in MW) submitted by the bidder multiplied by the credit margin of the CRR. *Id.*, section 12.6.2.1. The credit margin is based on a probability distribution of the congestion revenue of the CRR calculated using historical locational marginal price data (or proxy values until such data is available). *Id.*, section 12.6.3.4. For federal agencies, the CAISO determines CRR auction credit requirements pursuant to section 12.6.2.2 of its tariff.

[14] *Id.*, section 12.6.3.2. The historical expected value is based on one to three years of monthly historical market operation data for the applicable month. *Id.*, appendix A, definition of "Historical Expected Value".

[15] *Id.*, section 12.6.3(c).

[16] *Id.*

[17] The Commission has recognized that any ISO/RTO policy for offering credit to qualifying market participants involves risk: "In establishing credit policy, the role of an ISO is to balance the competing goals of minimizing risk to non-defaulting market participants (which could take the form of high collateral requirements) with low barriers to entry (low collateral requirements)." *Cal.*

Further, the CAISO's credit policy includes robust credit review provisions that allow its credit department personnel to evaluate whether market participants, including those that hold CRRs, are maintaining their creditworthiness. CRR holders are required at all times to maintain financial security amounts sufficient to cover their aggregate liabilities as estimated by the CAISO, and to provide additional financial security if needed to satisfy that requirement. The credit department will notify a CRR holder if at any time its estimated aggregate liability exceeds 90 percent of its financial security amount.[18] At any time, the CAISO may also request information and documents from any market participant regarding its risk management policies, procedures, and controls, including but not limited to information and documents regarding the liquidity of its financial resources and its settlement procedures. In addition, the CAISO annually selects, on a random basis, up to 10 percent of market participants that are not already subject to annual verification to provide risk policies, procedures, and guidelines demonstrating that they continue to satisfy the minimum requirements for participation in the CAISO markets, including capitalization requirements. Further, the CAISO may at any time select a market participant for review to determine whether it continues to satisfy the minimum

Indep. Sys. Operator Corp., 120 FERC ¶ 61,192, at P 33 (2007). The CAISO's credit policy appropriately addresses such risk.

[18] CAISO tariff, sections 12.4 and 12.6.3(b); CAISO Business Practice Manual for Credit Management & Market Clearing, sections 7.4.1 and 8.1 (BPM for Credit Management), available at https://bpmcm.caiso.com/Pages/BPMDetails.aspx?BPM=Credit%20Management%20and%20Market%20Clearing. A CRR holder's aggregate credit limit under the CAISO's credit policy equals its financial security amount and cannot include unsecured credit. CAISO tariff, sections 12.1(a) and 12.6.3(a).

participation requirements, based on risk factors that include, but are not limited to, the magnitude of the market participant's transactions or potential transactions, or the volume of the market participant's open positions in the CAISO markets.[19] These tariff provisions help to ensure that the CAISO maintains appropriate oversight of market participant credit risk.

Subsequent to the issuance of Order No. 741, the CAISO has also filed tariff revisions to enhance its CRR rules and benefit customers, including changes limiting the availability of certain types of CRRs. For example, under a tariff amendment the Commission accepted in 2018, the CAISO limited the combination of source and sink pairs that are eligible for CRR auctions to those pairs associated only with supply delivery.[20] In accepting that tariff amendment filing, the Commission found that:

> CAISO's proposal will help alleviate [its] persistent auction revenue shortfall by removing non-delivery source and sink pair CRRs that CAISO has demonstrated significantly contribute to the shortfall. CAISO's proposal should result in a CRR market that reduces the auction revenue shortfall, while still providing hedging opportunities. As CAISO explains, the primary purpose of its CRR market is to enable market participants to hedge congestion charges associated with supply delivery. CAISO's proposed framework provides all market participants an opportunity to obtain hedges for congestion costs associated with supply delivery transactions.[21]

This tariff change also service to reduce the volume of the riskier low and negatively priced CRRs. Further, the CAISO will continue to evaluate whether its CRR rules should be further enhanced pursuant to future tariff amendments. ETI

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[19] CAISO tariff, section 12.1(c); BPM for Credit Management, section 2.1.

[20] *See Cal. Indep. Sys. Operator Corp.*, 163 FERC ¶ 61,237, at P 62 (2018), *order on reh'g*, 168 FERC ¶ 61,105 (2019).

[21] 163 FERC ¶ 61,237, at P 62.

makes no allegation or showing that the CAISO's existing stakeholder initiative process is insufficient for this purpose.

C. The CAISO's Credit Working Group and Stakeholder Initiative Process Are the Appropriate Forums for ETI to Raise Credit Issues

The CAISO's standing Credit Working Group provides stakeholders with a forum for discussing the CAISO's credit practices and a means to propose policy enhancements before taking them to the larger stakeholder community through the CAISO's stakeholder initiative process.[22] Discussions in the Credit Working Group have led to the filing of revisions to the credit policy set forth in the CAISO tariff.[23] The CAISO commits to continue to work with the Credit Working Group to consider any future enhancements to its credit policy based on the specific risk profile of the CAISO markets.

The Credit Working Group comprises members from a broad range of electric industry sectors and includes market participant members who are credit and risk analysts and managers.[24] ETI or a subset of its participants are

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[22] The CAISO established the Credit Working Group pursuant to a Commission-approved offer of settlement that resolved all issues raised in a Commission complaint proceeding under section 206 of the Federal Power Act regarding the allocation of financial losses associated with defaults in the CAISO markets. *See Calpine Corp. v. Cal. Indep. Sys. Operator Corp.*, 133 FERC ¶ 63,006, at P 17 (2010) (order certifying uncontested settlement); *Calpine Corp. v. Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,097 (2011) (Commission letter order approving settlement).

[23] *See* transmittal letter for filing of CAISO tariff amendment to implement financial and credit policy enhancements, Docket No. ER13-471-000, at 1-2 (Nov. 29, 2012). The Commission accepted the revisions contained in that tariff amendment by letter order issued on January 29, 2013. *See also* transmittal letter for filing of CAISO tariff amendment to maintain effectiveness of default loss allocation tariff provisions, Docket No. ER16-305-000, at 7-8 (Nov. 10, 2015). The Commission accepted the revisions contained in that tariff amendment by letter order issued on February 2, 2016.

[24] The current members of the Credit Working Group are listed at http://www.caiso.com/Documents/CreditWorkingGroupMemberList.pdf#search=CreditWorkingGroupMemberList.

welcome to join the Credit Working Group, which provides them a platform to suggest enhancements to the CAISO's credit practices or comment on the suggestions of other Credit Working Group members.[25] To date, however, ETI has not joined the Credit Working Group. Similarly, if ETI wishes to suggest improvements to the credit practices of other ISOs and RTOs, the appropriate forums to make those suggestions are the stakeholder processes and any related working groups of specific ISOs and RTOs, and proceedings on tariff amendments submitted by the ISOs and RTOs.

For the reasons explained above, in addition to the reasons explained in the IRC Response, there is no need to establish a generally applicable technical conference or a subsequent rulemaking on credit issues for all ISOs and RTOs. The Commission has declined to grant requests for technical conferences in other proceedings where such requests have not been shown to be necessary.[26] The Commission should do the same here.

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[25] The Credit Working Group's review may include examination of any credit policy-related tariff revisions submitted by other ISOs and RTOs, to the extent the Commission accepts them for filing.

[26] *See, e.g.*, *Electric Storage Participation in Markets Operated by Regional Transmission Organizations and Independent System Operators*, Order No, 841, 162 FERC ¶ 61,127, at P 164 (2018) ("We also find a technical conference, as recommended by EEI, is unnecessary at this time given the existence of viable solutions to this issue identified by other commenters and given the flexibility that we provide each RTO/ISO and other market participants to address this issue."); *Cal. Indep. Sys. Operator Corp.*, 135 FERC ¶ 61,110, at P 22 (2011) ("Given CAISO's commitment to hold a stakeholder process, we find it unnecessary at this time to establish further proceedings, such as a technical conference.").

II. Conclusion

The CAISO requests that the Commission decline to grant ETI's request for technical conference and petition for rulemaking, and otherwise make findings consistent with the discussion in these comments and in the January 24, 2020, IRC Response.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing document has been served upon each person designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

Dated at Washington, D.C., this 12th day of March, 2020.

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