November 10, 2015

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

Re: California Independent System Operator Corporation
Docket No. ER16- ___-000

Filing to Maintain Effectiveness of Default Loss Allocation Tariff Provisions

Dear Secretary Bose:

The California Independent System Operator Corporation ("CAISO") submits this filing to maintain the effectiveness of existing provisions in its tariff regarding the allocation of financial default losses across all market participants.[1] The CAISO submits this filing in accordance with a settlement agreement the Commission approved in Docket No. EL09-62, which required the CAISO to submit a filing either to request that the effectiveness of these tariff provisions be maintained beyond February 11, 2016, or to file amendments to modify or replace the default loss allocation tariff provisions. Based on the justness and reasonableness of the existing approach as well as unanimous stakeholder comments supporting maintenance of the existing approach and the absence of any stakeholder proposals to modify it, the CAISO respectfully requests that the Commission issue an order that accepts this filing and maintains the effectiveness of the current tariff provisions.

I. Background

A. Commission Proceedings Related to the Settlement Agreement

From the start of CAISO operations in 1998, the CAISO tariff included provisions under which the CAISO would allocate financial losses associated

[1] The CAISO submits this filing pursuant to section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d.

with defaults in its markets ("default losses") to net CAISO creditors only. On June 30, 2009, a coalition of net sellers filed a complaint in Docket No. EL09-62 to replace those CAISO tariff provisions with a proposed alternative default loss allocation rule.

On September 23, 2009, the Commission issued an order finding that the CAISO's existing default loss rule was unjust and unreasonable but that the complainants had not satisfied their burden to demonstrate that their proposed alternative was just and reasonable.[2] The Commission stated that "because all market participants benefit from their participation in liquid ISO/RTO [independent system operator/regional transmission organization] markets, it would be equitable for a default loss allocation rule to apply to all market participants."[3] The Commission explained that, in addressing credit policies proposed by other ISOs and RTOs, "one consistent theme has been that ISOs and RTOs should establish credit policies that minimize the risk of defaults on all market participants," and that the CAISO's default loss rule did not sufficiently minimize that risk.[4] The Commission went on to state that, "While the details of their respective mechanisms differ, other ISOs/RTOs allocate default losses to both buyers and sellers. Although the CAISO and others are correct that we have not prescribed a one-size-fits-all approach to default loss rules in organized markets," the CAISO could not continue to require only net CAISO creditors to bear the risk of default losses.[5] The Commission also noted its previous finding that "those who benefit most from activity in the [ISO/RTO] markets should pay a larger share of default costs" and "the connection between the benefits a member experiences and the level of costs shared is a logical one."[6] The Commission established hearing and settlement judge procedures to address the issue of a revised default loss rule for the CAISO.[7]

A settlement judge was assigned in Docket No. EL09-62, and a series of fourteen in-person or telephonic settlement conferences was held over a period of almost a year, from October 2009 through September 2010. Nearly thirty parties actively participated in these settlement discussions. The settlement

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2 *Calpine Corp. v. Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,271, at P 39 (2009) ("September 2009 Order").

3 *Id.* at P 42.

4 *Id.* at P 44.

5 *Id.* at P 46.

6 *Id.* (quoting *PJM Interconnection, L.L.C.*, 108 FERC ¶ 61,116, at P 5 (2004)).

7 *See id.* at P 50.

conferences and related discussions among the active participants resulted in a settlement agreement that the CAISO filed, on behalf of itself and the other settling parties, on October 1, 2010. The settlement agreement included proposed CAISO tariff provisions to implement the new default loss allocation methodology set forth in the settlement agreement, which would allocate the risk of default losses to all market participants based on agreed-upon metrics representing their shares of market participation.

The settlement judge certified the settlement agreement as an uncontested settlement on November 10, 2010.[8] On February 11, 2011, the Commission issued an order approving the settlement agreement.[9] Pursuant to a provision in the settlement agreement and a directive in that Commission order,[10] the CAISO subsequently filed a tariff amendment in Docket No. ER11-2996 to incorporate the tariff provisions attached to the settlement agreement. The Commission accepted the tariff provisions in a delegated letter order issued on June 21, 2011.

B. Relevant Provisions of the Settlement Agreement

Section 2.2 of the settlement agreement states that the CAISO tariff provisions attached to the agreement will go into effect as of the April 1, 2009, trading day, and will expire as of the fifth anniversary of the date the Commission issues an order accepting the settlement agreement (*i.e.*, as of February 11, 2016), unless the effectiveness of the tariff provisions is maintained as described in section 2.3 of the agreement.

Section 2.3 requires that, no later than six months prior to the fifth anniversary of the date the Commission issues an order approving the settlement agreement (*i.e.*, by August 11, 2015), the CAISO must begin a stakeholder process to examine whether there is a need to modify or replace the default loss allocation tariff provisions. Section 2.3 also requires that, upon conclusion of the stakeholder process, and at least three months prior to the fifth anniversary of the date the Commission issues an order approving the settlement agreement (*i.e.*, by November 11, 2015), the CAISO must make a filing pursuant to section 205 of the FPA either to request that the effectiveness of the tariff provisions be maintained or to file amendments to modify or replace them.

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8 *Calpine Corp. v. Cal. Indep. Sys. Operator Corp.*, 133 FERC ¶ 63,006 (2010).

9 *Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,097 (2011).

10 *See id.* at P 3.

C. Stakeholder Process on the Extension of the Default Loss Allocation Tariff Provisions

In accordance with section 2.3 of the settlement agreement, the CAISO timely began a stakeholder process to examine whether there is a need to modify or replace the existing default loss allocation tariff provisions.[11] The CAISO announced the stakeholder process on August 4 and held a web conference meeting with stakeholders on August 11, 2015, at which the CAISO proposed to maintain the existing tariff provisions without modification. The CAISO also solicited written stakeholder comments on the matter. The four stakeholders that submitted written comments all supported maintaining the existing tariff provisions.

II. The Existing Tariff Provisions Should Remain in Effect

The Commission should maintain the effectiveness of the existing tariff provisions. Consistent with the principles discussed in the September 2009 Order quoted above, the tariff provisions are just and reasonable because they allocate the risk of default losses to all market participants based on metrics that represent their market participation. Under the CAISO's approach, each market participant bears a risk of default losses in proportion to the benefits it receives from its activity in the CAISO markets.[12]

Specifically, tariff section 11.29.17.2.1 allocates each payment default amount that remains unpaid by a defaulting CAISO debtor on the next practicable invoices to default-invoiced scheduling coordinator identification codes ("SCIDs"),[13] excluding the CAISO debtor that has not paid the payment default amount, using the following methodology:

- Twenty (20) percent of the payment default amount is allocated to the default-invoiced SCIDs in proportion to the net amounts that were payable in each applicable calendar quarter (and averaged within such calendar quarter) to the default-invoiced SCIDs over the applicable default look-back periods.[14]

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11 Materials related to the stakeholder process are available on the CAISO website at http://www.caiso.com/informed/Pages/StakeholderProcesses/PaymentDefaultAllocation.aspx.

12 *See* September 2009 Order at P 46.

13 Default-invoiced SCIDs are the SCID(s) selected by an entity pursuant to the default election procedures set forth in the tariff that are to be allocated a portion of any payment default amount pursuant to the tariff. Tariff appendix A, definition of "Default-Invoiced SCID(s)"; see also tariff section 11.29.17.2.4 (setting forth default election procedures).

14 Default look-back periods are the retrospective time periods determined pursuant to the

- Thirty (30) percent of the payment default amount is allocated to the default-invoiced SCIDs in proportion to the sum of the absolute values of the dollar amounts shown on their invoices payable or receivable in each applicable calendar quarter (and averaged within such calendar quarter) over the applicable default look-back periods, after excluding dollar amounts shown on the invoices for payments and charges for grid management charges, reliability must-run services, and wheeling access charge costs, and after excluding the billing of access charges and the payment of transmission revenue requirements to participating transmission owners.

- Fifty (50) percent of the payment default amount is allocated to the default-invoiced SCIDs in proportion to the largest of the following five (5) amounts calculated in megawatt-hours for every month in each applicable calendar quarter (and averaged within such calendar quarter) for each default-invoiced SCID over the applicable default look-back periods:

  (1) Cleared day-ahead schedules to supply energy, plus day-ahead ancillary services awards and qualified self-provided ancillary services, plus scheduled supply obligation for ancillary services (including imports but excluding residual unit commitment schedules), plus virtual supply awards;

  (2) Metered generation, plus real-time interchange import schedules, plus real-time ancillary services awards and qualified self-provided ancillary services, plus fifteen-minute market ancillary services awards and qualified self-provided ancillary services, plus real-time supply obligation for ancillary services;

  (3) Cleared day-ahead schedules for demand (including demand served by pumped-storage hydro units and exports) multiplied by one-hundred three (103) percent to reflect transmission losses, plus scheduled demand obligation for ancillary services, plus virtual demand awards;

  (4) Metered load multiplied by one-hundred three (103) percent to reflect transmission losses, plus real-time interchange export schedules, plus real-time demand obligation for ancillary services; or

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tariff for the purpose of allocating payment default amounts. Tariff appendix A, definition of “Default Look-Back Period.” Each default look-back period consists of the most recent four (4) full calendar quarters for which data published on the fifty-fifth business day after the relevant trading day (T+55B) is available. Tariff section 11.29.17.2.6(d).

(5) The greater of (A) the quantity of congestion revenue rights ("CRRs") acquired in CRR auctions or transferred through the secondary registration system (excluding CRRs acquired in CRR allocations) or (B) inter-scheduling coordinator trades of energy.

In sum, the tariff provisions allocate the risk of default losses to all market participants based on specified weighted metrics that represent the components of their market participation over the applicable default look-back periods.[15]

This allocation of default risk across all market participants based on their market participation minimizes the risk of disproportionate impact of a default by fairly spreading the risk over all market participants, consistent with the principles articulated in the September 2009 Order.[16] Of course, the CAISO also has strong credit policies to minimize the risk of a default, including the requirement for each market participant to have sufficient financial security to meet its estimated aggregate liability, limited reliance on unsecured credit, a credit risk adder applied to low- and negatively valued congestion revenue rights, and a pre-market credit check for virtual bids.[17] As was true in 2009, there are differences among the default loss allocation provisions of other ISOs/RTOs,[18] but as the Commission has explained, it does not require a one-size-fits-all approach and the CAISO now stands with other ISOs/RTOs in having a default allocation methodology that spreads the default risk broadly across the market.[19] The CAISO's tariff provisions remain just and reasonable because, like the tariff provisions of other ISOs/RTOs, they allocate the risk of default losses to all market participants based on their market participation.

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[15] Section 11.29.17.2.4 allows market participants that meet certain criteria to elect whether to consolidate data among multiple related SCIDs assigned to the same market participant for purposes of applying the default loss allocation methodology. Otherwise, the default loss allocation methodology applies to each SCID of a market participant on an SCID-by-SCID basis.

[16] *See* September 2009 Order at P 44.

[17] *See* tariff sections 12.1, 12.1.1, 12.6.3.1, 12.8.1.

[18] *Cf.* ISO New England Inc. Transmission, Markets and Services Tariff, Section I, Exhibit 1D – ISO New England Billing Policy, §§ 3.3(h)-(j), 3.4(f)-(h); Midcontinent Independent System Operator, Inc., FERC Electric Tariff, § 7.4(b), 7.8(b), 7.10; New York Independent System Operator, Inc., Open Access Transmission Tariff, Attachment U, § 27.3; PJM Interconnection, L.L.C., Operating Agreement, §§ 15.2-15.2.2; Southwest Power Pool, Open Access Transmission Tariff, Attachment L, §§ V.C.1, V.C.3, V.D.1.

[19] September 2009 Order at P 46.

In addition, the CAISO tariff provisions ensure that each market participant has information to understand its current exposure to default loss risk. Section 11.29.17.2.7 of the CAISO tariff requires the CAISO to provide each default-invoiced SCID with its own percentage share of any payment default amount that may be allocated in the calendar quarter to which the percentage share applies. This provides market participants with information they can use to assess their risk of default exposure in the CAISO's markets.

These tariff provisions reflect an appropriate and balanced compromise among different segments of market participants that bear the risk of any default loss. Moreover, the default loss allocation proposal was the result of lengthy negotiations among all interested parties over the course of nearly a year. In other words, the current tariff provisions resulted from an extremely robust stakeholder process.

Subsequent events have not provided any reason to question the continued justness and reasonableness of the default loss allocation tariff provisions. Although the CAISO occasionally receives late payments, there have been no payment defaults that have triggered the tariff provisions. As required by the settlement agreement, the CAISO has provided and continues to provide interested parties with the default loss allocation percentages that would apply if the tariff provisions were triggered.[20] The CAISO also has convened a Credit Working Group to consider related CAISO credit practices, but no stakeholder has raised issues with the current default loss allocation rules in that working group or in any other CAISO stakeholder process.[21] Indeed, in the stakeholder process to examine whether the default loss allocation tariff provisions need to be modified or replaced, all four stakeholders that provided written comments supported maintaining the tariff provisions and no stakeholder raised any concerns during the stakeholder meeting.

For all these reasons, the existing default loss allocation tariff provisions should remain in effect. Because the CAISO proposes to maintain the existing tariff provisions, the CAISO is submitting new eTariff records with an effective

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[20] Section 2.5.1 of the settlement agreement requires the CAISO to provide each party in Docket No. EL09-62 as of the date the settlement agreement was filed and that has executed a non-disclosure certificate with aggregate information on a quarterly basis regarding the default loss allocation percentages that would apply if the tariff provisions were triggered, for purposes of monitoring the settlement.

[21] Section 2.6 of the settlement agreement requires the CAISO to organize a stakeholder working group within ninety days of a Commission order approving the settlement that will meet at least quarterly to consider enhancements to the CAISO's credit practices ("Credit Working Group"), including additional credit risk data to be included in the periodic public reports on credit issues to the CAISO Governing Board.

date of February 11, 2016 without any changes to the language of the existing default loss allocation tariff provisions. Attachment A to this filing identifies the relevant tariff sections with default loss allocation provisions.

III. Communications

Correspondence and other communications regarding this filing should be directed to:

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IV. Service

The CAISO has served copies of this filing on the California Public Utilities Commission, the California Energy Commission, and all parties with scheduling coordinator agreements under the CAISO tariff. The CAISO has also served copies of this filing on the official service list in Docket No. EL09-62. In addition, the CAISO has posted a copy of the filing on the CAISO website.

V. Conclusion

For the reasons set forth in this filing, the CAISO respectfully requests that the Commission issue an order that accepts this filing and maintains the effectiveness of the existing default loss allocation tariff provisions beyond February 11, 2016.

Respectfully submitted,

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Attachment A – List of Tariff Sections with Default Loss Allocation Provisions

Filing to Maintain Effectiveness of Default Loss Allocation Provisions

November 10, 2015

California Independent System Operator Corporation

<u>CAISO Tariff Sections with Default Loss Allocation Provisions</u>

11.29.9.6.2.1 Replenishing the CAISO Reserve Account Following Payment Default.

11.29.10.3 Other Invoicing Provisions.

11.29.13.1 Notification and Interest.

11.29.13.10 Application of Funds Received.

11.29.17 Alternative Payment Procedures (including all subsections)**.**

13.5.3.2 Residual Amounts.

The following definitions from Appendix A, the Master Definition Supplement:

Default Election

Default-Invoiced SCID(s)

Default Look-Back Period

Real-Time Interchange Import Schedule