

138 FERC ¶ 61,181  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Philip D. Moeller, John R. Norris,  
and Cheryl A. LaFleur.

California Independent System  
Operator Corporation

Docket No. ER11-3973-002

ORDER ON COMPLIANCE FILING

(Issued March 15, 2012)

1. On December 14, 2011, California Independent System Operator Corporation (CAISO) submitted a filing in compliance with the Commission's September 15, 2011 order.<sup>1</sup> The Initial Compliance Order accepted the revised tariff sheets, subject to a further compliance filing, to be effective October 1, 2011. In this order, we conditionally accept CAISO's proposed revisions, to become effective April 30, 2012 and direct CAISO to submit a compliance filing within 60 days of the issuance of this order, as discussed below.

**I. Background**

2. In Order No. 741, the Commission adopted reforms to strengthen the credit policies used in organized wholesale electric power markets.<sup>2</sup> Citing its statutory responsibility to ensure that all rates charged for the transmission or sale of electric energy in interstate commerce are just, reasonable, and not unduly discriminatory or preferential,<sup>3</sup> the Commission directed regional transmission organizations (RTO) and independent system operators (ISO) to revise their tariffs to reflect the following reforms:

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<sup>1</sup> *Cal. Indep. Sys. Operator Corp.*, 136 FERC ¶ 61,194 (2011) (Initial Compliance Order).

<sup>2</sup> *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, FERC Stats. & Regs. ¶ 31,317 (2010), *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320, *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

<sup>3</sup> 16 U.S.C. §§ 824d, 824e (2006).

implementation of shortened settlement timeframes, restrictions on the use of unsecured credit, elimination of unsecured credit in all financial transmission rights (FTR) or equivalent markets, clarification of legal status to continue the netting and set-off of transactions in the event of bankruptcy,<sup>4</sup> establishment of minimum criteria for market participation, clarification regarding the organized markets' administrators' ability to invoke "material adverse change" clauses to demand additional collateral from market participants, and adoption of a two-day grace period for "curing" collateral calls. The Commission directed each RTO and ISO to submit tariff changes by June 30, 2011, with an effective date of October 1, 2011.

3. On June 30, 2011, CAISO submitted a compliance filing addressing these credit reform issues, which the Commission conditionally accepted in the Initial Compliance Order. In the Initial Compliance Order, the Commission generally accepted CAISO's proposed tariff revisions to eliminate the use of unsecured credit in its congestion revenue rights (CRR) market, but also directed CAISO to address an issue raised by the Western Area Power Administration (WAPA). In particular, the Commission directed CAISO to revise section 12.6 of its tariff to state that a federal agency can demonstrate financial security by submitting a letter to CAISO that: (1) attests that the federal agency is lawfully authorized to participate in the CRR market and that any debt it incurs due to its participation in the CRR market is a debt of the United States; (2) identifies its current year appropriations from Congress; and (3) verifies that the amount of its appropriations is sufficient to meet the credit requirements in section 12.1 of the CAISO tariff.<sup>5</sup>

4. The Commission also conditionally accepted CAISO's minimum participation criteria as consistent with the Commission's directive in Order No. 741, and as just and reasonable and not unduly discriminatory. However, the Commission found that CAISO's proposal to require each prospective or existing market participant to submit an officer-certified statement as part of its certification process on an annual basis was insufficient to ensure the protection of the market, and required it to engage in independent periodic compliance verification to minimize risk to the market.<sup>6</sup> Specifically, the Commission required CAISO to add a verification component to its certification process in order to ensure that risk management policies and procedures are actually being implemented and that adequate capitalization is being maintained.<sup>7</sup> The

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<sup>4</sup> The Commission extended the deadline for complying with this requirement to April 30, 2012. Accordingly, the Commission will address compliance with this requirement in a separate order.

<sup>5</sup> Initial Compliance Order, 136 FERC ¶ 61,194 at P 27.

<sup>6</sup> *Id.* P 49 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 131).

<sup>7</sup> *Id.*

Commission directed CAISO to submit a compliance filing addressing these issues within 90 days of the date of the Initial Compliance Order.

## **II. Notice of Filing and Responsive Pleadings**

5. Notice of CAISO's filing was published in the *Federal Register*, 76 Fed. Reg. 80,356 (2011), with interventions and protests due on or before January 4, 2012. Motions to intervene and protests were timely filed by: the City of Santa Clara, California, doing business as Silicon Valley Power (SVP); Financial Institutions Energy Group; J.P. Morgan Ventures Energy Corporation and BE CA LLC (J.P. Morgan); Morgan Stanley Capital Group Inc., Macquarie Energy LLC and DB Energy Trading LLC (collectively, Indicated Participants); and WAPA. CAISO filed an answer on January 19, 2012.

## **III. Discussion**

### **A. Procedural Matters**

6. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), the timely, unopposed motions to intervene serve to make those entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2011), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the CAISO Answer because it has provided information that assisted us in our decision-making process.

### **B. Substantive Matters**

#### **1. Risk Management Verification Process**

##### **a. Filing**

7. CAISO proposes to revise section 12.1(ii) of its tariff to require existing and prospective market participants to submit their risk management policies, procedures, and controls applicable to CRR trading activities to CAISO for review and verification on an annual basis, so long as the market participant has a CRR portfolio that meets the applicable risk criterion set forth in CAISO's Business Practice Manuals (BPM).<sup>8</sup> CAISO also revises section 12.1 to state that it may request information from market participants regarding their risk management policies, procedures, and controls at any time, subject to review and verification. If the market participant does not provide the

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<sup>8</sup> CAISO Transmittal Letter at 4.

requested information within the time period specified in CAISO's request, the proposed tariff language states that CAISO may take enforcement actions pursuant to section 12.5 of its tariff. The tariff revisions CAISO proposes state that CAISO may review and verify this information with or without an independent third party at its discretion, subject to the applicable confidentiality and non-disclosure restrictions, and will treat all information collected from market participants pursuant to proposed section 12.1 as confidential. Lastly, CAISO states that it has proposed minor clarifying revisions to the organization of section 12.1(i).

**b. Protests**

8. Financial Institutions Energy Group, J.P. Morgan, and Indicated Participants argue that the Commission should exempt from verification requirements any market participant whose CAISO market-related risk management practices are subject to the regulation, supervision, and audit by certain banking regulators.<sup>9</sup> They argue that the regulation undertaken by such banking regulators is more sophisticated and comprehensive than that which CAISO will conduct and, therefore, should suffice for a determination by CAISO that the necessary risk management policies and procedures are implemented.<sup>10</sup> Financial Institutions Energy Group and Indicated Participants assert that the risk management processes proposed by CAISO would be duplicative; result in unnecessary costs for CAISO and its market participants that outweigh the benefits; and create the possibility of conflicting regulation. Therefore, Financial Institutions Energy Groups and Indicated Participants request that the Commission require CAISO to exempt entities that are subject to the oversight and audit by such banking regulators from CAISO's periodic verification and audit of risk management policies and procedures.<sup>11</sup>

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<sup>9</sup> Financial Institutions Energy Group refers to the Federal Reserve Board as well as the Office of the Comptroller of the Currency as examples of such banking regulators. Financial Institutions Energy Group Protest at 4 & n.8 (citing *UBS AG*, 105 FERC ¶ 61,078, at P 8 n.6 (2003)). Indicated Participants refer to the Federal Reserve Board, or similar foreign regulator, that complies with applicable Basel Standards and/or certain exchange risk requirements. Indicated Participants Protest at 4.

<sup>10</sup> Financial Institutions Energy Group adds that the Commission has granted regulated entities certain limited exemptions from Commission regulations because they are subject to oversight by the Federal Reserve Board and other banking regulators. *Id.* at 6 (citing *Transactions Subject to Section 203 of the FPA*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006)).

<sup>11</sup> *Id.* at 4-5; Financial Institutions Energy Group Protest at 7.

9. Indicated Participants also request that the Commission direct CAISO to adopt certain minimum standards in the compliance verification process to avoid potential duplication and inefficiencies. Indicated Participants contend that the Commission should direct CAISO to adopt a proposal similar to that proposed by the New York Independent System Operator, Inc. (NYISO). Specifically, Indicated Participants request that the Commission direct CAISO to adopt the following approach as to the frequency of verification: (1) recognize successful verification by another RTO or ISO that applies substantively similar evaluation criteria as satisfying any applicable verification requirement; and (2) once verified, a market participant will be subject to subsequent verification only if the market participant materially changes its risk management policies or experiences a material adverse change, provided that such market participant must inform CAISO of any material change to its risk management policies. Indicated Participants argue that, other than the reasons listed, there is no cognizable reason to require additional verification of a market participant.<sup>12</sup> Furthermore, Indicated Participants assert that the evaluation criteria proposed by each of the RTOs and ISOs are substantially similar so that each RTO and ISO could reasonably rely on a verification determination by another RTO or ISO. They argue that any duplicative verification is unnecessary and inefficient, and should be avoided.<sup>13</sup>

10. Indicated Participants argue that the Commission should extend certain time periods in the verification process. They express concern that some of the time periods proposed by the RTOs and ISOs overly compress the window for market participants to comply with the RTO or ISO directive. Specifically, Indicated Participants request that the Commission direct CAISO to provide market participants with at least 14 days from the receipt of a notice of a request for submission of documentation to submit their risk management policies. Indicated Participants also argue that the Commission should require CAISO to adopt a 55-day cure period to fix any deficiencies in its risk management policies submission (similar to ISO New England Inc.'s proposal).<sup>14</sup>

11. In addition, Indicated Participants contend that CAISO should revise its proposal to provide a market participant that receives a negative determination regarding verification with at least an additional 14 days from the date the relevant cure period expires to appeal the negative determination to the Commission. They explain that a market participant will have to file an appeal with the Commission as soon as it receives an initial negative determination notice, regardless of whether the market participant is confident that it can address the concerns identified and receive its verification prior to

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<sup>12</sup> Indicated Participants Protest at 6-7.

<sup>13</sup> *Id.* at 7.

<sup>14</sup> *Id.* at 9.

expiration of the cure period. To avoid unnecessary appeals and to provide market participants with certainty, Indicated Participants argue that the Commission should direct CAISO to modify their proposals to allow for this additional time to file an appeal with the Commission.<sup>15</sup>

12. Finally, Indicated Participants argue that the Commission should direct CAISO to clarify that they will include a written explanation of why it is unable to complete a satisfactory verification of the market participant's risk management policies when it first notifies the market participants of a deficiency in verification and before the cure period begins. They explain that, without a written explanation, a market participant will be unable to effectively respond with additional evidence or properly characterize the basis of any appeal to the Commission.<sup>16</sup>

13. J.P. Morgan asks the Commission to direct CAISO to incorporate certain elements of its proposed certification and verification process into its tariff. Specifically, J.P. Morgan asserts that CAISO should include the applicable risk criteria in its tariff and attach its verification form, which is currently posted on its website, to its tariff as an appendix so that stakeholders and the Commission have the opportunity to review and approve the principles and standards. In addition, J.P. Morgan requests that CAISO incorporate certain language from its BPM into current tariff section 12.1 to clarify that disputes regarding a market participant's satisfaction of the minimum participation requirements are subject to the dispute resolution provisions described in section 13 of the CAISO tariff.<sup>17</sup>

14. SVP asserts that the Commission should direct CAISO to apply less burdensome verification requirements to load-serving entities that use CRR positions to hedge congestion, rather than speculate,<sup>18</sup> by exempting market participants that answer "yes" to either question 3(b)(i) or (ii) from meeting the section 3(a) requirements in CAISO's officer certification form.<sup>19</sup> SVP argues that CAISO's public data demonstrates that the

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<sup>15</sup> *Id.* at 8, 10.

<sup>16</sup> *Id.* at 10.

<sup>17</sup> J.P. Morgan Comments at 6-9.

<sup>18</sup> Specifically, SVP asks that CAISO provide a less burdensome certification process for entities that participate only in the allocation CRR process, or who limit their participation in the auction process to only unwinding previously allocated CRR positions. SVP Protest at 6.

<sup>19</sup> *Id.* at 8-9.

potential for CRR auction participants to take on riskier positions than CRR allocation participants is much greater. SVP attributes this difference in risk level to the fact that CRR allocation participants settle CRRs at load aggregation points instead of specific resource locations used by CRR auction participants. In support of its request, SVP references a recent PJM Interconnection, L.L.C. (PJM) proceeding in which it contends that the Commission approved different levels of certification requirements for load-serving entities and financial speculators.<sup>20</sup> Here, SVP argues that it would be discriminatory for CAISO not to implement a similarly-tiered verification process that differentiates between market participants that face dissimilar risk levels. SVP clarifies that such an exemption would not affect the security requirements that hedging load-serving entities face, but rather present them with lesser verification requirements.<sup>21</sup>

**c. CAISO Answer**

15. CAISO argues that most of the protesters' arguments are beyond the scope of the Initial Compliance Order's directives or have already been addressed by the Commission in previous orders.<sup>22</sup> CAISO, however, does address certain issues raised by J.P. Morgan and SVP in their respective pleadings.

16. CAISO objects to J.P. Morgan's request to add additional language to section 12.1 of its tariff regarding the dispute resolution procedures contained in section 13, claiming that incorporating such language would be redundant and unnecessary. CAISO clarifies that the provisions in section 13 of its tariff already contemplate dispute resolution procedures and already apply to the tariff generally, which includes the certification and verification procedures and related enforcement actions.<sup>23</sup> CAISO adds that incorporating additional language would be superfluous and potentially confusing, further noting that it has already added the language J.P. Morgan references to its BPM. Lastly, CAISO notes that the Commission did not direct CAISO to include this language in the Initial Compliance Order; thus, CAISO argues, J.P. Morgan's request is beyond the scope of this proceeding.

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<sup>20</sup> *Id.* at 9 (citing *PJM Interconnection, LLC.*, 136 FERC ¶ 61,190 (2011) (PJM Compliance Order)).

<sup>21</sup> *Id.* at 9-10.

<sup>22</sup> CAISO Answer at 2.

<sup>23</sup> *Id.* at 3.

17. CAISO states that SVP's proposed tariff revisions are unnecessary and beyond the scope of this proceeding.<sup>24</sup> CAISO argues that SVP's request that CAISO submit its officer certification form and revisions to its BPM to the Commission for informal review is unnecessary because both items are already posted on its website and the Commission did not direct CAISO to submit either item in the Initial Compliance Order. Regarding SVP's request that CAISO revise its officer certification form to hold load-serving entities that hedge congestion, rather than speculate, to lesser verification requirements, CAISO argues that such action is beyond the scope of this proceeding, as the Initial Compliance Order does not contain directives concerning this issue. In addition, CAISO asserts that there should be no difference in the standard of review that it applies to different types of existing or prospective CRR holders due to the inherent risks associated with the CRR market.<sup>25</sup> Thus, CAISO holds that the Commission should reject SVP's protests as beyond the scope of this proceeding.

**d. Commission Determination**

18. In the Initial Compliance Order, the Commission directed CAISO to develop a compliance verification process that will allow it to independently verify that risk management policies and procedures are actually being implemented and that adequate capitalization is being maintained. We find that CAISO's proposed compliance verification process complies with the Initial Compliance Order and is just and reasonable and not unduly discriminatory or preferential. However, we find that CAISO's proposal requires further clarification; therefore, we conditionally accept the proposal to be effective April 30, 2012, and direct CAISO to submit a compliance filing within 60 days of the issuance of this order, as discussed below.

19. CAISO proposes to require market participants and prospective market participants that have CRR portfolios that meet certain risk criteria to annually submit to CAISO, for its review and verification, risk management policies, procedures, and controls applicable to CRR trading activities. In addition, CAISO proposes to obtain this information and documentation from any prospective and existing market participants at any given time. However, CAISO does not explain when and how often it will request information from these market participants to verify that their risk management policies, procedures, and controls are in compliance. CAISO does not explain why only certain market participants that have CRR portfolios should be subject to annual verification, while other market participants are subject to verification at CAISO's discretion. In addition, CAISO does not include in its tariff the applicable risk criteria it will apply to verify that a market participant's risk management policies, practices, and procedures are

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<sup>24</sup> *Id.* at 3-4.

<sup>25</sup> *Id.* at 4.

in compliance. Rather, CAISO lists eight criteria that it will apply for its ongoing review and verification process in section 2.1 of its BPM for Credit Management. We find that the risk criteria used to verify compliance affect rates, terms and conditions of service and, therefore, must be filed as a part of CAISO's tariff.<sup>26</sup> Accordingly, we direct CAISO to submit a further compliance filing to clarify when and how often it will conduct verification of all market participants and to revise its tariff by incorporating the risk criteria detailed in section 2.1 of its BPM for Credit Management.

20. We reject Financial Institutions Energy Group's and Indicated Participants' request for an exemption for market participants that are regulated by banking regulators, such as the Federal Reserve Board, from CAISO's compliance verification policies and procedures. In Order No. 741, the Commission directed all RTOs and ISOs to adopt minimum participation criteria, but explicitly left it to each RTO and ISO and its stakeholders to develop minimum participation criteria that are applicable to its markets.<sup>27</sup> In this filing, CASIO did not propose to wholly exempt any particular class or group of market participants based on their being regulated by banking regulators from the compliance verification process and we are not persuaded to require it to adopt such an exemption. As we explained in the Initial Compliance Order, RTOs and ISOs are responsible for administering and otherwise overseeing their markets and we will not require them to delegate their responsibility to verify compliance with minimum participation criteria to another entity.<sup>28</sup>

21. Similarly, we decline to require CAISO to adopt Indicated Participants' proposal regarding when and how often CAISO will verify a market participant's compliance with risk management policies and practices. We find that annually verifying certain market participants and prospective market participants is reasonable. In addition, we find it appropriate to allow CAISO some flexibility with respect to how often it will conduct verifications within the annual review process. Similarly, we will not direct CAISO, as urged by Indicated Participants, to recognize successful verification by another RTO or ISO as satisfying its own risk management policies. Although the compliance verification processes between RTOs and ISOs may be similar, each RTO and ISO has adopted risk management policies and procedures that are appropriate for its particular market. Thus, we will not require CAISO to adopt Indicated Participants' proposal.

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<sup>26</sup> See *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985).

<sup>27</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 132-133, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33.

<sup>28</sup> Initial Compliance Order, 136 FERC ¶ 61,194 at P 48.

22. Further, we will not require CAISO to adopt certain practices and time periods as proposed by Indicated Participants. We disagree that a market participant needs at least 14 days to gather information regarding its risk management policies and procedures in response to a request from CAISO. We expect that a market participant that has implemented its risk management policies and procedures and maintained adequate capitalization will have the necessary documentation readily obtainable. Further, we will not require CAISO to adopt a 55-day cure period for market participants to cure any deficiency in its risk management policies and procedures. The compliance verification process is to ensure that market participants have implemented the appropriate risk management procedures and remain adequately capitalized. We expect that market participants will be able to cure any deficiencies in the time proposed by CAISO, and find that the cure period proposed by CAISO is reasonable. In addition, we will not require CAISO to revise its proposal to include an additional 14 days from the date the cure period expires to appeal a negative determination to the Commission. If a market participant disagrees with CAISO's determination, it should have sufficient information to appeal to the Commission at that time.

23. Finally, though, we require CAISO to provide a written explanation for any noted deficiencies in a market participant's risk management and policies.<sup>29</sup>

24. In the Initial Compliance Order, the Commission found that section 12.1 of CAISO's tariff, without the inclusion of its certification form or applicable risk criterion, was just, reasonable, and not unduly discriminatory or preferential.<sup>30</sup> We continue to find that section 12.1, without these items, complies with the directives of both Order No. 741 and the Initial Compliance Order. We also find that J.P. Morgan's request to revise section 12.1 of CAISO's tariff to specifically reference the dispute resolution procedures contained in tariff section 13 is unnecessary. We agree with CAISO that adding J.P. Morgan's suggested language would be redundant and potentially confusing, as CAISO has already included such information in its tariff and BPM. Furthermore, the Initial Compliance Order did not direct CAISO to explicitly cite to such procedures in section 12.1 and, therefore, this issue is beyond the scope of this proceeding. As a result, we will reject J.P. Morgan's proposed revisions to section 12.1 of CAISO's tariff.

25. We also agree with CAISO that SVP's request to apply less burdensome verification requirements to load-serving entities that use CRRs only for hedging is

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<sup>29</sup> *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,183, at P 25 (2012) (accepting compliance filing in which PJM stated that it would explain any deficiencies in a market participant's risk management policies in its initial written notification and directing PJM to address this explanation in its business rules).

<sup>30</sup> Initial Compliance Order, 136 FERC ¶ 61,194 at P 41.

beyond the scope of this proceeding. The Commission did not direct CAISO to revise its tariff to exempt certain load-serving entities from its verification requirements in the Initial Compliance Order, nor did SVP raise this issue in response to CAISO's June 30, 2011 filing. Thus, we will reject SVP's protest at this time as it is beyond the scope of this proceeding.

**2. Elimination of Unsecured Credit for Financial Transmission Rights Markets**

**a. Filing**

26. CAISO proposes to revise sections 12.6.2 and 12.6.3 of its tariff to recognize a letter from a federal agency that meets certain tariff requirements as sufficient financial security to participate in the CRR market. Specifically, CAISO proposes to add new tariff section 12.6.2.2, which states that existing and candidate CRR holders that are federal agencies may demonstrate sufficient financial security by submitting an officer-executed letter to CAISO that: (1) attests that the federal agency is lawfully authorized to participate in CAISO's CRR auction and that any debt of the federal agency incurs is a debt of the United States, (2) identifies the federal agency's current year's appropriations from Congress, and (3) verifies that this amount meets or exceeds the amount required to satisfy the credit requirements listed in section 12.1 of CAISO's tariff. CAISO has proposed other clarifying revisions to tariff sections 12.6.2 and 12.6.3 to effectuate the new proposed section that applies only to federal agencies.

**b. Comments**

27. WAPA states that it supports CAISO's proposed tariff revisions as consistent with the directives of the Initial Compliance Order.

**c. Commission Determination**

28. We find that CAISO's proposed revisions comply with the directives of the Initial Compliance Order to consider a letter from a federal agency that meets the requirements stated above as sufficient financial security to participate in CAISO's CRR market. Therefore, we accept CAISO's proposed tariff revisions to become effective April 30, 2012, as requested.

The Commission orders:

(A) CAISO's compliance filing is hereby conditionally accepted, subject to a further compliance filing, to become effective April 30, 2012, as discussed in the body of this order.

Docket No. ER11-3973-002

- 12 -

(B) CAISO is hereby directed to submit a further compliance filing in this docket within 60 days of the date of this order, as discussed in the body of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.