

May 14, 2012

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

**Re: California Independent System Operator Corporation
Filing to Comply with March 15, 2012 Order
Docket No. ER11-3973-_____**

Dear Secretary Bose:

On December 14, 2011, the California Independent System Operator Corporation submitted revisions to its tariff to comply with the directives in the Commission's September 15, 2011 order in this proceeding.¹ On March 15, 2012, the Commission issued an order conditionally accepting the December 14 compliance filing, subject to further tariff revisions, effective April 30, 2012.² The ISO submits this filing to comply with the directives in the March 15 order.³

I. Tariff Revisions to Comply with the March 15 Order

In the March 15 order, the Commission found that the ISO's proposed compliance verification process complies with the September 15 order and is just and reasonable. However, the Commission also found that the ISO's proposal required further clarifications to be made in a compliance filing submitted within

¹ *California Independent System Operator Corp.*, 136 FERC ¶ 61,194 (2011) (September 15 order).

² *California Independent System Operator Corp.*, 138 FERC ¶ 61,181 (2012) (March 15 order). Further background regarding this proceeding is provided in the December 14 compliance filing.

³ Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the Tariff. References herein to section numbers are references to sections of the Tariff unless otherwise specified.

60 days after issuance of March 15 order.⁴ The required items for clarification are discussed separately below.

A. Risk Management Verification Process

In the March 15 order, the Commission noted that Section 12.1 of the ISO tariff, as proposed in the December 14 compliance filing, would allow the ISO to obtain information and documentation from prospective and existing market participants at any given time to verify that their risk management policies, practices, and procedures comply with the ISO's risk management verification process. The Commission found that the ISO had not sufficiently explained when and how often it will request information from those market participants. Therefore, the Commission directed the ISO to "submit a further compliance filing to clarify when and how often it will conduct verification of all market participants."⁵ In this regard, the Commission had explained in the September 15 order that it would not mandate any particular form of verification but that such verification "could include periodic review of risk management policies, practices, and procedures, and their implementation conducted on a random basis or directed to certain market participants based on identified risk."⁶

To comply with the directives in the March 15 order consistent with the direction provided in the September 15 order, the ISO proposes to revise Section 12.1 of the tariff to include the following three types of verifications:

1. The ISO will review and verify that prospective market participants satisfy the minimum participation requirements set forth in Section 12.1, and the ISO will request any information from prospective market participants that is needed to complete the ISO's review and verification. This type of verification accords with the Commission's directives approving verification of prospective market participants by other Independent System Operators and Regional Transmission Organizations ("ISOs/RTOs").⁷

⁴ March 15 order at P 18.

⁵ *Id.* at P 19.

⁶ September 15 order at P 49 n.47.

⁷ See *ISO New England Inc. and New England Power Pool*, 138 FERC ¶ 61,185, at P 20 (2012) (accepting proposal to conduct verification regarding each applicant prior to commencing activity in the ISO New England Financial Transmission Rights market); (Commission Letter Order, Docket No. ER11-3949-004 (May 9, 2012) (accepting proposal to conduct verification regarding each applicant applying to participate in the New York ISO's Transmission Congestion Contracts market).

2. The ISO will annually select, on a random basis, up to ten (10) percent of the market participants that are not already subject to annual verification as set forth in Section 12.1(ii), and the ISO will request any information from those randomly selected market participants that is needed to review and verify whether the market participants continue to satisfy the minimum participation requirements set forth in Section 12.1. Each market participant randomly selected for annual verification and satisfactorily verified will be exempted from such random verification for the subsequent two (2) years, unless within that two-year period the market participant undergoes a material change in financial condition as set forth in Section 12.1.1.5 of the tariff, in which case the market participant will remain subject to random verification within the two-year period. Both the annual verification of up to ten percent of market participants on a random basis and the two-year exemption period are similar to proposals made by the Midwest ISO and accepted by the Commission.⁸
3. The ISO may at any time select any market participant for review to determine whether the market participant continues to satisfy the minimum participation requirements set forth in Section 12.1, based on identified risk factors that include, but are not limited to, the ISO markets in which the market participant is transacting or seeks to transact, the magnitude of the market participant's transactions or potential transactions, or the volume of the market participant's open positions in the ISO markets. Such review by the ISO based on identified risk factors will not be subject to the two-year period of exemption from random verification. This verification by the ISO based on identified risk factors is similar to proposals made by other ISOs/RTOs and accepted by the Commission.⁹

Both individually and together, the verification provisions in Section 12.1 of the tariff will help to ensure that market participants satisfy the ISO's risk management requirements. As a result, the verification provisions satisfy the requirements of the Commission's orders and are just and reasonable.

⁸ See *Midwest Independent Transmission System Operator, Inc.*, 138 FERC ¶ 61,184, at P 17 (2012) ("MISO proposes to randomly request verification from no more than 10 percent of its tariff customers on an annual basis, and to exclude tariff customers that successfully complete verification for two years. . . . We find that MISO's proposal is reasonable, and believe that it strikes an appropriate balance, by periodically verifying that market participants are complying with risk management practices and policies without unduly burdening participants.").

⁹ See *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,183, at P 24 (2012); *Southwest Power Pool, Inc.*, 138 FERC ¶ 61,187, at P 16 (2012); *ISO New England Inc. and New England Power Pool*, 138 FERC ¶ 61,185, at P 20.

B. Incorporation of Risk Criteria into the ISO Tariff

In the March 15 order, the Commission noted that Section 2.1 of the ISO's Business Practice Manual for Credit Management, but not the ISO tariff, lists eight criteria that the ISO will apply for its ongoing review and verification process. The Commission directed the ISO to incorporate these eight risk criteria into its tariff.¹⁰ The ISO has revised Section 12.1 of the tariff to include the risk criteria.

C. Written Explanation of Noted Deficiencies

In the March 15 order, the Commission directed the ISO to "provide a written explanation for any noted deficiencies in a market participant's risk management and policies."¹¹ Although the Commission indicated that the requirement to provide this written explanation could be included in a Business Practice Manual rather than in the tariff,¹² the ISO proposes to comply with the Commission's directive by including in Section 12.1 of the tariff the requirement to provide a written explanation for any noted deficiencies.

¹⁰ March 15 order at P 19.

¹¹ *Id.* at P 20.

¹² *Id.* at P 20 n. 29 (citing *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,183, at P 25).

II. Communications

Communications regarding this filing should be addressed to the following individuals, whose names should be placed on the official service listed established by the Secretary with respect to this submittal:

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General Counsel
Sidney Davies
Assistant General Counsel
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III. Service

The ISO has served copies of this transmittal letter and all attachments upon all parties in the official service list for this proceeding. In addition, the ISO is posting this transmittal letter and all attachments on the ISO website.

IV. Attachments

The following documents, in addition to this transmittal letter, support the instant filing:

- | | |
|--------------|---|
| Attachment A | Revised ISO tariff sheets to comply with the directives in the March 15 order |
| Attachment B | ISO tariff revisions show in black-line format |

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V. Conclusion

For the reasons stated above, the Commission should accept the instant filing as complying with the directives in the March 15 order. Please contact the undersigned with any questions.

Respectfully submitted,

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General Counsel

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California Independent System Operator Corporation

Attachment A – Clean Tariff

Credit Reforms Compliance Filing

May 14, 2012

* * *

12.1 Credit and Minimum Participation Requirements

The creditworthiness and minimum participation requirements in this section apply to the CAISO's acceptance of any transaction in a CAISO Market, to the payment of charges pursuant to the CAISO Tariff (including the Grid Management Charge), and to establish credit limits for participation in any CAISO auction of CRRs and to CRR Holders for the holding of CRRs. Each Market Participant that has a direct financial relationship with the CAISO (including each Scheduling Coordinator, UDC, MSS, CRR Holder, or Candidate CRR Holder) shall secure its financial transactions with the CAISO (including its participation in any auction of CRRs and for the holding of CRRs) by maintaining an Unsecured Credit Limit and/or by posting Financial Security, the level of which constitutes the Market Participant's Financial Security Amount. For each Market Participant, the sum of its Unsecured Credit Limit and its Financial Security Amount shall represent its Aggregate Credit Limit. Each Market Participant shall have the responsibility to maintain an Aggregate Credit Limit that is at least equal to its Estimated Aggregate Liability.

In order to participate in the CAISO Markets, each prospective Market Participant or existing Market Participant with a direct financial relationship with the CAISO must satisfy all of the following minimum participation requirements:

- (i) Provide the CAISO annually, as detailed in the Business Practice Manual, a certified statement executed by an officer of the prospective or existing Market Participant certifying that the prospective or existing Market Participant has met the following criteria and relevant requirements consistent with these criteria set forth in the Business Practice Manual:
 - (a) Has undergone training commensurate and proportional in sophistication, scope, and frequency to the volume of transactions and the nature and extent of the risk taken by the prospective or existing Market Participant, including but not limited to any applicable CAISO training requirements as specified in Sections 4.5.1.1.10.1 and 36.5.2;

- (b) Has and maintains written policies, procedures, and controls approved by the appropriate officer or corporate authority of the prospective or existing Market Participant's governing body which provide an appropriate, comprehensive risk management framework that, at a minimum, clearly identifies and documents the range of risks to which the prospective or existing Market Participant is exposed, including, but not limited to, legal risk, credit risk, liquidity risk, risk of loss of financial security amounts held and invested by the CAISO, investment risk, concentration risk, default risk, operation risk, market risk, and business risk;
 - (c) To the extent the Market Participant engages in the CRR market, the Market Participant must demonstrate that it has policies in place that are consistent with generally accepted industry risk management standards; and
 - (d) Has appropriate personnel resources, operating procedures and technical abilities to promptly and effectively respond to all CAISO communications and directions, including, but not limited to, the CAISO's issuance of invoices and collateral requests to the prospective or existing Market Participant.
- (ii) Provide annually for CAISO review and verification, as detailed in the Business Practice Manual, the risk management policies, procedures, and controls applicable to the CRR trading activities of the prospective or existing Market Participant, if the prospective or existing Market Participant has a CRR portfolio that meets the applicable risk criterion set forth in the Business Practice Manual.
- (iii) Satisfy the following capitalization requirements:
 - (a) Pursuant to Sections 12.1 and 12.1.1, the prospective or existing Market Participant or its guarantor must have at least \$1 million in Tangible Net Worth or \$10 million in total assets, or post Financial Security using one or more of the forms specified in Section 12.2 (a) through (e) in the amounts set forth below. In the event the prospective or existing Market Participant must post Financial Security, that financial security will not be added to Market Participant's Aggregate Credit Limit and, therefore, cannot be used to meet Market

Participant's minimum credit requirements to participate in a Congestion Revenue Rights auction or to offset any market obligations as reflected in Market Participant's Estimated Aggregate Liability. However, all Financial Security in any form may be used to satisfy any financial obligation of the Market Participant.

- (b) \$500,000 for a prospective or existing Market Participant with fewer than six (6) months of CAISO Market activity; \$100,000 for an existing Market Participant with six (6) months or more of CAISO Market activity and whose highest Estimated Aggregate Liability for the preceding six (6) months is less than or equal to \$100,000; or \$500,000 for an existing Market Participant with six (6) months or more of market activity and whose highest Estimated Aggregate Liability for the preceding six (6) months is greater than \$100,000.
- (c) The CAISO will review whether the prospective or existing Market Participant continues to satisfy the capitalization requirements set forth in Section 12.1(iii)(a). The CAISO will conduct such a review every six (6) months, when new financial statements are posted for the prospective or existing Market Participant, or when an increase in CAISO Market activity causes the Market Participant's Estimate Agreement Liability to exceed \$100,000.

The CAISO will review and verify that prospective Market Participants satisfy the minimum participation requirements set forth in this Section 12.1, and the CAISO will request any information from prospective Market Participants that is needed to complete the CAISO's review and verification. Further, the CAISO will annually select, on a random basis, up to ten (10) percent of the Market Participants that are not already subject to annual verification as set forth in Section 12.1(ii), and the CAISO will request any information from those randomly selected Market Participants that is needed to review and verify whether the Market Participants continue to satisfy the minimum participation requirements set forth in this Section 12.1. Each Market Participant randomly selected for annual verification and satisfactorily verified will be exempted from such random verification for the subsequent two (2) years, unless within that two-year period the Market Participant undergoes a Material Change in Financial Condition as set forth in Section 12.1.1.5, in which case the Market Participant will remain subject to random verification within the two-

year period. In addition, the CAISO may at any time select any Market Participant for review to determine whether the Market Participant continues to satisfy the minimum participation requirements set forth in this Section 12.1, based on identified risk factors that include, but are not limited to, the CAISO Markets in which the Market Participant is transacting or seeks to transact, 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. Such review by the CAISO based on identified risk factors will not be subject to the two-year period of exemption from random verification.

Each Market Participant shall respond to any CAISO request for information within the time period specified in the request, which shall be consistent with the time periods set forth in the Business Practice Manual. Failure to provide the requested information within the specified time period may result in the CAISO taking enforcement actions pursuant to Section 12.5. The CAISO may review and verify the information either with or without the assistance of a third party, at the CAISO's discretion, subject to confidentiality and non-disclosure restrictions, as applicable. The CAISO will provide the Market Participant with a written explanation of any deficiencies in the information provided. For purposes of Section 12, any documentation provided by a prospective or existing Market Participant in compliance with this Section shall be treated as confidential and the CAISO shall maintain the confidentiality of all such documents. Any CAISO review and verification of the Market Participant's risk management policies, procedures, and controls will be conducted according to generally accepted risk management standards that may be developed from time to time and shall include but not be limited to confirmation that:

- The Market Participant's risk management framework is documented in a risk policy addressing market, credit, and liquidity risks that has been approved by the Market Participant's risk management governance function, which includes appropriate corporate persons or bodies that are independent of the Market Participant's trading functions, such as a risk management committee, a designated risk officer, a board or board committee, or a board or committee of the Market Participant's parent company;

- The Market Participant maintains an organizational structure with clearly defined roles and responsibilities that segregate front-, middle-, and back-office functions to as high a level as is practicable;
- Delegations of authority specify the transactions in which traders are allowed to enter;
- The Market Participant ensures that traders have adequate training and experience relative to their delegations of authority in systems and the markets in which they transact;
- As appropriate, risk limits are in place to control risk exposures;
- Reporting is in place to ensure risks are adequately communicated throughout the organization;
- Processes are in place for independent confirmation of executed transactions; and
- As appropriate, there is periodic evaluation or mark-to-market of risk positions.

Each prospective Market Participant that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be prohibited from participating in the CAISO Markets. Each prospective Market Participant taking part in the Scheduling Coordinator certification process pursuant to Section 4.5.1 or the Candidate CRR Holder application process pursuant to Section 4.10.1 that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be ineligible to become a Market Participant or CRR Holder. Each existing Market Participant that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be out of compliance with the CAISO Tariff. Any failure of a Market Participant to satisfy the minimum participation requirements set forth in this Section 12.1 that is not cured within thirty (30) days of CAISO notification that a failure occurred will subject the Market Participant to CAISO enforcement actions as set forth in Section 12.5.

California Independent System Operator Corporation

Attachment B – Marked Tariff

Credit Reforms Compliance Filing

May 14, 2012

* * *

12.1 Credit and Minimum Participation Requirements

The creditworthiness and minimum participation requirements in this section apply to the CAISO's acceptance of any transaction in a CAISO Market, to the payment of charges pursuant to the CAISO Tariff (including the Grid Management Charge), and to establish credit limits for participation in any CAISO auction of CRRs and to CRR Holders for the holding of CRRs. Each Market Participant that has a direct financial relationship with the CAISO (including each Scheduling Coordinator, UDC, MSS, CRR Holder, or Candidate CRR Holder) shall secure its financial transactions with the CAISO (including its participation in any auction of CRRs and for the holding of CRRs) by maintaining an Unsecured Credit Limit and/or by posting Financial Security, the level of which constitutes the Market Participant's Financial Security Amount. For each Market Participant, the sum of its Unsecured Credit Limit and its Financial Security Amount shall represent its Aggregate Credit Limit. Each Market Participant shall have the responsibility to maintain an Aggregate Credit Limit that is at least equal to its Estimated Aggregate Liability.

In order to participate in the CAISO Markets, each prospective Market Participant or existing Market Participant with a direct financial relationship with the CAISO must satisfy all of the following minimum participation requirements:

- (i) Provide the CAISO annually, as detailed in the Business Practice Manual, a certified statement executed by an officer of the prospective or existing Market Participant certifying that the prospective or existing Market Participant has met the following criteria and relevant requirements consistent with these criteria set forth in the Business Practice Manual:
 - (a) Has undergone training commensurate and proportional in sophistication, scope, and frequency to the volume of transactions and the nature and extent of the risk taken by the prospective or existing Market Participant, including but not limited to any applicable CAISO training requirements as specified in Sections 4.5.1.1.10.1 and 36.5.2;

- (b) Has and maintains written policies, procedures, and controls approved by the appropriate officer or corporate authority of the prospective or existing Market Participant's governing body which provide an appropriate, comprehensive risk management framework that, at a minimum, clearly identifies and documents the range of risks to which the prospective or existing Market Participant is exposed, including, but not limited to, legal risk, credit risk, liquidity risk, risk of loss of financial security amounts held and invested by the CAISO, investment risk, concentration risk, default risk, operation risk, market risk, and business risk;
 - (c) To the extent the Market Participant engages in the CRR market, the Market Participant must demonstrate that it has policies in place that are consistent with generally accepted industry risk management standards; and
 - (d) Has appropriate personnel resources, operating procedures and technical abilities to promptly and effectively respond to all CAISO communications and directions, including, but not limited to, the CAISO's issuance of invoices and collateral requests to the prospective or existing Market Participant.
- (ii) Provide annually for CAISO review and verification, as detailed in the Business Practice Manual, the risk management policies, procedures, and controls applicable to the CRR trading activities of the prospective or existing Market Participant, if the prospective or existing Market Participant has a CRR portfolio that meets the applicable risk criterion set forth in the Business Practice Manual.
- (iii) Satisfy the following capitalization requirements:
 - (a) Pursuant to Sections 12.1 and 12.1.1, the prospective or existing Market Participant or its guarantor must have at least \$1 million in Tangible Net Worth or \$10 million in total assets, or post Financial Security using one or more of the forms specified in Section 12.2 (a) through (e) in the amounts set forth below. In the event the prospective or existing Market Participant must post Financial Security, that financial security will not be added to Market Participant's Aggregate Credit Limit and, therefore, cannot be used to meet Market

Participant's minimum credit requirements to participate in a Congestion Revenue Rights auction or to offset any market obligations as reflected in Market Participant's Estimated Aggregate Liability. However, all Financial Security in any form may be used to satisfy any financial obligation of the Market Participant.

- (b) \$500,000 for a prospective or existing Market Participant with fewer than six (6) months of CAISO Market activity; \$100,000 for an existing Market Participant with six (6) months or more of CAISO Market activity and whose highest Estimated Aggregate Liability for the preceding six (6) months is less than or equal to \$100,000; or \$500,000 for an existing Market Participant with six (6) months or more of market activity and whose highest Estimated Aggregate Liability for the preceding six (6) months is greater than \$100,000.
- (c) The CAISO will review whether the prospective or existing Market Participant continues to satisfy the capitalization requirements set forth in Section 12.1(iii)(a). The CAISO will conduct such a review every six (6) months, when new financial statements are posted for the prospective or existing Market Participant, or when an increase in CAISO Market activity causes the Market Participant's Estimate Agreement Liability to exceed \$100,000.

~~The CAISO, at its discretion, may at any time request any information from the prospective or existing Market Participant that the CAISO believes is needed to review and verify the Market Participant's continued satisfaction of the minimum participation requirements set forth in this Section 12.1. The Market Participant shall respond to the CAISO's request for such information within the time period specified in the request, which shall be consistent with the time periods set forth in the Business Practice Manual. Failure to provide the requested information within the specified time period may result in the CAISO taking enforcement actions pursuant to Section 12.5. The CAISO may review and verify the information either with or without the assistance of a third party, at the CAISO's discretion, subject to confidentiality and non-disclosure restrictions, as applicable. For purposes of Section 12, any documentation provided by a prospective or existing Market Participant in compliance with this Section shall be treated as confidential and the CAISO shall maintain the confidentiality of all such documents.~~

The CAISO will review and verify that prospective Market Participants satisfy the minimum participation requirements set forth in this Section 12.1, and the CAISO will request any information from prospective Market Participants that is needed to complete the CAISO's review and verification. Further, the CAISO will annually select, on a random basis, up to ten (10) percent of the Market Participants that are not already subject to annual verification as set forth in Section 12.1(ii), and the CAISO will request any information from those randomly selected Market Participants that is needed to review and verify whether the Market Participants continue to satisfy the minimum participation requirements set forth in this Section 12.1. Each Market Participant randomly selected for annual verification and satisfactorily verified will be exempted from such random verification for the subsequent two (2) years, unless within that two-year period the Market Participant undergoes a Material Change in Financial Condition as set forth in Section 12.1.1.5, in which case the Market Participant will remain subject to random verification within the two-year period. In addition, the CAISO may at any time select any Market Participant for review to determine whether the Market Participant continues to satisfy the minimum participation requirements set forth in this Section 12.1, based on identified risk factors that include, but are not limited to, the CAISO Markets in which the Market Participant is transacting or seeks to transact, 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. Such review by the CAISO based on identified risk factors will not be subject to the two-year period of exemption from random verification.

Each Market Participant shall respond to any CAISO request for information within the time period specified in the request, which shall be consistent with the time periods set forth in the Business Practice Manual. Failure to provide the requested information within the specified time period may result in the CAISO taking enforcement actions pursuant to Section 12.5. The CAISO may review and verify the information either with or without the assistance of a third party, at the CAISO's discretion, subject to confidentiality and non-disclosure restrictions, as applicable. The CAISO will provide the Market Participant with a written explanation of any deficiencies in the information provided. For purposes of Section 12, any documentation provided by a prospective or existing Market Participant in compliance with this Section shall be treated as confidential and the CAISO shall maintain the confidentiality of all such documents. Any CAISO review and verification of the Market Participant's risk management

policies, procedures, and controls will be conducted according to generally accepted risk management standards that may be developed from time to time and shall include but not be limited to confirmation that:

- The Market Participant's risk management framework is documented in a risk policy addressing market, credit, and liquidity risks that has been approved by the Market Participant's risk management governance function, which includes appropriate corporate persons or bodies that are independent of the Market Participant's trading functions, such as a risk management committee, a designated risk officer, a board or board committee, or a board or committee of the Market Participant's parent company;
- The Market Participant maintains an organizational structure with clearly defined roles and responsibilities that segregate front-, middle-, and back-office functions to as high a level as is practicable;
- Delegations of authority specify the transactions in which traders are allowed to enter;
- The Market Participant ensures that traders have adequate training and experience relative to their delegations of authority in systems and the markets in which they transact;
- As appropriate, risk limits are in place to control risk exposures;
- Reporting is in place to ensure risks are adequately communicated throughout the organization;
- Processes are in place for independent confirmation of executed transactions; and
- As appropriate, there is periodic evaluation or mark-to-market of risk positions.

Each prospective Market Participant that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be prohibited from participating in the CAISO Markets. Each prospective Market Participant taking part in the Scheduling Coordinator certification process pursuant to Section 4.5.1 or the Candidate CRR Holder application process pursuant to Section 4.10.1 that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be ineligible to become a Market Participant or CRR Holder. Each existing Market Participant that does not satisfy all of the minimum participation requirements set forth in this Section 12.1 will be out of compliance with the CAISO Tariff. Any failure of a Market Participant to satisfy the minimum participation requirements set forth in

this Section 12.1 that is not cured within thirty (30) days of CAISO notification that a failure occurred will subject the Market Participant to CAISO enforcement actions as set forth in Section 12.5.