May 13, 2011
Board of Governors
California Independent System Operator
250 Outcropping Way
Folsom, CA 95630

Subject: Proposed Credit Reform Creates Barrier to Participation

Governors;

Olivine is a start-up company based in California with the mission of enabling sustainable resources. One of the key reasons Olivine recently become a Scheduling Coordinator (SC) is to explore the integration of DR and other renewable resources into the CAISO market in support of the 33% renewable portfolio standard (RPS) initiative. Our efforts to bring renewables to the wholesale market currently includes work on multiple PDR pilots and the development and deployment of a Remote Intelligent Gateway (RIG) that has been certified by the CAISO, as well as loaned to the CAISO engineering group to study as a proof of concept. To date, no market participant has bid PDR into the market, but Olivine is working with other market participants and the CAISO to accomplish such bidding. Our certification as an SC is extremely important for us to continue to effectively enable the resources necessary for market participation that supports the goal of a PDR market and reaching the RPS standard.

Upon that backdrop, Olivine is concerned that it and other similarly situated entities will be unable to participate in CAISO markets if the proposed capitalization requirements of the Credit Reform initiative are approved and implemented. We agree that such capitalization requirements have a place in large commodity markets where risk is a significant factor; however, the model that the CAISO is proposing ignores the reality of the physical energy market where risk is dependent upon specific transaction types and the size of those transactions. A small physical market participant such as Olivine poses little risk to the CAISO market and the current credit practices in place more than adequately protect other market participants. The risk imposed to the market by small SCs representing small resources is primarily limited to the difference between Day Ahead and Real-time prices in the form of uninstructed energy charges. Because of these physical factors, the proposal of secured collateral for small entities is excessive. This is much different than the risk imposed by a participant that is transacting in the virtual or CRR market for which the proposed capitalization requirements seem applicable.

It is important to note that FERC Order 741 left a great deal of latitude for each ISO/RTO to develop participation criteria that makes sense and supports the broader policy objectives of each organization: "Each ISO and RTO will need to consider the minimum criteria that are most applicable to its markets,…"[1] In further discussing minimum participation criteria, FERC also opined that "…such standards might address adequate capitalization…"[2] but did not explicitly direct inclusion. Early on in the public discussion of the credit reform policy at FERC, the CAISO comments on capitalization requirements indicated that they were "not generally opposed so long as

[1] FERC Order 741 @ 132
[2] FERC Order 741 @ 133

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it doesn't result in a barrier to entry".[3] As currently proposed, the rule that entities that do not meet the proposed capitalization requirements post $500,000 of secured collateral poses a barrier to entry for small entities such as Olivine and contravenes the early position of the CAISO. Note that the proposal suggests that this barrier is mitigated by dropping the minimum collateral to $100,000 after six months based on market activity; however, this modification does not mitigate the initial barrier for new entrants, and the potential of a reduction to $100,000 of secured collateral is still excessive and unnecessary given the existing CAISO credit practices.

While FERC did direct that minimum participation criteria apply to all market participants, it did not require that it be applied indiscriminately and counseled that "...this additional safeguard should not be unduly burdensome compared to the need to protect the stability of the organized markets."[4] There is every indication that the other ISO/RTO will adopt positions that while similar to the CASIO, do a better job of matching risk with capitalization requirements. For example, PJM is considering higher capitalization requirements for virtual (i.e., FTR) participants than those for physical market participants. MISO too is considering differentiation for virtual/FTR market participants as well as minimum capitalization requirements scaled to the level of service for entities not meeting the high capitalization requirements for participants in the riskier markets.

Exclusive of the proposed capitalization criteria, Olivine believes that the other minimum participation requirements being contemplated in conjunction with the existing credit practices adequately protect the market and its participants from a participant who limits transactions to products in the physical market. However, if such capitalization criteria are to be adopted, cash postings for small entities transacting in the physical markets should be smaller than the amounts outlined in the CAISO proposal.

Olivine suggests that the CAISO considers the impacts and unintended consequences of the proposal as it currently stands and reconsiders the minimum security postings required for small non CRR/Convergence bidding participants. Specifically, removing the initial collateral requirement from the proposal would ease the integration of new resources into the wholesale market in support of the 33% RPS. If the CAISO insists on such a collateral requirement, Olivine strongly suggests that it be lowered dramatically from the proposal, to an initial value below $100,000 with an ongoing adjustment which more closely fits the risk profile based on historical activity. Some such change would reduce the barrier to entry and likely lead to a more robust market including innovative companies like ours.

Without this type of accommodation, the proposed levels of secured collateral will pose a significant barrier to small innovative Scheduling Coordinators whose interests are confined to the physical energy markets. At the end of the day this would have a significant impact on the effort to meet the broader public policy objective of the 33% RPS.

Sincerely,

Elizabeth Reid

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[3] CAISO Comment Summary 2/17/2010
[4] FERC Order 741 @ 134