131 FERC ¶ 61,009
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

California Independent System Operator Corporation — Docket No. ER10-753-000

ORDER CONDITIONALLY ACCEPTING TARIFF REVISIONS

(Issued April 6, 2010)

1. On February 5, 2010, the California Independent System Operator Corporation (CAISO) filed revisions to its Market Redesign and Technology Upgrade (MRTU) Tariff to add financial penalties to the progressive discipline process already in place for violations of credit-related provisions in the MRTU Tariff, and to establish a Penalty Reserve Fund. As discussed below, the Commission accepts CAISO's proposed revisions, effective April 7, 2010, subject to a compliance filing.

I. Background

2. Market participants that transact in CAISO markets are required to secure their financial transactions with the CAISO by maintaining an unsecured credit limit and/or by posting financial security, in accordance with section 12 to the MRTU Tariff, in order to provide reasonable assurance that present and future financial obligations will be met. The CAISO explains that it has periodically updated its credit policy.[1] In Docket No. ER09-589-000, the Commission accepted certain revisions which, among other things, enhanced the provisions of the MRTU Tariff that are used to mitigate credit-related risk by providing for non-financial CAISO enforcement actions against market participants that fail to timely post additional financial security or that fail to timely pay an amount set forth in an invoice from the CAISO.[2]

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[1] CAISO February 5, 2010 Tariff Revisions at 2 n.4 (*citing* Docket Nos. ER06-700, ER07-613, ER07-1077, ER08-1059, ER09-589 and ER09-1681).

[2] *Cal Indep. Sys. Operator Corp.*, 126 FERC ¶ 61,285, at P 41-42, 47 (2009) (March 30 Order).

3. The March 30 Order accepted the CAISO's proposal to send a warning letter to a market participant after the first two times the market participant is delinquent in posting additional financial security during a rolling 12-month period. After the third delinquency during a rolling 12-month period, the CAISO may require the market participant to post additional financial security that may be as high as the highest level of the market participant's estimated aggregate liability during the preceding 12 months, and the CAISO will hold the security for at least 12 months. If the market participant is late again in posting additional financial security, the additional financial security may be held for a longer period of time. In addition, the CAISO explained that repeat offenders would have their unsecured credit limit revoked and be required to post cash to secure their financial obligations.[3]

4. Additionally, in Docket No. ER10-589-000, the CAISO informed the Commission that the CAISO Governing Board had authorized further progressive, financial disciplinary measures, which the CAISO would submit for Commission approval at a later date. According to the CAISO, since the implementation of the non-financial penalty elements of the CAISO's progressive discipline process, approximately half of the active market participants in the CAISO's new market have failed to pay amounts set forth in invoices or to post financial security requested by the CAISO.[4] These credit defaults highlight the need for additional progressive, financial disciplinary measures, in the CAISO's estimation. Thus, the CAISO established a stakeholder process to develop the necessary tariff provisions to impose financial penalties to deter non-compliant behavior. Upon completion of that process, the CAISO submitted the instant filing which, according the CAISO, includes some stakeholder input.[5]

II. Proposed MRTU Tariff Revisions

A. Financial Penalties for Late Posting of Financial Security and Late Payments

5. The CAISO proposes to add provisions to section 12.5.2 of the MRTU Tariff to provide that a market participant that is late in posting financial security within 3 business days as required by MRTU Tariff section 12.4 will be subject to the listed enforcement actions. The CAISO proposes to add subsection 12.5.2(c) to reflect that after the third time and each subsequent time during a rolling 12-month period beginning no earlier than

[3] *Id.*

[4] CAISO February 5, 2010 Tariff Revisions at Attachment C P 7.

[5] *Id.* at 4 (The CAISO states it received three comments and was able to resolve the concerns without any substantive revisions to the tariff language.).

April 7, 2010 that a market participant is late in posting additional financial security, the CAISO will assess a penalty to be included in the market participant's next invoice equal to the greater of $1,000 or two percent of the additional financial security amount that the market participant has been late in posting, up to the maximum amount of $20,000 per each late posting.[6]

6. The CAISO proposes to apply the same financial penalty and tariff language for late payments of amounts set forth in invoices from the CAISO. These provisions will apply to section 12.5.3 on enforcement actions for late payments of CAISO invoices, which will be moved to section 11.29.14 because it is the portion of the tariff where the payment of invoices is primarily addressed.[7] Additionally, section 11.29.14(b) proposes to allow market participants to tender "another form of Financial Security reasonably acceptable to the CAISO," along with the existing option to post cash, when the market participant's unsecured credit limit is revoked, following the third occurrence during a rolling 12-month period that a market participant is late in paying the amount set forth in an invoice.

7. According to the CAISO, the financial penalties will enhance the provisions in section 12.5.2 by providing an additional deterrent to the late posting of financial security, at a dollar level that encourages timely posting but is not so high as to be unduly punitive.[8] Additionally, the CAISO anticipates that the prospect of incurring up to $20,000 in additional expense for each late posting (which means this penalty amount could be assessed multiple times to the same market participant) will cause market participants to make more timely postings. However, if experience shows that the maximum penalty of $20,000 per event needs to be augmented in order to have a sufficient deterrent effect, the CAISO states it will consider whether to make that adjustment at a later time.[9]

B. Suspension and Termination for Chronic Occurrences

8. The CAISO proposes a MRTU Tariff amendment to allow it to suspend and terminate the ability of chronic late posters of financial security and late payers of invoices to continue to participate in the CAISO markets. New section 12.5.2(e) of the MRTU tariff will provide that after the fifth time during a rolling 12-month period

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[6] *See* CAISO February 5, 2010 Tariff Revisions at 4-5, Attachment B § 12.5.2.

[7] *Id.* at 5.

[8] *Id.*

[9] *Id.*

beginning no earlier than April 7, 2010 that a market participant is late in posting additional financial security, the CAISO may (i) suspend any and all rights of the market participant under the CAISO Tariff, effective immediately after the CAISO sends written notice to the market participant, and (ii) terminate any agreement between the CAISO and the market participant that allows the market participant to participate in the CAISO markets, effective upon the CAISO's written notice of the termination or upon the date established in accordance with Commission rules.[10] The CAISO explains that if it sends a notice of suspension or termination to a market participant the market participant will not have the right to prevent suspension or termination by curing its late posting of additional financial security.[11] Following termination of an agreement the CAISO will return or release, as appropriate, any money or credit support provided by the market participant.

9. The CAISO proposes parallel tariff revisions to new section 11.29.14, which it states is applicable to market participants that chronically pay invoices after the 10 a.m. cutoff. CAISO claims the above tariff language is an appropriate measure to deter chronic late posting of financial security and late payment of invoices, as both increase credit-related risk in the CAISO markets.[12]

10. For both the late posting of financial security and the late payment of invoices, including suspension and termination for chronic late postings and payments, the CAISO proposes that the rolling 12-month period begin no earlier than April 7, 2010, for the purposes of assessing financial penalties. The CAISO asserts that this will permit market participants that have made late postings of financial security in the past to start with a clean slate. In addition, the CAISO asserts this provision eliminates any possible concern that market participants were not given advance notice that their late postings could result in financial penalties being assessed to them.[13]

C. CAISO Penalty Reserve Account

11. Under new section 11.29.9.6.4 to the MRTU Tariff, the CAISO proposes to create a market reserve account, the CAISO Penalty Reserve Account. All penalty amounts collected for late postings of financial security and late payment of invoices, according to

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[10] *Id.* at 7.

[11] *Id. See* Attachment B §§ 11.29.14(e), 12.5.2(e).

[12] *Id.*

[13] *Id.* at 5, 7.

the CAISO, will be used towards the funding of this Penalty Reserve Account.[14] The account, as proposed by the CAISO, will offset the CAISO Clearing Account when there are insufficient funds to pay CAISO creditors. Specifically, the CAISO states that, to the extent the CAISO receives payments after the 10 a.m. cutoff on the due date, the CAISO will be able to access the funds in the CAISO Penalty Reserve Account in order to help ensure that market participants that are owed money will receive it on the same day. Penalty Reserve Account funds, according to the CAISO, will be replenished upon receipt of funds from the market participant. Additionally, the CAISO asserts that revenues in the account will also be available to offset defaults in the event of a true default, where the market participant either cannot or does not pay, and there is insufficient financial security to cure the default.[15] Further, on December 31 of each year, the CAISO proposes to draw any funds then available in the CAISO Penalty Reserve Account in excess of $5 million to offset the following year's Grid Management Charge (GMC) revenue requirement.[16]

12. The CAISO explains that proposed section 11.29.9.6.4 regarding the Penalty Reserve Account is similar to the existing tariff provisions concerning the CAISO Reserve Account, with a few differences. One material difference is that, after revenues from the Penalty Reserve Account are used to offset a true default, any funds that are subsequently added to the CAISO Penalty Reserve Account can only be used for a subsequent default. The CAISO found it necessary to make clear that future penalties that the CAISO received would not be available for a historical default once the default is finally allocated to the market. Allowing future penalty revenues to apply to historical defaults, in the CAISO's estimation, would undermine one of the purposes of its proposed amendment – to have revenues available to cover defaults in order to minimize the risk that the CAISO would be unable to pay creditors on the same day it receives payments from debtors. Another difference between the proposed Penalty Reserve Account and the existing reserve account, according to the CAISO, is that the revenues in the Penalty Reserve Account will be capped, with any amounts in excess of $5 million as of December 31 used to offset the GMC.[17]

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[14] *Id.* at 5-7.

[15] The CAISO contrasts a "true default" where the market participant either cannot pay or does not pay with a "technical default" when the CAISO receives payment after 10 a.m. on the payment due date. *See Id.* at 6.

[16] *Id.* at 5-7.

[17] *Id.* at 6.

13. Lastly, the CAISO proposes to add section 11.29.9.6.4.1 concerning replenishment of the Penalty Reserve Account following payment default, which it states closely tracks the existing provisions regarding the replenishment of the CAISO Reserve Account following a payment default. As proposed, the CAISO Penalty Reserve Account will be replenished to the extent there is available financial security or after receipt of funds from market participants.

III. Notice of Filing and Responsive Pleadings

14. Notice of the CAISO's filing was published in the *Federal Register*, 75 Fed. Reg. 8692 (2010), with interventions, comments, and protests due on or before February 26, 2010. Timely motions to intervene or notices of intervention were filed by Southern California Edison Company; Pacific Gas and Electric Company; California Municipal Utilities Association; Northern California Power Agency; City of Santa Clara, California and M-S-R Public Power Agency; and Modesto Irrigation District. Timely comments and protests were filed by California Department of Water Resources State Water Project (SWP); Powerex Corporation (Powerex); and Dynegy Morro Bay, LLC, *et al*. (Dynegy).

15. On March 15, 2010, the CAISO filed an answer.

A. Comments

16. While SWP generally supports the CAISO's proposal to mitigate collective credit risks and reduce untimely payments, it argues that the proposal should distinguish between differently situated market participants.[18] Specifically, SWP argues that market participants that have loads and/or generators that are physically connected to and must use the CAISO-controlled grid experience far more severe consequences from denial of doing business with the CAISO than do market participants that only participate in the CASIO financial markets and do not have physical connections to the CAISO grid. SWP argues that governmental entities have payment review and approval processes which are distinct from those applicable to private entities. SWP proffers that its payment process is drawn out and must pass through multiple offices for approval and, therefore, may impact the timeliness of payments to the CAISO.

17. Powerex also generally supports the CAISO's proposal to impose financial penalties for late postings and late payments. However, it suggests three modifications to the proposed CAISO Penalty Reserve Account, in order to increase certainty to market participants with respect to the practical operation of this account. The first modification would be to clearly delineate how defaults will be covered. Powerex proposes tariff language to explicitly state that any defaults will be covered through the CAISO Penalty

[18] SWP February 26, 2010 Protest at 1-2.

Reserve Account *first* and will only be allocated to market participants in accordance with the MRTU tariff to the extent the amount of the default exceeds the amount of revenue available in the Penalty Reserve Account.[19]

18. Secondly, Powerex recommends tariff language to explicitly state that when a true default has exceeded the Penalty Reserve Account and been allocated to market participants, that any subsequent payment or amounts collected from a defaulting market participant will be credited first to the affected market participants to make them whole, then to the CAISO Penalty Reserve Account.[20] Powerex states, for instance, that if the CAISO Penalty Reserve Account contains $5 million, but a market participant is in default for $6 million, affected market participants will still be owed an excess of $1 million after payments are made from the Penalty Reserve Account. Powerex argues that, if this defaulting market participant eventually pays the full amount or some portion of the $6 million owed, the CAISO should allocate the first $1 million of this payment to the affected parties. Lastly, Powerex asks for clarification on whether the Penalty Reserve Account will accrue interest.[21]

19. Like SWP and Powerex, Dynegy generally supports the CAISO's proposal and agrees that using penalty funds to reduce or eliminate defaults that would otherwise be allocated to market participants is a benefit.[22] However, Dynegy disagrees with how the CAISO intends to replenish the Penalty Reserve Account after the moneys in that account are used, but are insufficient to clear the market following a true default. In this instance, the CAISO would allocate any remaining default to market participants.[23] Dynegy states that if the CAISO then recovers any subsequent late payments or penalties, it intends to deposit these amounts to offset any future default. Dynegy argues these moneys should be used to repay market participants who were allocated a share of a prior default. Thus, Dynegy asks the Commission to require the CAISO to modify its proposal so that penalty funds collected will be used to offset the effects of past defaults until those effects are

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[19] Powerex February 26, 2010 Protest at 4-5.

[20] *Id.* at 6-7.

[21] *Id.* at 8.

[22] Dynegy February 26, 2010 Protest at 3.

[23] *Id.* at 4 (noting that the Default Loss Rule governing allocation of losses from defaults is currently subject to settlement procedures in Docket No. EL09-62, *see Calpine Corp. v. Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,271 (2009)).

fully ameliorated, after which new penalty amounts may be amassed to serve as an offset against future defaults.[24]

B. Answer

20. In response to two of Powerex's suggested tariff modifications, the CAISO argues that Powerex's concerns are already well-documented in the CAISO's proposal. That is, section 11.29.9.6.4(a) already states that default amounts will be allocated to market participants only to the extent that the default amounts exceed the funds available in the CAISO Penalty Reserve Account, which adequately addresses Powerex's concern that any defaults will be recovered from the Penalty Reserve Account first.[25]

21. Additionally, the CAISO does not agree with Dynegy's argument and Powerex's suggested modification that the CAISO state that any repayment by a defaulting market participant will be used to reimburse any parties that continue to be owed money due to that default, and only if there are no such parties will the repayment amount be added to the CAISO Penalty Reserve Account. According to the CAISO, Commission acceptance of the tariff language exactly as filed by the CAISO will address this issue.

22. The CAISO provides the following example to show that market participants will be made whole for absorbing payment shortfalls by defaulting market participants before subsequent payments are applied to the CAISO Penalty Reserve Account.[26] Assume the Penalty Reserve Account contains $400,000 at the time that a defaulting market participant defaults on the obligation of $1 million. The CAISO would transfer the $400,000 from the Penalty Reserve Account to the CAISO Clearing Account to pay creditors on a pro rata basis, and allocate the $600,000 payment shortfall to market participants in accordance with the MRTU Tariff. Two months later the defaulting market participant repays $500,000. The CAISO would pay that entire $500,000 amount to the market participants that were allocated the $600,000 shortfall. Any additional amounts that the defaulting market participant subsequently repays would be provided to market participants until they are reimbursed for the $100,000 amount plus interest. Remaining amounts would be paid into the Penalty Reserve Account.[27]

23. The CAISO also opposes Dynegy's position that the CAISO modify its proposal to state that new penalty funds collected will be used to repay market participants that

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[24] *Id.* at 3-4.

[25] CAISO March 15, 2010 Answer at 3.

[26] *Id.* at 4–6.

[27] *Id.* at 5-6.

were allocated a share of a prior historical default rather than being deposited into the CAISO Penalty Reserve Account to be used to offset future defaults. According to the CAISO, the tariff language it proposed appropriately distinguishes between defaults that occur after a penalty is paid to the CAISO and defaults that occur prior to the date a penalty is paid to the CAISO. The CAISO explains that one of the primary purposes of the CAISO Penalty Reserve Account is to provide a pool of funds to offset the costs of "technical violations" when market participants do not pay the CAISO by 10 a.m., but if the CAISO used future penalty revenues to apply to historical defaults then the CAISO would not have that pool of funds available for clearing the account.[28]

24. With regard to Powerex's request for clarification on whether interest will accrue on funds in the CAISO Penalty Reserve Account, the CAISO states that the Penalty Reserve Account will be an interest-bearing account. The CAISO offers to modify the tariff in a compliance filing to clarify this point. The CAISO also states that its proposal does not alter the existing tariff provisions, stating that market participants that are late in making payments to the CAISO are required to pay interest on the overdue amounts, and the CAISO creditors are paid interest provided by those market participants.[29]

25. Lastly, the CAISO addresses SWP's arguments that differential treatment should be afforded market participants with facilities physically connected to the CAISO grid, and that the CAISO should recognize that certain market participants have protracted payment approval processes. First, the CAISO argues that extending differential treatment to loads/generators that are physically interconnected to the CAISO grid is beyond the scope of this proceeding, as the CAISO has not proposed to change existing tariff provisions previously approved by the Commission that subjects all market participants to the CAISO's progressive disciplinary program whether they are physically connected to the CAISO grid or are purely financial market participants.[30] Moreover, the CAISO states that its application of progressive disciplinary measures to all market participants is consistent with the credit policies reflected in the tariffs of other independent system operators and regional transmission organizations.[31] Emphasizing that its proposed tariff language states that the CAISO *may* suspend a chronically late payer or market participant that is chronically late in posting collateral, the CAISO states

[28] *Id.* at 9.

[29] *Id.* at 12.

[30] *Id.* at 13-14.

[31] *Id.* at 14 n.21 (citing the credit policies of PJM Interconnection, L.L.C., Midwest Independent Transmission System Operator, Inc., and New York Independent System Operator).

it will be mindful of the consequences (*e.g.*, system reliability) that might result from suspension and termination of market participants that have physical resources and facilities connected to the CAISO grid.[32]

26. Finally, the CAISO proffers that, to the extent that market participants believe that certain types of entities should be subject to different credit policy requirements than other types of entities, they can raise that issue in the rulemaking proceeding recently established by the Commission to consider revisions to its regulations to reform the credit practices in organized wholesale electricity markets or *Notice of Proposed Rulemaking, Credit Reforms in Organized Wholesale Electricity Markets*, 130 FERC ¶ 61,055 (2010).[33]

IV. <u>Discussion</u>

A. <u>Procedural Matters</u>

27. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2009), timely, unopposed motions to intervene, serve to make the entities that filed them parties to this proceeding.

28. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2009), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept CAISO's answer because it has provided information that assisted us in our decision-making process.

B. <u>Commission's Determination</u>

29. We accept the CAISO's tariff revisions which include financial penalties as a component of its progressive disciplinary program to mitigate credit-related risk, including the establishment of the CAISO Penalty Reserve Account to offset the existing CAISO Clearing Account when there are insufficient funds to pay CAISO creditors, subject to two compliance filings.

30. We find that the CAISO's proposal clearly delineates that defaults will be cleared through the new CAISO Penalty Reserve Account first, and only the amount that exceeds this account will be absorbed by market participants, in accordance with existing tariff provisions. This clarification addresses Powerex's concern by clarifying it in the way desired by Powerex.

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[32] *Id.* at 15.

[33] *Id.* at 16.

31. We recognize the CAISO's example which provides clarification and assurance that once a default is allocated to market participants, and subsequently the defaulting party remits its late payment and/or interest and penalty payments to the CAISO, that those moneys are first applied to make market participants whole, and any remainder remits to the CAISO Penalty Reserve Account. However, the Commission finds that the tariff language quoted by the CAISO is unclear on this point. The CAISO cites proposed section 11.29.9.6.4.1(a) that states:

> If, after the CAISO has debited the CAISO Penalty Reserve Account on a Payment Date, the CAISO Bank receives a remittance from a CAISO Debtor which has not been (but should have been, if it had been received on a timely basis) credited to the CAISO Clearing Account by 10:00 am on the Payment Date and which required the debiting of the CAISO Penalty Reserve Account, such remittance shall be credited to the CAISO Penalty Reserve Account.

The CAISO asserts that the "remittance" is the amount debited from the Penalty Reserve Account.[34] However, this clarification does not specify that market participants will be reimbursed before the Penalty Reserve Fund when a debtor subsequently repays the CAISO. Thus, the Commission requires the following addition to section 11.29.9.6.4.1(a):

> If, after the CAISO has debited the CAISO Penalty Reserve Account on a Payment Date, the CAISO Bank receives a remittance from a CAISO Debtor which has not been (but should have been, if it had been received on a timely basis) credited to the CAISO Clearing Account by 10:00 am on the Payment Date and which required the debiting of the CAISO Penalty Reserve Account, such remittance shall be credited to the CAISO Penalty Reserve Account, <u>less any amounts due to Market Participants.</u>

The Commission directs the CAISO to make a compliance filing within 30 days to include this additional language.

32. We accept the CAISO's proposal that new penalties will be applied to the Penalty Reserve Account, and will not flow to market participants for past default debts that were allocated to market participants. The CAISO has explained that new penalties must fund the Penalty Reserve Account in order for that account to serve its purpose as a reserve

[34] *Id.* at 5.

fund to clear the market in the event of late payments or true defaults. The Commission finds that Dynegy's concern that market participants be reimbursed for default losses is partially addressed by the above clarification that a debtor's repayment will first be credited to market participants that covered the shortage. The CAISO's proposal does not affect the existing risk of uncollectible true defaults being allocated to market participants. In fact, as Dynegy acknowledges, the CAISO's proposal reduces the odds that a market participant will be allocated a share of a future uncollectible true default by establishing, and directing funds to, the Penalty Reserve Account.[35] Thus, the CAISO's proposal reduces the risk of extending credit in its markets and is just and reasonable.

33. Further, we find that SWP's request for differential treatment for market participants with loads/generators that are physically interconnected to the CAISO grid is beyond the scope of this proceeding. We note the CAISO's assurance that it will be mindful of the consequences of suspending and terminating market participants that have physical connections to the CAISO grid.

34. Finally, we accept the CAISO's clarification on whether the CAISO Penalty Reserve Account will accrue interest and direct the CAISO to make a compliance filing within 30 days from the date of this order to expressly state that the CAISO Penalty Reserve Account will be an interest-bearing account, and clarify how the interest rate will be calculated.

<u>The Commission orders</u>:

(A) The CAISO's proposed tariff revisions are hereby accepted for filing, effective April 7, 2010, as discussed in the body of this order.

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[35] *See also* CAISO March 15, 2010 Answer at 9 n.14 (noting that stakeholders commented that funding a reserve account would be "very costly to market participants while not providing much additional benefit over participants individually accepting the risk of a default.").

(B) The CAISO is directed to file within thirty (30) days of the date of this order a compliance filing, as discussed herein.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.