

136 FERC ¶ 61,194  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator Corporation      Docket No. ER11-3973-000

ORDER ON COMPLIANCE FILING

(Issued September 15, 2011)

1. On June 30, 2011, the California Independent System Operator Corporation (CAISO) submitted revisions to its Open Access Transmission Tariff (OATT or Tariff) to comply with the credit reform requirements directed by the Commission in Order No. 741.<sup>1</sup> In this order, we conditionally accept the proposed Tariff revisions, to become effective October 1, 2011, and direct CAISO to submit a compliance filing within 90 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. 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>2</sup> the Commission directed regional transmission organizations (RTO) and independent system operators (ISO) to revise their tariffs to reflect the following reforms: 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,<sup>3</sup> clarification of legal status to continue the netting and set-off of transactions in the event of bankruptcy, establishment of minimum criteria for market participation, clarification regarding the organized markets' administrators' ability to

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<sup>1</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 (2011), *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

<sup>2</sup> 16 U.S.C. §§ 824d, 824e (2006).

<sup>3</sup> The Tariff refers to CAISO's financial transmission rights market as the congestion revenue rights (CRR) market.

invoke “material adverse change”<sup>4</sup> clauses to demand additional collateral from market participants, and adoption of a two-day grace period for “curing” collateral calls.

3. The Commission applied these reforms to all RTO and ISO markets, explaining that the activity of market participants is not confined to any one region or market. The Commission stated that the credit practices in all RTOs and ISOs are only as strong as the weakest credit practice because a default in one market could have ripple effects in another market. In order to implement these reforms, the Commission directed each RTO and ISO to submit tariff changes by June 30, 2011, with an effective date of October 1, 2011. In Order No. 741-A, the Commission extended the deadline for complying with the requirement regarding the ability to offset market obligations to September 30, 2011, with the relevant tariff revisions to take effect January 1, 2012.<sup>5</sup> Accordingly, the Commission will not address compliance with this requirement in this order.

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

4. Notice of CAISO’s filing was published in the *Federal Register*, 76 Fed. Reg. 41,774 (2011), with interventions and protests due on or before July 21, 2011.

5. Numerous parties filed timely motions to intervene: BP Energy Company; Brookfield Energy Marketing LP; the California Department of Water Resources State Water Project; Calpine Corporation; the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California; the City of Santa Clara, California and the M S R Public Power Agency; Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.; Electric Power Supply Association (EPSA); GenOn Energy Management, LLC, GenOn Delta, LLC, and GenOn West, LP; Golden State Water Company; J.P. Morgan Ventures Energy Corporation; Northern California Power Agency; and Shell Energy North America (U.S.), L.P. In addition, several parties filed timely motions to intervene and comments and/or protests: DC Energy, LLC; Modesto Irrigation District (Modesto); Morgan Stanley Capital Group Inc., Macquarie Energy LLC, and DB Energy Trading LLC (collectively, Indicated Participants); Powerex Corp. (Powerex); and Western Area Power Administration (WAPA).

6. On July 22, 2011, Twin Cities Power, LLC, Twin Cities Energy, LLC, TC Energy Trading, LLC, Cygnus Energy Futures, LLC, and Summit Energy, LLC (collectively, Twin Cities) submitted a motion to intervene and protest out-of-time. On July 25, 2011,

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<sup>4</sup> The Tariff refers to such circumstances as a “material change in financial condition.”

<sup>5</sup> Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 25.

EPSA submitted comments. The NRG Companies<sup>6</sup> and Southern California Edison Company (SoCal Edison) filed motions to intervene out-of-time.

7. On August 5, 2011, CAISO filed an answer to the comments and protests. On August 16, 2011, WAPA submitted an answer to CAISO's answer.

### **III. Discussion**

#### **A. Procedural Matters**

8. 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 the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R § 385.214(d) (2011), the Commission will grant NRG Companies, SoCal Edison, and Twin Cities' late-filed motions to intervene given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

9. 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 CAISO's and WAPA's answers because they have provided information that assisted us in our decision-making process.

#### **B. Substantive Matters**

##### **1. Shortening the Settlement Cycle**

10. Order No. 741 directed each RTO and ISO to submit a compliance filing that includes tariff revisions to establish shorter billing and settlement periods that are, at most, weekly.<sup>7</sup>

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

11. CAISO proposes to issue an initial settlement statement three business days after each trading day. The proposed Tariff provides for CAISO to send the market participant an invoice containing the aggregated settlement statements from Monday-Sunday (invoice) on Wednesday, three business days after this seven-day settlement period.

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<sup>6</sup> The NRG Companies include NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, Long Beach Generation LLC, and NRG Solar Blythe LLC.

<sup>7</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 32.

CAISO proposes that payment for the aggregated invoice be due the following Tuesday, four business days after issuing the invoice. Lastly, CAISO plans to issue a recalculation settlement statement twelve business days after the trading day in order to correct for differences between the estimated metered data that was used for the initial statement and the market participant's actual metered data.<sup>8</sup> No protests were filed on this proposal.

**b. Commission Determination**

12. We find that CAISO's proposed revisions comply with the directive of Order No. 741 to shorten its settlement cycle. Therefore, we accept CAISO's proposed Tariff revisions to become effective October 1, 2011.

**2. Use of Unsecured Credit**

13. Order No. 741, as revised by Order No. 741-A, required each RTO and ISO to revise its tariff provisions to establish a limit on unsecured credit of no more than \$50 million per market participant, including the corporate family to which a market participant belongs.<sup>9</sup>

14. The Commission emphasized that the \$50 million limit on unsecured credit is a ceiling, and that an organized wholesale electric market may establish a lower ceiling, either for individual market participants or, for example, based on the relative market size, the price of energy, the number of megawatt hours, and the size and number of members. The Commission also directed that RTOs and ISOs not take parent guarantees into account when establishing the appropriate level of unsecured credit for a market participant.<sup>10</sup>

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<sup>8</sup> CAISO Transmittal Letter at 8; CAISO, OATT, §§ 11.1.4 (1.0.0), 11.1.5 (5.0.0).

<sup>9</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 49, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 9. In Order No. 741-A, the Commission stated that "a corporate family may choose to have a single member company participate in an RTO/ISO's market, or instead opt to have more than one do so, [but] in either case, the single entity or multiple entities together will have a cap of no more than \$50 million." Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 9 & n.15.

<sup>10</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 55-56.

a. **Filing**

15. CAISO proposes to limit the amount of unsecured credit that both market participants and a group of market participant affiliates can post to \$50 million.<sup>11</sup> No protests were filed on this proposal.

b. **Commission Determination**

16. We find that CAISO's proposed revisions comply with the directives of Order Nos. 741 and 741-A to limit the use of unsecured credit. Therefore, we accept CAISO's proposed Tariff revisions to become effective October 1, 2011.

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

17. Order No. 741 directed each RTO and ISO to submit a compliance filing that includes tariff revisions to eliminate the use of unsecured credit in its FTR, or FTR-equivalent, markets.<sup>12</sup>

a. **Filing**

18. CAISO proposes to require market participants to post secure collateral in order to participate in its CRR market, thus, eliminating unsecured credit. CAISO identifies five acceptable forms of secure collateral that market participants may post, which include: (1) letter of credit from an acceptable financial institution; (2) cash deposit in an interest-bearing escrow account at an acceptable financial institution; (3) surety bond posted by an acceptable insurance company; (4) bond certificate made out to CAISO from an acceptable financial institution; and (5) prepayment.<sup>13</sup>

b. **Protests and Comments**

19. Modesto states that, although CAISO asserts in its transmittal letter that revised section 12.6.2 will require market participants in the CRR market to post financial security consistent with section 12.1.2 of the existing Tariff, the proposed Tariff, in fact, requires market participants to post financial security as described in section 12.2(a)

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<sup>11</sup> CAISO Transmittal Letter at 10; CAISO, OATT, §§ 12.1.1 (2.0.0), 12.1.1.4.

<sup>12</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 75.

<sup>13</sup> CAISO Transmittal Letter at 10-11; CAISO, OATT, §§ 12.6.1 (0.0.0), 12.6.2 (6.0.0), 12.3.1 (0.0.0), and 12.6.3.4 (3.0.0).

through (e) instead.<sup>14</sup> Modesto requests that CAISO clarify this discrepancy and, if necessary, correct the proposed revision.

20. WAPA protests CAISO's proposal to require a federal agency to post financial security before it may participate in the CRR market. WAPA maintains that the new requirements may preclude WAPA's participation because, as a federal agency that receives appropriations from Congress, it is unable to post secure collateral. WAPA asserts, however, that, as a federal agency, all of its financial obligations are backed by the United States government, which is more creditworthy than most banks, as evidenced by the 2008 financial crisis. Therefore, WAPA contends that, if CAISO accepts a letter of credit from a bank as adequate financial security to participate in the CRR market, CAISO also should accept an appropriation from Congress as adequate financial security.<sup>15</sup> As a remedy, WAPA proposes that the Commission either waive its requirement to post financial security or direct CAISO to change its Tariff definition of financial security to include a letter from a federal agency identifying its appropriation from Congress.<sup>16</sup>

**c. Answers**

21. In response to Modesto's assertion that there is a discrepancy between the Tariff section referenced on page 11 of CAISO's transmittal page and proposed section 12.6.2 regarding the forms of secured credit market participants must post to participate in the CRR market, CAISO states that although the transmittal letter could have been clearer, the Tariff language is clear. CAISO clarifies that existing and potential CRR market participants must post financial security as specified in section 12.2(a) through (e) of the Tariff.<sup>17</sup>

22. CAISO explains that there was insufficient justification to exempt federal, state, and locally-owned utilities from the ban on unsecured credit in the CRR market after initially considering such an exemption in its straw proposal.<sup>18</sup> CAISO argues that many stakeholders expressed concern regarding their risk of default, particularly in the current economic environment. CAISO also mentions that RTOs and ISOs nationally are trying to eliminate unsecured credit in this type of market.

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<sup>14</sup> Modesto July 21, 2011 Comments at 6.

<sup>15</sup> WAPA July 18, 2011 Protest at 7.

<sup>16</sup> *Id.* at 5.

<sup>17</sup> CAISO August 5, 2011 Answer at 2.

<sup>18</sup> *Id.* at 2-3.

23. WAPA asks that the Commission reject CAISO's answer, stating that it does not aid the Commission's understanding of the issue, provide additional information, or ensure an accurate record. WAPA asserts that CAISO mischaracterizes the issue, which WAPA contends is not whether or not the federal government is subject to risk of default or bankruptcy. The issue, according to WAPA, is the level of risk that an entity providing financial security is subject to. Accordingly, WAPA contends that this risk is considerably less for the federal government than all of the other entities that CAISO recognizes as able to provide financial security.<sup>19</sup>

**d. Commission Determination**

24. We find that CAISO's proposed Tariff revisions to eliminate the use of unsecured credit in its CRR market are generally compliant with the directive of Order No. 741. However, we direct CAISO to submit a compliance filing within 90 days of the issuance of this order to address the issue raised by WAPA, as discussed below.

25. With regard to Modesto's request for clarification, we find that CAISO adequately clarified in its answer that existing and potential CRR market participants must post financial security as specified in section 12.2(a) through (e) of the Tariff, rather than section 12.1.2 of the Tariff.

26. While we agree with WAPA that a federal agency's financial relationship with the United States government may constitute a form of financial security comparable to the other proposed forms of financial security listed in section 12.2(a) through (e) of the Tariff, we disagree that waiver of the section 12.1 requirement to post one of these acceptable forms of secure collateral is appropriate. Similarly, we find that a letter sent to CAISO by a federal agency that simply identifies the federal agency's appropriations from Congress, as WAPA proposes, does not sufficiently provide the requisite level of financial security mandated by Order No. 741. We do, however, agree with WAPA that federal agencies should be permitted to participate in CAISO's CRR market upon their demonstration of financial security albeit in a manner that CAISO did not propose in its Tariff revisions.

27. We find that a federal agency can adequately 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 (i.e., equal to or greater than the credit requirements) in section 12.1 of the Tariff. We find that this process is just and reasonable because it provides a

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<sup>19</sup> WAPA August 16, 2010 Answer at 3.

similar degree of financial security to CAISO's other indicia of financial security. Accordingly, we conditionally accept CAISO's proposed revisions on the elimination of the use of unsecured credit in its CRR market and direct CAISO to revise its Tariff to recognize a letter from a federal agency, as discussed above, as adequate financial security to participate in its CRR market, in a compliance filing submitted within 90 days of the date of this order.

#### **4. Minimum Criteria for Market Participation**

28. In Order No. 741, the Commission directed each RTO and ISO to revise its tariff to establish minimum criteria for market participation.<sup>20</sup> The Commission further directed each RTO and ISO to develop these criteria through its stakeholder processes.<sup>21</sup> While Order No. 741 did not provide specific criteria, the Commission offered examples of acceptable criteria, and stated that it would evaluate each RTO and ISO proposal to ensure that it is just and reasonable and not unduly discriminatory. For example, the Commission explained that minimum criteria for market participation could include the market participant having the capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification. The Commission stated that the minimum criteria for market participation would make sure that each market participant has adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole.<sup>22</sup> Moreover, the Commission stated that any minimum participation criteria apply to all market participants rather than only certain participants.<sup>23</sup> The Commission later clarified in Order No. 741-A that some criteria may be tiered or calibrated based on, for example, the size of a market participant's positions.<sup>24</sup>

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<sup>20</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 131.

<sup>21</sup> *Id.* P 132.

<sup>22</sup> *Id.* P 131.

<sup>23</sup> *Id.* P 133. While there needs to be minimum criteria for all market participants, as we explained in Order No. 741-A, not all market participants need necessarily be held to the same minimum criteria. Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33 & n.43.

<sup>24</sup> *Id.* P 33 & n.43.



a. **Filing**

29. CAISO proposes to require each market participant to submit a certified statement demonstrating: (1) its written policies, procedures, and controls that provide a comprehensive risk management framework to identify all exposed risks; (2) its operating procedures and technical capabilities to respond to all CAISO communications and directions; and (3) its completion of training requirements.<sup>25</sup> CAISO also proposes minimum capitalization requirements which require that market participants have at least \$1 million in tangible net worth; \$10 million in total assets; or post acceptable secure financial security that is not added to its aggregate credit limit, used for CRR market eligibility, or used to offset market obligations in estimated aggregate liability.<sup>26</sup> CAISO's proposal provides that the amount of financial security that each market participant must post depends on its experience in the CAISO market and estimated aggregate liability for the past six months. Market participants with less than six months of experience must post \$500,000 of financial security. Market participants with more than six months of experience and less than \$100,000 in estimated aggregate liability for the past six months must post \$100,000. Market participants with more than six months of experience and more than \$100,000 in estimated aggregate liability for the past six months must post \$500,000. CAISO proposes to allow market participants 30 days to correct a failure of any of these criteria, after receiving notice, before taking enforcement action. Lastly, CAISO proposes to review these requirements every six months or when a participant's activity in the CAISO market causes its estimated aggregate liability to exceed \$100,000.

30. In the transmittal letter, CAISO states that it intends for its proposal to address the needs of small market participants while ensuring that these entities maintain adequate capital so as not to risk disrupting the market. CAISO explains that it recognizes the barrier to entry that its proposal may create for small market participants and, in order to alleviate this concern, has committed to monitor the effects that the minimum participation criteria may have. If these Tariff provisions are found to inhibit meaningful participation from smaller market participants, CAISO commits to reassess the minimum participation criteria.<sup>27</sup>

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<sup>25</sup> CAISO, OATT, § 12.1(i)(a)-(c) (2.0.0).

<sup>26</sup> *Id.* § 12.1(ii)(a)-(b) (2.0.0).

<sup>27</sup> CAISO Transmittal Letter at 13.

**b. Protests and Comments**

31. EPSA urges the Commission to require that processes across RTOs and ISOs be sufficiently uniform to ensure compliance and clarity. In that vein, EPSA suggests that the Commission hold a compliance workshop so that RTOs, ISOs, and industry participants can discuss both the necessary differences in compliance across each region as well as areas in each tariff that can be standardized. Indicated Participants similarly ask the Commission to direct the RTOs and ISOs to coordinate their certification statements and verification processes both in terms of substance and dates for submission.<sup>28</sup>

32. Both Powerex and EPSA also request specific changes to CAISO's proposed Tariff section 12.1 regarding the certification form. Powerex also asserts that the certification form should be generally consistent with the forms adopted by other organized markets, and adds that the certification form should instead be included in the Tariff because it serves as a requirement to participate in the CAISO market. Therefore, Powerex requests that the Commission direct CAISO to remove the language "as specified in the applicable Business Practice Manual" from proposed Tariff section 12.1.<sup>29</sup> EPSA suggests that instead of requiring market participants to document all risks, which EPSA states would involve a never-ending drafting process, CAISO should simply require a statement that the market participant is aware of the risks and has sufficient controls in place.<sup>30</sup> EPSA also asserts that CAISO should include "risk of loss of financial security amounts held or invested by the ISO" in the larger category of "liquidity risk."<sup>31</sup>

33. Indicated Participants state that the RTOs and ISOs have proposed revisions to their Commission-jurisdictional tariffs to enable them to obtain an exemption from regulation of RTO and ISO products and services by the Commodity Futures Trading Commission (CFTC) under the Commodity Exchange Act.<sup>32</sup> However, Indicated Participants assert that they are not privy to the discussions between the RTOs and ISOs and the CFTC, and are not certain what changes are necessary to obtain an exemption.

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<sup>28</sup> Indicated Participants July 21, 2011 Comments at 12-13.

<sup>29</sup> Powerex July 21, 2011 Comments at 6.

<sup>30</sup> EPSA July 25, 2011 Comments at 6.

<sup>31</sup> *Id.*

<sup>32</sup> Indicated Participants July 21, 2011 Comments at 8; *see* Commodity Exchange Act, 7 U.S.C. § 1 (2006).

Given that RTOs and ISOs have not proposed uniform changes to their tariffs, Indicated Participants argue that individual RTOs and ISOs may fall short of, or exceed, whatever requirements are being set forth by the CFTC as creating a necessary basis for exemption, particularly the proposed certification statements. Thus, Indicated Participants request that the Commission solicit input from the CFTC explaining what that agency requires and require the RTOs and ISOs to tailor their revisions to satisfy only those requirements.

34. Regarding the certification form, EPSA argues that the Commission should direct RTOs and ISOs to amend their proposed certification forms to allow a corporate parent to make the certification on behalf of the market participant. Twin Cities specifically argue that CAISO should allow market participants to demonstrate tangible net worth or total assets with an internally-prepared and corporate officer-verified financial statement, instead of an audited financial statement. Twin Cities contend that CAISO's minimum capitalization requirements generally coincide with those of the CFTC; however, Twin Cities argue that the CFTC accepts internally-prepared, unaudited financial statements to meet their capitalization levels.<sup>33</sup> Thus, Twin Cities ask that the Commission require CAISO to allow officer-certified financial statements in its Tariff, similar to the CFTC's requirements.

35. In addition, Indicated Participants support a net worth requirement, consistent with the definition of Eligible Contract Participant as administered by the CFTC, instead of the tangible net worth requirement proposed by RTOs and ISOs. Indicated Participants argue that no demonstrable benefit arises from using a standard more burdensome than the CFTC's Eligible Contract Participant definition. Indicated Participants support the creation of an exemption from the minimum capitalization requirements (and from certain risk management and training requirements) for entities that are already subject to other stringent capitalization requirements (e.g., Federal Reserve (or similar foreign regulator) following Basel III Standards for banks and/or the exchange capitalization requirements of the ICE, the CME Group, and the Green Exchange).

36. Twin Cities also support the creation of a capitalization requirements exemption, and specifically request that CAISO exempt market participants with an estimated aggregate liability level below \$100,000.<sup>34</sup> Twin Cities explain that a minimum estimated aggregate liability level is important for small companies, such as itself, whose RTO or ISO registrations are not currently active, which can apply to participants with legacy settlements or little to no estimated aggregate liability. Twin Cities contend establishing a minimum estimated aggregate liability level complies with Order No. 741-A because the Commission stated that RTOs and ISOs may adjust minimum participation

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<sup>33</sup> Twin Cities July 22, 2011 Protest at 6-7.

<sup>34</sup> *Id.* at 7.

requirements based on the size of a market participant's position.<sup>35</sup> In addition, Twin Cities state that ISO New England Inc. (ISO-NE) has proposed a \$100,000 limit for estimated aggregate liability level for all markets other than the FTR market.<sup>36</sup>

**c. Answer**

37. In order to address EPSA's request for clarification regarding CAISO's proposed annual certification form, CAISO states that it will include the form in its Business Practice Manual. In addition, CAISO notes its plan to submit a supplemental Tariff filing that will propose additional requirements for current and prospective market participants and contain detail regarding the certification form.<sup>37</sup> Nevertheless, CAISO maintains that the form should remain as part of the Business Practice Manual instead of the Tariff.

38. Similarly, CAISO disagrees with Powerex that the officer certification form should be included in the Tariff, rather than "as specified in the applicable Business Practice Manual," as stated in proposed Tariff section 12.1. CAISO explains that other forms, such as letters of credit, are included in the Business Practice Manual, and that the revised Tariff, as proposed, contains the information necessary to advise market participants of what the certification form will include. Lastly, CAISO asserts that, by incorporating the form in the Business Practice Manual, CAISO can address future revisions without initiating a formal Tariff change.<sup>38</sup>

39. Regarding Twin Cities' request that CAISO accept internally-prepared and corporate officer-verified financial statements as a demonstration of tangible net worth or total assets, CAISO argues that proposed section 12.1.1.3 already permits officer-attested financial statements.<sup>39</sup> CAISO clarifies that the purpose of this section is not to require audited financial statements, but clarify that a corporate officer's statement that the company meets CAISO's financial requirements is insufficient.

40. CAISO asks that the Commission reject Twin Cities' request to establish a minimum estimated aggregate liability level below which the participation criteria will not apply to certain market participants.<sup>40</sup> CAISO asserts that its revised Tariff, which

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<sup>35</sup> *Id.* at 7-8 (citing Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33).

<sup>36</sup> *Id.* at 8.

<sup>37</sup> CAISO August 5, 2011 Answer at 5.

<sup>38</sup> *Id.* at 2.

<sup>39</sup> *Id.* at 4.

<sup>40</sup> *Id.*

requires market participants with six months of market activity to post \$100,000, balances the need for both sufficient capitalization and market entry, consistent with Order No. 741's directives. By not exempting certain market participants from the minimum participation requirements, CAISO believes it will be able to reduce the chance that thinly-capitalized entities trade in its markets.<sup>41</sup>

**d. Commission Determination**

41. In Order No. 741, the Commission required RTOs and ISOs to develop minimum participation criteria to ensure that markets are protected from risks posed by under-capitalized participants or those who do not have adequate risk management procedures in place.<sup>42</sup> In evaluating whether the proposed tariff revisions comply with Order No. 741, we are concerned with whether the proposed minimum participation criteria accomplish this goal, and are just and reasonable and not unduly discriminatory or preferential. In so doing, we review the proposal before us, and understand that there may be more than one just and reasonable set of minimum participation criteria. The minimum participation criteria submitted by CAISO are consistent with the Commission's directives and just and reasonable and not unduly discriminatory or preferential and, therefore, we conditionally accept the proposed Tariff revisions.

42. While we expect each RTO and ISO will comply with the applicable rules and requirements of all federal agencies, we are presently concerned with compliance with Order No. 741 and with the reasonableness of the proposed Tariff changes now before us. Any issues related to a potential CFTC exemption is outside the scope of this proceeding. The Commission, however, remains open to subsequent tariff revisions offered by the RTOs and ISOs in light of future events.

43. 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>43</sup> The Commission thus declines to require RTOs and ISOs to adopt uniform minimum participation criteria, including uniform certification statements, at this time. The Commission will not require CAISO to revise its proposal to reflect certain uniform changes proposed by EPSA and Indicated Participants, such as allowing a corporate parent to submit a certification on behalf of a market participant and exempting market participants that are already subject to capitalization requirements required by other

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<sup>41</sup> *Id.* at 5.

<sup>42</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 131.

<sup>43</sup> *Id.* at P 132-133; Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33.

regulators or entities. Although we decline to require uniform minimum participation criteria, we recognize that there may be merit in minimizing the differences in requirements for each ISO and RTO, and we are open to subsequent efforts by industry participants and the RTOs and ISOs to come up with uniform criteria.

44. Regarding protests specific to CAISO's compliance filing, such as CAISO's certification form in revised section 12.1, we continue to find that CAISO's proposal complies with Order No. 741. We note that where the Tariff establishes parameters of the form, as it does here, CAISO generally incorporates the forms into its Business Practice Manual in order to ease the revision process, as explained in its answer, and that CAISO is also in the process of revising its certification form with stakeholders. Therefore, we disagree with Powerex that the certification form should be incorporated directly into the Tariff, and find that section 12.1 of the Tariff is just, reasonable, and not unduly discriminatory in this regard.

45. Furthermore, we disagree with EPSA that CAISO should revise proposed section 12.1(i)(a) of the Tariff, which requires market participants to submit a comprehensive risk management framework that identifies and documents the range of risks to which the market participant is exposed. We find that this requirement will induce market participants to thoroughly examine their financial portfolios as well as provide CAISO with meaningful insight into the financial condition of the parties that currently or prospectively participate in its market. Lastly, we disagree that CAISO should revise its proposed list of possible risks as EPSA requests, finding that such a revision is unnecessary, as CAISO's proposal adequately complies with Order No. 741 as is.

46. We also agree with CAISO that a further Tariff revision is not necessary to clarify that market participants may submit non-audited financial statements to demonstrate tangible net worth and/or net assets. CAISO clarifies in its answer that current Tariff section 12.1.1.3 allows market participants to submit officer-attested financial statements and provides examples of information that market participants may include in the financial statement, language which the Commission has already approved.<sup>44</sup> Therefore, we find this element of CAISO's proposed minimum participation criteria to be just and reasonable.

47. We will not require CAISO to exempt certain market participants from meeting the proposed minimum capitalization requirements, as requested by Twin Cities. We agree with CAISO that the ability to ensure that a market participant is adequately capitalized appropriately considers market risk without unreasonably preventing market entry. In addition, we acknowledge that CAISO has committed to monitor the market regarding barriers to entry for smaller participants and is prepared to reassess its

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<sup>44</sup> *Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,070 (2011).

capitalization requirements if the revised tariff language proves to inhibit meaningful market participation for smaller entities.

48. Furthermore, we disagree with Twin Cities that we should direct CAISO to incorporate a Tariff exemption because the Commission has approved a similar provision for the ISO-NE tariff. ISO-NE's exemption of smaller market participants from its capitalization requirements does not render CAISO's Tariff unjust, unreasonable, or unduly discriminatory. Moreover, we reiterate that Order No. 741 did not require each RTO/ISO to implement standardized minimum participation criteria because the Commission recognized that each RTO/ISO must retain the flexibility to work with its own stakeholders to determine tariff language based on its specific regional needs. Order No. 741 did, however, require each RTO/ISO to propose just, reasonable, and not unduly discriminatory criteria, which we believe CAISO has done.

49. CAISO proposes to require each prospective or existing market participant to submit an officer-certified statement as part of its certification process on an annual basis. CAISO also notes that it has initiated a supplemental stakeholder process to develop a more robust verification component to the certification.<sup>45</sup> Absent such a verification component, we find CAISO's proposal is insufficient to ensure the protection of the markets from risks posed by under-capitalized participants or those who do not have adequate risk management procedures in place.<sup>46</sup> A market participant officer-certified form that attests to the existence of risk management policies and procedures, as CAISO proposes, does not by itself satisfy the above criterion without independent verification that risk management policies and procedures are actually being implemented and adequate capitalization is being maintained. We believe minimum participation criteria require CAISO to engage in periodic compliance verification to minimize risk to the market.<sup>47</sup> We, therefore, direct CAISO to make a compliance filing, within 90 days from the date of this order, to establish such verification as part of its minimum participation criteria.

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<sup>45</sup> CAISO Transmittal Letter at 12 n.20.

<sup>46</sup> *Id.*

<sup>47</sup> The Commission will not mandate a particular form of periodic verification of attestations concerning minimum risk management policies, practices, and procedures. However, such a periodic 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.

## 5. Use of “Material Adverse Change”

50. In Order No. 741, the Commission directed each RTO and ISO to submit a compliance filing that includes tariff revisions to establish and clarify when a market administrator may invoke a “material adverse change” clause to compel a market participant to post additional collateral, cease one or more transactions, or take other measures to restore confidence in the market participant’s ability to safely transact.<sup>48</sup> The Commission, however, declined to adopt a *pro forma* list of circumstances that may trigger a “material adverse change” clause. Instead, the Commission directed each RTO and ISO to develop its own tariff provisions identifying circumstances when each market administrator may invoke a “material adverse change” clause in the form of a list that is illustrative, rather than exhaustive. Furthermore, the Commission explained that the tools used to determine a “material adverse change” should be sufficiently forward-looking to allow the market administrator to take action prior to any adverse effect on the market.<sup>49</sup>

51. The Commission also directed each RTO and ISO to provide reasonable advance notice to a market participant, when feasible, when the RTO or ISO is compelled to invoke a “material adverse change” clause.<sup>50</sup> The Commission noted that the notification should be in writing, contain the reasoning behind invocation of the “material adverse change” clause, and be signed by a person with authority to represent the respective RTO or ISO in such action.

### a. Filing

52. CAISO proposes to add the following non-exhaustive list of material changes in financial condition to its tariff: downgrade to below investment grade from Moody’s KMV or another credit agency; placement on a negative credit watch list by a major rating agency; filing for bankruptcy; insolvency; the filing of a material lawsuit against the market participant that could significantly and adversely affect its past, current, or future financial results; issuance of a previous financial settlement restatement that reduces the amount of its previously-provided unsecured credit; default in another organized market that is not resolved during the cure period; and more than a five percent reduction in tangible net worth or net assets for the previous fiscal year. In the event that a material change causes an unsecured credit reduction, CAISO will notify the market participant in writing, providing a reason for the material change, as soon as reasonably possible.

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<sup>48</sup> *Id.* P 149.

<sup>49</sup> *Id.* P 149-150.

<sup>50</sup> *Id.* P 151.



**b. Protests and Comments**

53. Indicated Participants argue that the Commission should direct RTOs and ISOs to modify their proposals to clarify that RTOs and ISOs will consider the totality of circumstances to determine whether a material adverse change has occurred. Indicated Participants also argue that RTOs and ISOs should clarify that they, rather than market participants, will monitor conditions associated with a material adverse change. Indicated Participants argue that the Commission did not require each market participant itself monitor and report on each such circumstance, and that, during stakeholder conferences, RTOs and ISOs indicated that they would be responsible for monitoring these additional criteria.<sup>51</sup> To the extent that market participants will be responsible for monitoring any additional items, Indicated Participants and EPSA argue that market participants should not be required to purchase additional software review packages, such as Moody's KMV Expected Default Frequency, in order to remain in compliance with RTO/ISO requirements.

**c. Answer**

54. CAISO clarifies that its inclusion of a Moody's KMV rating downgrade as an example of a material change in financial condition in the proposed tariff will not require market participants to purchase Moody's KMV proprietary tools.<sup>52</sup>

**d. Commission Determination**

55. We have reviewed CAISO's proposal and its compliance with Order No. 741, and we find it to be just and reasonable as discussed further below.

56. The Commission intended in Order No. 741 to reduce ambiguity as to when a market administrator may request additional collateral due to a material adverse change, by requiring each RTO and ISO to list in its tariff events that could trigger a collateral call. However, the Commission also required that this list be merely illustrative, rather than exhaustive, allowing each RTO and ISO reasonable discretion to independently determine whether a material adverse change that would warrant seeking additional collateral has occurred. In this regard, RTOs and ISOs are responsible for administering and otherwise overseeing their markets, and as such, we expect them to exercise their reasonable discretion in deciding in what circumstances to seek additional collateral, and when they need not do so. We decline to limit an RTO's or ISO's exercise of such

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<sup>51</sup> Indicated Participants July 21, 2011 Comments at 18 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 148-149).

<sup>52</sup> CAISO August 5, 2011 Answer at 5-6.

discretion and so we will not require each RTO and ISO to modify its proposed tariff revisions to expressly require that it must consider the totality of the circumstances in determining whether a material adverse change has occurred. Accordingly, we find that CAISO's proposal is just and reasonable and in compliance with the directives noted above.

57. While protestors express concern regarding which party faces the burden of monitoring the conditions that may adversely affect a market participant's financial condition, we note that this element of CAISO's Tariff remains unchanged. The current Tariff states that market participants must notify CAISO in writing of a material change in financial condition within five business days, and has already been determined by the Commission to be just and reasonable. Thus, we will not require further revision because CAISO has not proposed new tariff language that changes the burden on market participants. Finally, we anticipate that every CAISO market participant has, or will have, sufficient resources for the participant to be aware of and report those events and circumstances identified in CAISO's illustrative list of material adverse changes.

58. Lastly, we agree with CAISO that the inclusion of a Moody's KMV rating downgrade to below investment grade as a circumstance that may result in a material change in financial condition will not require market participants to purchase additional software packages or proprietary tools.

59. Thus, CAISO's proposed Tariff revisions as they relate to a material change in financial condition are accepted, effective October 1, 2011.

## **6. Grace Period to "Cure" Collateral Posting**

60. In Order No. 741, the Commission directed each RTO and ISO to revise its tariff to allow no more than two days to post additional collateral due to invocation of a "material adverse change" clause or other provision of its tariff.<sup>53</sup>

### **a. Filing**

61. CAISO proposes to limit the grace period to no more than two days. No protests were filed on this proposal.

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<sup>53</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 160.

**b. Commission Determination**

62. We find that CAISO's proposed Tariff revisions comply with the directive of Order No. 741 to establish a two-day grace period to "cure" collateral postings. Therefore, we accept CAISO's proposed Tariff revisions to become effective October 1, 2011.

The Commission orders:

(A) CAISO's compliance filing is hereby conditionally accepted, subject to compliance, to become effective October 1, 2011, as discussed in the body of this order.

(B) CAISO is hereby directed to submit a compliance filing in this docket within 90 days of the date of this order, as discussed in the body of the order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.

Document Content(s)

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