J.P. Morgan Comments on FERC Notice of Proposed Rulemaking (NOPR) – Credit Reforms in Organized Wholesale Electric Markets

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Submitted by	Company	Date Submitted
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This template has been created for submission of stakeholder comments on the credit reform topics covered by FERC's NOPR. Upon completion of this template, please email your comments (as an attachment in MS Word format) to CreditPolicyComments@caiso.com by February 25th at 12:00 p.m.. All comments will be posted to CAISO's Credit Policy Stakeholder Process webpage at http://www.caiso.com/docs/2003/04/21/2003042117001924814.html.

General Comments

J.P. Morgan Ventures Energy Corporation and BE CA, LLC (collectively, "J.P. Morgan") appreciates this opportunity to provide comments to the California ISO ("CAISO") on the Federal Energy Regulatory Commission's ("FERC's") January 21, 2010, Noticed of Proposed Rulemaking ("NOPR") on Credit Reforms in Organized Wholesale Electric Markets (RM10-13-000).

Consistent with its previous comments submitted to both the CAISO and FERC, J.P. Morgan strongly supports efforts to strengthen the credit policies and practices in the organized electricity markets and the CAISO's efforts to align its policies with the "best practices" in place in both other organized electricity markets as well as other financial markets.

Please be advised that the statements and positions outlined below are preliminary and J.P. Morgan's position on each of the identified issues may change prior to filing formal comments on the NOPR at FERC.

Specific Comments

Please submit your comments to the following questions for each topic in the spaces indicated.

1. **Do you support the proposal to have a seven (7) day settlement period versus California ISO's current fifteen (15) day settlement period?**

Yes. J.P. Morgan contends that the best means to reduce market risk is to accelerate the CAISO settlement period to the shortest timeframe possible. Reducing the settlement period from fifteen days to seven will reduce the amount of required credit in the CAISO's market. Moreover, J.P. Morgan understands that a seven-day settlement period is consistent with the CAISO's long-term strategic objective to reduce the settlement period.

Finally, J.P. Morgan recommends that the CAISO consider facilitating automatic drafts for payments as a part of the upcoming implementation of the seven-day settlement period. Processing autodraft payments is a best practice currently in place in both the Midwest ISO and the PJM Interconnection markets. J.P. Morgan recommends that the CAISO facilitate and permit autodraft payments as it will facilitate timely payments by market participants, will permit market participants to avoid late payment penalties, and will enable market participants to focus their resources on the daily responsibilities of confirming the accuracy of market settlements, and thus avoid the need to administer payments in each of the regional RTO/ISO markets.

2. **Do you support organized wholesale electric markets implementing daily settlement periods? Do you support implementation of daily settlements within one year of the proposed seven day settlement period?**

Yes. If feasible to implement, J.P. Morgan supports the implementation of daily settlements within one year of the proposed seven day settlement period. J.P Morgan understands that implementation of both weekly and daily settlements would necessitate certain changes to the CAISO's recently implemented Payment Acceleration program and the policies and practices that support such a program, such as the use of estimated meter data submissions. Notwithstanding these challenges, and in accordance with a well-developed implementation and testing plan, J.P. Morgan supports the implementation of a daily settlement system.

3. **Do you support elimination of the use of unsecured credit to collateralize participation in a Congestion Revenue Rights auction?**

Yes. First, J.P. Morgan supports the elimination of the use of unsecured credit in all organized electricity markets. Most, if not all, financial markets do not extend unsecured credit to their participants; all participants must be fully collateralized. As stated in its previous comments on this issue, the exigent circumstances in the financial markets warrant reexamination of this issue in all organized electricity markets and J.P. Morgan applauds FERC for raising the issue. As California is aware, high credit ratings and presumed regulatory backstops are insufficient to prevent defaults in electricity markets.

Second, J.P. Morgan specifically supports the elimination of the use of unsecured credit to collateralize participation in the CAISO's Congestion Revenue Rights auction. While J.P. Morgan supports the elimination of the use of unsecured credit in general in the CAISO's markets, J.P. Morgan does not believe that unsecured credit should be extended to participants in the CAISO's CRR auction or to entities that will participate in the CAISO's upcoming Convergence Bidding market. The CRR and Convergence Bidding markets attract participation from a wide set of market participants with varying financial strengths and capabilities. While J.P. Morgan does not wish to create barriers to participation in these markets and potentially reduce needed liquidity, J.P. Morgan recommends that all participants in these markets be fully collateralized in order to reduce risk to, and build confidence in, the market as a whole.

Finally, J.P. Morgan acknowledges that full securitization does not completely eliminate all risk. To further reduce risk the CAISO must be vigilant and accurately assess and monitor each participant's estimated aggregate liability and, when and if appropriate, require further collateral. J.P. Morgan appreciates the CAISO's proactive efforts in this regard and encourages the CAISO to explore additional options for timely assessing and quantifying a market participant's liabilities. In particular, J.P. Morgan previously supported the CAISO's proposal to implement enhanced credit requirements and processes for use in the CAISO's soon-to-be-implemented convergence bidding market. J.P. Morgan recommends that the CAISO closely examine the possibility of using that system to more precisely measure aggregate liabilities for all bids in each of the CAISO's markets.

4. **Do you believe there is a need for California ISO to become a party to each transaction so as to eliminate any ambiguity or question as to its ability to manage defaults and offset market participants' obligations?**

J.P. Morgan does not have a final position on this issue at this point in time. While J.P. Morgan generally supports in concept FERC's proposal to eliminate ambiguity regarding an RTOs/ISOs ability to manage defaults and to offset market obligations in instances of a bankruptcy, J.P. Morgan appreciates the need to assess all of the legal and business implications of making an RTO/ISO party to each non-bilateral transaction processed through the RTO's/ISO's markets.

5. **Do you support reducing the number of days to post additional collateral resulting from a collateral call from the current three (3) business days to two (2) business days?**

Yes. J.P. Morgan supports the reduction in cure days from three to two. J.P. Morgan previously supported the CAISO proposal to reduce the cure period for satisfying a request for additional financial security from five (5) Business Days to no more than three (3) Business Days. However, as stated at that time, J.P. Morgan supports a cure period of one (1) or two (2) Business Days, recognizing that market participants have the ability to post cash immediately and then subsequently replace such cash deposits with permitted financial instruments of their choosing(e.g., letters of credit). As acknowledged in the FERC NPR, the PJM Interconnection recently reduced its cure period to two (2) business days.

6. **Do you agree that the ISO should establish minimum creditworthiness requirements to participate in the market?**

J.P. Morgan supports in concept the establishment of minimum criteria for market participation in the organized electricity markets. However, at this juncture, J.P. Morgan is not prepared to specify what it believes to be appropriate minimum criteria.

J.P. Morgan agrees with the statement in the FERC NOPR that, "…trading by undercapitalized entities without adequate risk management procedures in place poses an unwarranted risk to organized wholesale electric markets and to their market participants." (NOPR at ¶26). While J.P. Morgan supports a reduction in settlement periods and the elimination of the use unsecured credit as the best means to reduce risk to the market as a whole in the organized electricity markets, J.P. Morgan supports the establishment of minimum criteria and capabilities prior to certification for participation in the markets. However, J.P. Morgan acknowledges the difficulty of defining, and ultimately certifying, as stated by FERC, "…a participant's capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification…" to ensure, "…that each market participant has at its disposal adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole." (NOPR at ¶26). Furthermore, J.P. Morgan is concerned that Regional Transmission Organizations may not possess the requisite expertise to assess a market participant's risk management capabilities. J.P. Morgan posits that it may be necessary for RTOs and/or market participants to acquire the certification of an independent entity with demonstrated qualifications and expertise in the area of risk management in energy markets.

7. Do you agree that the ISO must establish standards over and above its existing standards for requiring additional collateral as the result of a "material adverse change"?

In general, J.P. Morgan supports FERC's proposal to revise its regulations to require that each RTO and ISO include in the credit provisions of its tariff language to specify under what circumstances a market administrator may invoke a "material adverse change" as a justification for requiring additional collateral. (NOPR at ¶29).

The CAISO Tariff defines a Material Change in Financial Condition as:

> A change in or potential threat to the financial condition of a Market Participant or CRR Holder that increases the risk that the Market Participant or CRR Holder will be unlikely to meet some or all of its financial obligations. The types of Material Change in Financial Condition include but are not limited to the following:
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> (a) a credit agency downgrade;
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> (b) being placed on a credit watch list by a major rating agency;
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> (c) a bankruptcy filing;
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> (d) insolvency;
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> (e) the filing of a material lawsuit that could significantly and adversely affect past, current, or future financial results; or
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> (f) any change in the financial condition of the Market Participant or CRR Holder which exceeds a five percent (5%) reduction in the Market Participant's or CRR Holder's Tangible Net Worth or Net Assets for the Market Participant or CRR Holder's preceding fiscal year, calculated in accordance with generally accepted accounting practices.

(CAISO Tariff Appendix A).

J.P. Morgan believes that the above circumstances are necessary and minimum conditions under which the CAISO should require a participant to provide additional collateral. At this juncture, while J.P. Morgan would not foreclose examination of other conditions or standards that may warrant a request for additional collateral, J.P. Morgan believes the CAISO's existing standards are adequate.

8. **Are you in favor of the ISO applying different credit standards to different types of market participants?**

No. J.P. Morgan does not support applying different credit standards to different types of market participants. All participants in the CAISO's markets should be subject to the same credit standards and those standards should be applied on a non-discriminatory basis.

9. **Do you agree that there should be a further aggregate unsecured credit cap to cover an entire corporate family? Should the cap be different for markets of different sizes?**

As noted above, J.P. Morgan does not support the extension of unsecured credit in the organized electricity markets. However, if, as proposed, the FERC permits the use of unsecured credit in the organized markets, J.P. Morgan supports the establishment of an aggregate cap to cover an entire corporate family (e.g., holding company, subsidiaries, associates, and affiliates) and to appropriate limit the market's exposure to risk from the entire corporate family.