

115 FERC ¶ 61, 170
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Sudeen G. Kelly.

California Independent System Operator Corporation Docket Nos. ER06-700-000
ER06-700-001

ORDER CONDITIONALLY ACCEPTING TARIFF REVISIONS
GOVERNING CREDIT POLICY

(Issued May 12, 2006)

1. On March 7, 2006, as amended on March 14, 2006, the California Independent System Operator Corporation (CAISO) filed credit policy revisions to its tariff.¹ Primarily, the CAISO proposes to replace market participants' right to hold an unlimited line of unsecured credit (if they maintain an approved credit rating) with a process by which the CAISO determines entity-specific unsecured credit limits. The CAISO states that its new policy will comply with the Commission's *Policy Statement on Electric Creditworthiness*² and discourage defaults in its markets. As discussed below, the Commission accepts the tariff revisions effective May 14, 2006, subject to conditions.

The Filing

2. Section 12 of the CAISO tariff requires market participants that schedule or transact in the CAISO markets to either satisfy certain creditworthiness requirements or post financial security to provide assurance that they can meet their present and future financial obligations in the settlement process. Among other changes, the CAISO proposes revisions to section 12 that: (1) apply the credit requirements to the acceptance of schedules and transactions in the CAISO markets, as well as the payment of charges; (2) clarify to what entities the credit provisions apply; and (3) allow the CAISO to determine entity-specific unsecured credit limits. The CAISO states that these changes

¹ FERC Electric Tariff, Second Replacement Volume Nos. I and II.

² 109 FERC ¶ 61,186 (2004) (*Policy Statement*).

will provide greater assurance that each market participant and firm transmission rights (FTR) bidder can satisfy its financial obligations and not present undue credit risk to CAISO market creditors. The changes are described in detail below.

3. The CAISO asserts that it analyzed the credit policies of its peer independent system operators (ISO) and regional transmission organizations (RTO), obtained internal and stakeholder feedback, and used that information to develop recommendations. The tariff revisions were approved by the CAISO Board of Governors on June 15, 2005.³

Notice of Filings and Responsive Pleadings

4. Notice of the March 7, 2006 filing was published in the *Federal Register*, 71 Fed. Reg. 14,195 (2006), with interventions or protests due on or before March 28, 2006. Notice of the March 14, 2006 filing was published in the *Federal Register*, 71 Fed. Reg. 16,771 (2006), with interventions or protests due on or before April 4, 2006.

5. The following parties filed timely motions to intervene: Sacramento Municipal Utility District, Pacific Gas and Electric Company, California Electricity Oversight Board, Williams Power Company, Inc., the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California, Modesto Irrigation District, Portland General Electric Company, and Strategic Energy L.L.C. Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, Constellation) filed a motion to intervene one day out of time on March 29, 2006.

6. Southern California Edison Company (SoCal Edison), Northern California Power Agency (NCPA), Transmission Agency of Northern California (TANC), and the Cities of Redding and Santa Clara, California and M-S-R Public Power Agency (collectively, Cities/M-S-R) filed timely motions to intervene and protest. The CAISO filed an answer to the protests, and SoCal Edison filed an answer to the CAISO's answer.

Discussion

A. Procedural Matters

7. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We accept Constellation's motion to intervene out-of-time.

³ See Attachment D of the CAISO filing.

8. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2005), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We accept the CAISO's answer because it has provided information that assisted us in our decision-making process. We are not persuaded to accept SoCal Edison's answer and will, therefore, reject it.

B. CAISO Proposed Credit Policy Revisions

9. The CAISO proposes to modify section 12.1 to state that the credit requirements apply not only to the acceptance of schedules and all transactions in the CAISO markets, but also to the payment of charges, including grid management charges. The CAISO also clarifies in section 12.1 that credit requirements will apply to all market participants including FTR bidders.⁴ Section 12.1 also replaces market participants' right to satisfy credit requirements by maintaining an approved credit rating with a process by which the CAISO determines entity-specific unsecured credit limits.⁵

10. Section 12.1 is revised to state that a market participant or FTR bidder's aggregate credit limit is the sum of its unsecured credit limit and the amount of posted financial security. Section 12.1 also states that each market participant is required to maintain an aggregate credit limit that is at least equal to its estimated aggregate liability.⁶ In order to receive an unsecured credit limit each market participant or FTR bidder must submit a credit application to the CAISO. The CAISO will determine whether the market participant or FTR bidder will receive an unsecured credit limit, and if so, what that limit will be. The unsecured credit limit will be a maximum of \$250 million, or a lesser amount as determined by the CAISO Board of Governors.

11. Section 12.1.1.2 provides the obligation of a market participant or FTR bidder to notify the CAISO of any change in financial condition that may pose a threat to its credit status. This section also lists the acceptable types of financial security to include letters

⁴ Prior to this filing, the credit provisions of section 12 applied only to scheduling coordinators (SC), utility distribution companies (UDC), and metered subsystems (MSS), while FTR bidders were subject to the credit requirements in section 36 of the CAISO Tariff.

⁵ The term "Unsecured Credit Limit" is defined in the filing as the level of credit established for a market participant or FTR bidder that is not secured by any form of financial security.

⁶ The term "Estimated Aggregate Liability" is defined in the filing as the sum of a market participant's or FTR bidder's known and reasonably estimated potential liabilities.

of credit, surety bonds, guarantees and escrow accounts. Permission may be sought to use another form of financial security not listed. The CAISO will determine whether the proposed form of financial security is reasonably acceptable and should be approved.

12. The CAISO proposes to amend section 12.1.2.2 to allow it to treat financial instruments that do not have automatic renewal provisions and that are not renewed or replaced within 30 days of their dates of expiration as being out of compliance with the standards for financial security under the tariff. The CAISO states that it may deem the value of those instruments to be zero and may draw upon the financial security prior to the stated expiration, if it deems it necessary. In section 12.1.2.3, the CAISO asserts that the risk of loss of a financial security amount held and invested by the CAISO on behalf of the market participant or FTR bidder will be borne by the market participant or FTR bidder. The risk of loss will be minimized by the safety of the investment made by the CAISO, unless the market participant or FTR bidder expressly directs the CAISO to invest the security in an alternative form of investment.

13. According to section 12.1.4, an FTR bidder may elect to allocate a portion of its aggregate credit limit toward satisfying the credit requirements for participating in FTR auctions. Section 12.1.5 states that the CAISO will periodically calculate an estimated aggregate liability for each market participant or FTR bidder. The CAISO will, upon request, provide each market participant or FTR bidder with information concerning the basis for the determination of its estimated aggregate liability, and this determination may be contested in accordance with the procedures set forth in the CAISO's Credit Policy and Procedures Guide (Credit Guide).

14. Section 12.4 states that in the event that a market participant's estimated aggregate liability exceeds its aggregate credit limit, the CAISO will direct the market participant or FTR bidder to post additional financial security within five business days. The CAISO will also inform a market participant if at any time its estimated aggregate liability exceeds 90 percent of its aggregate credit limit.

15. The CAISO describes, in section 12.5, what it characterizes as enforcement actions regarding under-secured market participants or FTR bidders. Among the actions available to the CAISO are withholding a pending payment distribution, limiting trading, requiring a market participant to post an additional financial security amount, restricting, suspending, or terminating a market participant's service agreement, or restricting or suspending a market participant's right to schedule.

C. Inclusion of Credit Policies in the Tariff**1. Protests**

16. Cities/M-S-R and TANC request an order requiring the CAISO to file its Credit Guide for Commission review and approval.⁷ Cities/M-S-R argues that the Credit Guide drives the entity-specific unsecured credit limit process and the tariff revisions only provide notice that the Credit Guide and mechanisms contained therein exist. Cities/M-S-R also request that the CAISO be prohibited from making any unilateral changes to the Credit Guide, and that all proposed changes to the Credit Guide should be subject to a section 205 rate filing.

17. SoCal Edison argues that many pertinent details of the credit policy that will affect rates, and terms and conditions of service are proposed to be contained in the Credit Guide. NCPA argues that the formula for determining a market participant's unsecured credit limit contained within the Credit Guide should be included in the filing and the Credit Guide should be on file with Commission. NCPA also argues that the CAISO should not have discretion to alter the Credit Guide without Commission approval.

2. CAISO Answer

18. In its answer, the CAISO defends its decision to leave credit policy implementation details in its Credit Guide, rather than incorporate them into the tariff. The CAISO asserts that the Commission, through its *Policy Statement*, anticipated that RTOs and ISOs would post credit policy details on their respective websites, and not put all provisions in their tariffs. The CAISO further states that it has satisfied the Commission's requirement that credit-related practices be transparent, posted on an entity's website, and provided for a written analysis if a customer is required to provide security.

19. In addition, the CAISO avers that it has maintained or increased the level of detail contained in section 12 governing its credit policies. The CAISO notes that, although NCPA and TANC seek to incorporate the Credit Guide into the tariff, it has never been a part of the tariff and that practice should not change now.

⁷ Cities/M-S-R state that in *Pacific Gas and Electric Co.*, 81 FERC ¶ 61,320 (1997), the Commission required the CAISO to file all its protocols.

3. Commission Determination

20. The Commission finds the tariff revisions to be generally reasonable, except as discussed herein. The CAISO approach to establishing unsecured credit limits is similar to that used by other ISOs and RTOs reflecting elements of those credit policies. Consistent with the *Policy Statement*, the CAISO considered qualitative and quantitative factors in setting the unsecured credit limits for rated entities and will not deny unsecured credit to financially strong entities merely because they do not maintain an agency credit rating.⁸

21. We agree with Cities/M-S-R and SoCal Edison that the CAISO has proposed to include in its Credit Guide information that will affect the rates, terms, and conditions of its service. Specifically, we find that the eight-step process used to calculate a market participant's unsecured credit limit affects rates and service.⁹ The CAISO's proposed revisions to section 12 of its tariff are, therefore, incomplete without this information.

22. We direct the CAISO to clarify to section 12.1.1's description of how the unsecured credit limit is determined. To this end, we instruct the CAISO to delete the sixth sentence of the section (regarding reliance on nationally recognized statistical rating organizations), and to replace it with section A-3 of the Credit Guide. That section details the eight-step process by which unsecured credit limits are calculated, and may be considered to affect the rates or terms of service. Further, we require the CAISO to file the Credit Guide as an attachment to its tariff and explain what provisions, if any, it recommends removing from the tariff. This requirement renders moot Cities/M-S-R's concern that the CAISO may change the Credit Guide without notice to market participants.

D. Establishment of Unsecured Credit Limits

1. Protests

23. Cities/M-S-R ask that the tariff revisions and Credit Guide be revised to provide that all market participants should be able to challenge the CAISO determination of

⁸ *Policy Statement* at P 13-15.

⁹ See, e.g., *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, 64 FERC ¶ 61,139 at 61,988 (quoting *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985) and finding that a public utility must include in its tariff practices that affect rates and services significantly, that are realistically susceptible of speculation and are not so generally understood as to render their recitation superfluous).

unsecured credit limits. Cities/M-S-R argue that without the authority of market participants to challenge CAISO-determined unsecured credit limits, market participants will be unable to protect themselves against the CAISO establishing improper unsecured credit limits for other market participants. Along similar lines, SoCal Edison argues that the CAISO should use public agency information to calculate the unsecured credit limit, so that SoCal Edison can “verify and validate” the calculation and to help ensure that the calculation is transparent and unambiguous.¹⁰

24. NCPA argues that the CAISO formula is not particularly well-suited to the measurement of the financial strength of an entity such as NCPA, which does not maintain large amounts of equity due to its status as a non-profit entity. NCPA requests that the Commission direct the CAISO to develop an alternative measure of creditworthiness for entities who fare substantially worse under the new policy, due to issues unrelated to financial strength.

25. SoCal Edison disagrees with the provision to treat all affiliates under one unsecured credit limit. SoCal Edison believes that if an affiliate is public and rated by a public agency it should be granted its own unsecured credit limit.

26. With regard to calculating exposure, SoCal Edison advocates that the CAISO apply netting across all charges and payments. It avers that exposure based on gross activity would result in unnecessary over-collateralization for the entire group of market participants. SoCal Edison also recommends that the CAISO provide sample calculations of how unsecured credit limits will be determined for all types of market participants. Further, SoCal Edison argues that the CAISO should notify market participants within a reasonable time if it makes a credit limit adjustment, so that the market participant may react as necessary.

2. CAISO Answer

27. With respect to Cities/M-S-R’s request that any market participant be permitted to challenge the CAISO determination of another market participant’s unsecured credit limit, the CAISO states in its answer that a market participant has the ability to challenge CAISO-determined unsecured credit limits through an FPA section 206 complaint.¹¹ The CAISO adds that by including a \$250 million cap on the amount of unsecured credit any single market participant is extended, it is limiting the potential liability of other market participants, in the event an entity were to default.

¹⁰ SoCal Edison Protest at 2.

¹¹ 16 U.S.C. § 824e (2000).

28. In response to SoCal Edison's concerns about using public agency rating information, the CAISO notes that the *Policy Statement* encourages ISOs and RTOs not to automatically determine that an applicant is not creditworthy if it does not have a credit rating or if that credit rating is below investment grade.¹² The CAISO indicates that it has chosen a non-public default probability measure, Moody's KMV, in addition to standard credit ratings because, at least for public companies, Moody's default probability measures are more responsive than traditional credit ratings to changes in underlying credit quality ahead of a bankruptcy event.

29. The CAISO also states that it does not intend to generally group all affiliated entities and restrict them to a single unsecured credit limit. However, it notes that in some circumstances, it would be imprudent to ignore relationships between financially troubled affiliates. Accordingly, the CAISO may, in some cases, restrict the amount of credit that it would otherwise grant to a particular affiliate.

30. The CAISO asserts its willingness to work with NCPA to develop an alternative measure of creditworthiness and to implement such a measure through changes to the Credit Guide.

31. With respect to SoCal Edison's suggestion that the CAISO should, when calculating exposure, apply netting across all charges and/or payments, the CAISO responds that all transactions are currently netted and that it does not envision modifying the netting approach in the future. The CAISO also states that it believes the sample calculations in the Credit Guide are sufficient to provide a general understanding of how unsecured credit limits will be calculated.

3. Commission Determination

32. It would be inappropriate for the CAISO to publicly reveal sensitive information, such as a market participant's unsecured credit limit, for scrutiny by other market participants. We agree with the CAISO that market participants have sufficient protections under the FPA to challenge the unsecured credit limit of other entities through the Commission's complaint process. To the extent that a market participant believes that their potential liability is unjust, unreasonable, unduly discriminatory or preferential as a result of the CAISO's credit policy, it may bring a complaint to the Commission.¹³ For now, we rely on the CAISO's proposal to limit an entity's unsecured credit to \$250

¹² CAISO Answer at 16-17 (quoting *Policy Statement* at P 14).

¹³ 16 U.S.C. § 824e (2000).

million as proof of reduced mutualized default risk.¹⁴ We are concerned, however, that this tariff provision allows the CAISO Board of Governors to reduce the unsecured credit limit without proper notice to market participants or Commission review. Therefore, we direct the CAISO to set the maximum unsecured credit limit in its tariff at \$250 million, and to delete the proviso that the limit may be further reduced by its Board of Governors and merely be posted on the CAISO website.

33. The CAISO has satisfied SoCal Edison's concerns about using public agency information to calculate unsecured credit limits. The CAISO states that Moody's KMV has developed default probability measures that it believes are more responsive than traditional credit ratings and SoCal Edison has not persuaded us otherwise, particularly in light of the fact that the CAISO should use both qualitative and quantitative criteria to evaluate a customer's creditworthiness.¹⁵ Therefore, we will not require the CAISO to change this tariff provision.

34. SoCal Edison asserts that those affiliates that are public and rated by a public agency should be viewed separately by the CAISO when determining unsecured credit limits. We disagree. The CAISO provision to consider the overall creditworthiness and financial condition of such affiliates when determining the applicable unsecured credit limit is reasonable given the financial interrelationships among such affiliates. The Commission has accepted similar tariff provisions in the credit policies of PJM Interconnection¹⁶ and the Midwest ISO.¹⁷ However, if the CAISO does take into consideration the financial health of a market participant's affiliates, it is appropriate to communicate this information to market participants. Therefore, we direct the CAISO to submit tariff language reflecting that it will inform market participants in writing whenever such an action is taken.

35. One of the CAISO's rationales for the instant tariff changes is that it would allow non-rated entities to more easily demonstrate creditworthiness. NCPA does not generally

¹⁴ The default risk is mutualized if one market participant defaults and it falls upon the remaining market participants to make up the shortfall.

¹⁵ *Policy Statement* at P 13-15.

¹⁶ PJM Interconnection, L.L.C., FERC Electric Tariff, Sixth Revised Volume No. 1, Attachment Q, section II.E, Second Revised Sheet No. 523I.

¹⁷ Midwest ISO, FERC Electric Tariff, Third Revised Volume No. 1, Attachment L, section II.C, First Revised Sheet No. 1221.

object to the acceptance of the CAISO proposed credit policy revisions. Instead, it asserts that the formulas the CAISO proposes to use to determine a market participant's unsecured credit limit are not well-suited to measuring the financial strength of non-profit entities. The CAISO states that it is willing to work with NCPA to develop an alternative measure of determining unsecured credit limits. Accordingly, we strongly encourage the CAISO to work with its stakeholders to develop an alternative measure to calculate the financial strength of non-profits' unsecured credit limits, to be included in the Credit Guide. We will require the CAISO to report to the Commission, on an informational basis, the progress made within 60 days of the date of this order.

36. We find the CAISO answer regarding its intention to continue netting a market participant's charges and payment when calculating credit exposure to be sufficient and responsive to SoCal Edison. However, the Commission finds that neither the tariff nor the Credit Guide provide sample calculations of how unsecured credit limits will be determined. It will assist all market participants, and the Commission as well, if sample calculations are made publicly available. We will therefore require the CAISO to file, as part of the Credit Guide, sample calculations showing how unsecured credit limits will be determined for all types of market participants and FTR bidders.¹⁸

E. Other Issues

1. Protests

37. SoCal Edison states that the tariff revisions do not indicate how often a credit application should be submitted, but it advocates requiring market participants to apply only one time, since the CAISO intends to review quarterly financial updates of each market participant. SoCal Edison also argues that only the year-end financial statements should be used to determine a market participant's tangible net worth, as the numbers have been verified and audited in year-end statements only.

38. SoCal Edison also expresses concern that the CAISO is not required to notify the market participant if it makes an adjustment to the market participant's unsecured credit limit.

39. SoCal Edison notes that the CAISO proposal obligates market participants to timely notify the CAISO of material changes in financial conditions. SoCal Edison

¹⁸ Within the Credit Guide, there are methods of calculating unsecured credit limits for rated public/private corporations, unrated public/private corporations, rated government entities, and unrated government entities.

argues that the filing of a document such as a Form 8-K with the Securities and Exchange Commission (SEC) should provide sufficient notification of a material change in financial condition of market participants under the CAISO proposal.

40. Finally, SoCal Edison asks how the CAISO credit proposal will work once the Market Redesign and Technology Upgrade (MRTU) tariff revisions pending before the Commission in Docket No. ER06-615-000 become effective. SoCal Edison states the MRTU tariff contains the credit requirements that were in effect prior to the instant filing, and that it is not clear what credit provisions will apply under MRTU. It adds that neither the tariff nor the Credit Guide clearly state whether, under MRTU, gross market purchases or net market purchases will be used as the basis for calculating the amount of credit or collateral required.

2. CAISO Answer

41. The CAISO answers SoCal Edison by stating that a market participant can satisfy the material change in financial condition by either providing the filed documents directly to the CAISO or by informing the CAISO where the information can be found on the SEC's website. The CAISO also clarifies in its answer that it plans to request a credit application only once, and that it intends to review the unsecured credit limit using quarterly financial information.

3. Commission Determination

42. The Commission will require the CAISO to amend section 12.1.1.2 to indicate that a market participant can satisfy the material change in financial condition by either providing filed documents (*e.g.*, SEC Forms 10-K and 10-Q or Form 8-K) directly to the CAISO or by informing the CAISO where the information can be found on the SEC's website.

43. The Commission directs the CAISO to describe in its tariff the notification process in the event that any change is made to reduce a market participant or FTR bidder's unsecured credit limit.

44. We further direct the CAISO to amend its tariff to clarify that it plans to request a credit application only once and to state how often it intends to review unsecured credit limits.

45. SoCal Edison's concerns about how the credit provisions will be applied upon implementation of MRTU (currently projected to be November 2007) are not at issue in this proceeding. Our determination here is without prejudice to SoCal Edison raising such concerns in the MRTU proceeding.

46. With respect to section 12.1.2.2, which proposes that the CAISO *may* deem a financial instrument without an automatic renewal provision to have a value of zero if not renewed or replaced within 30 days of its date of expiration, we have two concerns. First, the tariff language permits the CAISO considerable discretion as to how it will treat market participants' financial security; second, it allows the CAISO to effectively require market participants to over-secure themselves for 30 days to ensure that they have posted sufficient security. To give market participants certainty as to how the CAISO will treat their financial security, we direct the CAISO to replace "may" with "will." We also require that the CAISO explain why it needs 30 days, and not some shorter period, to prevent itself from becoming under-secured.

47. Finally, we call attention to a minor typographical error in the Master Definitions Supplement. Part (d) of "Material Change in Financial Condition" lists "involency" as a possible material change. We suspect the CAISO meant "insolvency," and we direct the CAISO to correct the term in its compliance filing.

The Commission orders:

(A) The CAISO tariff filing is hereby accepted, to be effective on May 14, 2006, subject to conditions and modifications, as discussed in the body of this order.

(B) The CAISO is hereby required to make a filing in compliance with the Commission's directives within 30 days of the date of this order, and to make an informational filing within 60 days of the date of this order, as described in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.