

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**Credit Reforms in Organized  
Wholesale Electric Markets** )  
)

**Docket No. RM10-13-000**

**COMMENTS OF THE ISO/RTO COUNCIL**

The ISO/RTO Council (the “IRC”)<sup>1</sup> respectfully submits these joint comments in response to the Notice of Proposed Rulemaking issued on January 21, 2010 in the captioned proceeding (the “Credit NOPR”),<sup>2</sup> in which the Federal Energy Regulatory Commission (the “Commission”) proposes to amend its regulations to reform credit practices in organized wholesale electric markets to ensure that credit practices result in jurisdictional rates that are just and reasonable.

**I. BACKGROUND**

The Commission issued the Credit NOPR as the latest in a series of initiatives and rulings regarding credit policies in wholesale electric markets. As noted in the Credit NOPR, credit practices and related risk management tools have developed incrementally within these markets, and regional transmission organizations (“RTOs”) and independent system operators (“ISOs”)

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<sup>1</sup> The IRC is comprised of the Independent System Operators operating as the Alberta Electric System Operator (“AESO”), the California Independent System Operator (“CAISO”), Electric Reliability Council of Texas (“ERCOT”), the Independent Electricity System Operator of Ontario, Inc., (“IESO”), ISO New England Inc. (“ISONE”), Midwest Independent Transmission System Operator, Inc., (“MISO”), New York Independent System Operator, Inc. (“NYISO”), PJM Interconnection, L.L.C. (“PJM”), Southwest Power Pool, Inc. (“SPP”), and New Brunswick System Operator (“NBSO”). The IESO, AESO, ERCOT, and NBSO are not subject to the Commission’s jurisdiction and therefore are not parties to the IRC’s comments in this docket.

<sup>2</sup> *Credit Reforms in Organized Wholesale Electric Markets*, 130 FERC ¶ 61,055 (2010).

historically developed their own processes for assessing risk, extending unsecured credit and settling accounts.<sup>3</sup> The November 2004 issuance of the Commission’s *Policy Statement on Electric Creditworthiness*<sup>4</sup> encouraged the RTOs and ISOs to consider specific reforms, and the Commission has subsequently considered and accepted a number of proposals by RTOs and ISOs to amend credit policies.<sup>5</sup>

The issuance of the Credit NOPR reflects the Commission’s concern, in light of the dialogue at the January 2009 technical conference on credit and capital issues,<sup>6</sup> that more needs to be done to ensure that credit policies of the organized markets can “reasonably protect consumers against the adverse effects of default.”<sup>7</sup> To that end, the Commission is requesting comments on proposals that operators of organized wholesale markets: (i) shorten the settlement cycle;<sup>8</sup> (ii) reduce the extension of unsecured credit;<sup>9</sup> (iii) eliminate unsecured credit in financial transmission rights (“FTR”) markets;<sup>10</sup> (iv) clarify RTOs’/ISOs’ status as a party to each transaction;<sup>11</sup> (v) specify minimum participation criteria for all market participants;<sup>12</sup> (vi) specify under what circumstances the market operator may invoke a “material adverse change” as a basis

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<sup>3</sup> Credit NOPR, at PP 3, 4.

<sup>4</sup> *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 (2004) (“Policy Statement”).

<sup>5</sup> Credit NOPR, at PP 7-9.

<sup>6</sup> Credit NOPR, at P 9.

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

<sup>8</sup> Credit NOPR, at PP 13-16.

<sup>9</sup> Credit NOPR, at PP 17-20.

<sup>10</sup> Credit NOPR, at PP 21-23.

<sup>11</sup> Credit NOPR, at PP 24-25.

<sup>12</sup> Credit NOPR, at PP 26-27.

for requiring additional collateral;<sup>13</sup> and (vii) limit the time period for posting additional collateral when requested by the market operator.<sup>14</sup>

## II. COMMENTS

The IRC supports the Commission’s rulemaking efforts to promote sound credit practices that properly balance the need for adequate access to capital in competitive markets while protecting consumers against the adverse effects of default.

The IRC has specific comments on a number of the areas for which the Commission has specifically sought input, namely:

- the permissibility of variations in the manner in which credit principles are applied to different types of market participants;
- the feasibility of daily settlement periods;
- the impact of shortened settlement periods on liquidity and rates;
- the means by which a reduction in extension of unsecured credit is implemented;
- the approach to developing and implementing minimum criteria for market participation;
- the degree of specificity with which a “material adverse change” (as a trigger for requiring additional collateral) must be defined for tariff purposes; and
- the establishment of a maximum time period for posting required additional collateral.

The IRC’s comments are set forth below.

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<sup>13</sup> Credit NOPR, at PP 28-29.

<sup>14</sup> Credit NOPR, at PP 30-31.

**A. The Permissibility Of Variations In The Manner In Which Credit Principles Are Applied To Different Types Of Market Participants**

The Commission requests comment on whether the credit practices discussed below should be applied in the same way to all market participants or whether they should be applied differently to certain market participants depending on their characteristics.<sup>15</sup>

The IRC believes that differing treatment for certain types of market participants is warranted. The business models and related risk profiles of certain market participants, such as public power entities, may be materially different from the business models and related risk profiles of other market participants. For example, most RTO and ISO tariffs currently recognize these differences in evaluating creditworthiness for the purpose of establishing eligibility for, and amount of, unsecured credit. The Commission's rules should continue to provide the flexibility to do so.

**B. The Feasibility Of Daily Settlement Periods**

The Commission requests comment on the practicality of organized market operators' implementation of daily settlement periods within one year of their implementation of weekly settlement periods.<sup>16</sup>

The IRC does not believe that the Commission should mandate a move to daily settlement periods at this time (even with a deadline of one year after the implementation of weekly settlement periods). While the concept may have merit, it has not been sufficiently developed and analyzed. Instead, the Commission should allow ISOs and RTOs to work with their stakeholders to research the proposal further and to evaluate the costs and benefits of daily

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<sup>15</sup> Credit NOPR, at P 11.

<sup>16</sup> Credit NOPR, at P 15.

settlement periods, both from the ISO/RTO perspective and the market participant perspective. Such evaluation should consider, but not be limited to, the viability and costs of required billing system changes plus personnel processing costs to implement daily settlements compared with the potential credit exposure reductions and financial security posting reductions. This process should also include a discussion of how much, if any, unsecured credit should be permitted if daily settlement periods are eventually adopted.

### **C. The Impact Of Shortened Settlement Periods On Liquidity And Rates**

The Commission recognizes that net wholesale buyers in organized markets may incur cash management costs to reconcile discrepancies in cash flow, and to manage the more frequent payments, entailed by the shortened settlement period proposed in the Credit NOPR.<sup>17</sup> The Commission invites comments on this proposal, and whether it would involve a one-time cost to establish such a facility or ongoing costs that could significantly affect liquidity and rates.<sup>18</sup>

The Commission is correct that a move to weekly settlement periods may require market participants to arrange cash management facilities to manage the more frequent payments. For individual market participants, such a change could involve a one-time cost, ongoing costs, or both. From an overall market perspective, the total amount of net working capital should not change at all, and therefore moving to shortened settlement cycles is unlikely to have a net increase in costs (one-time or ongoing) or to adversely impact liquidity. However, the IRC notes that the Commission has already approved moves to weekly billing cycles for some ISOs and RTOs,<sup>19</sup> and that in those regions, the changes have proven manageable. Indeed, the costs of

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<sup>17</sup> Credit NOPR, at P 16.

<sup>18</sup> *Id.*

<sup>19</sup> *See PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,017 at P 4 (2009); *New England Power Pool*, 107 FERC ¶ 61,201, at P 10-12 (2004).

such a change are offset to some extent by the other efficiencies associated with moving to shortened settlement periods, such as reduced collateral requirements, as noted in the Credit NOPR.<sup>20</sup>

**D. The Means By Which A Reduction In Extension Of Unsecured Credit Is Implemented**

The Commission proposes to revise its regulations to require that each RTO and ISO include in the credit provisions of its tariff revisions to reduce the extension of unsecured credit to no more than \$50 million per market participant.<sup>21</sup>

The IRC generally supports this proposal, subject to several observations. First, to the extent that the use of unsecured credit is permitted at all, it is important that the \$50 million amount remain a cap, rather than a specifically-mandated amount, such that individual RTOs and ISOs may use lower limits as appropriate (and as approved by the Commission). Second, for some RTOs and ISOs, imposing the \$50 million cap would need to be coupled with a move to shortened settlement cycles, as discussed above. Third, the Commission's rules should provide flexibility to determine, on a region by region basis, whether such a cap should apply where the ISO or RTO is performing a billing and collection function related to activities that do not pose market risks.

**E. The Approach To Developing And Implementing Minimum Criteria For Market Participation**

The Commission proposes to require that each RTO and ISO include language in the credit provisions of its tariff to specify minimum participation criteria for all market

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<sup>20</sup> Credit NOPR, at P 13.

<sup>21</sup> Credit NOPR, at P 19.

participants.<sup>22</sup> The Commission requests comment on what the minimum criteria should be, as well as the process by which the organized wholesale electric markets adopt such criteria.<sup>23</sup>

The IRC believes that the imposition of some minimum criteria for market participation could be beneficial, so long as the criteria are carefully crafted to ensure that they do not present an undue barrier to entry. Also, such minimum participation criteria must be recognized as just one component of aggregate credit risk management policies, and not viewed as a measure that prevents all potential defaults. In any event, this is a complex and sensitive issue which the IRC believes requires further study and consideration to determine what such minimum participation criteria should be that would not create undue barriers to entry.

**F. The Degree Of Specificity With Which A “Material Adverse Change” (As A Trigger For Requiring Additional Collateral) Must Be Defined For Tariff Purposes**

The Commission proposes to require that each RTO and ISO include language in the credit provisions of its tariff to specify under what circumstances a market administrator may invoke a “material adverse change” as a justification for requiring additional collateral.<sup>24</sup>

The IRC believes that tariff provisions providing the ISO or RTO certain rights where there is a “material adverse change” in a market participant’s financial status are important and beneficial. Such rights may include the ability to require the market participant to post an alternate form of collateral, the ability to require additional collateral over and above the requirements otherwise defined in the tariff, and the ability to commence suspension or termination procedures. Enumerating some items that may constitute material adverse change

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<sup>22</sup> Credit NOPR, at P 27.

<sup>23</sup> *Id.*

<sup>24</sup> Credit NOPR, at P 29.

could add helpful detail to the tariff, but given the broad array of differing circumstances that may come into play when assessing whether a material adverse change has occurred, maintaining the ISO's or RTO's flexibility in assessing a potential material adverse change is central to effective credit risk management.

The IRC supports a requirement that specific items be enumerated as part of the material adverse change tariff provisions, so long as it is clear that: (i) such a list is not exhaustive (that is, that other changes not listed may also be considered material adverse changes); and (ii) where an element on the list is present, the ISO or RTO retains the discretion to conclude based on the circumstances that it is not a material adverse change. To achieve this balance, the list should be preceded by verbiage stating that the list “includes, but is not limited to” the items enumerated, and it should be made clear that the items on the list “may” constitute a material adverse change, rather than be conclusively categorized as such.

The Commission also requests comment as to specific language regarding the circumstances under which a market administrator may invoke the “material adverse change” provision and the process by which the organized wholesale electric markets would adopt such language.<sup>25</sup> The IRC presents the language that follows this paragraph as an example of a “material adverse change” tariff provision that is consistent with the principles described above. The example below is not used specifically by any single ISO or RTO, because each region uses different terminology and may have chosen to enumerate different items. The items listed in the example below are, however, generally common to the material adverse change provisions for the ISOs and RTOs that have them. Again, the IRC urges the Commission to preserve flexibility with respect to the use of material adverse change clauses by individual ISOs and RTOs.

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<sup>25</sup> *Id.*

A “Material Change” in financial status may include, but is not limited to, the following:

- (i) a downgrade of any rating by any rating agency;
- (ii) being placed on credit watch with negative implication by any rating agency;
- (iii) a bankruptcy filing or other insolvency;
- (iv) a report of a significant quarterly loss or decline of earnings;
- (v) the resignation of key officer(s); or
- (vi) the filing of a material lawsuit that could materially adversely impact current or future financial results.

**G. The Establishment Of A Maximum Time Period For Posting Required Additional Collateral**

The Commission proposes to require each RTO and ISO to include, in the credit provisions of its tariff, a limitation on the time period allowed to post additional collateral when additional collateral is requested by the organized wholesale electric market.<sup>26</sup>

The IRC agrees with the Commission that establishing an outer limit on the amount of time granted for the posting of additional collateral will promote confidence in the ISO/RTO markets by limiting default exposure and by shortening collateral posting periods.<sup>27</sup>

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<sup>26</sup> Credit NOPR, at P 31.

<sup>27</sup> A number of ISO and RTO tariffs include a time limit for posting additional collateral in the range of 1 to 3 business days.

### III. CONCLUSION

The IRC respectfully requests that the Commission consider and act favorably on these comments.

Respectfully submitted,

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