

140 FERC ¶ 61,097
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

California Independent System Operator
Corporation

Docket No. ER12-1785-000

ORDER CONDITIONALLY ACCEPTING TARIFF REVISIONS

(Issued August 1, 2012)

1. On May 14, 2012, California Independent System Operator Corporation (CAISO) submitted a filing in response to the Commission's March 15, 2012 order.¹ The March 15, 2012 Order directed CAISO to provide further clarification regarding the compliance verification process it will use to ensure that market participants meet its creditworthiness and minimum participation requirements. In this order, we conditionally accept CAISO's proposed tariff revisions, to become effective April 30, 2012, 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.² 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,³ the Commission directed regional transmission organizations (RTOs) and independent system operators (ISOs) to revise their tariffs to reflect the following reforms: implementation of shortened settlement timeframes, restrictions on the use of

¹ *Cal. Indep. Sys. Operator Corp.*, 138 FERC ¶ 61,181 (2012) (March 15, 2012 Order)

² *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, *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

³ 16 U.S.C. §§ 824d, 824e (2006).

unsecured credit, elimination of unsecured credit in all financial transmission rights or equivalent markets, 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 invoke "material adverse change" clauses to demand additional collateral from market participants, and adoption of a two-day grace period for "curing" collateral calls. The Commission directed each RTO and ISO to submit tariff changes by June 30, 2011, with an effective date of October 1, 2011.

3. On September 15, 2011, the Commission conditionally accepted CAISO's proposed tariff revisions, and directed CAISO submit a compliance filing to address how a federal agency can demonstrate financial security in order to participate in its congestion revenue rights (CRR) market and to add a verification component to its certification process.⁴ CAISO filed tariff revisions to address these issues on December 14, 2011. In the March 15, 2012 Order, the Commission generally accepted CAISO's proposed tariff revisions, including CAISO's addition of new tariff language to consider a letter from a federal agency that meets certain tariff requirements as sufficient financial security to participate in the CRR market.⁵

4. The Commission also found that CAISO's proposed compliance verification process complied with the September 15, 2011 Order's directives, but directed CAISO to submit another compliance filing to provide additional clarification regarding this process.⁶ In particular, the Commission found that CAISO had not explained when and how often it would request information from existing and prospective market participants for verification, as well as why only certain market participants with CRR portfolios were subject to the review process. Additionally, the Commission directed CAISO to incorporate the applicable risk criteria it would apply during the verification process, contained in section 2.1 of its Business Practice Manuals (BPM) for Credit Management, into its tariff.⁷ Lastly, the Commission required CAISO to provide a written explanation for any noted deficiencies in a market participant's risk management and policies in its tariff.⁸

⁴ *Cal. Indep. Sys. Operator Corp.*, 136 FERC ¶ 61,194 (2011) (September 15, 2011 Order).

⁵ March 15, 2012 Order at P 28.

⁶ March 15, 2012 Order at P 18.

⁷ March 15, 2012 Order at P 19.

⁸ March 15, 2012 Order at P 23.

5. The Commission directed CAISO to submit a responsive filing by May 14, 2012.

II. CAISO Filing

6. CAISO proposes to add three compliance verification processes to section 12.1 of its tariff. Through these three processes, CAISO explains that it will be able to obtain from existing and prospective market participants information and documentation necessary to verify that their risk management polices, practices, and procedures satisfy the minimum participation requirements set forth in section 12.1 of its tariff.

7. First, CAISO proposes to review all prospective market participants, as well as retain the authority to request any information necessary to complete this verification process.

8. Second, CAISO proposes to select annually, on a random basis, up to ten percent of the market participants not subject to the annual verification described in tariff section 12.1(ii) for review and verification. In order to enable this review, the revised tariff provisions provide CAISO with the authority to request any information necessary to complete the verification process. Those market participants that CAISO randomly selects and verifies as satisfying the minimum participation criteria will be exempt from this second verification process for the subsequent two years, unless the market participant undergoes a material change in financial condition.⁹

9. Third, CAISO proposes to select market participants for review at any time based on identified risk factors including, but not limited to, the CAISO markets in which the market participant participates or seeks to participate, the magnitude of the market participant's transactions or potential transactions, or the volume of the market participant's open positions in the CAISO markets. CAISO notes that the market participants subject to this third verification process will not receive a two-year exemption from subsequent random verification.

10. In the event that CAISO notifies a market participant that it needs additional information to conduct the verification process, proposed tariff section 12.1 states that the market participant must respond to CAISO's request for information within the time period specified in the request, or face possible enforcement actions detailed in tariff section 12.5.¹⁰ Further, proposed tariff section 12.1 states that CAISO will provide market participants with a written explanation if there are any deficiencies in the

⁹ Section 12.1.1.15 of CAISO's tariff describes what would constitute a material change in financial condition.

¹⁰ Proposed tariff section 12.1 states that the time period in which the market participant must respond to CAISO's request for information will be consistent with the time periods set forth in CAISO's Business Practice Manuals.

information they provide and can review the information with or without the assistance of a third party.

11. When conducting verification, CAISO will review the market participant's risk management policies, procedures, and controls according to generally accepted risk management standards which are subject to periodical alteration; CAISO has revised tariff section 12.1 to incorporate these standards, which were previously contained in section 2.1 of its Business Practice Manuals for Credit Management.

III. Notice of Filing and Responsive Pleadings

12. Notice of CAISO's Filing was published in the *Federal Register*, 77 Fed. Reg. 30,272 (2012), with interventions and protests due on or before June 4, 2012. Timely motions to intervene were filed by the City of Santa Clara, California, and the M-S-R Public Power Agency; Exelon Corporation; Modesto Irrigation District; and Pacific Gas and Electric Company. A timely motion to intervene and protest were filed by the California Department of Water Resources State Water Project (SWP). CAISO filed an answer to SWP's protest on June 19, 2012.

IV. Discussion

A. Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2012), the timely, unopposed motions to intervene serve to make those entities that filed them parties to this proceeding.

14. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2012), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept CAISO's answer because it has provided information that assisted us in our decision-making process.

B. SWP Protest

15. SWP states that, while it generally supports CAISO's proposal, CAISO's revisions to section 12.1 of its tariff do not completely satisfy the March 15, 2012 Order's requirements. In particular, SWP argues that the phrase, "review...based on identified risk factors," contained in the provisions describing the third type of verification, is not sufficiently clear. SWP contends that the three examples of "identified risk factors" that CAISO provides lack the specificity and quantification necessary to help market participants conform their activities to lower their risk and avoid potential defaults.¹¹ To resolve this issue, SWP asserts that CAISO should revise section 12.1 of its tariff to

¹¹ SWP Comments at 3.

specify the “identified risk factors” it will use, provide prior notice to market participants regarding what the “identified risk factors” are, and specify the relationship among the identification, notification, and application of the “identified risk factors” will have during the review and verification process.¹²

16. SWP states that the application of the “identified risk factors” is especially confusing because the proposed tariff does not clearly indicate what will trigger a review. First, SWP explains that CAISO may constantly monitor “identified risk factors” for all market participants, and then initiate the review process when a market participant meets or exceeds a certain factor’s threshold. Alternatively, SWP claims that the tariff may provide CAISO with total discretion to review market participants, but that the review CAISO conducts will be based on the “identified risk factors.” Thus, SWP argues that CAISO should revise section 12.1 of its tariff to clarify exactly how it will conduct this review and verification process. By addressing this issue, SWP argues that market participants will be better able to avoid risky market behavior and defaults.

17. SWP also explains that transparency is an important factor for mitigating risk in the CRR market, as CAISO’s modeling errors can cause unanticipated outcomes for market participants. For example, SWP notes that CAISO’s tariff does not explain how CAISO will reimburse shortages in CRR revenues that result from its own modeling errors.¹³ SWP also contends that the CAISO tariff does not include the detail necessary to explain the determination of CRR settlement proxies.¹⁴ SWP argues that CAISO should revise its tariff to address the transparency necessary for market participants to mitigate CAISO modeling errors and convene a stakeholder process to develop tariff language describing CRR Settlement proxies.

C. CAISO’s Answer

18. CAISO disagrees with SWP, stating that the Commission should accept its proposal as filed. CAISO argues that its tariff revisions are substantively the same as the tariff provisions that PJM Interconnection, L.L.C. (PJM), Southwest Power Pool, Inc. (SPP), and ISO New England Inc. (ISO-NE) filed and that the Commission has accepted as compliant with Order No. 741.¹⁵ CAISO explains that the Commission accepted the RTO/ISOs’ proposals to select market participants for review “based on identified risk factors” because these provisions offer a reasonable and appropriate balance between periodically verifying that participants comply with risk management practices without

¹² SWP Comments at 3.

¹³ SWP Comments at 4.

¹⁴ SWP Comments at 5.

¹⁵ CAISO Answer at 2.

being unduly burdensome.¹⁶ As CAISO's proposal is substantively the same, CAISO asserts that the Commission should accept its proposed tariff revisions as compliant with Order No. 741 for the same reasons.

19. CAISO also refutes SWP's argument that its tariff requires additional clarity regarding risks related to CRRs. CAISO notes that the Commission has already accepted its tariff provisions concerning CRRs as satisfying the requirements of Order No. 741 and, thus, does not warrant further revision.¹⁷ Therefore, CAISO requests that the Commission accept its proposed tariff revisions as filed.

Commission Determination

20. We find that CAISO's proposed tariff revisions comply with the March 15, 2012 Order's directive to provide additional clarification regarding its verification process. Specifically, CAISO has incorporated the applicable risk criteria from its Business Practice Manuals into the tariff as well as added tariff language to provide a written explanation for any deficiencies in a market participant's risk management policies. Further, we find that CAISO's proposal to add three processes for verifying that a market participant continues to meet its minimum participation requirements is just, reasonable, and not unduly discriminatory or preferential.

21. We reject SWP's recommendation that CAISO revise section 12.1 of its tariff to provide additional information regarding the "identified risk factors" CAISO will use to select market participants for review and verification. The use of "identified risk factors" to select market participants for verification is consistent with Commission precedent; as the Commission has approved similar proposals submitted by PJM, SPP, and ISO-NE.¹⁸ In those orders, the Commission found that selecting market participants for verification either randomly and/or based on "identified risk factors" appropriately balanced the need to periodically verify that market participants comply with the tariff's credit requirements without being unduly burdensome. We note that CAISO's proposal is essentially identical to that of PJM and SPP, and neither PJM nor SPP's tariff contain the level of detail regarding the "identified risk factors" that SWP requests of CAISO. Thus, we find that CAISO's proposed tariff revisions are consistent with Commission precedent.

¹⁶ *Id.* at 3-4 (citing *PJM Interconnection, L.L.C.* 138 FERC ¶ 61,183, at P 24 (2012) (*PJM*); *Southwest Power Pool Inc.*, 138 FERC ¶ 61,185, at P 16 (2012) (*SPP*); *ISO New England Inc. and New England Power Pool*, 138 FERC ¶ 61,185, at PP 20, 22 (2012) (*ISO-NE*)).

¹⁷ *Id.* at 4 (citing *California Independent System Operator Corp.*, 136 FERC ¶ 61,194, at P 24 (2011)).

¹⁸ *PJM*, 138 FERC ¶ 61,183 at P 24; *SPP*, 138 FERC ¶ 61,187, at P 16 (2012); *ISO-NE*, 138 FERC ¶ 61,185 at PP 20, 22.

22. Moreover, we disagree with SWP that directing CAISO to add tariff language to explain the “identified risk factors” will help market participants to avoid risky behavior and default. In order to ensure that a market participant meets CAISO’s minimum participation requirements, particularly those described in tariff section 12.1(ii), market participants should ensure that their risk management policies, procedures, and controls meet CAISO’s applicable risk criteria at all times. Thus, regardless of what factors CAISO may use to select market participants for the third type of verification, those market participants still need to meet the tariff’s applicable risk criteria. Therefore, we find that CAISO’s tariff provides sufficient guidelines for meeting its minimum participation requirements, and will not direct CAISO to revise its proposal as SWP requests. In addition, we find that SWP’s recommendation that CAISO revise its tariff to address the transparency necessary for market participants to mitigate CAISO modeling errors is beyond the scope of this proceeding.

23. Last, while CAISO has complied with the March 15, 2012 Order’s directives, we find that CAISO should incorporate the time period for a market participant to respond to a request for information in the tariff, instead of only referencing the deadline in its Business Practice Manuals. Because a participant’s failure to comply within the time period to respond may result in CAISO’s taking enforcement actions pursuant to section 12.5 of its tariff, we find that CAISO should incorporate this deadline into the tariff. Therefore, we direct CAISO to submit a compliance filing, within 30 days of the date of this order, to revise section 12.1 of its tariff to specify the time period within which a market participant must respond to a request for additional information as part of the compliance verification process.

The Commission orders:

(A) CAISO’s tariff revisions are hereby conditionally accepted, effective April 30, 2012, subject to a compliance filing, as discussed in the body of this order.

(B) CAISO is hereby directed to submit a compliance filing within 30 days of the date of this order, as discussed in the body of the order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.