157 FERC ¶ 61,196
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, and Colette D. Honorable.

Southwest Power Pool, Inc. | Docket No. ER16-1086-001

ORDER DENYING REHEARING

(Issued December 12, 2016)

1. On May 3, 2016, the Commission issued an order rejecting revisions submitted by Southwest Power Pool, Inc. (SPP) to its Open Access Transmission Tariff (Tariff) to allow a credit customer's positively-valued Transmission Congestion Right (TCR)[1] portfolio to offset that customer's credit requirements for TCR bids, offers, and Auction Revenue Right (ARR)[2] self-conversions to TCRs during a current auction period.[3] In

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[1] TCRs are financial instruments entitling the holder to a stream of revenues, or obligating it to pay charges, based upon the difference between the hourly day-ahead marginal congestion component of the locational marginal price at the source and sink settlement locations associated with the TCR. TCRs are obtained in TCR auctions, either through purchase or self-conversion of Auction Revenue Rights (ARRs), or through secondary sales of TCRs. *Sw. Power Pool, Inc.*, 141 FERC ¶ 61,048, at n.330 (2012), *order on reh'g and clarification*, 142 FERC ¶ 61,205 (2013). TCRs have different names in different regional transmission organizations (RTOs) and independent system operators (ISOs), such as Financial Transmission Rights or Congestion Revenue Rights. For simplicity, this order also uses the term TCR when referring to the instrument more broadly.

[2] ARRs are rights that entitle the holder to a share of the auction revenues generated in the applicable TCR auctions and entitle the holder to self-convert the ARR to a TCR. An ARR can result in a credit or charge to the holder, based upon the TCR auction clearing price on the particular ARR path. *Sw. Power Pool, Inc.*, 141 FERC ¶ 61,048 at n.329.

[3] *Sw. Power Pool, Inc.*, 155 FERC ¶ 61,131 (2016) (May Letter Order).

this order, we deny SPP's and Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company's (collectively, KCP&L) requests for rehearing.

I. Background

2. On March 4, 2016, SPP filed, under section 205 of the Federal Power Act (FPA),[4] revisions to its credit requirements for TCRs affecting the amount of financial security a credit customer must provide to support the TCR positions for which it submits bids and offers. SPP proposed modifying its credit requirements to allow an entity's positively-valued TCR portfolio to be netted, during the course of a TCR auction, with the values of the bids, offers, and ARR self-conversions made during the TCR auction. In support of its proposal, SPP stated that its current practices may be overly conservative and possibly detrimental to a healthy market environment. SPP stated the proposal would minimize excess financial security requirements and would increase efficiency by reducing capital costs without an increase to risk of payment default or under-collateralization.

3. In the May Letter Order, the Commission rejected SPP's proposed revisions to its Tariff. The Commission stated that "besides asserting that its proposal will reduce credit customers' required financial security only for a limited time period, SPP provides no evidence to support the claim that there is no increase to risk of payment default or under-collateralization."[5] Consequently, the Commission rejected the proposal, finding that SPP had not "sufficiently demonstrated that its proposal provides adequate safeguards in its TCR market."[6]

II. Requests for Rehearing

4. Timely requests for rehearing were filed by SPP and KCP&L on June 2, 2016.

5. SPP asserts that it sufficiently supported its proposal and that the May Letter Order established an unsupported presumption that the proposal would increase the risk of default and under-collateralization. SPP argues that the Commission did not explain what evidence it found lacking and that requiring SPP to show the proposal will not increase the risk of default and under-collateralization is asking SPP to "prove a negative." SPP states that the proposed revisions would merely reduce unnecessary financial security and would not increase the potential for under-collateralization.

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[4] 16 U.S.C. § 824d (2012).

[5] May Letter Order, 155 FERC ¶ 61,131 at P 6.

[6] *Id.*

6. SPP further contends that the proposed revisions are consistent with Order No. 741.[7] SPP states that the proposed revisions do not allow for unsecured credit for any transmission rights product and do not allow netting of TCRs with other market products. Additionally, SPP asserts that the risks sought to be addressed by Order No. 741 (related to the potentially changing value of TCRs) are effectively mitigated because positively-valued TCRs are assessed for value on a daily basis and, to the extent the value changes, the netted amount is adjusted and, as necessary, additional collateral requirements are imposed, with collateral being due within two days.[8] SPP also asserts that the auction period is essentially a two-week period and therefore risk is transient relative to the term of the TCRs. Finally, SPP states that allowing netting for bids and offers is effectively the same as allowing netting for cleared rights.

7. KCP&L argues that the Commission rejected the filing without analyzing the arguments or evidence presented by SPP, including SPP's statement that the current Tariff may be detrimental to a healthy market environment. Additionally, KCP&L contends that until a customer has been awarded a TCR following an auction, there is no risk of payment default because the customer has not actually incurred any liability. KCP&L also states that the Commission's rejection of the proposal is inconsistent with the treatment of rights allocated during a prior auction.

III. Discussion

8. We deny the requests for rehearing. We reiterate that SPP did not sufficiently demonstrate that its proposal provides adequate safeguards in its TCR market, and that SPP provided no evidence to support its claim that its proposal would not increase the risk of payment default or under-collateralization. Specifically, SPP has not demonstrated that its proposal would satisfy the requirement in Order No. 741 to eliminate unsecured credit for TCR positions.

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[7] *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, *reh'g denied*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

[8] In support of this statement, SPP submitted an affidavit from Scott Smith, the Director of Treasury and Risk Management for SPP, who oversees the administration of SPP's credit and financial security requirements for market participants in SPP's Integrated Marketplace. Mr. Smith also states that, under SPP's current credit requirements, credit customers may be required to maintain financial security that is up to ten times greater than would be required under the proposed revisions. Mr. Smith asserts that the netting process reflected in the proposed revisions would improve market efficiencies by reducing unnecessarily high collateralization requirements for certain TCR transactions.

9. In Order No. 741, the Commission directed each RTO/ISO to require collateral to support all TCR transactions and to eliminate unsecured credit for TCR positions.[9] As discussed in the May Letter Order, the Commission in Order No. 741 expressed concern that TCRs have "unique risks that distinguish them from other wholesale electric markets," and that the "potentially rapidly changing value of [TCRs] warrants adoption of risk management measures."[10] The Commission explained that, given the risks associated with TCR markets, "the use of unsecured credit . . . can lead to unforeseen and substantial costs in the event of a default."[11]

10. SPP's proposal would reduce the amount of financial security a participant in a TCR auction must provide based on the value of TCRs awarded in previous auctions. In other words, positively-valued TCRs could be used to satisfy the credit requirements associated with a TCR auction as a substitute for other collateral. However, SPP has not shown that positively-valued TCRs are sufficiently stable or liquid to substitute for other collateral. Without such a showing, using TCRs as collateral would constitute unsecured credit, and therefore the Commission is unable to determine whether the use of positively-valued TCRs to satisfy credit requirements during an auction would introduce unsecured credit into SPP's TCR market. If SPP's proposal does introduce unsecured credit into its TCR market, then the proposal would be inconsistent with the requirements of Order No. 741. SPP must provide enough support for its proposal to allow the Commission to evaluate the proposal, and it has not done so here.

11. The information SPP provided in its filing and request for rehearing does not meet its burden for the Commission to find these changes just and reasonable. SPP has not demonstrated that its proposal does not result in the extension of unsecured credit. SPP's statements that positively-valued TCRs are assessed for value on a daily basis with collateral requirements adjusted accordingly and the short duration of the auction period do not allay the Commission's concerns about this proposal resulting in the extension of unsecured credit. SPP has therefore failed to demonstrate that its proposal would not allow unsecured credit.[12]

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[9] Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 70-72.

[10] May Letter Order, 155 FERC ¶ 61,131 at P 5 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 70). Additional factors that contribute to the risks associated with TCRs are their longer-term obligations to perform, values that depend on unforeseeable events, and relative illiquidity. Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 58-59, 70.

[11] Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 59.

[12] *See* Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 70, 72.

12. KCP&L's statement that there is no risk of payment default before a customer has incurred a liability likewise does not demonstrate whether the proposal would allow for unsecured credit during the auction period. Statements from SPP and KCP&L that the current financial security requirements are unnecessary, that the proposal would increase market efficiency, and that current practices are detrimental to a healthy market environment also do not show that the proposal would not result in the use of unsecured credit.

13. We reject SPP's assertion that allowing netting for TCR bids and offers during a current auction period is effectively the same as allowing netting for cleared rights, and KCP&L's statement that rejecting the proposed revisions is inconsistent with the treatment of rights allocated during a prior auction. SPP must demonstrate that the proposal under consideration here is consistent with Order No. 741. SPP and KCP&L do not point to any evidence from previous filings or orders on SPP's existing netting practices that demonstrates that netting positively-valued TCRs during an auction would not result in the use of unsecured credit.[13]

14. Our denial of the requests for rehearing is without prejudice to SPP filing the proposed Tariff revisions with additional support. For example, SPP could file testimony from an individual with expertise on credit practices that explains the concept of secured and unsecured credit and why the use of positively-valued TCRs as credit during an auction does not result in the use of unsecured credit. The testimony could, among other things, explain how positively-valued TCRs are similar to other forms of credit that are secured credit. The Commission would evaluate whether the evidence presented in such a filing sufficiently demonstrates that accepting the proposed Tariff revisions would be consistent with the requirements of Order No. 741.

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[13] Moreover, we are not persuaded by the fact that no party protested the filing and that there was consensus for the proposed change in the stakeholder process. SPP Request for Rehearing at 5. Unlike markets with multilateral clearing (e.g., NYMEX, CME, etc.), SPP is not a financial intermediary who is providing terms to market participants based on risks to its balance sheet. Rather, any default is socialized to market participants. Under section 205 of the FPA, the Commission must perform an independent review of a utility's filing to ensure it is just and reasonable.

<u>The Commission orders</u>:

SPP’s and KCP&L’s requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.