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 ELECTRIC POWER SUPPLY ASSOCIATION

The Electric Power Supply Association[1] (EPSA) submits these comments in response to the Federal Energy Regulatory Commission's (FERC or Commission) May 12, 2010 Notice establishing a date for comments in response to the May 11, 2010 technical conference in the above captioned proceeding.[2] The May 11 technical conference focused on the issue of whether or not ISOs/RTOs should be required to become central counterparties to most or all of the transactions occurring in their markets, which was proposed in the Notice of Proposed Rulemaking (NOPR) published in this proceeding on January 21, 2010.[3] EPSA submitted comments addressing the proposals in the Credit NOPR, including the proposal to mandate that ISOs/RTOs become central counterparties on March 29, 2010. For the most part, EPSA's March 29 comments raised general questions over the proposal, noting that the

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[1] EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

[2] *Notice establishing date for comments re Credit Reforms in Organized Wholesale Electric Markets,* Docket No. RM10-13 (May 12, 2010).

[3] *Credit Reforms in Organized Wholesale Electric Markets,* 130 FERC ¶ 61, 055, Docket No. RM10-13-000 (January 21, 2010) ("Credit NOPR").

Commission had neither developed an adequate proposal nor had it generated a significant enough record on the central counterparty issue broadly.

EPSA appreciates that the Commission has developed a record on this issue through the May 11 technical conference, followed by the May 12 notice requesting comments. However, the NOPR proposal remains insufficiently developed to allow parties to comment definitely on its merits for different markets. As EPSA stated in its March 29 comments, FERC must more clearly define the problem to be resolved so that a potential solution can be fully developed and include sufficient detail so that comments to the Commission can address functionality, impacts, costs, benefits and concerns. As the May 11 technical conference demonstrated, different ISOs/RTOs would address issues of mutuality differently; it is unclear that the problems the Commission pose require mandating central counterparty status for all RTOs/ISOs or not. In fact, the ISO/RTO representatives at the May 11 technical conference had varying views on the potential for and extent of a mutuality problem and, thus, would propose different solutions to that problem.

At this time, EPSA submits that the proposal as it appears in the Credit NOPR requires greater exploration and a greater record before a final rule on the counterparty issue is ripe for issuance. All ISO/RTO representatives at the May 11 technical conference agreed that there could be more than one solution to the mutuality problem. The Commission should not be proscriptive in its answer to the mutuality problem without a robust proceeding to clearly identify the problem and all viable solutions. Alternatively, EPSA submits that the Commission could

more clearly define the mutuality problem in a final rule on credit reform and order that each ISO/RTO submit a compliance report or filing to address this issue as appropriate for its market.

I. COMMUNICATIONS

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II. COMMENTS

The Commission addresses the central counterparty in the following two paragraphs in the NOPR, the second of which offers the full proposal to resolve the problem:

> Organized wholesale electric markets typically arrange for settlement and netting of transactions entered into between market participants and the market administrator, but do not take title to the underlying contract position of a participant at the time of settlement. This practice became an issue during the Mirant bankruptcy and its resulting default in the CAISO market. Because CAISO had not "taken title" of the transactions, CAISO could not net payments owed to Mirant against payments owed by Mirant. As a result, all of Mirant's creditors had a claim to revenues owed to Mirant by CAISO market participants, but CAISO market participants bore the loss for money owed and not paid by Mirant.
>
> The Commission therefore proposes to revise its regulations to require that each RTO and ISO include in the credit provisions of its tariff revisions to clarify their status as a party to each transaction so as to eliminate any ambiguity or question as to their ability to manage defaults and offset

> market obligations. The Commission seeks comment on whether this clarification of status would have ramifications beyond addressing the risk highlighted here.[4]

There is no accompanying tariff language, and the proposal is that ISOs/RTOs simply clarify their status, which implies that there are not related structural or operational changes associated with compliance. Additionally, as stated in EPSA's March 29 comments, the problem itself is not fully defined but for the reference to the situation in CAISO. Though the specific problem to be addressed remains unclear, during the technical conference, several options were laid out as potential solutions. However the Commission's proposal has not been amended or refined to include greater specificity. Therefore, EPSA cannot support the proposal that is currently proposed in the Credit NOPR as there is simply not enough detail or consideration for the potential implications that this "clarification" may have on various ISOs/RTOs.

The May 11 technical conference confirmed that there are several different views on the severity of the problem concerning mutuality. Accordingly, there are several possible solutions. Further, participants in the May 11 technical conference fundamentally disagreed on whether becoming a central counterparty was merely a "clarification" as the Credit NOPR characterizes it, or carries more serious implications to the ISO/RTO. The record in this proceeding is simply not sufficient to support a national mandate that ISOs/RTOs function as central counterparties. At this point, the next reasonable step for the Commission is to

[4] Credit NOPR at P 24 and P 25. As EPSA pointed out in its March 29 comments, if CAISO had been a central counterparty in the NOPR's example, it may not have made a difference as this situation was tied into a failing of the California Power Exchange.

define precisely the mutuality problem and ask ISOs/RTOs to propose stakeholder-driven solutions to that problem.

A. DEFINING THE PROBLEM TO BE RESOLVED

The Credit NOPR defined the problem to be addressed by detailing a specific example that occurred in CAISO, though it is not clear that it is relevant to all markets. At the conference, however, the problem was more clearly defined by panelists as a question of mutuality. As Vince Duane from PJM noted, "I think all would agree that if you're engaged in netting, you need to have mutuality."[5] Alex Cato from the Committee of Chief Risk Officers ("CCRO") further explained mutuality:

> The basic equitable right of a setoff is one person should not be required to pay somebody something when the other person is not going to pay them. So you are setting off obligations. So the mutuality that we're talking about is between the parties in the same right and capacity.[6]

All parties at the conference seemed to agree that in the event of a catastrophic default, mutuality would have to be established to gain legal standing in a bankruptcy court. All market participants at the conference also agreed that such an event has not yet occurred. Though FERC staff posited that the California example described in the NOPR was the "perfect storm" and that "we have seen a number of subsequent perfect storms," [7] every ISO/RTO representative agreed that the risk of

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[5] Transcript, p. 13, lines 3-5. (Quoting Vince Duane).

[6] Transcript, pp. 63-64, lines 20-2 (Quoting Alex Catto).

[7] Transcript, p. 31, lines 13-16 (Quoting Scott Miller). PJM noted: "I think this is something that isn't – hasn't happened, and it doesn't happen every day. Transcript, p. 15, lines 12-13 (Quoting

catastrophic default has not yet occurred. Thus, the two points were agreed to at the conference: (1) mutuality should exist for parties engaging in setoffs, and (2) the type of catastrophic event from which mutuality would protect an ISO/RTO has not yet occurred.

Where panelists disagreed was over the gravity of the legal risk and the need for a national solution to the mutuality question. PJM clearly agrees with the NOPR that becoming a central counterparty is the solution to the mutuality problem in its market, and that this can be accomplished as set out in this NOPR.

Other ISOs in attendance at the conference voiced concern about the legal implications of the central counterparty issue in the NOPR. These concerns are buffeted by the belief by CAISO and MISO that the mutuality risk is not extensive, certainly not as extensive as believed by PJM. Daniel Shonkwiler from CAISO noted "[I]t's hard to see a serious credit risk here to our market participants,"[8] and, "[I]t's a lost opportunity possibly for extra protection but nothing else."[9] Representatives from MISO noted that the risk is different for different RTOs. The operational tariffs and the market participant pools are far different in various ISOs and RTOs. Michael Holstein noted,

> The makeup of our market is very different. From the most recent weekly invoicing cycle, if we look at who our counterparties are,

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Vince Duane); MISO noted: "To date, that has not occurred. There has been no loss to an RTO and there has been no loss to a market participant due to netting not being allowed in a bankruptcy proceeding Transcript, p. 17, lines 4-7 (Quoting Michael Holstein).

[8] Transcript, p. 30, lines 20-21 (Quoting Daniel Shonkwiler).

[9] Transcript, p. 25, lines 12-14 (Quoting Daniel Shonkwiler).

> basically, vertically integrated utilities, cooperatives, municipalities, to a much lesser extent generators, a very much lesser extent, and even other ISOs, RTOs.[10]

Thus, while there was agreement that legal mutuality should be established for entities using setoffs in the event of a catastrophic default, there was not consensus on the severity of the legal threat and the need for a national solution.

B. CENTRAL COUNTERPARTIES AND OTHER POSSIBLE SOLUTIONS

One concept on which there was clear consensus throughout the conference is that there is more than one way to establish mutuality. Harold Novikoff, a bankruptcy lawyer from Lipton, Rosen & Katz laid out three possible solutions: (1) create mutuality by using a central counterparty; (2) create a collateral arrangement which will get to the same economic result; and (3) rewrite tariffs so they establish a net obligation rather than a gross obligation.[11] While PJM stakeholders have chosen to go with option (1), MISO's stakeholders prefer a security interest solution that more closely mirrors option (2). When pressed, Daniel Shonkwiler from CAISO asserted that he would rather CAISO craft a solution like MISO's than PJM's.

Vince Duane from PJM noted that the difference between the three solutions is "just a timing question of funding." [12] He then further framed the decision-making that goes into choosing a mutuality solution:

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[10] Transcript, p. 34, lines 5-10 (Quoting Michael Holstein); Also see: Transcript, p. 74, lines 18-20 (Quoting Stephen Dutton): "The risk is different or may be different among the various ISOs depending on their tariffs."

[11] Transcript, p. 72-74, lines 18-20 (Quoting Harold Novikoff).

[12] Transcript, p. 56, lines 8-14 (Quoting Vince Duane).

> [D]o you prefund it? The loss is the loss and the members are responsible for the loss under the mutualized structures that we all share. Are you going to seek that members fund in advance a pool of money to cover those potential losses? Or are you going to allocate them afterwards?[13]

Recognizing that other solutions exist, Mr. Duane went on to say:

> I think in terms of establishing mutuality [the MISO security interest solution] does the job. It does the job as well as establishing the RTO as a contract party to pool transactions… [I]mplementing the security, the perfected security interest approach comprehensively as the Midwest ISO sought to do back in 2004, I think would do the trick.[14]

Additionally, in its own counterparty proposal filed with the Commission, PJM notes, “"There may be alternative ways to address these matters in other regions, but as evidenced by the strong support of the PJM members, for PJM this proposal is ready for implementation."[15]

In discussing MISO’s preference for the security interest solution, Mr. Holstein explained that granting a security interest to MISO is voluntary, but MISO will not permit netting across categories by a market participant unless the market participant grants MISO a security interest. Mr. Holstein explained,

> Right now the security interest issue is voluntary. You can choose to elect or not elect. If you don't give us the security interest, then you have to give us potentially more collateral, depending upon the nature of your transactions.[16]

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[13] Ibid.

[14] Transcript, p. 50, lines 2-5 and 16-19 (Quoting Vince Duane).

[15] *PJM Interconnection, LLC submits Eleventh Revised Sheet No. 1 et al and the Amended and Restated Operating Agreement*, Docket No. ER10-1196-000 (May 5, 2010) (“May 5 PJM Proposal”), p 2. PJM’s proposal should not be viewed as precedent or a template for national policy or requirement. See: *Motion for Leave to Intervene and Comment of the Electric Power Supply Association,* Docket No. ER10-1196-000 (May 26, 2010).

[16] Transcript, p. 45, lines 20-24 (Quoting Michael Holstein)

However, the panelists recognized that there are drawbacks to the security interest approach as well. Mr. Novikoff noted:

> I think as has been pointed out, this can be difficult in the sense that there may be issues as to whether certain participants have the authority or the power to grant a security interest. Some entities -- for example, municipalities -- may not be able to do that. Others may be constrained by covenants in lending agreements or other agreements from granting security interests. So that is a practical damper on using that type of solution. But in theory you can get to the result through a collateral pool.[17]

The panel discussions make clear that, at a minimum, before the Commission implements the proposal as it stands in the Credit NOPR, a more thorough exploration of the three available options should be conducted. Alternatively, it is clear that there are several possible solutions and that each ISO/RTO may require different solutions based on their geographic region and stakeholder makeup. In the absence of a separate proceeding to consider all possible solutions, the Commission should allow each ISO/RTO to work independently with its stakeholders to craft a regionally tailored solution, as PJM has done.

C. DEBATE OVER "CLARIFICATION"

In its March 29 Comments, EPSA expressed concern that while the Credit NOPR frames becoming a central counterparty as a "clarification in status," it may indeed mark a major policy shift with significant legal, tax and financial implications.[18] This debate was continued at the technical conference; PJM

[17] Transcript, p. 73, lines 4-12 (Quoting Harold Novikoff)

[18] Indeed, PJM's counterparty proposal sets up a new, separate legal entity to function as the counterparty to market participants and customers. PJM included requests for certain waivers of

clearly agreed with the Credit NOPR, while MISO and CAISO disagreed, citing potentially fatal implications for the ISO structure. While PJM asserted that, “Nothing here is changing other than really some wording,”[19] MISO and CAISO enumerated significant potential consequences and cost.

MISO’s primary objection to the central counterparty proposal was that it would obligate MISO to pay for defaults in the event other parties to the transaction could not pay. Michael Holstein explained that in the event of a default, as a counterparty MISO may be obligated to pay even though MISO has no reserves for such an event. Thus, while becoming a counterparty would establish mutuality, it could also result in bankruptcy for the ISO. “The potential to the proposed cure for netting will in fact have the potential to create greater harm, which could be catastrophic to an RTO,” Mr. Holstein concluded.[20] CAISO raised cost concerns, noting that the ISO does not perceive a great enough credit risk to warrant the cost of becoming a central counterparty.[21] Daniel Shonkwiler asserted that:

> [B]ecoming a counterparty in our transactions would make the California ISO, or would take it from being a $200 million company, a nice small utility, to an $8 billion company, and that transformation is not simply achieved.[22]

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filing and regulatory requirements that would apply to PJM Settlement, Inc. but are duplicative and unnecessary as they are already applied to PJM Interconnection, L.L.C.[18] Clearly, if this clarification requires a 550 page filing from PJM, it may not be a simple, straightforward clarification of status as indicated in the short description in the NOPR. (May 5 PJM Proposal).

[19] Transcript, p. 15, lines 4-5 (Quoting Vince Duane).

[20] Transcript, p. 17, lines 12-14 (Quoting Michael Holstein).

[21] Transcript, p. 21, lines 22-24 (Quoting Daniel Shonkwiler).

[22] Transcript, p. 28, lines 3-7 (Quoting Daniel Shonkwiler).

Clearly, the ISOs/RTOs in attendance at the May 11 technical conference have varying degrees of comfort with the Commission's proposed "clarification in status." ISOs/RTOs not in attendance may still have other views.[23] As each ISO and RTO is structured differently – having different legal statuses, being incorporated differently, and having vastly different tariffs – it would be a mistake to assume that what could be construed as a "legal clarification" in one ISO/RTO would be exactly the same in another, and whether this proposal requires mere clarification is in question as well. The Commission should allow each ISO/RTO the opportunity to assess the legal risk involved with becoming a central counterparty based on its market design and structure and decide what framework would resolve the mutuality problem for its region.

D. RECORD IN THIS PROCEEDING

The Commission discussed mutualized default risk in a 2004 Policy Statement on credit-related issues.[24] In 2004, the Commission recognized that:

> Although the Commission believes that there is a consensus in the industry… that the goal of reducing the mutualized default risk is an important one, there are differences in opinion among various entities regarding the question of what types of methods should be used to reduce that risk and what the achievable reductions are.[25]

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[23] Indeed, ISO New England and NYISO did not take a position on the central counterparty issue in their Credit NOPR comments. ISO New England did, however, ask that the Commission undertake more review in a separate proceeding.

[24] *Policy Statement on Credit-Related Issues for Electric OATT Transmission Providers, Independent System Operators and Regional Transmission Organizations,* 109 FERC ¶ 61,186, Docket No. PL05-3 (November 19, 2004). ("2004 Policy Statement").

[25] 2004 Policy Statement at P 20.

At that time, the Commission offered shortened settlement periods and netting as cost-effective steps to reduce the exposure to risk among market participants. Many of the proposals in the Credit NOPR are resultant from the ISO/RTO practices that were born of the 2004 policy statement. However, only two sentences in the 2004 Policy Statement addressed the central counterparty idea; it was not explained in great detail, nor was it advanced as a mandatory measure.[26]

While EPSA appreciates that the Commission held the May 11 technical conference in order to establish a fuller record on this issue, the initial notice of the conference did not state an intention to build a record on this specific issue, nor did it ask for speaker requests or recommendations. By the time the intent of the May 11 conference was made known, the agenda was already set.[27] Finally, it was clear from FERC Staff's opening remarks as well as the May 12 notice requesting comments that the goal for the conference was to specifically expand the record concerning the Credit NOPR's central counterparty proposal.[28]

The record that has been produced thus far demonstrates the disparity in opinions on the central counterparty proposal among the ISOs/RTOs. The technical conference, which focused on the central counterparty issue, was open

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[26] 2004 Policy Statement at P 31. "Credit clearing might also provide a platform to net obligations and could possibly serve to transfer credit risk to entities that are better able to manage such risk. Specifically, clearing services could encompass a central counterparty, such as a clearinghouse, that would assume and manage the default risk that would otherwise be borne by an ISO's/RTO's market participants on a mutualized basis."

[27] *Notice of Agenda for Technical Conference,* Docket No. RM10-13-000 (May 5, 2010).

[28] Transcript, p. 4, lines 5-7. (Quoting Scott Miller). From the May 12 Notice Requesting Comments: "Specifically, the technical conference addressed the proposal in the *Credit Reforms NOPR* regarding whether Independent System Operators/Regional Transmission Operators should adopt tariff revisions to clarify their status as a counterparty to transactions in their markets."

only to a few selected speakers. In order for the Commission to fully appreciate the numerous aspects of the problem of mutalization, the available solutions, and the pros and cons of each solution, a more robust record must be developed. There simply has not been enough discussion of definition surrounding the mutuality problem to warrant a sweeping national policy.

III. CONCLUSION

Wherefore, EPSA respectfully requests that the Commission adopt the recommendations herein, including allowing for greater exploration and development of a complete record before issuing a final rule on the mutuality issue. Alternatively, the Commission should allow each region to work with its stakeholders to propose a solution in a compliance report or filing.

Respectfully Submitted,

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June 8, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the Comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. June 8, 2010.

Nancy Bagot, VP of Regulatory Affairs