

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

PJM Interconnection, L.L.C.)	Docket No. ER11-3972-001
California Independent System Operator Corporation)	Docket No. ER11-3973-000
ISO New England Inc.)	Docket No. ER11-3953-000
Midwest Independent Transmission System Operator, Inc.)	Docket No. ER11-3970-000
New York Independent System Operator, Inc.)	Docket Nos. ER11-3949-000 ER11-3949-001 ER11-3949-002
Southwest Power Pool, Inc.)	Docket Nos. ER11-3958-000 ER11-3967-000

**REQUEST FOR REHEARING, CLARIFICATION, AND TECHNICAL
CONFERENCE OF ELECTRIC POWER SUPPLY ASSOCIATION**

Pursuant to Section 313(a) of the Federal Power Act (the “FPA”),¹ and Rule 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (the “Commission”),² the Electric Power Supply Association (“EPSA”),³ hereby submits this request for rehearing and clarification of the Commission’s September 15, 2011 order in Docket No. ER11-3972,⁴ which conditionally accepted the June 30, 2011 filing by PJM Interconnection,

¹ 16 U.S.C. § 825I(a) (2006).

² 18 C.F.R. § 385.713 (2011).

³ EPSA is the national trade association representing competitive power suppliers, including generators and marketers. Competitive suppliers, which, collectively, 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.

⁴ *PJM Interconnection, L.L.C.*, 136 FERC ¶ 61,190 (2011) (the “PJM Compliance Order”). EPSA has been made a party to this proceeding. See *id.*, Appendix A.

L.L.C. (“PJM”)⁵ of proposed revisions to its Open Access Transmission Tariff (the “PJM Tariff”)⁶ in compliance with Order No. 741.⁷ EPSA respectfully requests rehearing of the Commission’s decision to treat “Seller Credit”⁸ as simply another form of unsecured credit to be included in the \$50 million unsecured credit cap and not allowing the use of Seller Credit to meet financial transmission rights (“FTR”) credit requirements.⁹ In addition, EPSA requests that the Commission convene a technical conference in all of the above-captioned Order No. 741 compliance proceedings¹⁰ to give the Commission, each independent system operator (“ISO”) and regional transmission organization (“RTO”), market participants, and other interested stakeholders the opportunity to identify areas in which uniform credit practices should be established across all organized markets, to reach agreement on the appropriate uniform standards, and to

⁵ PJM Interconnection, L.L.C., Order No. 741 Compliance Filing, Docket No. ER11-3972-000 (filed June 30, 2011) (the “PJM Compliance Filing”).

⁶ Except as otherwise indicated, all capitalized terms used herein shall have the same meaning as provided in the PJM Tariff or the PJM Compliance Filing.

⁷ *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, FERC Stats. & Regs. ¶ 31,317 (2010) (“Order No. 741”), *order on reh’g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 (“Order No. 741-A”), *reh’g denied*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

⁸ PJM extends credit to market participants that have a history of being a net seller into PJM markets over the prior 12 months. See PJM Tariff, Attachment Q, §§ II.C and IV.E (describing “Seller Credit” and “RPM seller credit”).

⁹ PJM Compliance Order at PP 22, 26. EPSA’s concerns about this aspect of the Commission’s PJM Compliance Order are the same as those raised in a separate request for rehearing filed by two of its member companies, Edison Mission Energy and Exelon Corporation. See Request for Rehearing and Clarification, Docket No. ER11-3972-001 (filed Oct. 14, 2011).

¹⁰ EPSA would emphasize that herein it is seeking rehearing and clarification of only the PJM Compliance Order, but not of any of the other ISO/RTO Compliance Orders issued in the other above-captioned dockets.

address other issues of common concern raised in these proceedings (the “ISO/RTO Compliance Proceedings”).¹¹

I. STATEMENT OF ISSUES AND ERRORS IN THE PJM COMPLIANCE ORDER

In accordance with Rule 713(c)(2) of the Commission’s Rules of Practice and Procedure,¹² EPSA hereby lists each issue on which it seeks rehearing or clarification of the PJM Compliance Order and provides representative precedent in support of its positions on these issues:

1. In previous decisions, the Commission has recognized that Seller Credit does not have the risks typically associated with unsecured credit. See *PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,323 (2008) (the “June 2008 Order”); *PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,017 (2009) (the “April 2009 Order”). In the PJM Compliance Order, however, the Commission inexplicably reversed its approach and treated Seller Credit as simply another form of unsecured credit. Thus, the PJM Compliance Order was arbitrary and capricious because the Commission deviated from its established precedent, without providing a reasoned explanation. See 5 U.S.C. § 706(2)(A) (2006). See also *FCC v. Fox Television Stations, Inc.*, 129 S.Ct. 1800 (2009) (“*Fox Television*”); *Panhandle E. Pipe Line Co. v. FERC*, 196 F.3d 1273 (D.C. Cir. 1999) (“*Panhandle*”); *Entergy Servs., Inc. v. FERC*, 391 F.3d 1240 (D.C. Cir. 2004) (“*Entergy*”).
2. The PJM Compliance Order is arbitrary and capricious, and is not the product of reasoned decisionmaking, because it is not supported by substantial evidence insofar as it treats Seller Credit like other forms of unsecured credit. See 5 U.S.C. § 706(2)(E) (2006). See also *Northern States Power Co. v. FERC*, 30 F.3d 177

¹¹ See *California Indep. Sys. Operator Corp.*, 136 FERC ¶ 61,194 (2011) (“CAISO Compliance Order”); *ISO New England Inc.*, 136 FERC ¶ 61,191 (2011) (“ISO-NE Compliance Order”); *Midwest Indep. Transmission Sys. Operator, Inc.*, 136 FERC ¶ 61,188 (2011) (“MISO Compliance Order”); *New York Indep. Sys. Operator, Inc.*, 136 FERC ¶ 61,193 (2011) (“NYISO Compliance Order”); PJM Compliance Order; *Southwest Power Pool, Inc.*, 136 FERC ¶ 61,189 (2011) (“SPP Compliance Order”) (collectively, the “ISO/RTO Compliance Orders”).

¹² 18 C.F.R. § 385.713(c)(2) (2011).

(D.C. Cir. 1994) (“*Northern States*”); *Mo. Pub. Serv. Comm’n v. FERC*, 337 F.3d 1066 (D.C. Cir. 2003) (“*MoPSC*”).

3. By treating Seller Credit as simply another form of unsecured credit, the Commission has required market participants to redeploy capital to support the same level of trading and harmed competition in the PJM markets without providing any additional protection against the risk of default. Accordingly, the Commission’s findings in the PJM Compliance Order with respect to Seller Credit are unjust and unreasonable in violation of Sections 205 and 206 of the FPA. 16 U.S.C. §§ 824d and 824e (2006).
4. The PJM Compliance Order requires PJM to remove Seller Credit from the \$50 million cap on unsecured credit and eliminate the use of Seller Credit from meeting FTR credit requirements, but fails to explain why it has not required the New York Independent System Operator, Inc. (“NYISO”), which has largely similar credit practices, to make similar changes. *Cf.* PJM Compliance Order at PP 22, 26 and NYISO Compliance Order at P 15. Thus, by treating the similar credit policies of PJM and NYISO differently, the Commission’s findings in the PJM Compliance Order with respect to Seller Credit are unduly discriminatory and preferential in violation of Sections 205 and 206 of the FPA. 16 U.S.C. §§ 824d and 824e (2006).
5. The Commission has recognized that undue discrimination occurs not only when similarly situated customers are treated differently but also when dissimilarly situated customers are treated the same. *See, e.g., Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,061 at P 69 (2007) (“*CAISO*”); *Southwest Power Pool, Inc.*, 127 FERC ¶ 61,283 at P 29 (2009) (“*SPP*”). Thus, by denying net sellers the use of Seller Credit to meet its credit obligations, the Commission has discriminated against net sellers and preferred net buyers when it comes to PJM’s credit policies. *See, e.g., “Complex” Consol. Edison Co. of N.Y., Inc. v. FERC*, 165 F.3d 992, 1012 (D.C. Cir. 1999) (“*Consolidated Edison*”).
6. The PJM Compliance Order is arbitrary and capricious, and is not the product of reasoned decisionmaking, because the Commission failed to address, or respond meaningfully to, the serious objections to its approach raised by EPSA. *See, e.g., Moraine Pipeline Co. v. FERC*, 906 F.2d 5 (D.C. Cir. 1990) (“*Moraine Pipeline*”); *Canadian Ass’n. of Petroleum Producers v. FERC*, 254 F.3d 289 (D.C. Cir. 2001) (“*CAPP*”); *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (“*State Farm*”).

7. To the extent the Commission denies rehearing of its determinations regarding the treatment of Seller Credit, EPSA respectfully requests that the Commission clarify that, if PJM was to require market participants to enter into a security agreement with PJM in order to qualify for Seller Credit, PJM could exclude Seller Credit from the \$50 million cap on unsecured credit and permit market participants to use Seller Credit to meet their FTR credit requirements consistent with Order No. 741.

II. BACKGROUND

A. Order No. 741

In Order No. 741, the Commission adopted a number of reforms to credit practices used in organized wholesale electric power markets including, *inter alia*, restrictions on the amount of unsecured credit that can be used¹³ and the elimination of unsecured credit in FTR or equivalent markets.¹⁴ The Commission therefore directed each independent system operator (“ISO”) and regional transmission organization (“RTO”) to “submit a compliance filing that includes tariff revisions to establish a limit on unsecured credit of no more than \$50 million per market participant.”¹⁵ In Order No. 741-A, the Commission granted rehearing and established that “the limit on the use of unsecured credit should be no more than \$50 million per entity, including the corporate family to which an entity belongs.”¹⁶ The Commission also directed “each ISO and RTO to submit a compliance filing that includes tariff revisions to eliminate the use of unsecured credit in its FTR, or FTR equivalent, markets.”¹⁷ The Commission required that

¹³ See Order No. 741 at PP 49-52.

¹⁴ See *id.* at PP 70-79.

¹⁵ *Id.* at P 52.

¹⁶ Order No. 741-A at P 9.

¹⁷ Order No. 741 at P 75.

such compliance filings “must be submitted by June 30, 2011, and the tariff revisions will take effect October 1, 2011.”¹⁸

B. The PJM Compliance Filing

On June 30, 2011, PJM submitted its revised tariff sheets in compliance with the Commission’s directives in Order No. 741.¹⁹ With respect to restrictions on the use of unsecured credit, PJM noted that it already had adopted a \$50 million cap on unsecured credit for a single market participant.²⁰ As a result, PJM simply added tariff language which clarified that the unsecured credit allowance of a market participant (either granted based on its own creditworthiness or conveyed through a guaranty) shall not exceed \$50 million and, in compliance with Order No. 741-A, reduced the limit for the aggregate unsecured credit allowance for a group of affiliates from \$150 million to \$50 million.²¹

PJM also indicated that its credit practices do not include Seller Credit in the \$50 million cap on unsecured credit.²² PJM described how such credit is only available to market participants that sell more in the PJM markets than they purchase.²³ Although Seller Credit is characterized as a type of unsecured credit, PJM described how it is more properly viewed as netting or offsetting and does not have the same risks associated with unsecured credit because, in the

¹⁸ *Id.* at PP 52, 75.

¹⁹ *See generally* PJM Compliance Filing.

²⁰ *Id.*, Transmittal Letter at 43 (*citing* Order No. 741 at P 50).

²¹ *Id.*

²² *Id.* at 44.

²³ *Id.* at 45.

event of a default, the market participant's net sell position would offset the default.²⁴ Accordingly, PJM argued that excluding Seller Credit from the cap on unsecured credit is consistent with the goals of Order No. 741.²⁵

With respect to the elimination of unsecured credit in FTR or equivalent markets, PJM noted that it previously eliminated the use of unsecured credit in the FTR market.²⁶ PJM also indicated that it permits the use of Seller Credit to meet FTR credit requirements and such elimination did not apply to FTRs that were acquired prior to the June 1, 2009 FTR auctions. Therefore, to the extent necessary, PJM requested confirmation from the Commission that "the continued utilization of an unsecured credit allowance for FTRs that were acquired prior to the June 2009 auction, and the continued availability of Seller Credit for use in the FTR credit limit, are consistent with and comply with the directives in Order No. 741."²⁷

On July 25, 2011, EPSA filed a limited protest and request for clarification to address a number of issues that were common to all six of the ISO/RTO Order No. 741 compliance filings.²⁸ In its protest, EPSA expressed concern regarding the lack of uniformity among the ISO/RTO Order No. 741 compliance filings. EPSA noted that, while many of the compliance proposals were similar, there were differences that could lead market participants to unintentionally run afoul of

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 55 (*citing* Order No. 741 at P 71).

²⁷ *Id.* at 57.

²⁸ See Limited Protest and Request for Clarification of the Electric Power Supply Association, Docket No. ER11-3973-000, *et al.* (filed July 25, 2011) ("EPSA Protest").

some of the requirements.²⁹ These differences included, but were not limited to: notarization requirements for annual certifications, the scope of the Material Adverse Change (“MAC”) clauses; and the use of different benchmarks or measures used to assess risk for the purposes of applying the MAC clauses.³⁰

C. The PJM Compliance Order

In the PJM Compliance Order, the Commission found that “seller credit is unsecured credit because it is potential value to the participant rather than actual secured value to PJM.”³¹ As a result, the Commission concluded that “any seller credit must be counted in the \$50 million cap on unsecured credit.”³² For the same reason, the Commission found that “the provisions of [the PJM Tariff] that permit the use of seller credit to meet the FTR credit requirements are contrary to Order No. 741’s requirement to eliminate the use of unsecured credit in the FTR markets.”³³ Accordingly, the Commission ordered the filing of revisions to the PJM Tariff within 90 days to provide that Seller Credit will be included in the \$50 million cap on unsecured credit and remove any provision that permits the use of Seller Credit to meet FTR credit requirements.³⁴ With respect to EPSA’s concerns, the Commission did not require the adoption of uniform credit standards across ISOs/RTOs, but “recognize[d] that that there may be merit in minimizing the differences in requirements for each RTO and ISO, and we are

²⁹ *Id.* at 2.

³⁰ *Id.*

³¹ PJM Compliance Order at P 22.

³² *Id.*

³³ *Id.* at P 26.

³⁴ *Id.* at PP 22, 26.

open to subsequent efforts by industry participants and the RTOs and ISOs to come up with uniform criteria.”³⁵

III. REQUEST FOR REHEARING OF THE PJM COMPLIANCE ORDER

A. The Commission’s Findings Regarding Seller Credit Are Arbitrary And Capricious Because These Findings Represent An Unexplained Departure From Long-Standing Commission Precedent And Are Not Supported By Substantial Evidence.

Over the past several years, the Commission has accepted a number of proposed improvements to PJM’s credit policies after PJM suffered defaults in its FTR market.³⁶ In June 2008, the Commission accepted certain revisions to PJM’s credit policies, which implemented the use of Seller Credit.³⁷ PJM described Seller Credit as a reduction in a qualified net seller’s financial security obligations from recognizing the potential value of consistent net positive sales positions in the PJM markets. In accepting PJM’s proposal, the Commission indicated that “[t]he requirement for a consistent net positive sales position over a 12 month period limits the Seller Credit to those participants with a sufficient financial history to warrant higher unsecured credit.”³⁸ The Commission also noted that Seller Credit would be available to market participants in the FTR market and found this acceptable because the requirement to have a net positive

³⁵ *Id.* at P 41.

³⁶ *See PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,279 at P 26 n. 10 (2008) (citing defaults by Excel Power Services, LLC and Power Edge, LLC in PJM’s FTR market).

³⁷ *See generally* June 2008 Order.

³⁸ *Id.* at P 24. *See also id.* at P 26 (“The instant proposal provides another way to obtain unsecured credit and is based on a different evaluation factor – a participant’s Net Sell Position, which allows a measure of creditworthiness that will only impact the collateral requirements of those participants who have been deemed to have higher creditworthiness.”)

sales position would prevent Seller Credit from being available to market participants “holding riskier unbalanced FTR portfolios.”³⁹

Ten months later in April 2009, the Commission accepted further revisions to PJM’s credit policies that reduced the amount of unsecured credit available to a single market participant from \$150 million to \$50 million and eliminated the use of unsecured credit by a market participant to meet its FTR credit requirements.⁴⁰ In accepting these revisions, the Commission recognized that Seller Credit was unlike other forms of unsecured credit and, therefore, does not need to be included within the proposed \$50 million cap on unsecured credit and could be used by a market participant to meet its FTR credit requirements.⁴¹

In January 2010, the Commission took the lessons learned from recent defaults in ISO/RTO markets and issued a notice of proposed rulemaking in which it proposed certain credit reforms in the organized wholesale electric power markets.⁴² In proposing a \$50 million cap on unsecured credit per market participant and the elimination of unsecured credit in FTR markets, the Commission cited the recent changes made to PJM’s credit policies in support of

³⁹ *Id.* at 27.

⁴⁰ PJM also proposed to establish a \$150 million cap on affiliated group aggregate Unsecured Credit Allowance. April 2009 Order at P 6.

⁴¹ The Commission also accepted certain revisions to the calculation of the Seller Credit allowance to be consistent with PJM’s additional change from a monthly to weekly billing and settlement process. *See id.* at PP 7, 34 (accepting change in the amount of seller credit from two-thirds of the 3rd smallest monthly net sell position over the last 12 months to 60 percent of the 13th smallest weekly net sell position over the last 52 weeks).

⁴² *See generally Credit Reforms in Organized Wholesale Electric Markets*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,651 (2010) (“Credit Reforms NOPR”).

its proposals.⁴³ Further, when adopting these same proposals in Order No. 741, the Commission again cited the recent changes to PJM's credit policies in support of its new requirements.⁴⁴

After lauding PJM's revised credit practices in Order No. 741, however, the Commission inexplicably reversed itself in the PJM Compliance Order. Specifically, the Commission required PJM to revise the PJM Tariff to provide that Seller Credit be included in the \$50 million cap on unsecured credit and to remove any provisions that permit the use of Seller Credit to meet FTR credit requirements.⁴⁵ The Commission's explanation for this abrupt reversal was simply that "seller credit is unsecured credit because it is potential value to the participant rather than actual secured value to PJM."⁴⁶ Based on this erroneous assumption that Seller Credit is unsecured (rather than secured) credit, the Commission concluded that any Seller Credit must be counted in the \$50 million cap on unsecured credit and cannot be used by a market participant to meet its FTR credit requirements.

⁴³ See *id.* at P 7 (*citing* April 2009 Order at P 4) (noting that PJM "has made several filings revising its tariff to modify its credit practices" and that the Commission had "recently accepted PJM's proposal to revise its tariff to reduce its settlement cycle from 30 days to seven days, reduce the amount of unsecured credit allowed to \$50 million for a member company and \$150 million for an affiliated group, and eliminate unsecured credit in the financial transmission rights market.")

⁴⁴ See Order No. 741 at P 50 (noting that the California Independent System Operator Corporation ("CAISO") and PJM had "adopted a \$50 million cap on unsecured credit for a single market participant, indicating that this level has already been accepted and incorporated into the business practices of market participants throughout the country."). See *also id.* at P 71 (*citing* April 2009 Order at PP 8, 36) (noting that "PJM suffered a significant default in December 2007 in its FTR market and moved to eliminate the use of unsecured credit in that market due to its risk."). See *also* Credit Reforms NOPR at P 7.

⁴⁵ PJM Compliance Order at PP 22, 26.

⁴⁶ *Id.* at P 22.

The Commission's dichotomy between secured and unsecured credit is a "red herring" when it comes to the use of Seller Credit in the PJM markets. Although it is characterized as a type of unsecured credit, PJM explained that Seller Credit does not have the same risks associated with unsecured credit and is more properly viewed as a form of netting or offsetting.⁴⁷ In the event of a default by a market participant with Seller Credit, PJM would net or offset the amount of the default (*i.e.*, accounts payable to PJM) against amounts owed by PJM to the market participant from its net sell position in the PJM markets (*i.e.*, accounts receivable from PJM). The Commission has advocated the use of netting for several years now. For example, in its 2004 *Policy Statement on Electric Creditworthiness*,⁴⁸ the Commission explained that:

Another method of minimizing the size of the credit risk exposure in ISOs/RTOs is to net obligations owed by and to individual market participants whenever possible. Under netting, obligations for transactions with a given counterparty are offset against revenues for other transactions with that counterparty. Thus, a market participant's payment obligation to an ISO/RTO would be offset, or netted against, what the market participant is owed from ISO/RTO. As a result, exposure will usually be considerably smaller than if the obligations were not netted.⁴⁹

The Commission recognized that there is some risk to an ISO/RTO of netting accounts payable against accounts receivable due to the lack of mutuality

⁴⁷ PJM Compliance Filing, Transmittal Letter at 45 ("Although the Seller Credit is characterized as a type of unsecured credit, it does not have the same risks associated with unsecured credit based on a participant's financial condition. Instead, Seller Credit is more similar to the netting or offsetting of the positions and obligations of a participant in the credit evaluation. In the event of a default of a participant with Seller Credit, it would be expected that its sell position would offset the default by netting offsetting obligations, and the risk to other market participants of defaults would be small.").

⁴⁸ 109 FERC ¶ 61,186 (2004) ("Electric Creditworthiness Policy Statement").

⁴⁹ *Id.* at P 25.

between the ISO/RTO and the market participants if bankruptcy protection is sought.⁵⁰ However, the Commission addressed this potential risk when it approved PJM's creation of a central counterparty, PJM Settlement, Inc. ("PJM Settlement"), to establish mutuality for transactions in the PJM markets.⁵¹ As PJM explained, PJM Settlement "will establish mutuality between market participants and a specified counterparty to best ensure the enforceability of netting and set-off of a market participant's debits and credits in a default situation, reducing the risk of exposure of members to defaults."⁵² Thus, Seller Credit is protected against bankruptcy-related risks just like other forms of netting or offsetting used by PJM.⁵³

Thus, Seller Credit does not have the risks typically associated with unsecured credit. As a result, Seller Credit should not be viewed by the Commission as either secured or unsecured credit. Instead, it should be viewed as a form of netting or offsetting. Previously, in the June 2008 Order (establishing Seller Credit) and the April 2009 Order (excluding Seller Credit from the \$50 million cap on unsecured credit and allowing Seller Credit to be used in

⁵⁰ See *id.* at P 27; Order No. 741 at P 116 ("The Commission supports netting, which allows ISOs and RTOs to collect less collateral from market participants, but netting must be established in a way that helps ensure that market participants are protected from a substantial default should a participant file for bankruptcy protection.").

⁵¹ See generally *PJM Interconnection, L.L.C.*, 132 FERC ¶ 61,207 (2010) ("September 2010 Order") (accepting PJM's proposal to establish PJM Settlement as the counterparty to transactions in PJM's markets).

⁵² *Id.* at P 5.

⁵³ See PJM Tariff, Attachment Q § VII ("No payments shall be due to a Participant, nor shall any payments be made to a Participant, which the Participant is in default or has been declared in Breach of this policy or the Agreements, or while a Collateral Call is outstanding. PJM Settlement may apply towards an ongoing default any amounts that are held or later become available or due to the defaulting Participant through PJM's markets and systems.").

the FTR markets), the Commission recognized the important distinctions between Seller Credit and other forms of unsecured credit, and even lauded PJM's existing credit policies in the Credit Reform NOPR and Order No. 741.⁵⁴ In the PJM Compliance Order, however, the Commission inexplicably reversed its approach and treated Seller Credit as simply another form of unsecured credit. The Commission's determination was arbitrary and capricious because it constituted an unacknowledged, and unexplained, departure from its established precedent on PJM's use of Seller Credit.⁵⁵ Moreover, the Commission's finding in the PJM Compliance Order that Seller Credit is like unsecured credit not only conflicts with its previous findings, but is not supported by evidence in the record, much less the substantial evidence necessary to survive judicial review.⁵⁶ The Commission must therefore grant rehearing and reverse its determination regarding Seller Credit.

⁵⁴ See Order No. 741 at PP 50, 71.

⁵⁵ See Administrative Procedure Act ("APA"), 5 U.S.C. § 706(2)(A) (an agency decision must not be upheld if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."). See also *Fox Television*, 129 S.Ct. at 1811 (where the Commission departs from prior precedent, it must, first, "display awareness that it *is* changing position," and second, it must show that the new policy "is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better.") (emphasis in original); *Panhandle*, 196 F.3d at 1275 ("if [FERC] wishes to depart from its prior policies, it must explain the reasons for its departure.") (internal citations omitted); *Entergy*, 391 F.3d at 1251.

⁵⁶ See APA, 5 U.S.C. § 706(2)(E) (an agency decision must not be upheld if it is "unsupported by substantial evidence"). See also *Northern States*, 30 F.3d at 180 (quoting *Town of Norwood v. FERC*, 962 F.2d 20, 22 (D.C. Cir. 1992)) (finding that the Commission must be able to demonstrate that it has "made a reasoned decision based upon substantial evidence in the record"); *MoPSC*, 337 F.3d 1066, 1072-75 (vacating and remanding Commission orders because it found, among other things, that the Commission's findings were based on demonstrably false factual premises, and that the reasons cited by the Commission in support of its decision were "speculative," unsupported by record evidence, and did not, in fact, support its decision).

B. The Commission's Findings With Respect To Seller Credit Are Unjust And Unreasonable.

In adopting credit reforms in Order No. 741, the Commission sought to balance the potential risk of default by market participants against the need for liquidity to facilitate competition.⁵⁷ The Commission recognized that:

If access to credit is too restrictive, competition suffers because fewer entities are eligible to participate, which can potentially reduce competition. Conversely, if more risk is tolerated and access to credit is too easy to obtain, then the market is more susceptible to defaults and customers bear the burden of the costs that flow from such defaults. In organized wholesale electric markets, defaults not supported by collateral are socialized among all other market participants.⁵⁸

However, by treating Seller Credit as simply another form of unsecured credit (rather than a form of netting or offsetting), the Commission disrupted the balance it carefully sought to establish in Order No. 741.

PJM has gone to great lengths to ensure that the use of Seller Credit does not expose other market participants to default risk. First, PJM established a high threshold before a market participant can qualify for the use of Seller Credit. PJM makes Seller Credit available only to market participants that have maintained monthly net positive sales positions in the PJM markets over a continuous 12 month period prior to the month in which the Seller Credit applies.⁵⁹ Thus, if a market participant fails to maintain a net positive sales position in the PJM markets for a single month, it loses the ability to use Seller

⁵⁷ Order No. 741 at P 2.

⁵⁸ *Id.* See also Credit Reforms NOPR at P 1 (“Credit policies are particularly important in the organized energy markets, in which [RTOs] and [ISOs] must balance the need for market liquidity against corresponding risk.”).

⁵⁹ June 2008 Order at PP 7, 24; PJM Tariff, Attachment Q § II.C.

Credit for at least a year until it can re-establish another continuous 12 months of monthly net positive sales positions.

Second, PJM conservatively limited the amount of Seller Credit that an eligible market participant can use to meet its financial security obligations in the PJM markets. PJM permits a market participant to receive a Seller Credit equal to 60 percent of the 13th smallest net sell position invoiced in the past 52 weeks.⁶⁰

Third, once Seller Credit is issued to a market participant, PJM requires the market participant to maintain the Seller Credit and its “total net sell position”⁶¹ in an amount at least equal to its overall credit requirement net of other established credit.⁶² These requirements ensure that a market participant has adequate net positive sales positions to support the amount of Seller Credit permitted by PJM and that it has sufficient overall credit to meet its financial security obligations to PJM.

Fourth, PJM Settlement forecasts the net sell positions of all market participants that receive Seller Credit. PJM Settlement’s forecasts are based on “at least a participant’s Total Net Sell Position and recent trends in that position, such as generator outages, changes in load responsibility, and bilateral

⁶⁰ April 2009 Order at PP 7, 34; PJM Tariff, Attachment Q § II.C (“A Participant’s Seller Credit will be equal to sixty percent of the Participant’s thirteenth smallest weekly Net Sell Position invoiced in the past 52 weeks.”).

⁶¹ See June 2008 Order at P 9 n. 3 (“Stated simply, Total Net Sell Position is the amount that PJM owes the participant at any time.”).

⁶² See June 2008 Order at PP 9, 24; PJM Tariff, Attachment Q § II.C (“Each Participant receiving Seller Credit must maintain both its Seller Credit and its Total Net Sell Position equal to or greater than the Participant’s aggregate credit requirements, less any Financial Security or other sources of credit provided.”).

transactions impacting the participant.”⁶³ If the forecast indicates that the market participant’s total net sell position is not adequate to cover its credit obligations net of other established credit, PJM Settlement may require additional financial security to cover any difference.⁶⁴ The use of these forecasts by PJM permits it to adapt quickly to rapidly changing market conditions.⁶⁵ Finally, Seller Credit cannot be conveyed to another entity in the form of a guaranty.⁶⁶

Through the implementation of these requirements, PJM has taken detailed steps to ensure that, if a market participant that qualifies for Seller Credit defaults on its obligations, PJM will have sufficient collateral to cover any such default through netting or offsetting, without causing harm to other customers. For example, in a simplified scenario, assume that a market participant must maintain \$5 million in collateral to cover its credit obligations to PJM, that the participant qualifies for \$1 million in Seller Credit, and that it elects to post a letter of credit for the remaining \$4 million. PJM’s requirements for Seller Credit

⁶³ See June 2008 Order at PP 10, 24; PJM Tariff, Attachment Q § II.C (“For every participant receiving Seller Credit, PJMSettlement will maintain a forecast of the Participant’s Total Net Sell Position considering the Participant’s current Total Net Sell Position, recent trends in the Participant’s Net Sell Position, and other information available to PJMSettlement, such as, but not limited to, known generator outages, changes in load responsibility, and bilateral transactions impacting the Participant.”).

⁶⁴ See June 2008 Order at PP 10, 24; PJM Tariff, Attachment Q § II.C (“If PJMSettlement’s forecast ever indicates that the Participant’s Total Net Sell Position may in the future be less than the Participant’s aggregate credit requirements, less any Financial Security or other sources of credit provided, then PJMSettlement may require Financial Security as needed to cover the difference. Failure to pay the required amount of additional Financial Security within two Business Days shall be an event of default.”).

⁶⁵ See Order No. 741 at P 50 (“the Commission is concerned that the assumptions upon which any credit analysis is made can change rapidly. For instance, Lehman Brothers was rated as ‘investment grade’ by all ratings agencies on Friday, September 12, 2008, only to file for bankruptcy on Monday, September 15, 2008.”)

⁶⁶ See June 2008 Order at P 10; PJM Tariff, Attachment Q § II.C.

ensure that, if this market participant defaults upon its obligations, PJM will have at least \$1 million in net receivables owed to this participant that it can net or offset against the \$5 million default and draw upon the \$4 million letter of credit to cover the remaining \$4 million of the default. Thus, the Seller Credit requirements ensure PJM has adequate collateral (in the form of cash held in net receivables owed to the market participant) to cover, net of other established credit, any potential default. Further, as described above, PJM has created a central counterparty, PJM Settlement, to ensure the enforceability of netting and set-off of a market participant's debits and credits in the event of bankruptcy.

Thus, by treating Seller Credit as simply another form of unsecured credit, the Commission has reduced liquidity in the PJM markets and harmed competition, without providing any additional protection against the risk of default. Consequently, the Commission's findings in the PJM Compliance Order with respect to Seller Credit are unjust and unreasonable in violation of Sections 205 and 206 of the FPA.⁶⁷

C. The Commission's Findings Regarding Seller Credit Are Unduly Discriminatory and Preferential.

PJM is not the only ISO or RTO that extends credit to a market participant based on its net sell position. Since 2003, NYISO has allowed a market participant to treat as cash collateral a net receivable amount owed to the participant by NYISO.⁶⁸ In its Order No. 741 compliance filing, NYISO proposed to continue this practice but, like PJM, made certain changes to accommodate its

⁶⁷ See 16 U.S.C. §§ 824d, 824e (2006).

⁶⁸ See *New York Indep. Sys. Operator, Inc.*, 104 FERC ¶ 61,311 at PP 51-52 (2003).

transition from a monthly to a weekly billing and settlement process.⁶⁹

Specifically, NYISO proposed “to allow a customer, as of the day after NYISO makes its weekly settlement payments, to treat as cash collateral the net amount receivable the customer has accrued for its prior week’s activity, which amount NYISO will pay to the customer the following week.”⁷⁰ As part of its proposal, NYISO also required a customer to enter into a security agreement with NYISO in order for the customer to treat its net receivable amount as cash collateral.⁷¹ The Commission accepted NYISO’s proposal “conditioned upon acceptance of NYISO’s future filing regarding the ability to offset market obligations.”⁷²

The similarities between the credit policies of PJM and NYISO are readily apparent. Both PJM and NYISO extend credit to a market participant based on its net sell position in the organized wholesale electric power markets. Further, both NYISO and PJM have established mutuality with market participants in order to ensure netting or offsetting of accounts receivable against any potential default if bankruptcy protection is sought.⁷³ In Order No. 741, the Commission expressed its support for netting, but emphasized that netting provisions “must be established in a way that helps ensure that market participants are protected from a substantial default should a participant file for bankruptcy protection.”⁷⁴

⁶⁹ NYISO Compliance Order at P 13.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.* at P 15.

⁷³ *See id.* at P 13.

⁷⁴ Order No. 741 at P 116 (*citing* Electric Creditworthiness Policy Statement at P 29).

To address this concern, the Commission directed each ISO and RTO to submit a compliance filing that adopted one of the following options:

- Establish a central counterparty
- Require market participants to provide a security interest in their transactions in order to establish collateral requirements based on net exposure.
- Propose another alternative, which provides the same degree of protection
- Choose none of the above three alternatives, and instead establish credit requirements for market participants based on their gross obligations.⁷⁵

NYISO proposed to address this risk by requiring a security agreement with market participants.⁷⁶ PJM proposed to do so by establishing PJM Settlement as a central counterparty for transactions with market participants.⁷⁷ Therefore, the fact that NYISO chose to address this bankruptcy-related risk in one manner (requiring a security agreement) and PJM chose another manner (through the establishment of a central counterparty) is a distinction without a difference. What is relevant is not whether the net receivable amount is considered secured or unsecured credit, but the facts that both PJM and NYISO net or offset a market participant's accounts receivable against any potential default and that this practice is protects market participants against bankruptcy-related risks.

Despite the similarities between the credit policies of PJM and NYISO, the Commission accepted NYISO's proposal to require a security agreement in its Order No. 741 compliance filing, but required PJM to remove Seller Credit from

⁷⁵ *Id.* at P 117.

⁷⁶ See NYISO Compliance Order at PP 13, 15.

⁷⁷ See PJM Compliance Filing at 59. See *generally* September 2010 Order.

the \$50 million cap on unsecured credit and eliminate the use of Seller Credit from meeting FTR credit requirements. Thus, by treating the similar credit policies of PJM and NYISO differently, the Commission's findings in the PJM Compliance Order with respect to Seller Credit are unduly discriminatory and preferential in violation of Sections 205 and 206 of the FPA.⁷⁸

Further, the Commission has recognized that undue discrimination occurs not only when similarly situated customers are treated differently but also when dissimilarly situated customers are treated the same.⁷⁹ The Commission accepted PJM's credit proposals in the June 2008 and April 2009 Orders because it recognized that net sellers should not be treated the same as net buyers. Unlike net buyers, net sellers have a net amount receivable that PJM can use to net or offset against any potential default. Taking the simplified

⁷⁸ See 16 U.S.C. §§ 824d and 824e. See also *CAISO* at P 69 (citing *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 115 (2003)) ("The Commission has determined that discrimination is undue when there is a difference in rates or services among similarly situated customers that is not justified by some legitimate factor."); *Consolidated Edison*, 165 F.3d at 1012 (explaining that undue rate discrimination occurs when "two classes of customers receive different rate treatment," if "they are similarly situated," and "there are no factual considerations that would justify such differential rate treatment").

⁷⁹ For example, the Commission has recognized that location-constrained renewable resources should not be treated the same as other generation resources. See *CAISO* at P 62 ("The difficulties faced by generation developers seeking to interconnect location-constrained resources are real, are distinguishable from those faced by other generation developers, and such impediments can thwart the efficient development of infrastructure. In this regard, we find that the CAISO's proposal is an appropriate mechanism to accommodate the unique characteristics of location-constrained resources and that doing so does not constitute undue discrimination against other generators."); *SPP* at P 29 (2009) ("We find it reasonable for SPP to institute a cost allocation methodology that appropriately addresses the issues created by these location-constrained wind resources, even if it is dissimilar to the allocation methodology for other resources. Dissimilar treatment of dissimilar resources does not in and of itself constitute undue discrimination, and we find SPP's distinct treatment of these location-constrained resources is not unduly discriminatory given the fact and circumstances of this case.").

example used earlier, assume there is a net seller that qualifies for a \$1 million Seller Credit and a net buyer that has \$1 million in a net amount payable it owes to PJM and both market participants must maintain \$5 million in total collateral to cover its credit obligations. If the net seller cannot use Seller Credit to meet its credit obligations, it must post \$5 million in collateral even though PJM holds an additional \$1 million in a net amount receivable that it owes to the net seller. Thus, the net seller must effectively maintain \$6 million in total collateral to cover \$5 million of credit obligations. Conversely, the net buyer only needs to maintain \$5 million in collateral even though it may owe \$6 million to PJM if it defaults because of the \$1 million in net amount payable it owes to PJM. Thus, by denying net sellers the use of Seller Credit to meet its credit obligations, the Commission has unduly discriminated against net sellers and unduly preferred net buyers when it comes to PJM's credit policies.

D. The PJM Compliance Order Is Arbitrary and Capricious Because the Commission Failed to Respond to Serious Objections to its Proposed Approach.

In the PJM Compliance Order, the Commission did not address, much less meaningfully respond to, the objections to the Commission's approach raised by EPSA.⁸⁰ In failing to respond to these serious objections, the Commission has not satisfied its "fundamental obligation to engage in reasoned

⁸⁰ See generally EPSA Protest.

decision making,”⁸¹ which necessarily “renders its decision ... arbitrary and capricious.”⁸²

IV. REQUEST FOR CLARIFICATION OF PJM COMPLIANCE ORDER

To the extent the Commission denies their request for rehearing, EPSA respectfully requests that the Commission clarify that, if PJM was to require market participants to enter into a security agreement with PJM in order to qualify for Seller Credit, PJM could exclude Seller Credit from the \$50 million cap on unsecured credit and permit market participants to use Seller Credit to meet their FTR credit requirements consistent with Order No. 741. PJM’s adoption of this requirement would convert Seller Credit into secured credit and make PJM’s credit policies with respect to Seller Credit identical to NYISO’s credit policies with respect to the treatment of net receivables.

V. REQUEST FOR TECHNICAL CONFERENCE FOR ALL ISO/RTO COMPLIANCE PROCEEDINGS

A. The Commission Should Convene a Technical Conference in All of the ISO/RTO Compliance Proceedings to Identify Areas in Which Uniformity in Credit Practices Can Be Achieved Across the Organized Markets.

In its limited protest, EPSA commended the Commission for its call for measured standardization in Order No. 741,⁸³ highlighting the Commission’s statement that:

⁸¹ *Moraine Pipeline*, 906 F.3d at 8 (finding that the Commission failed to satisfy its “fundamental obligation to engage in reasoned decision making” by failing to respond to petitioner’s argument).

⁸² *CAPP*, 254 F.3d at 299. *See also State Farm*, 463 U.S. at 43 (finding that an agency decision is arbitrary and capricious when it “entirely failed to consider an important aspect of the problem [or] offered an explanation for its decision that runs counter to the evidence before the agency.”) (internal citations omitted).

⁸³ *See, e.g., EPSA Protest* at 3.

Because the activity of market participants is not confined to any one region/market and because the credit rules differ, a default in one market could weaken that participant and have ripple effects in another market. In this way, the credit practices in all ISOs and RTOs may be only as strong as the weakest credit practice.⁸⁴

Importantly, the Commission stated at the outset that “clear and **consistent** credit practices are an important element of [just, reasonable, and not unduly discriminatory or preferential] rates.”⁸⁵

After reviewing the ISO/RTO Order No. 741 compliance filings, however, EPISA was troubled by the lack of adherence to the Commission’s stated directives, and pointed out to the Commission its concerns regarding the “lack of uniformity among the ISO/RTO proposals for compliance.”⁸⁶ The EPISA Protest stressed the fact that, “[a]lthough many of the ISO/RTO requirements are similar, they are not uniform and could lead market participants to unintentionally run afoul of some of the requirements.”⁸⁷

The importance of credit practice uniformity cannot be understated. Lack of consistency may lead to the unintended outcome alluded to in the Commission’s statements in Order No. 741, namely, that ISOs/RTOs may come to rely on each other’s minimum standards, rather than on stronger, carefully agreed-upon uniform practices. Lack of consistency may also lead to the untenable situation where each ISO/RTO attempts to implement certain procedures of other ISOs/RTOs while continuing to impose their own individual

⁸⁴ Order No. 741 at P 3.

⁸⁵ *Id.* at P 2 (emphasis added).

⁸⁶ EPISA Protest at 2.

⁸⁷ *Id.*

requirements, leaving market participants with the nearly impossible task of managing each ISO/RTO's convoluted, multi-layered credit compliance program. Moreover, with respect to the varying degrees of certifications required across each of the ISOs/RTOs, EPSA remains concerned that a market participant will bear a significant burden in providing training specific to each ISO/RTO, maintaining ISO/RTO-specific risk management procedures, and conducting six different audits for its activities and compliance in each of the ISOs/RTOs.

Despite the Commission's important prior statements regarding credit practice uniformity, as well as the lack of uniformity in the ISO/RTO compliance filings, the Commission declined to **require** the ISOs/RTOs to revise their compliance proposals to adopt uniform and consistent requirements across the organized markets. Instead, the Commission approved the use of non-uniform practices, though it incongruously (but correctly) continues to recognize the importance of minimizing differences between such markets. For instance, the Commission states in each of the ISO/RTO Compliance Orders that:

Although we decline to require uniform minimum participation criteria, we recognize that there may be merit in minimizing the differences in requirements for each RTO and ISO, and we are open to subsequent efforts by industry participants and the RTOs and ISOs to come up with uniform criteria.⁸⁸

As the "industry participants and the RTOs and ISOs" are left to their own devices since the issuance of Order No. 741 has failed to discuss, much less reach agreement on, uniform credit practices, EPSA submits that it is

⁸⁸ PJM Compliance Order at P 41. See also CAISO Compliance Order at P 43; ISO-NE Compliance Order at P 46; MISO Compliance Order at P 34; NYISO Compliance Order at P41; SPP Compliance Order at P 37.

inappropriate for the Commission at this time to continue to rely on them to coordinate amongst themselves “to come up with uniform criteria.”

The Commission should therefore convene a Technical Conference in each of the above-captioned ISO/RTO Compliance Proceedings that would include representatives from each ISO/RTO and other interested stakeholders:

[S]o that the ISOs/RTOs and industry can come together and discuss both the necessary differences in compliance across the regions and areas that can be standardized across regions as entities begin to comply.⁸⁹

EPSA respectfully submits that convening a technical conference at the rehearing stage in these proceedings is appropriate, and consistent with Commission precedent,⁹⁰ where, as here, parties have raised serious concerns on rehearing that require further exploration and discussion among interested stakeholders. Towards this end, the Commission should be mindful to establish a process that will allow appropriate time for the industry to consider and address the issues raised in the EPSA Protest and any other specific areas where uniform credit practices are needed.⁹¹

⁸⁹ EPSA Protest at 3.

⁹⁰ See, e.g., *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,228 (2011) (order establishing technical conference to address issues raised on rehearing of order conditionally accepting PJM’s proposed revisions to, and a related complaint requesting further changes to, PJM’s Minimum Offer Price Rule).

⁹¹ EPSA notes that the Committee of Chief Risk Officers is initiating a process to bring about additional uniformity across all ISOs and RTOs. ISOs and RTOs, as well as market participants, have been invited to participate in this effort.

B. The Commission Should Require Each ISO/RTO to Revise its Respective Order No. 741 Compliance Filing to Adopt Appropriate, Uniform Credit Practices Identified in the Technical Conference.

EPSA respectfully requests that, in its order convening the Technical Conference, the Commission should direct each ISO/RTO and the parties to the above-captioned proceedings to identify credit practices for which greater uniformity is needed, and where possible, to reach agreement on the appropriate uniform standards. The EPSA Protest identified several of these areas of importance including, but not limited to, uniformity in MAC provisions, annual certification practices, and risk assessment methods.⁹² In addition to these, EPSA would urge the Commission to require increased consistency across ISOs/RTOs in the following areas:

- Deadlines for minimum certifications verifications;
- Frequency and timing for periodic verification of minimum certifications;
- Officer certifications
- Risk management frameworks;
- Minimum capital requirements;
- Market participants' ISO/RTO credit training procedures;
- Submission of market participants' financial statements;
- Unsecured credit standards and forms of collateral;
- Swaps valuations;
- Guidelines for use of swap products as hedges; and
- Product definitions for financially forward settling transactions, such as FTRs, renewable energy credits ("RECs"), emissions products and capacity transactions.

⁹² See *id.* at 2.

Following the conclusion of the Technical Conference, the Commission should require each ISO/RTO to file revised tariff sheets that reflect the agreed upon uniform credit practices. Requiring ISOs/RTOs, market participants, and other interested stakeholders to address these issues of common concern through a Technical Conference process will jump start the collaboration that the Commission encouraged in Order No. 741 and in its ISO/RTO compliance orders. Moreover, by requiring each ISO/RTO to revise its Order No. 741 compliance proposal to adopt uniform credit practices in these areas, the Commission will enhance the clarity and consistency of the credit rules in organized markets and market participants' ability to participate and compete in these markets on a level playing field.

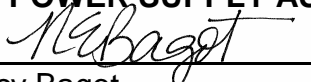
VI. CONCLUSION

WHEREFORE, for the foregoing reasons, EPSA respectfully requests that the Commission grant rehearing of the PJM Compliance Order and convene a technical conference in all of the ISO/RTO Compliance Proceedings to address the issues discussed herein.

Respectfully submitted,

ELECTRIC POWER SUPPLY ASSOCIATION

By:



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On behalf of the **Electric Power Supply Association**

Dated: October 17, 2011

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document via e-mail upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 17th day of October, 2011.



Nancy Bagot