

urges the Commission to act within its statutory authority to provide the greatest possible degree of regulatory certainty to energy markets. Certainty in the long term can be attained by assuring market participants that the Commission's regulations will not fluctuate indiscriminately; certainty in the short term can be attained by clarifying and standardizing credit policies to the extent that the Commission is able.

I. COMMUNICATION

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II. COMMENTS

A. The Health of Long-Term Investments Requires Regulatory Certainty

A few broad consensus points emerged from the first panel of the January 13 conference. First, commissioners and panelists alike agreed that the duration and depth of the current financial crisis cannot be accurately determined at this time.⁴ Given this uncertainty, panelists further agreed that the need for regulatory certainty is particularly important in the face of the industry's and the nation's uncertain financial future. Additionally, it was noted that FERC's ability to encourage certainty and long-term investment is limited by the Commission's

⁴ *Transcript of Credit and Capital Issues Technical Conference*, discussion prompted by Commissioners Spitzer and Moeller, Docket No. AD09-2-000 (January 13, 2009), pp. 60-72.

statutory authority,⁵ including with respect to some solutions offered by panelists. In light of the discussion at the conference, EPSA encourages the Commission to take the most important action within its purview – to assure market participants that market rules will not change without a robust, reasoned process. Assurance of regulatory certainty, especially in the recently implemented capacity markets, is critical and will, at the very least, offer some level of market and rule stability to the investment community.

Anthony Ianno of Morgan Stanley asserted that “we're trying to build long-term assets with short-term pricing, and that just doesn't line up, particularly if you want to get to something that is investment grade.”⁶ On this point several panelists noted that mechanisms including forward capacity markets and long-term PPAs, among others, would help bridge this disconnect. Chairman Kelliher observed that, in his view, FERC can do little to encourage long-term power purchase agreements (PPAs) to spur investment as he says that is beyond FERC’s authority over power sellers.⁷ This perceived regulatory gap, in which there is federal authority over power sellers and state authority over power buyers, should be an item for deliberation and action by the joint FERC/NARUC collaborative on competitive procurement.

In light of jurisdictional limits, EPSA encourages the Commission to act in other pending proceedings to provide long-term revenue streams for generators.

⁵ Transcript, quoting Chairman Kelliher, p. 47-48 beginning at line 16.

⁶ Transcript, p. 50, lines 14-17.

⁷ Transcript, p. 47-48 beginning at line 16.

The Commission should, where possible, implement policy that facilitates long-term revenue streams for new and existing facilities.⁸

Panelists also cited a bigger problem – that there is tighter competition for capital among industries because liquidity and leverage have diminished considerably from the market.⁹ Some panel members pointed to the desire to further increase renewable generation in today’s political climate and the inherent need for accelerated transmission investment that comes with renewable builds.¹⁰ Other panelists cited the need for utilities to find balance between assuring reliability and safety, yet not borrowing money at an excessive rate to do so.¹¹ Some of the solutions to these problems fall under state jurisdiction, while others can be provided for through energy market rules that fall under FERC’s jurisdiction. The markets and market participants themselves also shoulder some of the burden to work out credit problems. Assessing risk and making sound capital investments in the face of current market conditions are the responsibility of market participants, with important oversight and incentive roles reserved for state and federal policymakers.

In light of this discussion, Chairman Kelliher posed the question “what are the worst changes [FERC] could make?” Panelists all agreed that abrupt policy or market structure changes would likely create rather than resolve problems facing the electric industry by negatively impacting utilities’ ability to finance and

⁸ For example, this issue is currently before the Commission in PJM’s Reliability Pricing Model proceeding.

⁹ Transcript, p. 73, lines 14-16.

¹⁰ Transcript, p. 75.

¹¹ Transcript, p. 77.

develop new infrastructure needed to meet our demand.¹² It is important to note here the significance of the consensus of the diverse panel on the negative impact abrupt policy changes could have; the panelists were varied in nature, represent a number of different stakeholder groups, and operate in both organized and vertically-integrated markets. Participants from all types of markets said definitively that rushed changes to market structures could have detrimental effects on investment in new infrastructure.¹³ The needed investment is not an obligation to be taken lightly, as the nation faces \$600 billion in investment for new generation facilities alone, an amount which does not account for the concomitant investment in transmission required to compliment those facilities or the costs of necessary carbon regulation.¹⁴ EPSC encourages the Commission to continue to promote steady policies for the marketplace, only making changes through reasoned, well-vetted processes.

Importantly, the Commission should continue to pursue its vision – “[a]bundant, reliable energy in a fair competitive market,” and work to “provide regulatory certainty through consistent Commission approaches and actions.”¹⁵ Competition is a national policy priority and is integral to ensuring just and reasonable electric rates that are not unduly discriminatory.¹⁶ Organized

¹² Transcript, p. 55, lines 3-4.

¹³ Transcript, pp. 55-56, responses from Bruce Levy of International Power and Paul Bowers of Southern Company.

¹⁴ *Prepared Direct Testimony of Bruce Levy for the Credit and Capital Issues Technical Conference*, Docket No. AD09-2-000 (January 13, 2009), p. 1.

¹⁵ *FERC Strategic Plan, Vision*, at: <http://www.ferc.gov/about/strat-docs/strat-plan.asp>

¹⁶ *Final Rule on Wholesale Competition in Organized Electric Markets*, 125 FERC ¶ 61,071 (October 17, 2008), P. 1.

competitive electricity markets have improved transmission access and reliability, created high levels of coordination and efficiency in the dispatch of resources over large regional markets, and brought transparency to the costs of transmission constraints. However, competitive markets remain subject to second-guessing from some quarters and criticism for outcomes that actually reflect supply and demand fundamentals of the market itself. It is appropriate for the Commission to continue to examine these markets, as it just did in its wholesale competition proceeding under Docket No. RM07-19-000 last year. The Commission should make any necessary changes to wholesale markets through such processes that take into consideration the inherent time-lag between the initial implementation of market rules and the actualization of the implications of those rules. Specifically, as Bruce Levy of International Power pointed out, “organized capacity markets are new. There's been limited experience with them, and ... the next few years of them will be more telling.”¹⁷ Forward capacity markets in RTOs such as PJM and ISO-NE were only fully implemented this year. While refinements should be (and are being) considered, to replace or roll back the current construct at this early stage would be very costly and counter-productive.

The capacity markets that exist today in PJM and ISO New England are the result of extensively negotiated settlements that were established to address significant capacity shortage predictions. Uncertainties about credit and market rules arising from the current financial crisis only serve to compound those that

¹⁷ Transcript, p. 49, lines 22-24.

already exist due to increasing commodity costs, climate change legislation and fuel cost volatility. To date, these capacity markets have largely met their intended purpose – ensuring adequate capacity at a reasonable cost.¹⁸ They may, in fact, directly address Mr. Ianno’s comments, as with regulatory stability these markets are more likely to provide longer term reliable revenue streams necessary for longer term investments. It is imperative that the Commission allow time for these markets to mature, and allow market participants to gain confidence in these Commission-approved markets over a multi-year period.

Finally, the Commission can ensure regulatory certainty by continuing to promote competitive power procurement by coordinating with state regulators, such as through the joint FERC-NARUC collaborative on the subject. This collaborative was noted by panelist New York Public Service Commission Chairman Garry Brown as a “shining example of the way that regulatory bodies can work together in trying to resolve some difficult issues that, frankly, cross jurisdictional lines.”¹⁹ EPSA agrees, and cites the report issued by the collaborative last summer which recounts the constructive dialogue between FERC and the states, highlighting best practices on competitive procurement.²⁰

¹⁸ The Brattle Group, *Review of PJM’s Reliability Pricing Model* (June 30, 2008), p. 2. Also see: *Testimony of Andrew Ott on Behalf of PJM Interconnection*, Pennsylvania Public Utility Commission En Banc Hearing on the Current and Future Wholesale Electricity Markets, October 23, 2008, pgs. 8-9.

¹⁹ Transcript, pp. 45-46.

²⁰ EPSA commented extensively on this effort and has been able to cite the results of this effort in various state proceedings, including recent proceedings in Virginia and North Carolina. The existence of best practices on competitive procurement sanctioned by both FERC and NARUC aid regulatory certainty for all market participants. See *Comments of the Electric Power Supply Association on the Initial Report of the FERC/NARUC Competitive Procurement Collaborative* (September 9, 2008).

Outside-of-the-box efforts like these to work across jurisdictional boundaries should certainly continue at the Commission, and are especially integral in ensuring regulatory certainty, which should be the Commission's most important goal in responding to the current financial crisis.

B. The Commission Should Act to Strengthen and Standardize Short-Term Credit Policies

The second panel of the day focused on more specific, actionable solutions for the Commission to consider. Shorter term credit problems, which arise from the credit policies written into an RTO/ISO's tariff, have solutions that are within the Commission's jurisdiction to consider and fix. Panelists on this second panel identified three specific issues for the Commission to consider: (1) financial settlement timetables; (2) the use of unsecured credit within RTOs; and (3) gaps created by differing credit policies across the various RTOs/ISOs. EPSA asserts that there are solutions to each of these identified problems that the Commission can and should implement.

Every panelist on the second panel speaking about operations in organized markets with set financial settlement schedules mentioned the benefits of shortening those financial settlement timetables in their opening statement. EPSA supports shortening financial settlement timelines. Morgan Davies of Calpine noted that shortening settlement periods would be "the biggest driver in reducing credit risk," explaining that shorter settlement periods "reduce [a market's] cash conversion cycle. The shorter the cycle, the less risk of not

performing.”²¹ J.C. Kneale of ICE agreed that the smallest possible timeframe for financial settlements is ideal and noted that getting all markets to a weekly settlement time frame is realistic.²² The largest obstacle to implementing shorter settlement times, as identified by panelists, is finding software that can accommodate them. However, as Commissioner Kelly pointed out, if RTO software cannot accommodate shorter settlement timeframes today, “they, over time, could.”²³ EPSA advocates a weekly settlement period as a means of reducing credit risk exposure. The Commission should require that all RTOs shorten financial settlement periods to one week, leaving implementation details to the individual RTOs. EPSA also advocates that the Commission set a specific deadline for this change, mandating that all RTOs are in compliance in order to assure settlement timelines are shortened in a timely manner.

Limiting the use of unsecured credit was another common theme throughout the discussion of short-term credit solutions. While several panelists advocated complete elimination of unsecured credit, others noted that there is an inverse relationship between collateral protection and liquidity – in gaining credit security by reducing unsecured credit, the market will lose liquidity.²⁴ Keeping this in mind, it is clear that some RTOs have very few limits as to how much unsecured credit is allowed to exist in their markets. EPSA supports limiting (but not the elimination of) the use of unsecured credit commensurate with the shorter

²¹ Transcript. p. 107, lines 5-7.

²² Transcript, p. 128, lines 15-20.

²³ Transcript, p. 137, lines 2-3.

²⁴ Transcript, p. 142, lines 2-8.

financial settlement timelines. Several RTOs are already working on unsecured credit limitations. Representatives from the California ISO and ISO New England on the panel indicated that those RTOs are working towards this goal, and Morgan Davies cited work with ERCOT toward that end.²⁵ PJM is considering reducing settlement times from monthly to weekly, and therefore is considering reducing each member's unsecured credit limit by two-thirds or half "to align the unsecured credit allowances with the revised time period for which credit requirements will be set."²⁶ EPSA supports changes like those being considered in PJM. Limiting unsecured credit is an important step in protecting markets from financial and reliability exposure, and as previously noted, it is important that unsecured credit should be reduced in conjunction with accelerating settlement cycles. EPSA urges the Commission to mandate that each RTO examine its unsecured credit limits, in conjunction with examining its settlement cycles, and work with stakeholders to revise those unsecured limits and reduce those settlement cycles as necessary.

The final major issue for Commission consideration in addressing short term credit policies in the January 13 conference was standardization across various RTOs. Although EPSA has long supported each RTO's ability to maintain regional differences and urged FERC to give great deference to stakeholders within each region, EPSA supports standardization of credit policies to the extent

²⁵ Transcript, p. 108, lines 10-18.

²⁶ *PJM Package of Unsecured Credit Revisions – Alternatives for Market Committee Consideration* (December 30, 2008), p. 1. See: <http://www.pjm.com/Media/committees-groups/committees/mic/20090106-item-02a1-mic-alternatives-unsecured-credit-revisions-updated.pdf>.

possible in this case. FERC can best achieve this by developing a Commission-sanctioned set of best practices for RTO credit policies. RTOs could then take those best practices and implement them with the amount of regional variation necessary. The Commission should continue to allow for “regional innovation” in credit policies by allowing full consideration and input by stakeholders.²⁷ It is also important to allow each region implementation freedom, as the FERC-approved best practices could apply very differently to different RTOs.

Strengthening and standardizing credit practices within and across RTOs is an important tool for managing market risk, especially in the face of the current financial crisis. EPSCA urges the Commission to consider initiating a proceeding to look at best practices in credit policies. The Commission’s best practices should address the items mentioned above – shortening settlement times and limiting unsecured credit – as well as a myriad of smaller items, like standardizing material adverse change provisions for power contracts and RTO management of market participant collateral. FERC should address an RTO’s responsibility to measure and calculate the credit risks of both its market participants and the products it offers. Each RTO has dedicated staff monitoring the credit risk exposure of the market. FERC’s best practices should more carefully outline the responsibilities and obligations of that staff. As part of this best practice review , RTO's should be required to assess the credit standards regularly for products transacted in their market, especially less liquid products such as FTRs, which

²⁷ Allowing for regional innovation was a concern of Commissioner Kelly and Morgan Davies alike during the conference. Transcript, pp. 137-138.

were developed before the credit policies of most RTOs.²⁸ Finally, there are several elements that exist in some RTOs, but not in others.²⁹ The Commission's best practices should explore the essential elements of well-functioning credit policies and ask each RTO to implement those elements as best suits its particular market.

III. CONCLUSION

EPSA appreciates the Commission's timely consideration and development of a record on matters affecting long and short term credit and capital issues. In order to address these issues, the Commission should assure markets of long-term regulatory certainty and initiate a proceeding to consider whether RTOs should shorten financial settlement timelines, limit the use of unsecured credit and standardize certain elements to more fully manage risk across markets.

Respectfully Submitted,



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²⁸ The Commission should also require RTOs to continue to look for opportunities to net market products, consistent with its 2004 Credit Policy Statement. This would include the ability to net across market products, including FTRs and other market products.

²⁹ For example, most RTOs have standing credit working groups; most RTOs also provide for makeup of uplift losses. California ISO has neither of these things. Also, some RTOs directly manage participants' collateral while others outsource management (these policies exist in PJM and NYISO). While these processes may not look exactly the same in all markets, they should at least exist in each market.

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