

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

Southwest Power Pool, Inc.) Docket No. ER22-108-000

Motion to Intervene and Protest of
the Energy Trading Institute

Pursuant to Rules 211, 212 and 214 of the Federal Energy Regulatory Commission’s (“FERC” or “Commission”) Rules of Practice and Procedure,¹ Energy Trading Institute (“ETI”) moves to intervene and protest the Southwest Power Pool, Inc. (“SPP”) initial filing of its Tariff Revisions to Modify the Minimum Capitalization Requirements.² For the reasons discussed below, SPP’s proposed capitalization requirements fail to meet the requirements of section 205 of the Federal Power Act (“FPA”) to ensure that rates are just and reasonable, and not unduly discriminatory. As such, the Commission should reject SPP’s filing.

SPP justifies its capitalization increase proposal based on a risk assessment of its credit practices performed after GreenHat Energy LLC (“GreenHat”) defaulted trading Financial Transmission Rights (“FTR”) within PJM Interconnection, L.L.C. (“PJM”).³ While SPP has rightly sought to enhance protections for the SPP market against financial defaults, it has misplaced its focus on capitalization for entities engaged in Transmission Congestion Rights (“TCR”) transactions. Increasing capitalization requirements beyond

¹ 18 C.F.R. §§ 385.211, 385.212 and 385.214.

² Southwest Power Pool, Inc., *Submission of Tariff Revisions to Modify Minimum Capitalization Requirements*, Docket No. ER22-108-000 (filed Oct. 14, 2021) (“SPP Tariff Revisions”).

³ SPP Tariff Revisions at p. 4.

the standards established by significant Commodity Futures Trading Commission (“CFTC”) precedent and, more specifically, orders exempting SPP and the other power pools from Commodity Exchange Act (“CEA”) swap regulation, does not mitigate the credit risks posed by transactions that were found to be the root causes of the GreenHat default or the defaults coming out of Winter Storm Uri. As adeptly demonstrated by the Independent Consultants who evaluated the circumstances of the GreenHat default (the “Independent Consultants”), the GreenHat default primarily involved improper collateral risk management performed by a Regional Transmission Organization.⁴ Minimum capitalization would not have helped in the GreenHat scenario; proper margining of positions would have and PJM has taken steps in that direction. Further, the defaults arising out of Winter Storm Uri involved unhedged electric cooperatives and a higher minimum capitalization requirement would not have been productive in those instances either.⁵ Power pools would be deluded in thinking that mere capitalization increases would have mitigated these credit risks problems. Instead, SPP has proposed changes that will only serve to result in capitalization requirements that are unduly burdensome on market participants, and discriminatory toward smaller, niche competitors. Further, SPP’s

⁴ See *Report of the Independent Consultants on the Greenhat Default*, at. pp. 2, 15, 18 (Mar. 26, 2019) (“Greenhat Report”) (explaining that the “PJM Credit Policy Failed to Address Critical Risks” associated with collateral management), found at, <https://www.pjm.com/-/media/library/reports-notice/special-reports/2019/report-of-the-independent-consultants-on-the-greenhat-default.pdf>

⁵ Will Englund and Neena Satija, *As Texans went without heat, light or water, some companies scored a big payday*, WASHINGTON POST (February 27, 2021) available online at <https://www.washingtonpost.com/business/2021/02/27/texas-power-winners-losers/> (“[I]n past freezes and price spikes, a significant number of unhedged retailers were forced under .. [There is a] real risk of a cascade of bankruptcies coming out of this”); see also Bob Smith, *Climate and Credit Risks Collide in the Aftermath of Uri*, SAGE (March 12, 2021) (“Undoubtedly, the most adversely affected utilities will be those that were caught short or were unhedged on their natural gas supplies and had to buy power and gas at peak market prices to meet consumer demand”) available online: <https://www.sageadvisory.com/wp-content/uploads/2021/03/Climate-and-Credit-Risks-Collide-3.12.21.pdf>

proposal conditioning market participant asset calculations to exclude cash holdings at other ISO-RTO is unreasonable and discriminatory to both market participants and other ISO-RTOs. The formulation of the increased capitalization requirements does not properly address the credit risks presented by the TCR market or other products utilized by SPP market participants, and as proposed by SPP, increases risk and unreasonably burdens qualified and eligible market participants engaging in the market.

SPP's misplaced focus on capitalization critically demonstrates that credit risk must be *properly* addressed by the ISO-RTOs, and therefore, the Commission should initiate a credit rulemaking to modernize Order No. 741 and address the credit challenges of today.

I. COMMUNICATIONS AND CORRESPONDENCE

ETI requests that the following names to be placed on the service list for this proceeding, and that all correspondence and communication with respect to this proceeding be addressed to the following⁶:

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⁶ Persons denoted with an asterisk (*) are those designated for service pursuant to 18 C.F.R. § 385.2010.

II. MOTION TO INTERVENE

ETI respectfully moves to intervene in this proceeding and requests that it be granted full status as a party under Rule 214 of the Commission's Rules of Practice and Procedure.⁷ ETI represents a diverse group of energy market participants, all with substantial interests in electricity transactions in SPP markets. ETI members include Market Participants that engage in SPP's physical and financial markets, including the market for TCR that are subject to the above captioned proceeding.

ETI has a substantial interest in this proceeding that will not be adequately represented by any other party, and respectfully requests that it be granted full party status in this proceeding.

III. PROTEST

SPP's proposal to increase capitalization for TCR market participants is misplaced and fails to serve the goal of mitigating credit risks to the SPP market.

Specifically, SPP proposes to increase the minimum capitalization for Market Participants engaged in the SPP TCR Market to:

- **Tenfold** increase the tangible net worth from \$1 million to \$10 million;
- **Double** the total asset requirement from \$10 million to \$20 million; and
- **Tenfold** increase the alternative minimum deposit from \$200 thousand to \$2 million.⁸

⁷ 18 C.F.R. § 385.214.

⁸ SPP Tariff Revisions at p. 6.

SPP also proposes to condition these net worth and tangible asset calculations to exclude “any trading collateral balances held at any” Independent System Operators (“ISO”) and Regional Transmission Organizations (“RTO”) as such security deposits “may present collection burdens for the market in which a default actually occurred.” SPP views capitalization increases for TCR participants to be “more appropriate requirement[s] for counterparty creditworthiness in the TCR market in the post-GreenHat market environment.”

It would greatly benefit SPP and the power pools to better understand the circumstances of the GreenHat default and the far more significant defaults that occurred in ERCOT. GreenHat primarily involved a failure in collateral risk management with insufficient variation margining (actually zero variation margin), not a capitalization problem.⁹ Accordingly, the primary recommendation of the GreenHat Independent Consultants is for the ISO/RTOs to advance credit and collateral best practices into their respective tariffs, including:

“Use the mark to auction values established in the more frequent auctions ... as the basis for ‘variation margin’ charging as a current debt the value erosion between the purchase price and the current market value as determined by the latest auction.”¹⁰

⁹ See Greenhat Report at p. 1.

¹⁰ See Greenhat Report at App. p. 1.

“More frequent auctions” means “at least bi-monthly auctions” for FTRs and TCRs “in order reduce collateral requirements and to better manage risk and offer more opportunity for market participants to do the same.”¹¹

Even after its post-GreenHat review, SPP has not taken the course of action to establish more frequent auctions to better enable variation margining to provide for a more effective and holistic mechanism to allow SPP and their market participants to manage credit risk. However, SPP did implement minimum collateral requirements and ETI believes such collateral focused requirements are a step in the right direction.

Instead of focusing on enabling better variation margining through more frequent auctions and developing sophisticated initial margin models, SPP has proposed to enact an alleged panacea to unreasonably increase capitalization in a manner that merely burdens Market Participants without the benefit of real credit mitigation for its TCR market or other markets. It is instructive that PJM explored the idea of increasing minimum capitalization, and found that there would be a notable decrease in liquidity, with 62 out of 197 FTR participants negatively impacted. As such, PJM dropped the capitalization increase as an inviable credit risk management enhancement.¹² Given the significant overlap of participants in SPP and PJM, we believe if SPP conducted the same analysis, they would find a similar or more harmful impact on liquidity.

¹¹ *Id.* at App. p. 5.

¹² See *PJM Interconnection*, Minimum Capitalization Requirements, Financial Risk Mitigation Senior Task Force, at p. 6 (Nov. 9, 2020) (finding after feedback and analysis, that PJM should maintain the status quo for capitalization thresholds).

As explained further below, these proposed capitalization increases a) are inconsistent with the CFTC precedent and orders granting exemptions to SPP and other power pools the relief from swap and exchange regulation, b) reduce liquidity, increase volatility, and increase the cost of doing business in the SPP Market, c) inhibit the growth of renewable generation, and d) decrease hedging opportunities for all market participants. Additionally, this proposal is an unjust and unreasonable tariff design that unduly discriminates against a class of market participants based on a specific product and their participation in other ISO/RTOs that should be rejected by the Commission. All the while, the proposed increase in capitalization does not squarely address the risks presented. Indeed, as explained further herein defaults and credit events have come in all shapes and sizes, regardless of capitalization and product type.

There are also several gaps in SPP's proposal that will need to be addressed including the consideration of adverse consequences. ETI proposes that the real solution lies in a more wholistic approach to credit risk management that includes a substantial focus on collateral risk management.

a. The Modified Capitalization Requirements Are Inconsistent with the Relief Set by the CFTC Order Exempting SPP and Other Power Pools from Certain Swap Regulation.

SPP's existing minimum capitalization requirements are in line with the CFTC eligibility requirements established pursuant to the exemptive relief provided by the CFTC under Dodd-Frank legislation.¹³

¹³ Public Law 111-203, 124 Stat. 1376 (2010).

The Dodd-Frank Act amended the CEA¹⁴ and granted the CFTC authority over certain “swap” transactions. The CFTC promulgated rules under this new authority including certain rules governing market participants’ financial wherewithal to undertake swap transactions.¹⁵ Because of the broad definition of “swap”, it is likely that certain transactions in ISOs and RTOs would be subject to Commission authority.

However, Section 722 of the Dodd-Frank legislation made clear that FERC continues to have authority under the FPA with respect to agreements, contracts, or transactions that are entered into pursuant to a tariff approved by FERC executed, traded, or cleared on a registered entity or trading facility owned or operated by a regional transmission organization (“RTO”) or an independent system operator (“ISO”). However, such ISOs or RTOs would have to apply to the CFTC for an exemption.

SPP’s proposed changes to the minimum capitalization rules are inconsistent with the well-established CEA standards laid out in the CFTC exemption order for market participant eligibility, particularly for legal entities engaged in complex swap activity. Under CEA section 4(c)(3) the term “appropriate person” includes, among other things, that any organization or business entity with a net worth exceeding \$1,000,000 or total assets exceeding \$5,000,000.¹⁶ Furthermore, under CEA section 1a(18)(A) and in CFTC regulations the term “eligible contract participant” includes any organization or business entity with a net worth exceeding \$1,000,000 or total assets exceeding \$10,000,000.¹⁷

¹⁴ 7 U.S.C. § 1 et seq.

¹⁵ 17 C.F.R. § 1 et seq.

¹⁶ 7 U.S.C. § 4(c)(3).

¹⁷ 7 U.S.C. § 1a(18)(A); *see also* 17 C.F.R. § 1.3.

These are the same thresholds that the CFTC applied in its final order granting exemptions to SPP and the other ISO/RTOs.¹⁸ The CFTC has explained that market participants with \$1 million net worth or \$10 million total assets are considered “**sophisticated entities that are able to, from a financial standpoint, understand and manage the risks associated with the exempted transactions**” like TCRs.¹⁹

As a condition of the exemptive relief provided by the CFTC, each of the FERC jurisdictional power pools as well as Electric Reliability Council of Texas (“ERCOT”), have been ordered to establish the relevant capitalization thresholds for net worth and total assets. Indeed, SPP applied to the CFTC for an exemption in 2013. As part of its application, SPP represented that its Tariff includes minimum capitalization criteria that require market participants to have at a minimum: (a) a tangible net worth of \$1 million; (b) assets of \$10 million...”²⁰ It is worth noting that although there is some variation among the minimum participation criteria adopted by each ISO/RTO, each application included a baseline capitalization requirement that participants have a net worth of \$1 million or total assets of \$10 million.²¹ That is, every power pool has followed the CFTC’s

¹⁸ *Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations To Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act*, 78 Fed. Reg. 19,879 (2013) (citing *Industrial Coalitions* at 4 n.12 (citing FERC regulation 35.47 and stating that “all market participants are required to meet a baseline capitalization requirement totaling \$1 million net worth or \$10 million total assets”)) (“Final Order”)

¹⁹ *Id.*

²⁰ *In the Matter of the Application for an Exemptive Order Under Section 4(c) of the Commodity Exchange Act by Southwest Power Pool, Inc.* (October 1, 2013) available online at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@requestsandactions/documents/ifdocs/spp4camdappl080114.pdf>; See also *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, III FERC Stats. & Regs., Regs. Preambles ¶ 31,317 (2010), order on reh’g, Order No. 741-A, III FERC Stats. & Regs., Regs. Preambles ¶ 31,320, reh’g denied, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

²¹ *In the Matter of the Application for an Exemptive Order Under Section 4(c) of the Commodity Exchange Act by California Independent System Operator Corporation et al.* at p. 27 (February 7, 2012) (Updated copy, as of June 11, 2012).

long held requirements for minimum capitalization established in the CEA and such thresholds have been effective in every other commodity market. These thresholds were heavily debated as it was critical that they protect the market, while also maintaining liquidity and competition in commodity markets.

Since market participants with \$1 million net worth or \$10 million total assets have consistently been found to be sophisticated entities, logically, increasing the minimum capitalization requirements by *ten-fold* in the case of net-worth and *doubling* the minimum total-assets, would only serve to burden a substantial number of appropriate persons and eligible contract participants in their SPP market participation. Since these thresholds (*i.e.* net worth of \$1 million or total assets of \$10 million) have been established and have functioned well in derivatives markets broadly under CEA standards, SPP must do more than merely assert that “increases in capitalization requirements are designed to help ensure that settled losses can be better absorbed by a TCR Market Participant.”²² This statement also fails to acknowledge or address the risk experienced during the ERCOT winter event and simply singles out one particular product in the market.

A better approach would include initiating credit risk enhancing mechanisms like initial and variation models and more frequent TCR auctions to better enable such models.

b. The Modified Capitalization Requirements Unjustly Discriminates Based on Participation in other “ISO/RTOs.”

In addition to increasing the net worth and total assets requirements, SPP also requires that Market Participants omit from these calculations any cash deposits held at any

²² SPP Tariff Revisions at p. 6.

other “ISO/RTO” by a Market Participant.²³ It is not clear from the SPP filing as to what constitutes an “ISO/RTO” and whether that includes non-jurisdictional entities like ERCOT, Alberta Electric System Operator (“AESO”), or the Ontario Independent System Operator (“IESO”).²⁴ What is clear, is that the Commission lacks the jurisdiction to enable SPP to discriminate against entities like ERCOT, AESO, or IESO. Additionally, the Commission should reject SPP’s efforts here to penalize Market Participants based on participation in other jurisdictional ISO/RTOs as unduly discriminatory. That is, under the convoluted structure proposed by SPP even if Market Participants meet the facial requirements of having either a net worth of \$10 million or total assets of \$20 million, once cash deposits at another ISO or RTO are considered, they could fail to meet the higher capitalization requirements.

SPP has assumed that other funds that Market Participants have held with other entities like FCMs are superior in credit quality relative to cash held at other ISO/RTOs. SPP has provided no basis for discriminating against assets held by ISO/RTOs and not by other entities. Further, SPP has not demonstrated why all ISO/RTOs should be lumped into the same credit quality bucket or why they should be treated differently than FCMs. Distinguishing between market participants based on their participation in other ISO/RTOs seems to serve only a discriminatory purpose. Take for example a market participant that

²³ See SPP Revisions at Revised Volume No. 1 Redline Section 3.1.1.8.2 Minimum Capitalization Requirements.

²⁴ SPP’s Glossary suggests that the definition of ISO and RTO are FERC jurisdictional. An ISO means an “independent entity regulated by the Federal Government that coordinates regional transmission in a non-discriminatory manner and ensures the safety and reliability of the electric system” and an RTO means an “organization that FERC has deemed to meet certain criteria, including independence and scope. Regional Transmission Organizations are mandated by FERC to ensure reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices of electricity.” See SPP Glossary available online at <https://www.spp.org/glossary/> (last accessed Nov. 2, 2021).

only transacts in SPP under its power operation but has a robust cryptocurrency trading operation with significant cash posted at an FCM. SPP's proposal would not penalize that market participant for funds posted at an FCM for the cryptocurrency operation. Contrast that to another market participant who is engaged in multiple RTOs/ISOs, and does not have a robust cryptocurrency operation. SPP's proposal would penalize the second market participant because they have a more robust power operation. Yet, it is market participant A with the cryptocurrency operation who could be operating a riskier business. SPP has determines without any justification that funds posted at other ISOs/RTOs is an indicator of greater risk than funds posted at an FCM, when in fact the very opposite might be true depending on the asset class being traded. Further, this requirement will likely impact financial participants, entities who finance assets and entities who offer hedging services to a great extent as they are more likely to have operations in multiple RTOs/ISOs under the same umbrella. For these reasons, SPP's decision to exclude cash deposits held by other ISO/RTOs from net worth and asset calculations is unreasonable and unduly discriminatory.

c. The Modified Capitalization Requirements Reduces Liquidity, Adds Volatility, Increases the Cost of Doing Business, and Fails to Enhance Protections for Market Participants.

The Modified Capitalization Requirements do not enhance SPP's role as a gatekeeper or enhance credit protections for market participants.

First, the proposed revisions result in anti-competitive outcomes. The increase in minimum capitalization requirements are likely to limit the market participant pool to those that can meet the new net worth and total asset requirements (especially when excluding

funds held with other ISO/RTOs). SPP provides no analysis to the market impact of implementing these new rules. At its core therefore, SPP's proposed revisions advocate for a change that results in reduced open access and competition, which runs counter to FERC policy and precedent, particularly under Order 888.²⁵

Second, without sufficient market participants, *i.e.* market liquidity to trade instruments in SPP, it is likely that the variance in buy-sell spreads will increase in the market and consequently increase the cost of hedging. Reduced liquidity is not just detrimental to all market participants, but also reduces the capability of SPP to strengthen variation margining allowing undercollateralized positions (based on mark-to-auction pricing) to be able to exit such positions. Such high variance in spreads also results in additional volatility in the market. In a way, the additional capitalization requirements exacerbate the very problem that they try to solve. This leads to reduced competition potentially leading to undervaluation of TCRs that harms auction rights holders, and could lead to poor auction price formation and increased arbitrage opportunities for more highly capitalized speculators.

Third, as described above, the requirement to exclude other RTO/ISO trading collateral also substantially increases the cost of doing business by requiring market participants to hold less funds in other ISO/RTOs so as to meet the higher capitalization

²⁵ *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (1996), FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (1997), FERC Statutes and Regulations ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998) ("Order No. 888").

requirements. Many market participants leave excess funds at other RTOs/ISOs for operational efficiency and SPP's current proposal creates a disincentive to do so.

ETI submits that PJM's experiences can help shed light on policies that can balance the need for financial assurances against issues of volatility and costs of doing business. The GreenHat Independent Consultant's report did not recommend any changes to the minimum capitalization requirements.²⁶ Indeed, when PJM explored increasing the minimum capitalization requirements, PJM's analysis demonstrated that there would be a notable decrease in liquidity.²⁷ PJM analyzed different thresholds and determined that at a \$20 million threshold, 62 out of 197 FTR participants would be negatively impacted, and the PJM proposal did not include SPP's proposed discriminatory net worth and asset calculations.²⁸ Such capitalization changes would have been harmful to long-time PJM members that have transacted responsibly in the market for many years. The same is very likely true, if not worse, in SPP.

In its current filing, SPP does not provide any information on how the proposed capitalization requirements would impact market participants in various market. Following PJM's model, SPP should undertake a deep assessment of how different thresholds would affect liquidity in their market and make such results public. Such an assessment would not only provide market participants with much needed insight into

²⁷ See *PJM Interconnection, Minimum Capitalization Requirements*, Financial Risk Mitigation Senior Task Force, at p. 6 (Nov. 9, 2020) (finding after feedback and analysis, that PJM should maintain the status quo for capitalization thresholds).

²⁷ See *PJM Interconnection, Minimum Capitalization Requirements*, Financial Risk Mitigation Senior Task Force, at p. 6 (Nov. 9, 2020) (finding after feedback and analysis, that PJM should maintain the status quo for capitalization thresholds).

²⁸ *Presentation on Minimum Capital Requirements* at Slide 3, PJM (2020) available online at <https://www.pjm.com/-/media/committees-groups/task-forces/frmstf/2020/20201015/20201015-item-06a-minimum-capitalization.ashx>

SPP's approach to setting thresholds, but would also explain whether the ultimate threshold is just and reasonable. It would also provide market participants with necessary information regarding the impact on liquidity and future risk in SPP.

While SPP argues that this proposal was voted on and approved by stakeholders and that FERC should give deference to that process, SPP neglects to mention that many commercial participants do not have voting rights in SPP because applying for full membership leaves a market participant potentially liable for millions of dollars in exit fees. The vote touted here by SPP, unfortunately, is not representative of the entire market participant pool in SPP.

Reducing SPP market liquidity at this time will prove problematic, particularly when there is a continued need to be able to hedge market exposures utilizing TCRs as other weather events arise like Winter Storm Uri, and as renewable intermittent resources continue to grow within SPP. Had more market participants been able to express their views in its governance process, SPP would have had to review and respond to this feedback and pursue more constructive changes. ETI did file comments in the SPP stakeholder process raising many of these concerns but unfortunately, these comments were largely ignored.

d. The Modified Capitalization Requirements Fail to Consider Several Ground Realities.

The increased minimum capitalization requirements fundamentally requires a segregation of funds by market. Yet, financial firms and asset owners do not generally manage their balance sheets by segregating funds to each specific market. Additionally,

most market participants often leave excess funds with their FCM for trading other financial products.

Based on ETI's review of the SPP stakeholder comments,²⁹ we have not found instances whereby SPP has considered how to mechanically implement the increased minimum collateralization requirements, including the requirement that market participants cannot incorporate in their calculations of net worth or total assets, the cash deposits held at any other ISO or RTOs. A segregation of funds approach to calculation of net worth and assets raises several questions and potential adverse consequences that needed to be considered prior to implementation. It appears that SPP has not considered: (1) how to consider and label (or not consider) funds held at FCMs for trading other products; (2) how to distinguish funds required to be held for positions in other markets versus purely excess funds deposited at an RTO/ISO for operational efficiency; and (3) whether the segregation of funds creates operational difficulties that may thereby create an incentive to leave minimal funds with the RTOs/ISOs.

It appears from the process thus far that SPP has not thought through the practical requirements and potential adverse consequences from the increased minimum

²⁹ CPWG Minutes, dated February 20, 2020, at Agenda Item 6 posted at:

<https://www.spp.org/documents/61677/cpwg%20minutes%20&%20attachments%20200220.pdf>.

Finance Committee Minutes, dated April 27, 2020, at Agenda Item 2 posted at:

<https://www.spp.org/documents/62029/fc%20minutes%20and%20attachments%20updated%20200427.pdf>.

MWG Minutes, dated May 19-20, 2020, at Agenda Item 7 posted at:

<https://www.spp.org/documents/62270/mwg%20minutes%20&%20attachments%20200519%2020.pdf>.

RTWG Minutes, dated June 25, 2020, at Agenda Item 8b posted at:

<https://www.spp.org/documents/62525/rtwg%20meeting%20minutes%202020%2006%2025.pdf>.

MOPC Minutes, dated July 15, 2020, at Agenda Item 3 posted at:

<https://www.spp.org/documents/62635/200715%20mopc%20minutes%20&%20materials.pdf>.

capitalization. The Commission should therefore not approve such an incomplete tariff proposal.

e. Historically, Defaults and Credit Events Have Come in All Shapes and Sizes, Regardless of Capitalization.

Regardless of capitalization, derivatives and energy market defaults have occurred with all types of market participants whether physical or financial. In concluding that TCRs are risky because of the GreenHat default, SPP ignores, for example, the aftermath of Winter Storm Uri and subsequent defaults of entities in ERCOT dwarfed the ultimate size of the GreenHat default. In the aftermath of Winter Storm Uri, market participants gained and lost the millions from the physical purchase and sale of power and natural gas — “tipping energy companies into bankruptcy, triggering legal challenges and prompting government intervention.”³⁰

Yet, these events were related to various other products such as day ahead physical power and not TCRs. One of the first conclusions reached in SPP’s post-event analysis report is that Winter Storm Uri created wild swings in energy prices created a liquidity crisis in the energy market that caused some participants to default.³¹ The report concludes that extremely high natural gas prices were the primary driver of record-high energy offers that exceeded the FERC-required offer cap of \$1,000/megawatt-hour (MWh) “for the first

³⁰ *Here’s who else stands to make money off Texas’ Winter Storm*, DALLAS NEWS (Mar. 5, 2021) <https://www.dallasnews.com/business/energy/2021/03/05/heres-who-else-stands-to-make-money-off-texas-winter-storm/>; see also PUCT Final Order, *Application of Electric Reliability Council of Texas, Inc. for a Debt Obligation Order Pursuant to Chapter 39, Subchapter M, of the Public Utility Regulatory Act*, Docket No. 52321 (Oct. 14, 2021) available online https://interchange.puc.texas.gov/Documents/52321_214_1159471.PDF; see also *Brazos Electric Power Cooperative*, Chapter 11 Voluntary Petition, Case 21-30725 (Filed March 1, 2021).

³¹ *A Comprehensive Review of Southwest Power Pool’s Response To The February 2021 Winter Storm – Analysis and Recommendations* at p. 74, SPP (July 19, 2021) <https://spp.org/documents/65037/comprehensive%20review%20of%20spp's%20response%20to%20the%20feb.%202021%20winter%20storm%202021%2007%2019.pdf>.

time in SPP's market history."³² The report notes that SPP's market price hit an all-time high of \$4,274.96/MWh in the day-ahead market (contrast this with the 2020 day-ahead market yearly average of \$17.69/MWh).³³ The SPP report further determines that the rapid spike in market prices resulted in liquidity concerns and "created an exponential increase in short-term credit exposure."³⁴ The solutions in this report focus on developing policy changes surrounding price/volume risk, determination of total potential exposure, and participant/counterparty risk, along with improving resource planning, and emergency response communications. What is noteworthy is that the term "minimum capitalization" is not mentioned even once in this report. The changes proposed herein are a rounding error in the ERCOT default scenario. Simply, minimum capitalization should not be the focus because it is not critical to developing a solution framework and SPP implies as much in its report.

The conclusions in the SPP report indicate that one cannot assume that there is credit risk just because the product is financial instead of physical. The fundamental truth of the market is that *any* type of transaction has the capacity to pose credit risks to markets whether physical power or financially settled commodity markets. To single out one product class is unduly discriminatory and forces a lack of competition where it is needed most – a hedging product. An illiquid market, all else equal, is a riskier market. Instead, just and reasonable collateralization is striking a delicate balance between the collection of sufficient collateral for the positions held while maintaining robust liquidity in the market.

³² *Id.* at p. 9.

³³ *Id.*

³⁴ *Id.*

f. The Modified Capitalization Requirements inhibits the growth of renewable generation intended to mitigate climate change.

Between 2009 and 2020, renewable energy production in SPP has grown 800% from 3 GW in 2009 to 27 GW in 2020.³⁵ Growth in renewable generation requires financial investments which in turn requires careful consideration of volatile volumes and prices. Market Participants use virtuals and other financial products as part of their hedging strategies to manage physical and financial risks.

To accelerate clean energy deployment, regulators like the CFTC, have noted that derivatives regulations must support “more capital toward sustainable investments and net-zero activities including low carbon and renewable energy, energy efficiency ... and resilience against climate impacts.”³⁶ The CFTC has further determined that markets like “renewable generation and electricity derivatives” will streamline “capital to climate-related opportunities and help manage climate risk.”³⁷

The rapid scale up in renewable resources in SPP in the past decade demonstrates the importance of both liquidity and hedging activity in the SPP market. The increases to minimum capitalization requirements for TCR markets will likely mean inhibited hedging capabilities, and thereby impacting the capital available for renewable generation. Ultimately, the increases to minimum capitalization will curtail hedging activity, limit

³⁵ SPP 101, *An Introduction To Southwest Power Pool*, available online at <https://www.spp.org/documents/31587/spp101%20-%20an%20introduction%20to%20spp%20-%20all%20slides%20print.pdf> (last accessed November 1, 2021).

³⁶ *Managing Climate Risk in the U.S. Financial System, Report of the Climate-Related Market Risk Subcommittee of the U.S. Commodity Futures Trading Commission*, at p. 2 (Sep. 9, 2020) (“CFTC Climate Report”).

³⁷ *Id.* at vi.

liquidity, handicap renewable investment in SPP, and hamper the effort to decarbonization of electric generation.

SPP should focus efforts on proper collateral risk management strategies such as initial margin and variation margin, not minimum capitalization.

g. SPP Should Instead Focus on Collateral Risk Management Policies

A higher net worth or total assets requirement would not have solved GreenHat or even the recent Winter Storm Uri defaults. Investor owned utilities with such higher net worth or total assets requirement have not been protected from defaults and bankruptcies.³⁸ Simply stated, capitalization is not a day to day credit risk mitigation tool, but a lagging indicator of a company's credit capability. Initial and variation margin are day-to-day mechanisms that more effectively mitigate credit risk.

SPP has proposed to increase the alternative minimum deposit to a level of \$2 million. This clunky mechanism does not address the credit risk to a particular position.

Consider the following hypothetical: Company A has \$20 million in assets that are not being held by any other market. Company A is extended credit to trade FTRs, suffers a catastrophic overnight loss of say \$50 million, and must utilize its reserves to pay a portion of the loss. Company A then defaults in SPP. Although company A met the higher

³⁸ Troy Segal, *Enron Scandal: The Fall of a Wall Street Darling* (May 31, 2021) available online at <https://www.investopedia.com/updates/enron-scandal-summary/>; see also *PG&E, owner of biggest US power utility, files for bankruptcy*, CNBC (Jan. 29, 2021) available online at <https://www.cnbc.com/2019/01/29/pge-owner-of-biggest-us-power-utility-files-for-bankruptcy.html>; David Weinberg, *A Texas-sized bankruptcy for giant Texas energy deal* (Apr. 29, 2014) ("When Energy Future [f/k/a/ TXU] filed for bankruptcy ... its total assets were **\$36.4 billion**"), available online <https://www.marketplace.org/2014/04/29/texas-sized-bankruptcy-giant-texas-energy-deal/>; Sonal Patel, *Troubled FirstEnergy Companies Seek Bankruptcy Protection* (Apr. 1, 2018) (When First Energy Solutions filed for bankruptcy it had reported total assets, liabilities, and capitalization of about **\$5.5 billion**), available online <https://www.powermag.com/troubled-firstenergy-companies-seek-bankruptcy-protection/>.

minimum capitalization requirement, did not need to post \$2 million, the capitalization failed to protect other market participants from company A's default of \$25 million. By focusing on capitalization alone, SPP misses the forest for the trees.

Instead, as recommended by the GreenHat Independent Consultants, SPP and its stakeholders should refocus the discussion on having appropriate collateral risk management policies in place. The collateral requirements like initial and variation margin should be specifically tied to the positions that a market participant executes, thus addressing the root causes of the GreenHat default.³⁹

Initial margin should be posted by a market participant "to ensure a minimum level of position-based collateral for each customer proportional to the customer's trading activity..."⁴⁰ Variation margin should be posted by a market participant "to fully collateralize net mark-to-market losses associated with a customer's trading positions."⁴¹ Consider the same hypothetical as above. If SPP had proper initial and variation margin, company A's default in another market would be less problematic for SPP members because SPP is already holding the funds necessary for company A's specific positions. Further, if SPP initiated more auctions as recommended by the GreenHat Independent Consultants, then there would be much more capability to liquidate positions as needed to meet margin calls.

³⁹ *Comments of the Energy Trading Institute*, Credit Reforms in Organized Wholesale Electric Markets, Docket Nos. AD20-6-000 and AD21-6-000 (June 7, 2021).

⁴⁰ Abram Klein, *Impact of Market Design on Credit Risk: Opening Statement of Abram Klein*, Managing Partner, Appian Way Energy Partners, Docket No. AD21-6-000, at p. 2 (Mar. 1, 2021) ("Klein Comments"). This is the same concept implemented by PJM, which imposes a 0.10/MWh minimum.

⁴¹ *Id.*

Indeed, such margining is already in place with respect to futures derivatives trading as administered by Designated Contract Markets subject to the CEA. The RTO/ISO markets should similarly be required to maintain credit and counterparty risk management, including initial and variation margining of market participant positions, that the RTO/ISO markets have the capability to perform, particularly in creating their own respective risk models.⁴²

ETI recommends that the Commission should reject SPP's proposal, and SPP should focus on establishing solid credit models that hold appropriate collateral for the positions held, not arbitrarily penalizing participants in one financial product class based on one negative event while ignoring a larger scale event entirely.

IV. CONCLUSION

For the reasons discussed above, SPP's proposed capitalization requirements fails to meet the requirements of section 205 of the Federal Power Act ("FPA") to ensure that rates are just and reasonable, and not unduly discriminatory. As such, the Commission should reject SPP's filing. Lastly, ETI strongly urges the Commission to initiate a credit rulemaking to help address these issues and modernize Order No. 741 to address the credit challenges of today.

⁴² GreenHat Report at. p. 30 – App. p.4. (explaining that the "PJM Credit Policy Failed to Address Critical Risks" associated with collateral management).

Dated: November 4, 2021

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CERTIFICATE OF SERVICE

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

Dated at San Francisco this 4th day of November 2021.

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