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| NPRR Number | [1112](https://www.ercot.com/mktrules/issues/NPRR1112) | NPRR Title | Reduction of Unsecured Credit Limits |
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| Date | | April 21, 2022 | |
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| Submitter’s Information | | | |
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| Cell Number | |  | |
| Market Segment | | Not applicable | |

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| Comments |

Pursuant to Section 8.1 of the ERCOT Board Policies & Procedures, ERCOT respectfully requests that the Board of Directors (1) reject the Technical Advisory Committee (TAC) recommendation on Nodal Protocol Revision Request (NPRR) 1112, and (2) recommend approval of the 4/13/22 TAC Report for NPRR1112 as amended by the [3/18/22 ERCOT comments](https://www.ercot.com/files/docs/2022/03/18/1112NPRR-15%20ERCOT%20Comments%20031822.docx). This TAC Recommendation Opposition includes the points raised in the 4/12/22 ERCOT comments, as well as rebuttals of certain rationalizations for continuing the ERCOT wholesale market’s assumption of credit risk for certain Market Participants that were asserted during the 4/13/22 TAC meeting. These additional points are covered in paragraphs (f) through (h) below.

ERCOT appreciates the attention stakeholders have devoted to addressing NPRR1112. However, ERCOT asserts, for the reasons discussed below, that the financial integrity of the ERCOT wholesale market is better protected by eliminating Unsecured Credit Limits altogether.

**Background**

ERCOT submitted NPRR1112 to implement a lesson learned from the 2021 extreme winter weather event and its aftermath –Counter-Parties (and, ultimately perhaps, end-use customers) are unnecessarily at risk of assuming the costs of defaults by certain other Market Participants. While this risk can never be entirely eliminated, it can be appropriately mitigated, and, therefore, ERCOT proposed to eliminate the extension of unsecured credit to certain Market Participants. As ERCOT noted in its submission of NPRR1112, under ERCOT Protocols, currently unsecured credit is only available to certain Market Participants. The extension of unsecured credit reduces Financial Security, and therefore, in the event of a default, increases the potential future default uplift amounts that are borne by other Counter-Parties. As explained more fully below, requiring all active Counter-Parties to assume default uplift that is attributable to the extension of unsecured credit to certain Market Participants is inequitable.

After ERCOT submitted NPRR1112, it was revised by stakeholders and recommended by TAC in the 4/13/22 TAC Report to merely reduce the amount of unsecured credit made available to certain Market Participants from $50M to $30M. It may be tempting to consider these revisions as a compromise; however, that would be incorrect because reduction of the maximum Unsecured Credit Limit does not acknowledge that any extension of unsecured credit by the overall ERCOT wholesale market is inconsistent with the goals of preventing improper subsidization of credit risk and costs. ERCOT urges the Board to recognize the logical fallacy of the “false compromise” offered in TAC’s recommendation in the 4/13/22 TAC Report. Instead ERCOT urges the Board to eliminate the Unsecured Credit Limits by recommending approval of the [3/18/22 ERCOT comments](https://www.ercot.com/files/docs/2022/03/18/1112NPRR-15%20ERCOT%20Comments%20031822.docx).

**Concerns with the TAC Recommendation in the 4/13/22 TAC Report**

As expressed in the 3/18/22 ERCOT comments, which are provided in the Board’s meeting materials, ERCOT disagrees with the resinstatement of Unsecured Credit Limits as recommended by TAC in the 4/13/22 TAC Report. ERCOT’s position may be summarized as follows:

1. Since Independent System Operators/Regional Transmisison Operators (ISO/RTOs) function as central clearinghouses, there is no inherent reason why ISO/RTOs should provide free credit for some Market Participants. Since banks are in the business of understanding and pricing credit risk, they are better positioned to provide credit support for Market Participants.
2. The availability of Unsecured Credit Limits is in effect a shifting of the credit risk and associated costs of some Market Partipants to others, since all Market Participants must share in default uplift costs.
3. Highly-rated Market Participants eligible for Unsecured Credit Limits should be able to obtain replacement financing from eligible letter of credit-issuing banks. If such a bank is unwilling to execute a letter of credit with one of these Market Participants, it is doubtful whether the overall ERCOT wholesale market should be financing their credit risk at no cost to the Market Participant.
4. Relatedly, ERCOT creditworthiness requirements for banks issuing letters of credit are, in the aggregate, more stringent than those currently used to grant Unsecured Credit Limits. Therefore, it can be expected that elimination of Unsecured Credit Limits, and assumption of those credit risks by banks, would improve ERCOT’s overall credit profile. To illustrate this, the percentage distribution by credit rating of Counter-Parties with Unsecured Credit Limits compared to banks with currently posted letters of credit is shown below.
5. It has been suggested that NPRR1112 is unnecessary since ERCOT has discretionary authority under Section 16.11.2, Requirements for Setting a Counter-Party’s Unsecured Credit Limit, to set Unsecured Credit Limits, and under Section 16.11.4.1, Determination of Total Potential Exposure for a Counter-Party, to revise Total Potential Exposure to reflect a Counter-Party’s financial risk. Historically, ERCOT has interpreted these provisions as providing responses to specific market-related risks (*e*.*g*. an unexpected bankruptcy filing), rather than providing means to set overall credit policy. As such, ERCOT does not believe that discretionary authority was meant to apply broadly as a net but rather as a spear. Notwithstanding allowable discretionary authority, ERCOT believes that NPRR1112, as amended by the 3/18/22 ERCOT comments, is an appropriate credit policy.
6. A stakeholder at TAC asserted that ERCOT’s assumption of credit risk via unsecured credit is costless. This is belied by the fact that, as Market Participants readily agree, they would be charged by banks for letters of credit. If there were no cost for credit support and the assumption of credit risk, then banks would have no reason to charge for letters of credit. Provision of unsecured credit does not make the cost of credit risk vanish; instead, it socializes that cost among other Market Participants.
7. Some stakeholders also argued that the cost of credit support by banks would increase costs to end-use consumers. Consistent with paragraph (f) above, ERCOT believes that elimination of Unsecured Credit Limits will not increase the cost of ERCOT market credit risk in the aggregate, but rather reallocate that cost in an appropriate and non-distortive manner.
8. Some stakeholders further stated that actions taken by the PUC since the 2021 extreme winter weather event, such as the reduction in the System-Wide Offer Cap, have reduced credit risk in the ERCOT wholesale market to the extent that Unsecured Credit Limits remain justifiable. Notwithstanding changes made since the winter event, ERCOT wholesale market credit risk has not been eliminated. Market Participant defaults may be driven by any number of factors outside the scope of ERCOT market design, such as poor hedging strategies, and therefore the ERCOT wholesale market should maintain a conservative credit risk profile.

ERCOT appreciates the Board’s consideration of this TAC Recommendation Opposition. In view of the above, ERCOT requests that the Board reject the TAC recommendation on NPRR1112 and recommend approval of the 4/13/22 TAC Report for NPRR1112 as amended by the [3/18/22 ERCOT comments](https://www.ercot.com/files/docs/2022/03/18/1112NPRR-15%20ERCOT%20Comments%20031822.docx).