NPRR1112
Reduction of Unsecured Credit Limits

ERCOT Board of Directors Meeting
August 16, 2022

Presented by Darrell Cline
General Manager and CEO, Garland Power & Light

Background

- December 2021: ERCOT proposed the elimination of unsecured credit
- February 2022: a group of joint commenters filed a revision to lower the unsecured credit limit from $50.0M to $27.5M
- Credit Work Group (Credit WG) unanimously endorsed retaining unsecured credit with a $30M limit
- Protocol Revision Subcommittee (PRS) endorsed (90.5%) the reduction of the unsecured credit limit to $30M
- Technical Advisory Committee (TAC) recommended approval (92%) of the reduction of the unsecured credit limit to $30M
- No party has filed comments in support of ERCOT's position

ISO/RTO Unsecured Credit Findings

- All ISO/RTOs offer unsecured credit
- All ISO/RTOs offer up to $50M in unsecured credit
- According to ERCOT staff's findings:
  - Unsecured credit amounts in other ISO/RTOs are up to $1.75B
  - ERCOT has $1.4B in outstanding unsecured credit
  - Reducing the unsecured credit limit from $50M to $30M will reduce outstanding unsecured credit to approximately $1.1B

Eliminating Unsecured Credit Will Have Unintended Consequences

- Failure to Differentiate Creditworthiness
- Less Market Liquidity
- Increase in Cost to Consumers

Failure to Differentiate Creditworthiness

- Elimination of unsecured credit is ERCOT's attempt to "provide a more level playing field" and prevent "subsidization" of other Market Participants
- This attempt eliminates the current process that properly differentiates a Market Participant's creditworthiness and effectively places an investment grade entity above a non-investment grade entity
- ERCOT's proposal could <u>**require a Market Participant with a non-investment grade credit rating to post the same security as a Market Participant with a AAA credit rating**</u>
- ERCOT's proposal is a step backward in properly differentiating risk between entities based on their creditworthiness
- ERCOT's proposal does not align with its stated objective of "credit best practices to reduce the risk of future under-collateralization"

Less Market Liquidity

- Elimination of unsecured credit will reduce liquidity in the ERCOT Market, which could increase cost of transacting in ERCOT for Market Participants and electric consumers in ERCOT
- In setting the $50M unsecured credit limit for the other ISOs, FERC recognized that unsecured credit provides liquidity to wholesale energy markets [1]
- FERC recognized the need to balance market liquidity and risk (cost to the market) in setting the $50M unsecured credit limit [2]

(1) FERC Docket RM10-13-000; Order 741; PP 50

(2) FERC Docket RM10-13-000; Order 741; PP 52

Increased Costs for Consumers

- Secured credit creates an expense that must be recovered from consumers without any appreciable benefit in reducing risk
- Market Participants with investor grade ratings will need to seek secured credit from a limited number of financial institutions – increasing exposure to financial institutions and financial institutions to ERCOT
- For FERC, the $50 million cap was an appropriate balance between the costs that would need to be incurred by market participants to provide this level of secured credit and the effects of potential market disruption under a market participant default event

Conclusion

- All ISO/RTOs offer unsecured credit up to $50M
- Market Participants, who bear the risk for non-performance by Counterparties, overwhelmingly support retaining unsecured credit at the reduced limit of $30M
- ERCOT's unsecured credit limit would be the lowest of the ISO/RTOs
- Elimination of unsecured credit will have unintended consequences
  - Failure to Differentiate Creditworthiness
  - Less Market Liquidity
  - Increase in Cost to Consumers

Recommendations

- TAC recommends the Board approve NPRR1112 as endorsed by the Credit Working Group on March 14, 2022 and as endorsed by TAC on April 13, 2022
- Other, more appropriate vehicles exist to target credit risk, such as:
  - NPRR1067, *Market Entry Qualifications, Continued Participation Requirements, and Credit Risk Assessment*
  - A comprehensive study of unsecured credit and associated practices