

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D. C. 20426

OFFICE OF THE GENERAL COUNSEL

February 22, 2011

**VIA ELECTRONIC SUBMISSION**

David Stawick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

**Re: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant” (RIN 3235–AK65)**

**Comments of the Staff of the Federal Energy Regulatory Commission**

Dear Mr. Stawick:

On December 1, 2010, the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) issued a joint notice of proposed rulemaking and interpretative guidance<sup>1</sup> under various provisions of the Commodity Exchange Act (CEA)<sup>2</sup> and the Securities Exchange Act of 1934,<sup>3</sup> as recently amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).<sup>4</sup> The proposed rules and guidance define the terms “swap dealer,” “major swap participant,” and certain other terms that were added to the CEA by Dodd-Frank. The CFTC and the SEC have specifically requested comment on how these terms would apply to participants in the generation and transmission of electricity. These comments are submitted by the staff of the Federal Energy Regulatory Commission (FERC) to address these issues.

**CFTC and FERC Regulation of Energy Markets**

FERC regulates the transmission and sale for resale of electricity in interstate commerce pursuant to the Federal Power Act (FPA),<sup>5</sup> as well as the transportation and

---

<sup>1</sup> 75 Fed. Reg. 80,174 (Dec. 21, 2010).

<sup>2</sup> 7 U.S.C. §§ 1 et seq. (2006).

<sup>3</sup> 15 U.S.C. §§ 78a et seq. (2006).

<sup>4</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> 16 U.S.C. §§ 824 et seq. (2006).

sale for resale of natural gas in interstate commerce pursuant to the Natural Gas Act.<sup>6</sup> Generally, FERC has a statutory mandate to ensure that all rates charged for these sales or services are just, reasonable, and not unduly discriminatory or preferential. This responsibility extends to contracts or other arrangements and practices that significantly affect those sales and services.

Since the late-1970s, Congress and FERC have encouraged competition in both the electricity and natural gas industries. In the natural gas industry, Congress enacted the Natural Gas Policy Act of 1978<sup>7</sup> and the Natural Gas Wellhead Decontrol Act of 1989,<sup>8</sup> removing price controls on first sales of natural gas. FERC also adopted pro-competitive regulations, particularly Order No. 636, requiring the interstate pipelines to unbundle their sales and transportation services.

In the electric industry, this effort has included legislation such as the Public Utility Regulatory Policies Act of 1978<sup>9</sup> (facilitating market entry by combined heat-and-power facilities and small renewable energy facilities), the Energy Policy Act of 1992<sup>10</sup> (expanding FERC's authority to require transmission service upon customer application, and reducing barriers to entry by independent power producers) and the Energy Policy Act of 2005 (EPAAct 2005)<sup>11</sup> (reducing barriers to investment in the industry, subject to protection against cross-subsidization by ratepayers).

FERC's efforts in the electric industry include the landmark Order No. 888, issued in 1996. Order No. 888 required public utilities to offer transmission service to others on non-discriminatory rates, terms and conditions. Order No. 888 also encouraged the formation of independent system operators (ISO), to operate all of the transmission facilities in a geographic area. ISOs were aimed at encouraging competition by facilitating development of regional power markets, and enhancing trading opportunities for a region's buyers and sellers. Several years later, FERC's Order No. 2000 encouraged the formation of regional transmission organizations (RTO), which perform the same transmission functions as ISOs but generally are larger in geographic scale.

---

<sup>6</sup> 15 U.S.C. §§ 771 et. seq. (2006).

<sup>7</sup> Natural Gas Policy Act, 15 U.S.C. §§ 3301 et seq. (2006).

<sup>8</sup> Pub. L. No. 101-60, 103 Stat. 157 (1989).

<sup>9</sup> 16 U.S.C. §§ 2601 et seq. (2006).

<sup>10</sup> Pub. L. No. 102-486, 106 Stat. 2776 (1992).

<sup>11</sup> Pub. L. No. 109-58, 119 Stat. 594 (2005) (codified in scattered titles of the U.S.C.).

Today, RTOs and ISOs operate not only transmission facilities but also markets for trading electric energy among utilities.

Additionally, under EPAct 2005, FERC approves and enforces (or oversees enforcement of) standards for the reliability of the bulk power system. An important component of these standards addresses the grid's cyber security.

Given FERC's oversight of wholesale sales and transmission/transportation in energy markets and the reliability of the grid, the CFTC should interpret and apply the CEA as amended by Dodd-Frank to ensure that CFTC jurisdiction and FERC jurisdiction do not overlap (except as determined by Congress in anti-manipulation contexts). In addition, regulatory gaps should be avoided in energy markets. Market participants should not be subjected to potentially duplicative and conflicting regulatory requirements. Otherwise, regulatory uncertainty could chill investment critically needed in our Nation's energy infrastructure, or unnecessarily add to the costs ultimately imposed on energy consumers.

In this regard, President Obama recently reminded federal agencies that certain industries may face a significant number of redundant, inconsistent or overlapping requirements. In such cases, the President directed that there be greater coordination across agencies to reduce costs and simplify and harmonize rules. The President stated: "In developing regulatory actions, and identifying appropriate approaches, each agency shall attempt to promote such coordination, simplification and harmonization." The President further directed that agency regulations should "promote predictability and reduce uncertainty" and that each agency should "tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations."<sup>12</sup>

These principles should guide the CFTC-FERC jurisdictional relationship in energy markets, similar to the approach taken before and in Dodd-Frank to the CFTC-SEC relationship in financial markets. There, too, the approach is to minimize the potential for regulatory conflict and its harmful effects on regulated activities. The efforts taken, and techniques used, to avoid regulatory conflict in financial markets may provide a helpful model for the CFTC-FERC relationship in energy markets.

### **FERC Should Retain Comprehensive Oversight of RTOs and ISOs**

As noted above, the FPA requires that FERC ensure that rates for wholesale power and transmission are just and reasonable. Because of this requirement, along with the unique nature of electricity – its limited storage potential, the long-lead time for

---

<sup>12</sup> See Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 21, 2011), Improving Regulation and Regulatory Review.

deployment of certain resources, and the view by many that it is a “public good” rather than a commodity, RTO and ISO power markets and transmission services are tightly integrated, and regulated to a greater extent than most other commodity markets. Among other things, RTOs/ISOs are subject to comprehensive regulation of their planning of the transmission grid, their dispatch of generation and operation of the grid, their compliance with reliability standards and their administration of the markets they operate. Every material action taken by an RTO/ISO in performing these functions must be authorized by FERC, and these authorizations are implemented in lengthy tariffs (hundreds or thousands of pages) reviewed and approved by FERC. In order to analyze these tariffs, FERC draws upon expertise in various disciplines, including attorneys, economists, energy industry analysts, and engineers. The tariffs contain numerous requirements and mechanisms to ensure reasonable rates and a reliable supply of electricity. These rules are carefully designed to facilitate competitive forces within a heavily-regulated industry. The RTOs and ISOs themselves are legally considered to be “public utilities” and in fact are regulated by FERC more extensively than other public utilities.

FERC staff monitors the electricity and natural gas markets to ensure that the markets are functioning efficiently and appropriately. This is done by monitoring market results and conditions and identifying anomalies. When the available data does not explain the anomalies, staff examines the matter and, if legitimate reasons are not found, investigations are initiated to determine if fraud or manipulation has occurred. FERC also requires each RTO or ISO to have an independent market monitor. The market monitors can review all market activities in real-time. They also evaluate market rules and recommend changes, review and report on the performance of these markets, and must refer to FERC any potential violations of FERC’s rules, regulations or orders including fraud and manipulation. They are authorized within parameters defined in the RTO or ISO’s tariffs to take immediate mitigative action in the event of market participant misbehavior.

EPA 2005 gave FERC the authority to assess substantial penalties (\$1 million a day per violation) for fraud and market manipulation (and other violations), including manipulation of RTO and ISO markets. This authority greatly helps FERC deter and penalize the types of abuses we found during the California energy crisis several years earlier. FERC has initiated several proceedings based on this authority, which applies to participants in RTO and ISO markets as well as any other entity engaging in fraud or market manipulation in connection with a FERC-jurisdictional transaction.

FERC’s efforts on market oversight and enforcement have increased greatly in recent years. Ten years ago, FERC investigatory staff consisted of 14 attorneys and a few support personnel within its Office of General Counsel. Today, staff in FERC’s Office of Enforcement (including market oversight, investigations and audits) numbers approximately 188, including 44 attorneys in its Division of Investigations. FERC’s enforcement efforts under EPA 2005 have yielded over \$121 million in civil penalties

and over \$35 million in disgorgement. Many of the highest penalty and disgorgement amounts involved market manipulation claims.<sup>13</sup>

FERC's transparency requirements are also quite extensive. For example, every public utility (whether within or outside of an RTO or ISO) must file a quarterly report listing every wholesale sale it made during the preceding quarter. These reports, which include the names of counter-parties and many of the terms of the transaction, are made publicly available the moment they are processed by FERC. The RTOs and ISOs also have substantial reporting requirements for bids and transactions in their markets.

Further, recognizing that clear and consistent credit practices used in organized markets are an important element of rates, FERC recently adopted new requirements pertaining to the risk and credit procedures used in organized markets focused on such matters as the maximum length of billing and settlement periods, limits on the use of unsecured credit by market participants (including the elimination of unsecured credit in all financial transmission rights markets), and procedures applicable to posting of collateral.<sup>14</sup>

**Because of FERC's existing, comprehensive regulation, Dodd-Frank terms should be interpreted as not applying to any contract or instrument traded in an RTO/ISO market pursuant to a FERC accepted or approved rate schedule or tariff. Applying Dodd-Frank swaps regulation to RTOs/ISOs is not only unnecessary but also potentially harmful.**

The question of CFTC regulation of energy markets under the CEA, as amended by Dodd-Frank, has arisen in several contexts, in large measure due to concern that contracts that are typically subject to FERC-approved tariffs could be construed to be "swaps." Examples include RTO/ISO markets for financial transmission rights (FTRs), forward capacity markets and day-ahead markets. Closely related to this is the question of whether RTOs/ISOs should be considered "swap dealers" and/or required to submit to regulation as "clearing" organizations or "swap execution facilities" under CFTC jurisdiction.

The example of FTRs illustrates the possible effects of CFTC regulation in these areas. FTRs allow customers to protect against the risk of price increases for

---

<sup>13</sup> A list of all EPCRA 2005 civil penalty orders is available at <http://www.ferc.gov/enforcement/civil-penalties/civil-penalty-action.asp>. For the Office of Enforcement's 2010 Report on Enforcement, see <http://www.ferc.gov/legal/staff-reports/11-18-10-enforcement.pdf>.

<sup>14</sup> See *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, 75 FR 65942 (Oct. 21, 2010), *order on reh'g*, 134 FERC ¶ 61,126 (2011)..

transmission services in RTOs/ISOs. An FTR is a right to lock in congestion costs between two specific points. For example, if the transmission capacity going from Point A to Point B is 500 megawatt (MW), but the RTO or ISO seeks to send 600 MW of power from Point A to Point B when calling on the least-cost generators to serve load, the path will be congested, and the price of service will increase because a more expensive generator at Point B will need to be dispatched. The increase is referred to as congestion costs.

As demonstrated by this example, FTRs are inextricably linked to both the locational-priced energy markets and the provision of firm transmission service by RTOs/ISOs. They are also closely linked to the transmission system planning processes – the means by which the grid is expanded to meet growing need - another set of RTO/ISO functions subject to extensive FERC regulation.

In general, load-serving entities in RTOs/ISOs are allocated either FTRs or rights convertible into FTRs. The allocation is generally based on usage during a historical period, as modified in certain circumstances for later changes. While allocated FTRs are generally limited to load-serving entities and to those who funded construction of specific transmission facilities, other FTRs are auctioned and these generally can be purchased by any creditworthy entity.

Historically, FTRs were developed to give load-serving entities price certainty similar to the pricing methods in non-RTO/ISO markets. In most cases, FTRs have terms of one year or less. In EPAAct 2005, however, Congress enacted FPA section 217, requiring FERC to use its authority in a way that enables load-serving entities to secure FTRs on a long-term basis for long-term power supply arrangements made to meet their customer needs.<sup>15</sup>

---

<sup>15</sup> Specifically, in FPA section 217(b)(4), Congress directed FERC to:

*exercise the authority of the Commission . . . in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities, and enables load-serving entities to secure firm transmission rights (or equivalent tradable or financial transmission rights) on a long term basis for long-term power supply arrangements made, or planned, to meet such needs.*

This statutory mandate demonstrates that Congress intended for FERC to make FTRs available to load-serving entities to meet their power supply needs, and did not intend for FTRs to be treated as just another type of derivative instrument to be regulated separately and, perhaps, inconsistently by the CFTC, which has no responsibility for ensuring an adequate supply of energy at reasonable prices.

FTRs are available only to the extent allowed by the physical limits of the grid. All of the FTRs must be “simultaneously feasible” on the grid. Financial derivatives, by contrast, are not limited by physical capacities and instead are limited only by the willingness of market participants to take an opposite “bet.”

Also, markets for FTRs include hundreds or thousands of different FTRs (for each pairing of receipt and delivery points) and thus are much more fragmented and less liquid than typical contracts based on fungible commodities traded on futures exchanges. Since an FTR applies to a specific pair of receipt and delivery points, it is not fungible with an FTR for a different pair of points.

FTR markets do not pose systemic risk to the economy. All FTR markets combined amount to roughly several billion dollars. This market level fluctuates depending on the level of physical congestion in each RTO and is expected to decrease substantially as more transmission is built relieving congestion.

Any expansive interpretation of terms such as “swap,” “swap dealer,” “major swap participant,” “swap execution facility” or “derivatives clearing organization” that would result in overlapping (and possibly inconsistent) regulation by the CFTC of RTOs and ISOs and transactions, such as FTRs, that are already subject to extensive regulation by FERC would be a wasteful and unneeded distraction from the CFTC’s important task of reforming the oversight of those products and trading environments that, prior to passage of Dodd-Frank, were unduly opaque or inadequately supervised.

However, as discussed, this is more than just a cost issue, or an issue of inconvenience to a particular industry. From an operational (as well as policy) standpoint, it makes little sense to subject organized electricity markets and transactions that are carried out in accordance with FERC-approved tariffs, subject to extensive reporting, as well as to FERC’s enforcement authority, to an entirely different regulatory model that does not have as a basis the requirement to ensure that rates for wholesale power and transmission are just and reasonable.

Mr. David Stawick, Secretary  
February 22, 2011  
Page 8

FERC staff thanks the CFTC and the SEC for soliciting comments on their proposed swaps-related definitions and guidance.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Bardee", with a stylized flourish at the end.

Michael Bardee  
General Counsel  
Phone: (202) 502-6000  
Email: [michael.bardee@ferc.gov](mailto:michael.bardee@ferc.gov)

Cc: Jon Wellinghoff, Chairman  
Marc Spitzer, Commissioner  
Philip D. Moeller, Commissioner  
John R. Norris, Commissioner  
Cheryl A. LaFleur, Commissioner