

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D. C. 20426

OFFICE OF THE GENERAL COUNSEL

September 27, 2012

VIA ELECTRONIC SUBMISSION

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Order and Request for Comment on Petition of Independent System Operators and Regional Transmission Organizations for Exemption of Specified Transactions from Certain Provisions of the Commodity Exchange Act

Comments of the Staff of the Federal Energy Regulatory Commission

Dear Mr. Stawick:

On August 21, 2012, the Commodity Futures Trading Commission (CFTC) issued a proposed order (Proposed Order) and request for comment¹ on a consolidated petition (Petition) of certain independent system operators (ISOs) and regional transmission organizations (RTOs) for exemption, pursuant to section 4(c)(6) of the Commodity Exchange Act (CEA),² as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).³ The Petition seeks exemption of certain specified contracts, agreements and transactions for the purchase and sale of electricity products that are offered pursuant to tariffs approved by the Federal Energy Regulatory Commission (FERC) (or, in the case of one of the petitioners, by the Public Utility Commission of Texas). If certain conditions are met, the Proposed Order would exempt four categories of contracts, agreements and transactions and those who engage in such transactions from most, but not all, provisions of the CEA that would be applicable to swaps and parties to swaps.

¹ 77 Fed. Reg. 52,138 (Aug. 28, 2012).

² 7 U.S.C. §§ 1 et seq. (2006).

³ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

These comments are submitted by the staff of FERC to address certain issues.

FERC Regulation of ISO/RTO Markets

As discussed in our prior comment letters,⁴ FERC regulates the transmission and sale for resale of electricity in interstate commerce pursuant to the Federal Power Act (FPA).⁵ 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. In our prior comment letters, we discussed the development of RTOs and ISOs as critical components in carrying out FERC's statutory responsibilities. To summarize briefly, FERC's efforts started with 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 ISOs, 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 RTOs, which perform the same transmission functions as ISOs but generally are larger in geographic scale. Today, RTOs and ISOs operate not only transmission facilities but also markets for trading electric energy among utilities.

RTO and ISO power markets and transmission services are tightly integrated, and regulated to a greater extent than other commodity markets. Among other things, RTOs/ISOs are subject to comprehensive regulation of their planning of the transmission grid, their dispatch of generation resources and operation of the transmission grid, their compliance with reliability standards and

⁴ See, e.g., FERC Staff Comments to Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 Fed. Reg. 29,818 (May 23, 2011), filed July 22, 2011; FERC Staff Comments to Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174 (Dec. 21, 2010), filed Feb. 22, 2011.

⁵ 16 U.S.C. §§ 824 et seq. (2006).

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. 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 RTO/ISO markets to ensure that these markets are functioning efficiently and appropriately. 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 are required to refer to FERC any potential violations of FERC’s rules, regulations or orders including fraud and manipulation. They are authorized within parameters defined in an RTO or ISO’s tariff to take immediate action to correct market participant misbehavior.

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 counterparties and many of the terms of the transactions, 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 RTOs and ISOs are an important element of rates, FERC in 2010 adopted requirements pertaining to their risk and credit procedures 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.⁶

⁶ 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).

Comments on the Proposed Order

In our prior comment letters on other Dodd-Frank rulemakings,⁷ we urged the CFTC to interpret Dodd-Frank 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 regulations to RTO/ISO products and services is not only unnecessary but also potentially harmful. It makes little sense to subject organized electricity markets and transactions that are conducted pursuant to FERC-approved tariffs, subject to extensive reporting, as well as to FERC's enforcement authority, to an entirely different regulatory model lacking the requirement to ensure that rates for wholesale power and transmission are just and reasonable.

In short, no exemption should be needed because transactions that are executed or traded in an RTO/ISO market pursuant to a FERC-accepted or approved rate schedule or tariff should not be considered swaps under Dodd-Frank. Transactions that are executed or traded on RTOs/ISOs should be excluded from the definition of "swap," because defining these transactions as swaps is inconsistent with the text, goals, and purpose of Dodd-Frank. Thus, rather than address these issues through the exemption process, the CFTC should exclude RTO/ISO contracts or instruments from the definition of swap.

However, FERC staff recognizes that the Petition seeks an exemption only for certain categories of RTO/ISO transactions, and that the CFTC may choose to address only the specific exemption sought in the Petition and not broader issues beyond the Petition. If so, we nonetheless have the following concerns with the Proposed Order.

1. Scope of the Exemption

The Proposed Order would exempt four categories of RTO/ISO transactions that are specifically described in the Petition: financial transmission rights, energy transactions, forward capacity transactions, and reserve or regulation transactions. As noted by the CFTC, the petitioners also requested relief for "the purchase and sale of a product or service that is directly related to, and a logical outgrowth of, any [of the Petitioner's] core functions as an ISO/RTO . . . and all services related thereto."⁸ The CFTC's proposal to decline extending

⁷ *Supra* note 4.

⁸ 77 Fed. Reg. at 52,163 (quoting Petition at 9.).

the exemption beyond the scope of the four specific categories of RTO/ISO transactions detailed in the Petition to other products or services that are the “logical outgrowth” of RTO/ISO core functions could, in our view, give rise to situations in which new RTO/ISO products and services approved by FERC, within its statutorily-defined jurisdiction, and incorporated in the terms of RTO/ISO tariffs, would be subject to a second layer of regulatory review by the CFTC. The CFTC appears to recognize that the proposed scope of the exemption may not allow for innovation and requests comment on how “the scope could be expanded, without exempting products that may be substantially different from those reviewed by the [CFTC].”⁹

We do not believe Congress intended, or that sound public policy warrants, the Proposed Order’s constraint on RTO/ISO adaptations approved by FERC. Formation of RTOs and ISOs was encouraged by FERC-initiated policy objectives, and the products and services they offer are an essential means for carrying out FERC’s statutory responsibilities. The Proposed Order may unduly inhibit or delay innovation by RTOs and ISOs. Thus, the CFTC should not limit the exemption to the four proposed categories of transactions but also allow flexibility for RTOs and ISOs to adapt their products and services over time.

The Proposed Exemption (consistent with the Petition) also does not extend to the CFTC’s anti-fraud and manipulation authority, which Dodd-Frank expanded to cover swaps and also broadened to mirror the Securities and Exchange Commission’s section 10(b) authority (similar to Congress’s broadening of FERC’s authority in EPAct 2005). While FERC staff does not take issue with the CFTC’s retention of anti-manipulation jurisdiction generally, we note that the exemption order cannot extend the CFTC’s anti-manipulation jurisdiction further than Dodd-Frank itself provides.

2. “Appropriate Persons” Definition

One of the conditions for the Proposed Exemption to apply is that all parties to covered transactions must be either “appropriate persons,” as defined in CEA section 4(c)(3)(A) through (J), or “eligible contract participants” (ECPs), as defined in CEA section 1a(18)(A). As noted by the CFTC, it is adding ECPs to the list of “appropriate persons” through the exercise of its authority under CEA section 4(c)(3)(K).¹⁰ The CFTC requests comment on whether there are entities

⁹ *Id.*

¹⁰ Proposed Order at 52,142 n. 67.

currently engaging in covered transactions that are not “appropriate persons,” as defined in CEA section 4(c)(3)(A) through (J), or ECPs, but should nonetheless be considered “appropriate persons” pursuant to exercise of the CFTC’s authority under CEA section 4(c)(3)(K). In this regard, we note that certain smaller entities (e.g., small cooperatives) that currently participate in RTO/ISO markets may not satisfy the minimum size criteria in section 4(c)(3)(F) and also would not qualify as ECPs (i.e., swap dealers and “major swap participants”). The exclusion of such entities could have a negative effect on the functioning of RTO/ISO markets, by reducing liquidity and creating uncertainty as to the applicability of the exemption to RTO/ISO products and services bought and sold by a person outside the definition of “appropriate persons” and to the counterparties in such transactions, to the extent that such a person chooses to transact in an RTO/ISO market. Conversely, allowing continued participation by these smaller entities subject to FERC-approved rules poses little risk to RTO/ISO markets. Thus, we believe that the CFTC should exercise its authority under section 4(c)(3)(K) of the CEA to include within the definition of “appropriate persons” any person who satisfies the minimum participation standards under a FERC-approved RTO/ISO tariff.

FERC staff thanks the CFTC for soliciting comments on its Proposed Order.

Sincerely,



Michael Bardee

General Counsel

Phone: (202) 502-6000

Email: michael.bardee@ferc.gov

Cc: Jon Wellinghoff, Chairman
Philip D. Moeller, Commissioner
John R. Norris, Commissioner
Cheryl A. LaFleur, Commissioner
Tony T. Clark, Commissioner