

June 22, 2015

Via Electronic Submission

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: **Comments of First Principles Economics, LLC on the Notice of Proposed Order and Request for Comment on an Application for an Exemptive Order from Southwest Power Pool, Inc. from Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in Section 4(c)(6) of the Act**

Dear Secretary Kirkpatrick:

First Principles Economics, LLC respectfully submits these comments in response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Proposed Order and Request for Comment on an Application for an Exemptive Order from the Southwest Power Pool ("SPP") ("Proposed Exemption").

First Principles Economics is an economic consulting firm with over twenty years of experience in designing and implementing electricity markets in North America, New Zealand, Australia, the Philippines, Ghana and Nigeria.

While we are supportive of the Proposed Order, we are particularly encouraged by the Commission's explicit language clarifying that the original RTO-ISO Exemption Order¹ "does not prevent private claims for fraud or manipulation under the Act."² And in particular, "for the avoidance of doubt, the Commission notes that this view equally applies to SPP's Proposed Exemption. Therefore, the Proposed Exemption also would not preclude such private claims." Hence we are at a loss to understand why the opponents of this language believe the original exemption excluded the

¹ *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. 19880 (Apr. 2, 2013).

² Proposed Order at 29493.

private right of action given the complete lack of any language in the original order to support this position.³

As was understood during the development of the original RTO-ISO exemption order, the private right of action under Section 22 of the CEA is an important structural component of the overall market design. Eliminating the private right of action will undermine the integrity of the market and ensure that efficient, and in the case of electricity, reliable market outcomes are threatened. In particular, eliminating the private right of a market participant to seek damages for violations of the CEA necessarily creates perverse incentives – why would anybody willingly participate in a market where they are prevented from seeking damages if they believe they have been the victim of anti-competitive behavior? This perversion of incentives is particularly acute in electricity markets because a physical consumer of electricity has no choice in regards to participation in the RTO/ISO-run physical wholesale markets. Since there can be only one dispatch process, *i.e.*, there can be only one real time electricity market, for a given region, a participant cannot choose not to participate.

The argument that the private right of action is unnecessary in RTO/ISO markets because electricity markets are sufficiently regulated and monitored is not relevant and is an attempt to re-write history and the law. Moreover, this line of thinking ignores the fundamental *economic* role played by the private right of action. As succinctly stated by the Commission, “It would be highly unusual for the Commission to reserve to itself the power to pursue claims for fraud and manipulation—a power that includes the option of seeking restitution for persons who have sustained losses from such violations or a disgorgement of gains received in connection with such violations while at the same time denying private rights of action and damages remedies for the same violations.”⁴ From an economic perspective this is a significant point – the private right of action applies to individuals and potential redress does not depend upon the decisions of a third party. By providing actual market participants the surety that if they believe they have been harmed they themselves can seek remedy, the underlying risks are better understood and managed.

Having spent the past 20+ years involved in the design of electricity markets we are aware of how complex the issues are. Modern electricity markets, and energy markets in general, are characterized by their complexity and the degree of

³ Proposed order at 29493, “In the RTO–ISO Order, the Commission excepted certain CEA provisions pertaining to fraud and manipulation, and scienter-based prohibitions, from the exemption. *Neither the proposed nor the final RTO– ISO Order discussed, referred to, or mentioned CEA section 22, which provides for private rights of action for damages against persons who violate the CEA, or persons who willfully aid, abet, counsel, induce, or procure the commission of a violation of the Act.*” (Emphasis added).

⁴ Proposed order at 29493.

integration between and among the various markets. Indeed there is no single market that can be described as “the” electricity market; rather it is system of interconnected markets all of which rely, to a greater or lesser extent, on the information produced within the aggregate system. Thus the physical RTO/ISO-administered markets do not exist in isolation from the financial electricity markets operated by organized exchanges. As has been noted elsewhere, manipulation of electricity markets is similarly complex and integrated.⁵ Thus a participant can take actions in one market that are solely designed to advantage their actual or potential position in a separate but integrated market.

Those that argue the RTO/ISO exemption order provides immunity for behavior in one market – regardless of the legality of the actions in that market – that is designed to manipulate outcomes in another market have an overly simplistic and unrealistic view of the actual operation of markets.

The foundation of every market is built upon a set of cornerstones and the private right of action is fundamental because it provides a vital check/balance against the exercise of manipulative behavior. If a market participant believes they have been damaged by manipulative behavior as defined in the CEA, then they have an opportunity to pursue damages against the offending party. The participant has to weigh the potential costs and benefits of pursuing such an action.

We simply cannot understand how eliminating this fundamental check and balance can possibly lead to efficient market outcomes.

Sincerely,

/s/ Ronald R. McNamara

Ronald R. McNamara, PhD
Managing Director
First Principles Economics, LLC
4771 Sweetwater Blvd, Suite 310
Sugar Land, Texas 77479
(281) 491-0750
ron@fpeconomics.com

⁵ See Shaun D. Ledgerwood & Paul R. Carpenter, *A Framework for the Analysis of Market Manipulation*, 8 Rev. of L. and Econ. 253 (2012).