

June 15, 2016

Via Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Secretary Kirkpatrick:

Raiden Commodities (“Raiden”) provides these comments in response to the Commission’s Request pursuant to the *Notice of Proposed Amendment to and Request for Comment on the 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* (“Proposed Amendment”).

Raiden is an active participant in physical electricity markets. Raiden has a significant interest in those markets’ integrity and transparency. Use of the physical markets to manipulate financial markets harms the integrity and transparency of the physical markets.

Raiden believes that the private right of action in Section 22 of the Commodity Exchange Act (“CEA”) is necessary to prevent such manipulation and exploitation. The private right of action is also consistent with Congressional intent and the purpose of the CEA and will not materially harm the RTO/ISO markets. By contrast, eliminating the private right of action will decrease oversight and increase the likelihood of illegal market manipulation, which will in turn increase market risk, increase transaction costs and increase consumer utility prices, all of which should – and must -- be avoided.

Raiden’s comments below focus on the unique need for the private right of action to identify and deter market manipulation existing in or originating from RTO/ISO markets.

The CFTC correctly recognized that its March 28, 2013 Order (“RTO-ISO Order”) did not eliminate the private right of action under Section 22 of the CEA, even for manipulation originating in Covered Transactions (as defined in the Exemption Order), stating:

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.

By enacting CEA section 22, Congress provided private rights of action as a means for addressing violations of the Act alternative to Commission enforcement action. 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. Moreover, if the Commission intended to take such a differentiated approach (i.e., to limit the rights of private persons to bring such claims while reserving to itself the right to bring the same claims), the RTO-ISO Order would have included a discussion or analysis of the reasons therefore. Thus, the Commission did not intend to create such a limitation, and believes that the RTO-ISO Order does not prevent private claims for fraud or manipulation under the Act. 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.¹

Raiden supports the CFTC's view that the treatment of Section 22 private right of action should be consistent across all RTOs and ISOs. Raiden also supports the CFTC's view that:

Covered Entities will be subject to the same substantive CEA provisions, including judicial interpretations of those provisions, regardless of whether the plaintiff who brings an action alleging a violation of one of those provisions is the Commission or a private party acting under CEA section 22. When such interpretations are necessary in a civil action, the identity of the plaintiff is of little significance. Thus, any potential for conflict among regulators and others or for conflicting judicial interpretations does not depend on

¹ 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, 80 FR 29490 at 29493 (2015)(citations omitted).

whether the plaintiff is a private litigant or the Commission. The Commission also notes that the CFTC frequently participates as amicus curiae in cases where significant interpretive issues arise under the CEA. The existence of a private right of action also is not inconsistent with or detrimental to cooperation between the CFTC and FERC.²

Raiden also supports the CFTC's position that allowing the private right of action is in the public interest:

...[T]he private right of action in the CEA is instrumental in protecting the American public, deterring bad actors, and maintaining the credibility of the markets subject to the Commission's jurisdiction. Private claims serve the public interest by empowering injured parties to seek compensation for damages where the Commission lacks the resources to do so on their behalf. Moreover, the prospect of private rights of action serves the public interest by deterring misconduct in and maintaining the integrity of the markets subject to the Commission's jurisdiction.³

Additionally, Raiden supports that CFTC's view that existing legal and regulatory structures provide sufficient channels for the complaints of individual participants:

...[T]he private right of action under CEA section 22 was established by Congress as an integral part of the CEA's enforcement and remedial scheme. The Act grants the Commission various administrative tools to enforce the statute, and it also authorizes the Commission to seek redress in court in the form of injunctions, penalties, and restitution for injured parties. But Congress deemed those tools insufficient, and, in the Futures Trading Act of 1982, codified an express private right of action because it found that private damages actions are "critical to protecting the public and fundamental to maintaining the creditability of the futures market." The Federal Power Act ("FPA"), on the other hand, expressly prohibits private rights of action for fraud and manipulation with respect to the purchase or sale of electric energy subject to FERC's jurisdiction. The fact that Congress made different judgments with respect to a private right of action in the CEA and the FPA does not persuade the Commission to strip injured parties of their remedy under the CEA, nor does it amount to a conflict between the two statutes. The difference between the two statutes in this respect is by Congress's design, subject to the proviso that the

² 81 Fed. Reg. 30245 at 30248 (May 16, 2016).

³ *Id.*

Commission is to issue exemptions where it determines exemptions would be in the public interest.⁴

Simply put, allowing private rights of action for illegal manipulation is in the public interest and will not increase the social and private costs of regulatory oversight. A private right of action is necessary to effectuate and preserve open, transparent, competitive, and financially sound physical and financial electricity markets.

Raiden believes one issue deserves greater attention: the unique need to allow private rights of action to identify, prevent and compensate injured parties from the harm caused by market manipulation facilitated by exploitation of RTO/ISO rules, practices and procedures. These comments focus on that issue.

The goal of any market is efficient and optimal allocation of scarce resources. The more complex the market, the less likely that centralized command-and-control will yield efficient, optimal results. There is simply too much information, with too great a range and from too many different sources, for a centralized body to make efficient, optimal decisions. That is why the energy utilities were deregulated and RTO/ISO markets established. Markets allocate energy much more efficiently than even the best command and control models.

Creation of the RTO/ISO markets resulted in robust trading of energy futures on separate financial markets like the InterContinental Exchange (“ICE”). Participants in the RTO/ISO physical markets (where energy is generated and dispatched) rely on the financial markets to hedge commercial risk in the physical market. Thus, a generator in a particular RTO may sell energy in that RTO and simultaneously trade derivatives on the financial markets that are directly connected to the RTO physical market in which it participates.

There is no question that activity in the physical market affects trading prices in the financial market. A generator can thus affect both physical market prices and the trading prices on financial markets by changing its behavior in the physical market. Similarly, policies in an RTO can affect derivative trading prices. Given that the two markets are tied, transactions, activities and policies applicable to, and intended to affect only the RTO markets, can be exploited for purposes of manipulating the tied financial markets, where RTO participants trade.

The complexity of the RTO markets, together with their tie to the financial markets, makes it virtually impossible for any regulatory body to police activity in the physical market that could be used as a means for manipulating financial markets. And, it is perhaps understandable why RTOs/ISOs would not seek to analyze, attempt to look for, police or prevent such manipulation. In practice,

⁴ *Id.*

electricity “market” performance and efficiency has been defined in terms of outcomes in the RTO/ISO markets. That is, market monitoring and evaluation only takes place within the RTO/ISO markets and is measured only against the requirements of the RTO/ISO rules. If the activity violates the RTO/ISO rules, the RTO and its market monitor take action. If the activity complies with the RTO/ISO rules, the RTOs/ISOs are neither in a position nor incentivized to analyze the affect of the activity on the financial markets.

The PUCT’s “small fish” rule provides a perfect example of the RTOs/ISOs myopia. Pursuant to its “small fish” rule, PUCT assumes that a generator controlling less than 5% of aggregate generation has no market power and thus cannot affect the market through its generation decisions. That assumption is incorrect. A “small fish” can dramatically affect electricity prices in ERCOT during times of tight supply, which, in turn, can dramatically affect correlated prices on ICE. ERCOT’s own market monitor has acknowledged that correlation. As a result, a “small fish” can intentionally withhold energy generation in ERCOT, for the purpose of manipulating prices on ICE in a way and at a time of its choosing. That “small fish” decides to forgo profits in the physical market, as a result of its withholding, in return for the opportunity to make greater profits trading on ICE during its periods of manipulation. Such activity provides a clear example of a generator exploiting the PUCT’s rules to manipulate the financial market. Nonetheless, the PUCT limits its analysis to whether the small fish manipulator violates any PUCT rule, which, according to the PUCT, it hasn’t, despite its clear intent to use the PUCT’s rules to manipulate a financial market. The “small fish” rule is just one example. The complexity and RTO/ISO focus of the RTO/ISO rules create virtually boundless possibilities to use those rules as a mechanism to manipulate tied financial markets.

The 2015 State of the Market Report for ERCOT⁵ demonstrates the RTOs/ISOs indifference to the effect of their rules and activity in their markets on the financial markets. The report does not mention futures contracts, speculation, use of financial markets as hedging tools or manipulation. Nor is there any discussion or analysis of the performance of the tied financial markets. In other words, the year-end report summarizing the performance of the ERCOT electricity market does not include any analysis or information regarding the financial electricity markets tied to the ERCOT markets. The prices and volumes of electricity contracts exchanged on financial markets are not analyzed, nor is the effect of ERCOT policies and practices on those markets. The reports for the prior three years also do not mention any of the aforementioned concepts. A review of similar reports for PJM and MISO for the same period yields the same results – there is no mention or analysis of the financial markets or the relationship between the financial markets and the operation and performance of the RTO/ISO markets.

⁵ State of the Market Report, 2015 prepared by Potomac Economics.

In this situation – highly complex and interdependent markets – the market participants have the best information on how the markets are working. Participants who operate, trade, invest, and writing contracts are far better placed to possess the information, the knowledge and the understanding necessary to know if manipulation is taking place than is a market monitor or regulatory body. Those private individuals have the tools and resources to enable them to better understand the questions that need to be asked, the data that needs to be gathered, and the analysis that needs to be performed in order to either prove or disprove that manipulation took place. And, because their private interests are directly affected, they have the incentive to look for, detect and expose illegal manipulation.

Empowering these private actors to pursue actions for illegal market manipulation allows for an entirely different “information paradigm” to be brought to bear in the electricity market. When manipulative behavior results in a loss of profit to a participant, he or she has a financial incentive to bring their information to the public domain, i.e., to seek recompense for the damage they have suffered. If the private right of action is eliminated, then there is no legal means by which an individual market participant can recover the damages he or she has suffered as a result of another participant’s manipulative behavior. A participant may raise the issue with a market monitor or with FERC and even in they are proven correct, the underlying legal framework does not allow for the participant to be awarded the full damage they suffered. In other words, eliminating the private right of action reduces or even eliminates the incentive of a participant to bring relevant information - information that, if true, will improve the efficiency of the market – to the market.

History has shown that electricity markets are particularly susceptible to gaming and other manipulative behavior. This is largely due the specific characteristics of electricity, the complexity of the RTO/ISO markets, the direct tie of those markets to trading prices on financial markets and participation by RTO/ISO market participants in both the physical and financial markets.

Those conditions create nearly endless opportunity to use the RTO/ISO markets as a tool for manipulation of financial markets. Understanding the linkages between the physical characteristics of electricity, the market rules, information, manipulative behavior and the resulting pricing effects is extremely difficult. The agent that is best placed to see and understand manipulative behavior is a market participant. By allowing the harmed participant to recover the losses they have suffered, the information is made available to everybody and ultimately this leads to a better market with more efficient outcomes. The private right of action must be preserved in order to ensure efficient physical and financial markets.

Sincerely,

/s/ Adam Sinn

Adam Sinn
President, Raiden Commodities, L.P.