UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.	**)**	**Docket No. EL10-78-000**

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION IN SUPPORT OF PJM INTERCONNECTION, L.L.C.'s PETITION FOR DECLARATORY ORDER OR, IN THE ALTERNATIVE, REQUEST FOR LIMITED WAIVER OF 18 C.F.R. § 35.34(j)(1)(i)

I. INTRODUCTION

The California Independent System Operator (California ISO) submits these comments in support of the Petition for Declaratory Order or, in the Alternative, Request for Limited Waiver of 18 C.F.R. § 35.34(j)(1)(i) of PJM Interconnection, L.L.C. (PJM). PJM interprets a regulation, which the Commission adopted, to allow employees and directors of Regional Transmission Organizations to invest in securities issued by certain market participants. Specifically, PJM proposes criteria for establishing when an entity's market activity is clearly immaterial to the value of its securities. PJM's proposed interpretation is sound and practical, and ensures strong controls to protect against conflicts of interest without imposing punitive restrictions on individual's investment opportunities.

While the policy of avoiding conflicts of interest and promoting the independence of RTOs is essential, the competing interest of avoiding unnecessary restrictions against investment is similarly important. The significance of that interest is particularly evident where the link between an entity's financial condition and an RTO's market is so attenuated as to render illogical any prohibition against investment in its securities. Fortunately, the regulation expressly incorporates the means of striking a balance between the competing interests by allowing for an exception. The lack of guidance on this exception, however, has impaired the ability of ISOs and RTOs to recruit qualified directors and employees, and will continue to do so. Accordingly, it is of significant importance that PJM's petition and request be granted.

II. STATEMENT OF INTEREST

Although the California ISO is not an RTO and thus is not subject to 18 C.F.R. § 35.34, it has an interest in the implementation of the investment rule in this regulation. As an independent system operator, the California ISO is subject to a virtually identical restriction. One of the principles applicable to ISOs, established by the Commission in Order 888, is that "an ISO and its employees should have no financial interest in the economic performance of any power market participant."[1] Consistent with this principle, the California ISO's codes of conduct prohibits both the members of its governing board and its employees

[1] Order 888, pp. 280-81; *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed.Reg. 21,540 (1996).

from holding any "financial interest in any market participant that would be prohibited by 18 C.F.R. § 35.34(j)(1)(i)...." Thus, the Commission's reasoning in this matter could affect the California ISO's consideration of submitting a proposal seeking similar guidance.[2]

III. Title 18 C.F.R. § 35.34 ALLOWS INVESTMENT IN COMPANIES WHOSE MARKET ACTIVITY IS IMMATERIAL TO THEIR OVERALL FINANCIAL PERFORMANCE, JUST AS PJM PROPOSES.

PJM correctly emphasizes that, under 18 C.F.R. § 35.34, investments in companies whose RTO market activity is immaterial to their bottom line are permitted. Specifically, section 35.34(j) prohibits non-stakeholder directors and employees of RTOs from investing in securities of market participants and their affiliates. The definition of "market participant" (18 C.F.R. § 35.34 (b)(2)(i)), however, recognizes that, under some circumstances, an entity may "not have economic or commercial interests that would be *significantly affected* by the [RTO]'s actions or decisions." (Emphasis added.) In that case, the entity is not deemed to be a "market participant" and, thus, RTO directors and employees may invest in its securities. The apparent rationale for the exclusion is that, if the actions of the RTO cannot significantly affect the company's economic and commercial interests, then ownership of its securities will not pose a conflict of interest for RTO directors and employees, and could not reasonably be perceived as posing such a conflict.

[2] The ISO principle on financial interests in Order 888 includes the qualification – not included in 18 C.F.R. § 35.34(j)(1)(i)– that the financial interest be affected by "economic performance" of a market participant. This is similar in effect to 18 C.F.R. § 35.34(b)(2)(i).

Furthermore, where an RTO's independence is not at issue, there is no reason to restrict its individual directors and employees from investing in companies whose securities would not measurably be impacted by its participation in the RTO markets. Avoiding unnecessary government restrictions on persons, particularly where no interest is served by such restrictions, is reason enough to provide for the exception.

Ample support for granting PJM's proposal is found in an analogous policy under a similar federal law. Thus, although federal officers and employees are prohibited from having financial interests that conflict with their public employment duties, waivers and exemptions are allowed under circumstances in which an agency finds "the interest is not so substantial as to be deemed likely to affect the integrity of the services which the Government may expect from such officer or employee." *See* Title 18 U.S.C. § 208(b). In this situation, the Office of Government Ethics must issue regulations to list and describe exemptions, and to "provide guidance with respect to the types of interests that are not so substantial as to be deemed likely to affect the integrity of the services the Government may expect from the employee." *Id.* at § 208(d); *see* 5 C.F.R. § 2635 ("Standards of Conduct for Employees of the Executive Branch.")[3] These

[3] This Commission has chosen to ban its employees from owning interests in any company subject to its regulation, but permits a waiver of the ban in cases where the prohibition "is not necessary to avoid the appearance of misuse of position or loss of impartiality, or otherwise to ensure confidence in the impartiality and objectivity with which Commission programs are administered." 5 C.F.R. § 3401.102.

regulations allow employees of the United States government to hold financial interests that are at least as significant as PJM proposes.[4]

PJM seeks a reasonable application of the regulation in light of the expansion of companies which might be considered RTO market participants but whose participation is immaterial to their business. PJM points out the complexity and burden of its method for ascertaining whether conglomerates are market participants which results in a risk of an inadvertent violation of its investment policy by directors and employees, and a violation of 18 CFR § 35.34 by PJM itself. It has crafted a proposal that will avoid the slightest possibility of an actual or potential conflict of interest.

For example, the less than one percent exception proposed by PJM provides a standard for determining whether economic or commercial interests are "significantly affected" that is well below the recognized threshold for materiality applied by the Securities and Exchange Commission and courts in reviewing financial statements.[5] "The use of a percentage as a numerical threshold, such as 5%, may provide a basis for a preliminary assumption that . . . a deviation of less than the specified percentage with respect to a particular item

[4] *See* 5 C.F.R. § 2640.103(b) and Example 1 (a government employee evaluating an application from the State of Minnesota for a grant may hold bonds issued by the State); 5 C.F.R. 2640.202(a)(2) and Examples 1-3 (a government employee evaluating a bid from XYZ corporation for performing computer maintenance services at his agency may hold up to $15,000 of shares in XYZ corporation, regardless of the dollar amount of the potential contract).

[5] *See* PJM Filing at 8 (the market participant's total market activity must be less than 1% of gross revenues over the pertinent time).

on the registrant's financial statements is unlikely to be material."[6] While the determination of materiality generally must be made on a case-by-case basis, after considering other factors, amounts below one percent are typically immaterial as a matter of law, and are not submitted to a trier of fact.[7] In that respect, PJM's proposal covers only cases in which a market participant's RTO activity clearly cannot affect the value of its securities.

IV. CONCLUSION

The California ISO supports PJM's petition and waiver request. The proposal meets the criterion in section subdivision (b)(2)(i) of section 35.34, and makes rational the otherwise total ban on investments in market participants.

[6] *ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase*, 553 F.3d 187, 197-198, 204 (2d Cir. 2009) (quoting SEC Staff Bulletin regarding determination of materiality).

[7] See *Mathews v. Centex Telemanagement, Inc.*, 1994 WL 269734 (N.D. Cal. June 8, 1994) ("Courts have . . . found that allegedly fraudulent transactions which are under one or two percent of net operating revenues are immaterial" as a matter of law); *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 546-547 (8th Cir. 1997) (although materiality often presents factual questions for a jury to decide, an alleged overstatement of assets by $6.8 million was immaterial as a matter of law, because this represented only two percent of defendants total assets); *Pavlidis v. New England Patriots Football Club*, 675 F. Supp. 688, 692 (D. Mass. 1986) (failure to disclose an increase in revenue of less than 1% was immaterial); *In re Convergent Techs. Second Half 1984 Sec. Litig.*, 1990 WL 606271, at *10 (N.D. Cal. Jan. 10, 1990) (transactions amounting to $1.2 million, which accounted for 1 ½ % of revenue, were immaterial as a matter of law).

Respectfully submitted,

Gregory J. Fisher
Nancy J. Saracino
General Counsel,
Gregory J. Fisher
Assistant General Counsel – Corporate
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7206
Fax: (916) 608-7222
gfisher@caiso.com

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CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon the parties listed on the official service list in the captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 19th day of August, 2010.

/s/ Anna Pascuzzo

Anna Pascuzzo