

September 27, 2012

Sauntia Warfield
Assistant Secretary
Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st Street N.W.
Washington, DC 20581

Re: Notice of Proposed Order and Request for Comment on a Petition From Certain Independent System Operators and Regional Transmission Organizations

Dear Ms. Warfield:

Petitioners California Independent System Operator Corporation (“CAISO”), Electric Reliability Council of Texas, Inc. (“ERCOT”), ISO New England Inc. (“ISO-NE”), Midwest Independent Transmission System Operator, Inc. (“MISO”), New York Independent System Operator, Inc. (“NYISO”), and PJM Interconnection, L.L.C. (“PJM”) (each an Independent System Operator (“ISO”) or Regional Transmission Organization (“RTO”) and, together, the “Petitioners”) appreciate the opportunity to comment on the Proposed Order and Request for Comment released by the Commission on August 28, 2012.¹

The Proposed Order was issued by the Commodity Futures Trading Commission (“CFTC” or the “Commission”) in response to Petitioners’ consolidated requests for an exemption (“Exemption”) from all but the anti-manipulation and anti-fraud provisions of the Commodity Exchange Act, as amended (“CEA”) filed with the Commission on February 7, 2012, as updated on June 11, 2012.

The Petitioners’ comments address the following aspects of the Proposed Order:

- (1) the eligibility criteria for participants in Petitioners’ markets under the Proposed Order;
- (2) the manner in which new and modified products developed by Petitioners will be addressed by the Commission;
- (3) the treatment of virtual transactions under the Proposed Order;
- (4) the Commission’s proposal to issue one order applicable to all of the Petitioners;

¹ Proposed Order and Request for Comment on 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 Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act, 77 Fed. Reg. 52138 (Aug. 28, 2012) (the “Proposed Order”).

- (5) certain requirements for the memoranda of counsel requested by the Commission; and
- (6) certain requests for comment posed by the Commission in the Proposed Order, applicable to the Petitioners generally and, in some instances, to ERCOT in particular.

I. The Commission Should Apply the Exemption to All Persons Authorized to Transact in Petitioners' Markets

In the joint application, the Petitioners requested that all persons authorized to transact in ISOs/RTOs regulated by the Federal Energy Regulatory Commission ("FERC") or Public Utility Commission of Texas ("PUCT") should be determined by the Commission to be "appropriate persons" in light of their qualifications, including their traditional participation in the wholesale markets for electricity and the minimal degree of risk that they pose to the ISO/RTO market.² In its Proposed Order, the Commission applies the Exemption to only those market participants that are defined under the Commission's regulations as "appropriate persons" or "eligible contract participants," ("Appropriate Persons") which, in pertinent part, includes entities that meet the baseline capitalization amounts prescribed in the CEA. The Commission seeks comment as to whether "the Commission should exercise its authority pursuant to section 4(c)(3)(K) of the CEA to extend the Proposed Exemption to agreements, contracts or transactions that are entered into by parties other than 'appropriate persons' as defined in sections 4(c)(3)(A) through (J) of the CEA or 'eligible contract participants' as defined in section 1a(18)(A) or (B) of the CEA and Commission Regulation 1.3(m)."³

Petitioners respectfully submit that the Commission should conclude that all persons who are authorized to transact in FERC or PUCT-regulated ISOs/RTOs are Appropriate Persons because they must satisfy the financial requirements of the ISOs/RTOs and because of the applicability of "appropriate regulatory protections," namely FERC and PUCT oversight of the organized electricity markets and their participants. The Commission has discretion to determine that such persons qualify as Appropriate Persons "in light of their financial or other qualifications, or the applicability of appropriate regulatory protections."⁴

There are two fundamental problems with the Commission's proposal. First, the Commission's proposal appears to subject Petitioners to conflicting and inconsistent regulatory requirements of two Federal agencies and the PUCT. At a minimum, it causes confusion about the consequences to ISOs/RTOs if they transact with non-Appropriate Persons. While the continued participation of these entities poses little risk of harm, their participation in the Petitioners' markets following an order like that proposed by the Commission raises extremely

² Petition at 27.

³ 77 Fed Reg. at 52172.

⁴ 7 U.S.C. 6(c)(3)(K).

troubling issues about the Petitioners' need and ability to comply with FERC, PUCT and Commission regulations – compliance that may not be possible if the three agencies' regulations conflict.

The potential for inconsistent regulatory requirements would significantly weaken the regulatory certainty that is the primary benefit of the Exemption. Petitioners are required to comply with their tariffs, including access and participation requirements approved by FERC or the PUCT, as relevant.⁵ Would the Commission's proposed limitation make ISOs/RTOs Designated Contract Markets, Swap Execution Facilities, or Derivatives Clearing Organizations with respect to transactions with non-Appropriate Person? Would all regulations that apply to swaps also apply to transactions between ISOs/RTOs and non-Appropriate Persons? Petitioners filed a request for this Exemption in the first instance to avoid the uncertainty presented in leaving these kinds of questions open and unanswered. Indeed, in passing the Dodd-Frank Wall Street Reform and Consumer Protection Act amendments to the CEA, Congress intended to charge the Commission to use its exemptive authority under section 4(c), precisely to avoid ISOs/RTOs facing this kind of uncertainty. Accordingly, the Exemption should apply to any person permitted to participate in the Petitioners' markets in accordance with the respective ISO/RTO tariff regulated by FERC or PUCT. Consistent Federal and state regulation of participation requirements is necessary to enable ISOs/RTOs and their market participants to operate on the basis of unambiguous rules without being subject to conflicting requirements.

Second, the Proposed Order could exclude a significant number of market participants from the definition of Appropriate Persons, notwithstanding that those market participants meet Petitioners' stringent participation criteria, which includes posting financial security in amounts tailored to address market risks in lieu of meeting a baseline capitalization amount. Participants in Petitioners' markets are subject to comprehensive regulatory and market oversight designed to ensure the financial integrity of market transactions, minimize systemic risk, promote fair and liquid markets, and protect both market participants and, ultimately, electric ratepayers. As a result, these participants, which play an important role in Petitioners' markets, pose little risk of harm to the ISO/RTO markets. These participation requirements are included in Petitioners' tariffs, which are regulated by FERC or the PUCT, as relevant, and amendments are similarly subject to oversight by the relevant regulatory authority.

A. Petitioners' Mandatory Participation Criteria Provide Protection Substantially Similar to the Commission's Appropriate Person Requirements

The Commission should exercise its statutory discretion under CEA Section 4(c)(3)(K) to conclude that all participants that are qualified to participate in Petitioners' markets are Appropriate Persons "in light of their financial or other qualifications, or the applicability of appropriate regulatory protections." The Commission can base this determination on the

⁵ With respect to ERCOT, references to "tariffs" include the ERCOT Protocols approved by the PUCT, which are equivalent to the FERC-approved tariffs of other ISOs/RTOs.

stringent mandatory participation criteria these participants must satisfy, together with the additional financial qualifications and regulatory protections to which all ISO/RTO market participants are subject.

1. Financial Qualifications of Market Participants

Each Petitioner imposes comprehensive and mandatory criteria on all participants seeking to participate in the Petitioners' markets. These criteria, including those implemented in response to FERC Order No. 741, include the satisfaction of a capitalization requirement in addition to credit requirements and are designed to ensure the financial integrity of market transactions, minimize systemic risk, promote fair and liquid markets, and protect both market participants and, ultimately, electric ratepayers.⁶ Furthermore, market participants must submit risk management policies and procedures as specified in each Petitioners' tariffs – subject to verification by Petitioners (or other third party experts acting as agent for the Petitioner) – that address those risks that could materially and adversely affect the participant's ability to pay its invoices when due. In addition, employees and agents of a participant with the right to bid, offer, or schedule in Petitioners' markets must have appropriate training and/or experience to transact in such markets. Participants also must have appropriate personnel resources and technical capabilities to allow the participants to promptly and effectively respond to all communications and directions from Petitioners related to both operational and financial matters.

Above and beyond the participation criteria required by FERC Order No. 741, Petitioners employ other mechanisms to limit the degree of risk posed by market participants and protect their markets against payment defaults. For example, Petitioners establish separate credit requirements for each of their product or service categories based on the unique characteristics of each product or market. These credit requirements serve as an exposure cap to limit the exposure of individual participants according to their financial security and positions in specific products, as determined by tariff-defined formulae. Petitioners also employ margining methodology in which their credit departments and automated credit management systems monitor market participants' positions against posted security and make margin calls when certain established thresholds are reached. Moreover, all Petitioners devote significant resources to market monitoring to ensure market participant activities are consistent with Petitioners' tariffs. The specific participation criteria and credit requirements that are prerequisites to participating in each ISO/RTO are detailed in Attachment C of the Petitioners' joint application.

Many participants satisfy Petitioners' capitalization requirement by meeting the baseline capitalization thresholds set forth in Petitioners' tariffs. To satisfy these thresholds, a participant must have a net worth of at least \$1 million or total assets of at least \$10 million, which is more stringent than the \$5 million in assets required by Section 4(c)(3)(F) of the CEA. Participants that satisfy Petitioners' baseline capitalization criteria will also satisfy the definition of "appropriate persons" set forth in Section 4(c)(3)(F) of the CEA.

⁶ Although ERCOT is not subject to the requirements of FERC Order No. 741, it has implemented market participant eligibility requirements comparable to those implemented by the other ISOs/RTOs.

A significant number of participants satisfy the capitalization requirement by posting financial security in addition to the amount the participant must provide to satisfy its credit requirements. This additional financial security amount is determined by each Petitioner based on the nature and extent of an entity's participation in its markets and the associated risks. Each Petitioner requires varying amounts of additional financial security up to \$500,000. This security, in conjunction with other mandatory participation criteria and protections described above, provides a level of protection substantially similar to that provided by the baseline capitalization requirements by ensuring that such entities' positions are adequately collateralized.

2. *Other Qualifications and Mechanisms That Protect the Financial Integrity of Petitioners' Markets*

In addition to the mandatory participation criteria and the financial qualifications described above, Petitioners employ other mechanisms to support and protect the financial integrity of their markets. For example, Petitioners generally issue invoices on a weekly basis. As Petitioners have transitioned from monthly to weekly invoicing, they have thereby decreased their market exposure significantly by reducing their settlement cycles. Participant weekly payment obligations are now a fraction of prior monthly invoice amounts.

In addition, the credit departments of each ISO/RTO conduct daily monitoring of market participant compliance with the ISO's/RTO's credit policies and use various tools and methodologies to obtain and monitor information relevant to the financial health of market participants. Each Petitioner has the ability to change a market participant's permitted level of unsecured credit, if any, and the amount of the market participant's credit requirement under "material adverse change" clauses in their tariff. These clauses provide that the ISO/RTO may adjust permitted levels of unsecured credit and/or the amount of applicable credit requirements, at the discretion of the ISO/RTO, in the event that there is a material adverse change affecting the risk of nonpayment by the market participant. Examples of material adverse changes are specified in each Petitioner's tariff and include, in general: (1) a material change in financial status; (2) a downgrade of an equivalency rating; (3) a significant change in the market participant's expected default frequency; (4) a significant variation in the market participant's credit assessment; (5) or a significant decline in a market participant's market capitalization. The specified examples do not limit Petitioners' rights to declare a material adverse change for other reasons.

In order to determine if market participants have undergone a material adverse change, Petitioners' credit departments monitor the creditworthiness of their market participants on a daily basis.

3. *Regulatory Oversight*

As discussed extensively in the Petition and the attachments thereto, and as recognized by the Commission in the Proposed Order, Petitioners are all subject to long-standing, comprehensive regulatory regimes – specifically, those imposed by the FERC or PUCT. In

addition, all transactions in the Petitioners' markets are monitored by the respective Petitioners and subject to their tariffs. Notably, Petitioners' tariffs cannot be amended without approval from the relevant regulatory authorities. Any such amendments are subject to stringent regulatory procedures and standards, including, for example, that they be just and reasonable and not unduly discriminatory or preferential.⁷

Certain market participants that currently satisfy Petitioners' participation criteria by posting additional financial security may qualify as Appropriate Persons as defined in the Commission's Proposed Order. However, some – particularly smaller participants – likely will not. These smaller market participants include load serving entities, demand response providers, marketers, and generators that play important roles in Petitioners' markets. In addition, these participants fulfill long-established federal and state market designs for electric products and services.

B. The Proposed Definition of Appropriate Person Will Adversely Affect Petitioners' Markets

There are currently many active participants in Petitioners' markets that may not fall within Sections 4(c)(3)(A) through (J) of the CEA and are not eligible contract participants. Estimates of the numbers and types of such potentially impacted participants vary from Petitioner to Petitioner.⁸ For the reasons explained herein, these participants should be designated by the Commission as Appropriate Persons pursuant to Section 4(c)(3)(K) of the CEA.

Participants in Petitioners' markets serve roughly two-thirds of all retail electricity customers in the United States. The participation of qualified, long-standing participants in Petitioners' markets contributes to the robustness, competitiveness, and economic efficiency of those markets and reduces price volatility (and resulting harm to ratepayers) in those markets. For example:

- The load-serving entities in Petitioners' markets facilitate state retail access programs that depend on load-serving entities competing to offer end-use customers competitive energy prices and services.

⁷ See 18 C.F.R § 35 et seq. (2012); *see also* 18 C.F. R. § 385.205 (2012).

⁸ For example, NYISO has confirmed that the Commission's proposal will have a significant impact on its market participants and has provided additional detail concerning these potentially impacted market participants as well as additional detail regarding their specific financial and other qualifications. *See* Attachment B. Detailed information concerning participant eligibility requirements is set forth in Attachment C of the Petitioners' joint application. As another example, ERCOT expects that the Commission's proposed definition of appropriate persons would exclude a non-trivial number of market participants unnecessarily given the pervasive regulations at the wholesale and, with respect to retail electric providers, at the retail level, that effectively mitigate financial risk associated with such entities.

- The entities conducting virtual (or convergence) trading increase the liquidity in the markets, improve price convergence, and decrease volatility between Petitioners' Day-Ahead Markets and the Real-Time Markets.⁹
 - The increased price convergence results in greater price predictability and more economically efficient wholesale electricity prices.
 - Since most generators in Petitioners' markets are committed through the Day-Ahead Market, efficient performance of that market is essential to efficient commitment of generation.
- Market participants that purchase Financial Transmission Rights ("FTRs") create a source of revenues that is used to recover capital expenditures in the transmission system. Furthermore, load-serving entities rely on these instruments to hedge their congestion costs, thereby reducing energy price volatility and the resulting impact on retail ratepayers.

Petitioners respectfully request that the Commission expand the scope of Appropriate Persons eligible for the Exemption to explicitly include these market participants that play important roles in Petitioners' markets, satisfy Petitioners' participation requirements, and are subject to pervasive regulatory oversight by the FERC, or in the case of ERCOT, the PUCT.

C. The Petitioners Request Clarification of the "Appropriate Person" Definition

The precise scope of market participants that are Appropriate Persons as outlined in the Commission's Proposed Order depends, in part, on how the following underlined language from Section 4(c)(3)(F) of the "Appropriate Person" definition will be applied to market participant obligations to Petitioners: "A [business entity] with a net worth exceeding \$1,000,000 or total assets exceeding \$5,000,000, or the obligations of which under the agreement, contract or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement."

Petitioners seek confirmation regarding the manner in which they quantify "the obligations of [the business entity] under the agreement, contract or transaction" and interpret "guaranteed or otherwise supported." Petitioners interpret this language to mean that a market participant that provides an ISO/RTO a letter of credit (issued by an Appropriate Person) in the

⁹ Virtual (or convergence) bidding in ISO/RTO markets allows market participants to bid to buy or sell energy in the Day-Ahead Market without physically producing or consuming electricity because of the explicit requirement to buy or sell back that energy in the Real-Time Market. Virtual positions are included in the same simultaneous feasibility tests and price determination processes as real positions. Thus they can serve to reduce inefficiencies in the market. Virtual bidding promotes price convergence between the Day-Ahead Market and Real-Time Market thereby reducing incentives to forego bidding schedules in the Day-Ahead Market in expectation of better prices in the Real-Time Market. A more detailed description of virtual bidding follows.

amount of its ISO/RTO-specific credit requirements (*i.e.*, in the amount of its estimated obligations to the ISO/RTO) satisfies Section 4(c)(3)(F) of the CEA. In addition, Petitioners interpret this language to mean that an ISO/RTO market participant that provides to the ISO/RTO an unlimited guaranty (issued by an “Appropriate Person”) thereby supports its “obligations” to the ISO/RTO and satisfies the underlined criteria.

D. The Commission’s Proposed Categories of “Appropriate Person” Impose Significant Costs on the ISO/RTO Markets

As explained above, the various consequences of the Commission not concluding that all participants authorized to transact in ISO/RTO markets are Appropriate Persons have potentially significant detrimental impacts on Petitioners’ markets, including: (1) conflicting and inconsistent regulatory requirements of FERC/PUCT and the Commission; (2) regulatory uncertainty; and (3) the potential exclusion of a significant number of market participants from the definition of Appropriate Persons, notwithstanding that those market participants meet stringent ISO/RTO participation criteria and are subject to comprehensive regulatory and market oversight. These consequences could all have a detrimental impact on the robustness of the Petitioners’ markets, which in turn could make the markets less efficient, with the ultimate harm to consumers who will be subject to less efficient wholesale electricity prices. At the same time, the Commission’s resources could be taxed with the additional regulatory burden of regulating Petitioners’ markets and Petitioners may have to increase their resources to respond to the regulatory and compliance requirements that would result from CFTC regulation.

The Commission should exercise its statutory discretion under CEA Section 4(c)(3)(K) to conclude that all participants that are qualified by FERC or PUCT-approved rules to participate in Petitioners’ markets are Appropriate Persons “in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.” The mandatory participation criteria, including capitalization or alternative financial posting requirements that already apply to all of Petitioners’ market participants, as well as the regulatory and market oversight programs in place in Petitioners’ markets, support such a determination. Moreover, as the Commission recognizes in the Proposed Order, Petitioners’ practices, in the context of Petitioners’ activities within the scope of the Exemption, “appear congruent with, and to accomplish sufficiently, the regulatory objectives of each DCO core principle.”¹⁰

II. The Commission Should Clarify the Treatment of New or Modified Products

The Commission proposes to exempt the following four categories of transactions entered into on the markets administered by Petitioners pursuant to their FERC or PUCT-approved tariffs or protocols: FTRs, Energy Transactions, Forward Capacity Transactions, and Reserve or Regulation Transactions (together, the “Transactions”). Petitioners also requested that the Exemption apply to “the purchase and sale of a product or service that is directly related to, and a logical outgrowth of, any [of Petitioner’s] core functions as an ISO/RTO...and all

¹⁰ 77 Fed Reg. at 52149.

services related thereto.” The Commission declined this request,¹¹ but asked for comment on whether the scope of the Proposed Order is sufficient to allow for innovation and, if not, how the scope should be modified to allow for innovation without exempting products that may be materially different from those reviewed by the Commission.¹²

First, Petitioners request that the Commission confirm that modifications to existing products or new products, however named, that meet the broad definitions of the Transactions included in the Proposed Order, fall within the scope of the Exemption. Second, Petitioners request that the Commission adopt a standard to allow ISOs/RTOs that innovate by introducing new products or services to benefit from the protection of the Exemption *provided* that the new product or service: (i) is jurisdictional under the Federal Power Act (or Public Utility Regulatory Act of Texas) and filed with and accepted by the relevant regulatory authority; and (ii) is economically comparable in substance to one of the exempted categories of Transactions. Third, Petitioners request that the Commission adopt a streamlined process to confirm that new products or services, which raise a *bona fide* question as to whether they are “economically comparable in substance” to an exempted category of Transactions, fall within the scope of the Exemption.

A. The Commission Should Confirm that the Proposed Order Is Not Limited to Products Currently Traded in Petitioners’ Markets

Petitioners request that the Commission clarify that modifications to existing products or the introduction of new products, however named, that meet the broad definitions of the Transactions and are offered pursuant to Petitioners’ tariffs or protocols fall within the scope of the Exemption. This will provide Petitioners with the ability to update products and permit them to evolve with the certainty that modifications to existing products and the introduction of related new products will be subject to the Exemption provided the new or modified products fall within the broad definitions of the Transactions. This should be the case regardless of the name given to any such new product.

The Petitioners, in consultation with their members, amend their tariffs or protocols at least dozens of times every year, often at the direction of FERC or the PUCT, to update and refine the operation of their markets. Each such amendment is regulated by FERC or PUCT, and many of them effect a relatively routine change in the characteristics of a product or service offered by the particular Petitioner. In many instances, these tariff/protocol changes are also subject to an iterative process wherein one or more subsequent amended filings is required to address comments or directives from FERC/PUCT. It is the Petitioners’ understanding that a new request for exemptive relief from the Commission – which might number in the hundreds in a given year – is neither necessary nor desired by the Commission, as long as the modified product or service falls within the broad definitions of the Transactions. A clear statement to this

¹¹ 77 Fed. Reg. at 52163.

¹² 77 Fed. Reg. at 52172.

effect would provide much needed assurance that the Petitioners can update and modify their existing tariffs and protocols relating to the Transactions with certainty that the modified products and services will be covered by the Exemption.

In addition, the Petitioners may introduce new or additional products or services that fit within the Transactions defined in the Proposed Order. The Commission should clarify that new instruments, however named, are also within the scope of the Exemption if they fall broadly within the Proposed Order's definitions of the Transactions. In examining a new product or service in this light, Petitioners urge the Commission to provide all interested parties helpful guidance by further stating that a new product or service that is subject to the jurisdiction of the ISO's/RTO's rate regulator and is "economically comparable in substance" to an exempted transaction defined in the Proposed Order, would fall within the scope of the Exemption. An articulation of this standard would provide the Petitioners and market participants with greater legal certainty regarding the contours of the intended relief.

B. The Commission Should Adopt a Streamlined Process For Confirming Whether New ISO/RTO Products Are Within the Scope of the Exemptive Relief

As discussed above, the Petitioners believe that new products falling within the broad definitions of the Transactions in the Proposed Order, which would include new products accepted by the ISO's/RTO's rate regulator that are "economically comparable in substance," should be covered by the Exemption. In the event, however, that a Petitioner intends to introduce a product and is uncertain whether it falls within the intended scope of the Commission's relief, the Petitioners request that the Commission adopt a streamlined approval process to confirm whether such new products fall within the Exemption. This procedure would provide greater certainty for product innovation without subjecting such innovations to a lengthy approval process or unduly burdening the Commission's resources.

Petitioners propose that the Commission adopt a streamlined mechanism by which the Commission can determine that supplemental exemptive relief is not required for certain new products and confirm that such products are within the granted relief. Such a mechanism would be appropriate for a new product where there is a question as to whether it shares substantive economic characteristics comparable to products covered by the Proposed Order. This mechanism will offer all parties the opportunity to obtain regulatory certainty where there is a question concerning how economically comparable in substance a new product might be relative to those enumerated in the Proposed Order. It would also be available in the rare instance where a Petitioner wanted to confirm that evolutionary changes to an existing product remain within the scope of the Exemption.

The Petitioners' proposed mechanism is designed to work in parallel with the FERC or ERCOT/PUCT review and approval processes. Petitioners recommend that the Commission adopt a process whereby a Petitioner could simultaneously provide the Commission a copy of its FERC filing (or in the case of ERCOT, the Protocol revisions) when the Petitioner determined

that confirmation was warranted because a new (or modified) product that does not fall neatly within the definitions of the Transactions is economically and operationally comparable to one of the Transactions. For FERC regulated ISOs/RTOs, if, during the 60-day FERC review period, the Commission informs the Petitioner that the new or modified product is not covered by the Exemption or that the Commission needs additional time to review the product, the Petitioner would delay offering the new product until such time as the Commission completes its review or, if necessary, grants supplemental relief. For ERCOT, protocol revisions, including market modifications, are approved by the ERCOT Board of Directors (“ERCOT Board”). When the ERCOT Board approves a change, the effective date is established at that time as well. The proposed Commission review process for ERCOT would be consistent with the 60-day FERC notice and comment period. However, the review period would be relative to the ERCOT Board approval. Pursuant to this process, when a change is approved by the ERCOT Board, it would trigger the 60-day Commission review period. The ERCOT Board could then align the effective date with Commission review and determination that the change warrants inclusion within the ERCOT 4(c) exemption. Thus, the ERCOT review process would effectively align with the review process for the FERC regulated ISOs/RTOs. If the Commission takes no action during the relevant 60-day review period, the product would be deemed to be within the scope of the Exemption. Just as it does when designated contract markets or swap execution facilities voluntarily submit new products for Commission review and approval, the Commission would retain the ability to extend the 60-day review period if the product raises novel or complex issues that require additional time to analyze.¹³

Petitioners believe that this proposed mechanism would satisfy the need to ensure that new or modified products, which raise *bona fide* questions as to their eligibility under the Exemption, can seek such confirmation without unduly inhibiting or delaying innovation in Petitioners’ markets.

C. The Petitioners Are Not Seeking a Blanket Exemption for All New Products Developed Outside the Scope of the Exemption

Petitioners have not requested a blanket exemption and agree that they should seek to supplement the Proposed Order if they develop new products that are potentially within the Commission’s jurisdiction and that present significantly different economic characteristics from those products covered by the Proposed Order.

III. The Commission Should Explicitly Exempt Virtual and Convergence Bids and Offers as Part of the Exemption for Energy Transactions

The Petitioners requested that the Exemption apply to the classes of contracts, agreements or transactions offered under a FERC or PUCT-approved tariff for the purchase or

¹³ See Commission Regulation §40.3(d); see also Commission Regulation §40.5(d) (commencement and extension of time for review of new rules voluntarily submitted by registered entities for review and approval by the Commission).

sale of any of the following electricity-related product, “(including, generation, demand response or convergence or virtual bids/transactions): FTRs [...]; Energy Transactions [...]; Forward Capacity Transactions [...], and Reserve or Regulation Transactions.”¹⁴ The Commission has deleted the parenthetical, noting in the preamble to the Proposed Order that convergence or virtual bids/transactions (“Virtual Transactions”) would be included in the scope of the Exemption “if they qualify as FTRs, energy transactions, forward capacity transactions or reserve or regulation transactions.”¹⁵

Petitioners respectfully submit that the exclusion of a specific reference to Virtual Transactions and the addition of this condition in the preamble create uncertainty. Although Virtual Transactions are part of the energy market and, therefore, fall within the definition of Energy Transactions, Petitioners believe that they should be explicitly discussed because they are a type of Energy Transactions whose particular attributes merit discussion under the Exemption.¹⁶ As Virtual Transactions are: (1) tied to the allocation of the physical capabilities of an electric transmission grid even though they are not physical load or supply;¹⁷ and

¹⁴ Petition at 6.

¹⁵ 77 Fed Reg. at 52163.

¹⁶ For example, see *PJM Interconnection LLC*, 91 FERC ¶ 61,148 (2000) – letter order accepting PJM procedures for a two-settlement system, which includes both day-ahead and real-time markets and the ability of market participants to submit increment and decrement bids for virtual supply and demand as a hedging tool (May 18, 2000); *ISO New England, Inc., et al.*, 91 FERC ¶ 61,311 (2000) – order accepting ISO-NE proposals for congestion management and multi-settlement systems, including explicit virtual demand bidding (June 28, 2000); *New York Independent System Operator, Inc., et al.*, 97 FERC ¶ 61,091 (2001) – order accepting virtual bidding proposal and related market mitigation measures (October 25, 2001); *New England Power Pool and ISO New England Inc.*, 100 FERC ¶ 61,287 (2002) – order accepting ISO-NE proposal for standard market design based on locational marginal pricing, including Financial Transmission Rights and both virtual supply and demand bidding (September 20, 2002); *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,196 (2003) – order accepting MISO petition seeking approval of the principal components of market rules based on locational marginal pricing, including Financial Transmission Rights and virtual bidding in the day-ahead market (February 24, 2003); *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,280 (2003) – order accepting market mitigation measures for virtual bidding (March 13, 2003); *PJM Interconnection, LLC*, 104 FERC ¶ 61,309 (2003) – order accepting PJM credit requirements applicable to virtual bidding (September 22, 2003); *California Independent System Operator, Inc.*, 130 FERC ¶ 61,122 (2010) – order accepting California ISO’s conceptual convergence bidding (*i.e.*, virtual bidding) design policy filing (February 18, 2010); ERCOT Protocols 4.4.9.5; 4.4.9.5.1; 4.4.9.5.2; 4.4.9.6; 4.4.9.6.1, and 4.4.9.6.2. (NE)

¹⁷ See the ISO New England definitions of Increment Bid and Decrement Bid. As set forth in Section I of the ISO New England Transmission, Markets and Services Tariff, “Increment Offer means an offer to sell energy at a specified Location in the Day-Ahead Energy Market which is not associated with a physical supply. An accepted Increment Offer results in scheduled generation at the specified Location in the Day-Ahead Energy Market.” Similarly, “Decrement Bid means a bid to purchase energy at a specified Location in the Day-Ahead Energy Market which is not associated with a physical load. An accepted Decrement Bid results in scheduled load at the specified Location in the Day-Ahead Energy Market.”

(2) entered into pursuant to FERC and PUCT-approved tariffs and protocols, they fall within the Commission's requirements for the Exemption.¹⁸

The Commission should eliminate the uncertainty in the Proposed Order by clarifying that the definition of Energy Transactions includes Virtual Transactions. Explicitly including Virtual Transactions within the scope of the Exemption, as contemplated by Section 4(c)(6) of the CEA, would clarify the regulatory treatment of these transactions for the ISOs/RTOs and their members. Specifically, Petitioners propose that Paragraph 5b of the Proposed Order be modified by adding the underlined language below:

5. *Definitions.*

b. "Energy Transactions" are transactions in a "Day-Ahead Market" or "Real-Time Market," as those terms are defined in paragraphs 5e and 5f of this Order, for the purchase or sale of a specified quantity of electricity at a specified location (including virtual and convergence bids and offers, and "Demand Response," as defined in paragraph 5c(2) of this Order, where:

- (1) The price of the electricity is established at the time the transaction is executed;
- (2) Performance occurs in the Real-Time Market by either
 - (a) Delivery or receipt of the specified electricity, or
 - (b) A cash payment or receipt at the price established in the Real-Time Market; and
- (3) The aggregate cleared volume of both physical and cash-settled energy transactions for any period of time is limited by the physical capability of the electricity transmission system operated by a Requesting Party for that period of time.¹⁹

¹⁸ Like the four categories of transactions included in the Commission's Proposed Order, Virtual Transactions are: "an agreement, contract, or transaction that is entered into—

- a. pursuant to a tariff or rate schedule approved or permitted to take effect by the Federal Energy Regulatory Commission; or
- b. pursuant to a tariff or rate schedule establishing rates or charges for, or protocols governing, the sale of electric energy approved or permitted to take effect by the regulatory authority of the State or municipality having jurisdiction to regulate rates and charges for the sale of electric energy within the State or municipality"

¹⁹ In addition, the Petitioners request that the Commission delete from the preamble in the final order the following language: "[t]o be eligible for the proposed exemption, the contract, agreement or transaction would be required to be offered or entered into in a market administered by a Petitioner pursuant to that Petitioner's tariff or protocol for the purposes of allocating such Petitioner's physical resources." 77 Fed Reg. at 52138.

As noted above, Virtual Transactions are tied to the allocation of the physical capabilities of an electric transmission grid. On a net basis, Virtual Transactions in the ISOs/RTOs are modeled identically to generation and load; therefore, the net cleared amount of all bids and offers (including virtual bids and offers) cannot exceed the physical capability of the grid to flow electricity. A Virtual Transaction is a cleared offer to sell energy in the day-ahead market (an “increment offer” or “inc”) or a cleared bid to buy energy in the day-ahead market (a “decremental bid” or “dec”). An “inc” or a “dec” may be submitted by market participants that do not have a physical position in the ISO/RTO markets, which is to say, they do not own generation or serve load. In addition to “incs” and “decs,” owners of physical generating units that are capacity resources in the ISO/RTO must submit an offer to sell the energy output of their units into the day-ahead market. Similarly, participants that serve load in an ISO/RTO market may additionally submit bids into the day-ahead market.

Excepting physical limitations facing the operation of generation (ramp times, minimum run times and the like), the ISO/RTO clears the day-ahead market by modeling *all* bids and offers without distinction as to whether they are related to generation or load or whether they are incs or decs. The market clearing software regards all bids and offers as withdrawals and injections respectively, without regard to the nature of a particular bid or offer. While injections and withdrawals can clear as offsets against each other at a given location of the system, the maximum volume that the day-ahead market can clear on a net basis is constrained by what can be physically delivered over the transmission grid operated by the ISO/RTO.

Because Virtual Transactions meet the Commission’s proposed condition for exemption in every case, Petitioners request that the Commission eliminate the uncertainty that might result from not explicitly including all Virtual Transactions within the scope the Proposed Order.

IV. The Commission Should Grant Separate Exemption Orders or Specify How and When a Single Order Will Take Effect for Each of the Petitioners

Petitioners requested, and believe it is appropriate for the Commission to issue, a separate order applicable to each Petitioner. By filing the consolidated Petitions, Petitioners did not intend that the Commission issue a single order covering six different and unrelated legal entities, one of which (ERCOT) is not subject to FERC jurisdiction. Petitioners filed the consolidated petitions for the administrative convenience of the Commission and its Staff.

Petitioners hereby renew their request for separate orders applicable to each ISO or RTO. Should the Commission decline to issue separate orders for each Petitioner, Petitioners request that the Commission clarify the process by which a single order would become effective for each of the Petitioners, which are likely to fulfill the applicable conditions at different times, and the mechanics of any future supplemental relief requested by Petitioners.

A. Effectiveness of the Proposed Order Is Complicated Given the Single Order and Multiple Conditions Precedent

The Commission proposes to require Petitioners to meet three conditions precedent before the single Proposed Order becomes effective. This structure complicates the manner in which a single Exemption would become effective for each of the Petitioners. As stated in the Proposal, the Commission intends to “refrain from issuing a final order to a specific RTO or ISO” until (1) the Petitioner has adopted all of the requirements of FERC regulation 35.47 through tariff provisions that have been approved and taken effect; (2) the Petitioner has provided to the Commission a legal opinion or memorandum providing assurance that the Petitioner’s netting arrangements will provide the Petitioner with enforceable rights of setoff against a bankrupt market participant; and (3) with respect to ERCOT, an information sharing agreement is in place between the Commission and the PUCT.

Each Petitioner’s ability to satisfy the proposed conditions precedent depends on the terms of the final Exemption and the individual Petitioner’s stakeholder process for amending its tariff or protocol. In the case of ERCOT, satisfaction of the final condition precedent is entirely out of its control.²⁰ As a result, each Petitioner is likely to satisfy the proposed conditions precedent at a different time. If the Commission elects, contrary to Petitioners’ request and Section 4(c)(6) of the CEA, to issue one Exemption applicable to all six Petitioners, Petitioners request clarification of how and when the Proposed Order would take effect for each of the Petitioners.

It would be unreasonable for the Commission to delay the effectiveness of the Exemption until all of the Petitioners have satisfied all of the conditions precedent (as applicable). Accordingly, should the Commission determine to issue a single Exemption, Petitioners request that the Commission clarify that the Exemption automatically will become effective as to each individual Petitioner at such time as the Petitioner notifies the Commission that it has satisfied the conditions precedent.

B. The Commission Should Clarify Treatment of Future Supplemental Relief

A decision by the Commission to issue a single order applicable to all six Petitioners also would create confusion as to how any supplemental relief requested by one Petitioner would or would not apply to the other Petitioners. Accordingly, Petitioners request that the Commission clarify that any supplemental relief requested by one Petitioner would not, if granted by the Commission, apply to any other Petitioner unless requested by them. While the Petition describes, and the Proposed Order would apply to products common to Petitioners, Petitioners are not identical in their operations. It is necessary for each Petitioner to have the ability to evaluate whether any supplemental relief requested in the future by another Petitioner should

²⁰ For this reason, as discussed further below, ERCOT believes that the requirement that an information-sharing memorandum of understanding be in place between the Commission and the PUCT should be a condition subsequent to the effectiveness of an order.

apply to its market and whether the Petitioner is willing to be bound by conditions, if any, set forth in such supplemental relief.²¹

V. The Commission Should Forego the Requirements Related to the Requested Memoranda of Counsel

In several places in the Proposed Order, the Commission discusses a proposed precondition to issuance of the Exemption that each of the Petitioners provide a memorandum of counsel related to the treatment of its existing or proposed netting arrangements in the event of a market participant's bankruptcy. For example, the Commission proposes to require each of the Petitioners to "provide a well-reasoned legal opinion or memorandum from outside counsel that, in the Commission's sole discretion, provides the Commission with assurance that the netting arrangements contained in the approach selected by the particular Petitioner to satisfy the obligations contained in FERC regulation 35.47(d) will, in fact, provide the Petitioner with enforceable rights of setoff against any of its market participants under title 11 of the United States Code in the event of the bankruptcy of the market participant."²² Separately, in the portion of the Proposed Order discussing cost-benefit considerations, the Commission includes the additional requirements that any such opinion or memorandum "be addressed to the Commission and...signed on behalf of the law firm that is issuing the opinion, rather than by specific partners and/or associates." The Commission further indicates that the text of any such opinion or memoranda would be required to satisfy certain, unidentified "enumerated criteria."

The Petitioners respectfully request that the Commission forego the requirement for an opinion or memorandum. The requirement that the Petitioners become central counterparties is a regulatory requirement for FERC regulated ISOs/RTOs, and ERCOT is similarly implementing that structure. Accordingly, the central counterparty arrangements are or will be provided for in the Petitioners' tariffs or protocols, which are subject to regulation by FERC or PUCT, as applicable. The requirement to file with the Commission an opinion of counsel on this issue is redundant.

If the Commission determines not to forego this requirement, Petitioners request that the Commission clarify that any opinion or memorandum of counsel need not be signed by the law firm that provides it, as opposed to any particular partner. The Commission has indicated that it retains sole discretion as to whether any opinion or memorandum provided by Petitioners provides the Commission with the assurance it seeks. Petitioners believe that the Commission should be able to reach this determination based on an evaluation of the reasoning of the opinion

²¹ Petitioners note that the extent to which innovation is allowed under the Exemption will directly impact the nature and number of supplemental requests for supplemental relief. As each Petitioner introduces new products or changes to existing products, the scope of exempted activity required by each Petitioner will necessarily diverge. Separate Exemptions will ease the administrative burden associated with such differences.

²² 77 Fed. Reg. at 52165 (internal citation omitted).

or memorandum without the need to require that it be addressed from the law firm providing it, a requirement that could greatly increase the time and expense involved in obtaining such an opinion or memorandum. The Petitioners further request that the Commission clarify that the reference to certain “enumerated criteria” was inadvertent, as the Petitioners have not been informed of these criteria and, as noted, the Commission retains sole discretion to determine whether any opinion or memorandum is satisfactory.

VI. Comments on Specific Commission Questions

A. Speculative Position Limits Are Not Necessary

The Commission requested comment on whether the lack of position limits or position accountability thresholds for speculators in Petitioners’ markets would prevent the Commission from determining that the Proposed Order is consistent with the public interest and the purposes of the CEA, given the nature of Petitioners’ markets and market participants, and the other regulatory protections applicable to these markets.²³ Petitioners believe that such limits or thresholds are not necessary to prevent manipulative conduct in their markets.

Petitioners’ markets do not operate in the same fashion as the futures and swaps markets, and, as requested by Petitioners, the Commission has not made a determination that the products covered by the proposed exemption are swaps or futures.²⁴ Accordingly, there is no reason or basis to apply the Commission’s regulatory regime for futures markets to Petitioners’ markets.

Specifically, Petitioners’ markets are administered so that the total amount of energy represented by instruments created on the markets is related to the deliverable capacity of the Petitioners’ systems. In other words, the capacity of the electrical grids administered by Petitioners acts as a governor on the overall size of Petitioners’ markets. This is unlike the futures markets, where two traders have the ability to create additional open interest without any limitation tied to deliverable physical supply. The limitation of system capacity in Petitioners’ markets is a more effective limitation than speculative position limits, which do not, as currently applied, limit overall open interest.

The nature of Petitioners’ markets is also such that speculative position limits are not necessary to prevent a trader from exercising market power. The Commission has developed speculative position limits on cash-settled contracts that are designed to ensure that no single trader can “exert market power and influence the cash settlement price, with the aim of having a spot-month limit level that effectively limits a trader’s incentive to exercise such market power.”²⁵ This result is ensured by the market structure of Petitioners’ markets, because

²³ 77 Fed. Reg. at 52173.

²⁴ Petitioners appreciate that, as requested, the Commission did not make an express finding as to whether the transactions covered by the Proposed Exemption are subject to regulation under the CEA and further ask that any final Order note that no such determination has been made.

²⁵ 76 Fed. Reg. 4758.

generators and load are required to use the ISO/RTO markets for the purpose of delivering electricity. This is a fundamental difference from the markets regulated under the CEA. Moreover, as discussed extensively in the Petition and the attachments thereto, the Petitioners are subject to comprehensive FERC and PUCT oversight and have employed market monitors to ensure the integrity of the markets.

B. RTOs/ISOs Should Not Be Required to Have the Ability to Recreate Day-Ahead and Real-Time Market Prices

The Commission seeks comment on “whether the Petitioners should be capable of recreating the Day Ahead Market and Real-Time prices.”²⁶ Assuming that the Commission is asking only that the Petitioners retain records of all bids submitted to their markets in a given interval, whether those bids were accepted and at what price, the Petitioners can provide this information. The Petitioners cannot, however, recreate market outcomes under different hypothetical circumstances. To the extent the Commission is asking Petitioners to construct hypothetical market outcomes, they respectfully submit that the Commission should not require the Petitioners to have the capability to re-create the Day-Ahead and Real-Time Market prices. As explained in detail below, there is inherent uncertainty in the results of a market rerun that attempts to create any hypothetical scenario. Furthermore, the current computing environment makes market reruns extremely expensive and, in many cases impossible.

The principal and fatal flaw in any attempt to re-create a market under conditions different than those that occurred originally is that it is impossible to predict how other market participants will react to the changed conditions. Having the capability to re-run a market that allows for “what ifs” or entertains any scenario other than a straight reproduction of the original case would require manual database edits or more appropriately the development of a user interface (“UI”). The UI required to vary inputs would require its own development cycle and maintenance to account for how things such as market rules and data formats change over time.

The concept of re-running markets has been routinely rejected by FERC because this approach fails to acknowledge the reality that the market reacts to price signals. The Petitioners have identified at least 18 FERC decisions and related ISO/RTO filings that unequivocally reject the market re-run concept.²⁷ Moreover, in cases involving the Commission and the U.S. Securities and Exchange Commission, courts repeatedly have recognized the difficulty of predicting market outcomes by isolating specific variables.²⁸ Because market reruns are not a viable way to predict what would have occurred in the market but for a particular transaction, the

²⁶ 77 Fed Reg. at 52172.

²⁷ See Petition Attachment A.

²⁸ See, e.g., *S.E.C. v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) (“Despite sophisticated econometric modeling, *predicting stock market responses to alternative variables is . . . at best speculative.*”) (emphasis added); *In re Indiana Farm Bureau Coop. Assoc.*, CFTC No. 75-14, 1982 WL 30249 at *26 (CFTC Dec. 17, 1982) (“Prices and quantities can be observed in a market, but forces resist observation.”).

Petitioners request that the Commission should not require them to have the capability to recreate the Day-Ahead and Real-Time prices.

In addition to the issues discussed above, the Petitioners have considered their ability to replicate the energy markets and have determined that a number of difficulties are inherent in recreating market clearing outside of a narrow window of time. The most challenging issue is how to replicate the computing environment in place on any given day. Replicating the computing environment would require the Petitioners to keep, for example, every version of each server involved in clearing. This would also require the Petitioners to retain versions of non-market system software that are no longer required for production support or explicit business activity as well as unused or fully depreciated hardware. To recreate every version of software and hardware going back in time would be extremely expensive in all cases, and in some, impossible.

Other difficulties include transforming the network and market data from its flat file format to a database format, restoring data archived outside the flat files and also replicating operator manual actions. For the foregoing reasons, the Commission should not require the Petitioners to have the capability to recreate Day-Ahead and Real-Time Market prices.

C. Responses to ERCOT-Specific Questions

1. ERCOT Should Not Be Required To Comply with the Requirements of FERC Order No. 741

The Commission requests comment on a number of ERCOT- specific questions, including whether ERCOT should “be required to comply with the requirements of FERC Order 741 as a prerequisite to the issuance to ERCOT of a final order granting the Exemption as to ERCOT.”²⁹ In particular, the Commission requests comments concerning (a) “whether and why ERCOT would or would not be able to comply with each of the requirements set forth in FERC Order 741;” and (b) whether “ERCOT [should] be permitted to adopt alternatives to any of the specific requirements set forth in FERC Order 741.”³⁰

ERCOT is not subject to FERC jurisdiction and, therefore, should not (and cannot) be required to comply with the requirements of FERC Order No. 741. Nevertheless, ERCOT voluntarily, in consultation with its market participants, and with the approval of the PUCT, has implemented practices that are comparable to the standards and requirements set forth in FERC Order No. 741. As a result, ERCOT has adopted credit standards that are either the same as or substantially equivalent to those set forth in FERC Order No. 741.

²⁹ 77 Fed Reg. at 52172.

³⁰ *Id.*

As summarized by ERCOT in the FERC Order 741 Implementation chart attached to the consolidated applications:

- Unsecured credit in the ERCOT market is subject to a \$50 million limit, which also applies at the corporate family level.³¹
- As the Commission correctly notes in the Proposed Order, ERCOT's settlement cycle "appears to be congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle E. . . ."³² ERCOT's settlement cycle is consistent with the standards set in FERC Order No. 741. In part, FERC Order No. 741 requires ISOs/RTOs to adopt tariff provisions that include billing statements to be issued within seven days and paid within an additional seven days, for a 14-day total payment timeframe from the relevant operating day. ERCOT's rules for the Day-Ahead Market ("DAM") are more conservative than the FERC Order No. 741 rules in both respects (*i.e.*, statement issuance and payment deadlines). DAM invoices are posted two business days after the relevant operating day, and payments to ERCOT are due within two bank business days after the DAM invoices are posted.³³ Payments from ERCOT will be made on the third day after the DAM invoices are posted. The Real-Time Market ("RTM") settlement rules have a longer statement issuance period of nine days, but a shorter payment period of two bank business days within issuance of the statement and invoice.³⁴ ERCOT's shorter payment period makes ERCOT's RTM settlement timeline consistent with the goals of FERC Order No. 741. RTM transactions are paid between 11 and 13 days for greater than 92% of operating days, which is sooner than the FERC Order No. 741 14-day timeframe. RTM transactions are paid within 14 days for greater than 98% of operating days. As FERC notes in Order 741, the requirement for a shortened billing cycle is meant to address timely closure of outstanding debt.³⁵ Thus, despite a longer statement issuance timeframe, ERCOT's rules will require payment in a more timely fashion than the 14-day total settlement timeframe (*i.e.*, seven-day issuance/seven day settlement period) required under FERC Order No. 741. ERCOT's settlement time period is shorter than 14 days for greater than 92% of operating days, and within 14 days for greater than 98% of operating days. RTM transactions that are paid beyond 14 days from the operating day, which is less than two percent of

³¹ ERCOT Creditworthiness Standards.

³² 77 Fed Reg. at 52153.

³³ ERCOT Protocol, Sections 9.3 and 9.7 as modified by Nodal Protocol Revision Request ("NPRR") 347.

³⁴ ERCOT Protocol, Sections 9.5.4.

³⁵ Order No. 741 at P 33.

operating days, are paid on day 15.³⁶ The default risks for RTM transactions (as well as DAM) are further mitigated because the positions are known and collateralized. RTM positions in the ERCOT market are known and fully collateralized subsequent to the relevant operating day and prior to the FERC Order No. 741 seven-day statement issuance period. This additional and independent protection mitigates any incremental risk related to ERCOT's RTM nine-day statement issuance period.

- ERCOT protocols have been revised to eliminate unsecured credit in the CRR markets. ERCOT expects these revised protocols to be fully implemented by December 2012.³⁷
- ERCOT submitted revised protocols to the ERCOT Board of Directors that establish ERCOT as a central counterparty. The Board approved the revisions in July 2012. ERCOT expects to fully implement these changes by January 2013.³⁸
- ERCOT limits the time period by which a market participant must cure collateral calls to two bank business days.³⁹
- ERCOT submitted revised protocols to the ERCOT Board of Directors that provide additional minimum participation requirements, including verification requirements. The ERCOT Board approved the new revisions in July 2012. ERCOT expects that these new requirements will be fully implemented by January 2013.⁴⁰
- Within the scope of the proposed eligibility requirements, market participants would be subject to periodic verification of their risk management framework to be performed by ERCOT or an agent acting on ERCOT's behalf.⁴¹
- ERCOT may request additional collateral if ERCOT determines that the calculated exposure does not adequately match the financial risk created by a market participant's activities under the protocols.⁴²

³⁶ The less than two percent that is payable beyond the 12 or 14 days respective payment deadlines is related to billing periods with holidays.

³⁷ ERCOT Protocol, Sections 16.11.4.1 and 16.11.4.6 as modified by NPRR 400.

³⁸ NPRR 458.

³⁹ ERCOT Protocol, Section 16.11.5(3).

⁴⁰ NPRR 438.

⁴¹ *Id.*

⁴² ERCOT Protocol Section 16.11.4.1(3).

As detailed above, ERCOT has adopted credit standards that are substantially similar to and consistent with the requirements set forth in FERC Order No. 741. For this reason and because it is not subject to FERC's jurisdiction, ERCOT respectfully submits that its Exemption should not be conditioned upon exact compliance with the requirements of FERC Order No. 741. Such a requirement would be a form over substance obligation that would provide no benefit, because, as discussed, ERCOT has, or is in the process of, revising its rules to be substantially consistent with the requirements in FERC Order No. 741.

2. *The Commission Should Not Condition the Exemption for ERCOT on the Execution of an Information Sharing Agreement between the Commission and the PUCT*

The Commission requests comment as to whether it should require the execution of an acceptable information sharing agreement between the Commission and the PUCT as a condition precedent to the issuance of a final order granting ERCOT's request for an exemption.⁴³ The timing and the terms of any information sharing agreement between the Commission and PUCT is controlled by the Commission (and, to some extent, PUCT), not by ERCOT.⁴⁴ ERCOT respectfully submits that the Commission should not condition an exemption order for ERCOT on an acceptable information sharing arrangement between the Commission and PUCT. ERCOT and its members should not be required to operate after October 12, 2012 with any uncertainty about whether ERCOT, its products and services, and its members are exempt from all but the anti-manipulation and anti-fraud provisions of the CEA.

VII. Conclusion

Petitioners appreciate the Commission's consideration of their requests for exemptive relief. For the foregoing reasons, Petitioners respectfully submit that the requested relief will only be fully realized, as Congress intended, if the Commission amends the final Order as requested herein.

⁴³ 77 Fed Reg. at 52172.

⁴⁴ Indeed, ERCOT understands that the Commission had not even contacted the PUCT about this issue before it published the Proposed Exemption Order in the Federal Register.

Respectfully submitted,



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September 27, 2012

ATTACHMENT A

FERC Precedent

New York Independent System Operator, Inc., 91 FERC ¶ 61,218, 61,804-805 (2000)
 (“[I]t would be very difficult . . . to simply recalculate the correct market-based rates.”)

New York Independent System Operator, Inc., 92 FERC ¶ 61,073, 61,307 (2000)
 (Re-computation is “complex and would encourage needless litigation.”)

New York Independent System Operator, Inc., 90 FERC ¶ 61,317, 62,055 (2000) (“We do not intend for mitigation to entail any retroactive calculation of market-clearing prices.”)

San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, 92 FERC ¶ 61,172, 61,609 (2000). (Market re-runs “undermine . . . reliability of service and robustness of competitive markets.”)

Bangor Hydro-Electric Company v. ISO New England Inc., 97 FERC ¶ 61,339, 62,590 (2001),
 reh’g denied, 98 FERC ¶ 61,298 (2002) (Re-run does “far more harm to wholesale electricity markets than is justifiable or appropriate.”)

Wisvest-Connecticut, LLC v. ISO New England, Inc., 103 FERC ¶ 61,302, 62,174 (2003).
 (“We will not disturb the finality of past ICAP market transactions.”)

New York Independent System Operator, Inc., Report of Tariff Implementation Errors and Request for Limited Tariff Waivers of the New York Independent System Operator, Inc., Docket No. ER06-185-000 at 7 (filed Nov. 8, 2005). (“[I]t would be all but impossible, if indeed not impossible,” to accurately re-run the market.)

New York Independent System Operator, Inc., 115 FERC ¶ 61,026, 61,068. (Market re-run “an exercise in futility.”)

California Independent System Operator Corporation, Request for Clarification, or in the Alternative, Rehearing of the California Independent System Operator Corporation, Docket No. ER06-615-001 at 10 (filed May 21, 2007). (Market re-runs would “subject nearly all CAISO Market Participants to a high degree of price uncertainty.”)

California Independent System Operator Corporation, 120 FERC ¶ 61,271, 62,267 (2007).
 (“[A] market re-run would be the exception, not the rule.”)

New York Independent System Operator, Inc., Report of Tariff Implementation Issues and Request for Limited Tariff Waivers of the New York Independent System Operator, Inc., Docket No. ER08-321-000 at 17 (filed December 10, 2007). (Market re-run “would significantly disrupt Market Participants’ settled expectations.”)

New York Independent System Operator, Inc., 122 FERC ¶ 61,119 at P 17 (2008). (“[T]he expense in time and capital to perform such re-determinations will be greater than any potential benefits the exercise may produce.”)

Maryland Public Service Commission v. PJM Interconnection, L.L.C., 123 FERC ¶ 61,169 at P 49(2008). (“[W]e . . . do not order refunds that require re-running a market.”)

New York Independent System Operator, Inc., Request for Limited Tariff Waiver of New York Independent System Operator, Inc., Docket No. ER09-405-000 at 9 (filed Dec. 11, 2008). (“[R]e-running the NYISO markets cannot be accurately accomplished” and “would undermine confidence in the NYISO market.”)

New York Independent System Operator, Inc., 126 FERC ¶ 61,100 at P 16 (2009). (“[R]ecalculation of settlement prices would likely not produce accurate real-world results.”)

New York Independent System Operator, Inc., 129 FERC ¶ 61,217 at P 48 (2009). (Only make corrections that “do not have unintended, and adverse, market consequences, including unsettling expectations.”)

Ameren Services Company Northern Indiana Public Service Company v. Midwest Independent Transmission System Operator, Inc., 127 FERC ¶ 61,121 at P 157 (2009). (Market re-run “would necessarily be inaccurate.”)

Northeast Utilities Service Company, 135 FERC ¶ 61,223 at P 12(2011). (Market re-run “something the Commission has been reticent to require.”)

ATTACHMENT B

New York Independent System Operator “Appropriate Persons” - Supplemental Information

A. Overview

Currently, 203 of the NYISO’s 360 market participants (approximately 57%) satisfy the NYISO’s minimum capitalization requirement by providing additional financial security in lieu of providing, as otherwise required by the NYISO tariffs, audited financial statements that demonstrate at least \$1 million in tangible net worth or \$10 million in assets.¹ The NYISO does not know precisely how many of those 203 market participants could qualify as an “appropriate person” as defined by the Commission in the Proposed Exemption (“Appropriate Persons”), though it is likely that a significant number could not. The NYISO is working with its market participants to ascertain this information, and so far approximately 10% have affirmatively indicated that they do not believe they can qualify as an Appropriate Person. In total, it appears that up to 20% of all NYISO market participants (“Affected Market Participants”) may not qualify as an Appropriate Person as currently defined under the Proposed Exemption.

The Affected Market Participants play important roles in NYISO’s markets and represent an important segment of total market participants. The Commission should exercise its statutory discretion under CEA Section 4(c)(3)(K) to conclude that all participants that are qualified to participate in NYISO’s markets are Appropriate Persons, for the limited purpose of transacting in the NYISO’s markets, “in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.” The Commission can base this determination on the stringent mandatory participation criteria these participants must satisfy, as described above in the Joint Comments, and the financial posting requirements and additional NYISO protections described below.

B. Financial Qualifications of Market Participants

i. Additional Financial Security

If a NYISO market participant chooses to meet its capitalization requirement by posting additional financial security, the market participant must post a minimum of \$200,000.² This amount is increased to \$500,000 if the market participant wants to transact in the TCC market.³ The financial security posted by a participant to meet its capitalization requirement is above and beyond the credit requirements that these participants must satisfy to engage in specific

¹ The NYISO’s capitalization requirement is more stringent than the CFTC’s requirement set forth in Section 4(c)(3)(F) of the CEA in that the NYISO’s baseline capitalization amounts are \$1 million in tangible net worth (vs. \$1 million in net worth required by Section 4(c)(3)(F)) and \$10 million in assets (vs. \$5 million in assets required by Section 4(c)(3)(F)). In addition, NYISO market participants must also submit audited financial statements as evidence of satisfaction of the baseline capitalization thresholds. *See* NYISO Market Administration and Control Area Services Tariff (“Services Tariff”) Section 26.1.1(d).

² *See* Services Tariff Section 26.1.1(d)(ii).

³ *See* Services Tariff Section 26.1.1(d)(ii).

transactions. The \$200,000 in additional collateral is based on NYISO's experience with defaults and uncollected debts, which, with limited exceptions, have averaged approximately \$200,000. The NYISO increased this threshold for market participants that transact in the TCC market to account for the longer duration of TCCs.

The additional security, in conjunction with the other mandatory participation criteria and protections described below, provides a meaningful level of protection as an alternative to the baseline capitalization requirements. Consider, for example, the scenario in which Market Participant "A" satisfies its capitalization requirement by demonstrating net worth in excess of \$1 million and Market Participant "B" satisfies its capitalization requirement by posting \$200,000 or \$500,000 in additional financial security. The fact that NYISO has at its disposal \$200,000 to \$500,000, in addition to any security posted by Market Participant "B" to meet its credit requirements, to cover any unpaid obligations is arguably of equal or greater value than the knowledge that Market Participant "A" has \$1 million in net worth.

ii. Credit Requirements

The NYISO has established distinct credit requirements, including additional collateral requirements, as set forth in its tariffs, for all of its products and markets based on the unique characteristics of each one. FERC approval is required to modify these credit requirements. Each credit requirement is a conservative estimate of the maximum amount a market participant will owe the NYISO for its transactions in a specific product or market and serves as an effective exposure cap. Notably, these credit requirements are above and beyond the additional financial security required as part of the minimum participation criteria described above. The NYISO does not permit a market participant to offset its credit requirement for a specific product or market with its gains for its transactions in another one.⁴

A market participant's total credit requirement is the sum of each of the individual credit requirements for each market in which the market participant participates (e.g., TCC market, ICAP market, Day-Ahead and Real-Time Markets, Virtual Transaction zones).⁵ Additional detail regarding the TCC credit requirement and the Virtual Transaction credit requirement is provided below.

a. TCC Credit Requirement

A market participant engaging in TCC transactions must satisfy credit requirements tailored specifically to the obligations that it may incur in that market.⁶ These credit requirements are conservative, based on a statistical analysis of historical TCC auction prices and congestion rents.

⁴ See Services Tariff Section 26.4.1-26.4.2.

⁵ See Services Tariff Section 26.4.2.

⁶ See Services Tariff Section 26.4.2.3.

NYISO's current credit requirements for holding TCCs are calculated as the greater of:

- An amount determined based on historical TCC data and probabilistic loss expectations per TCC, calculated using a 97% confidence level for monthly and six-month TCCs and a 95% confidence level for annual TCCs, or
- A mark-to-market analysis calculated as the projected amount of the TCC holder's payment obligations to the NYISO at the end of the TCC term based on average congestion rents over the previous 90 days.⁷

NYISO also employs a strict margining methodology with respect to TCC credit requirements. NYISO adjusts each Market Participant's TCC credit requirement upwards on a daily basis to the extent the net mark-to-market value of all of the TCCs in the Market Participant's portfolio exceeds the Market Participant's baseline credit requirement.⁸ Using this calculation, NYISO imposes a strict margin factor. If, at any time, the net amount owed by a market participant for TCC congestion rents reaches fifty percent (50%) of the security posted by the market participant to meet its TCC credit requirement, the NYISO will demand additional security.⁹ If the market participant fails to meet the demand by 4:00 pm, the NYISO may suspend the market participant and cancel any pending TCC bids.¹⁰

b. Virtual Transaction Credit Requirement

A market participant engaging in Virtual Transactions must satisfy credit requirements designed specifically to cover the obligations that it may incur in that market.¹¹ The Virtual Transaction credit requirement is conservative, based initially on a statistical analysis of historical market results. Then, through its automated credit management system, the NYISO marks-to-market and adjusts Virtual Transaction credit requirements on a near real-time basis (*i.e.*, every 15 minutes).¹²

As with TCCs, Virtual Transactions are also subject to a strict margining methodology. The NYISO will make a margin call when a market participant's net amount owed for Virtual Transactions reaches 50% of the credit support allocated to Virtual Transaction activity.¹³ If the market participant fails to meet the demand by 4:00 pm, the NYISO may suspend the market participant and cancel any pending Virtual Transactions.¹⁴ If, at any time, the net amount owed by a market participant for Virtual Transactions reaches one hundred percent (100%) of the

⁷ *Id.*

⁸ *See* Services Tariff Section 26.4.2.3(b).

⁹ *See* Services Tariff Section 26.7.1.

¹⁰ *Id.*

¹¹ *See* Services Tariff Section 26.4.2.5.

¹² *Id.*

¹³ *See* Services Tariff Section 26.8.2.

¹⁴ *Id.*

market participant's Virtual Transaction credit support, the NYISO will immediately suspend the market participant and cancel any pending Virtual Transaction bids.¹⁵

C. Other Qualifications and Mechanisms to Protect Financial Integrity of NYISO Markets

In addition to the mandatory participation criteria described in the joint comments and the financial qualifications described above, the NYISO employs the mechanisms described below to support and protect the financial integrity of its markets.

i. Weekly Settlement

The NYISO issues invoices on a weekly basis and settles invoices within seven days of issuance for approximately 99% of the dollar volume of transactions in the NYISO-administered markets.¹⁶ The NYISO transitioned from monthly to weekly invoicing in October 2011, thereby decreasing its market exposure by approximately 68% by reducing its settlement cycle from 50 days to 16 days. Market Participant weekly payment obligations are approximately 25% of prior monthly invoice amounts. Only six market participants have had invoices in excess of \$5 million since the NYISO shortened its settlement cycle. Each of those market participants is a traditional electric company (i.e., transmission owner, generator, load-serving entity, or energy service company) and each is either a publicly traded company or the affiliate of a publicly traded company.

ii. Bad Debt Loss Reserve

The NYISO maintains \$33 million in a working capital fund.¹⁷ This fund effectively serves as a bad debt loss reserve. The \$33 million is contributed by market participants and is over and above the funds posted by market participants to meet their credit requirements and/or capitalization requirement.¹⁸ In the event the NYISO draws on this reserve to cover a bad debt, it will replenish those funds with amounts recovered from the defaulting market participant or with amounts recovered from all market participants through the mutualization of the bad debt in accordance with its tariff provisions.¹⁹

Even with a historical 50 day settlement cycle, the NYISO's cumulative bad debt loss is miniscule in relation to the dollar volume of transactions in its markets. Since the NYISO's inception nearly 13 years ago, it has experienced only \$2.1 million in bad debt loss out of approximately \$82 billion in transactions. The resulting bad debt loss ratio is 0.003%.

¹⁵ *Id.*

¹⁶ *See* Services Tariff Section 7.2.2.1.

¹⁷ *See* NYISO Open Access Transmission Tariff ("OATT") Section 28.1.

¹⁸ *See* OATT Section 28.9.

¹⁹ *See* OATT Section 28.6.2.

iii. Regular Monitoring of Market Participant Positions

The NYISO Credit Department conducts daily monitoring of market participant compliance with the NYISO's credit policies and uses subscription tools provided by Moody's, Standard and Poor's, Fitch Ratings, Dunn & Bradstreet, and SNL Financial to obtain and monitor information relevant to the financial health of market participants.

iv. Ability to Respond to Material Adverse Change in Participants' Financial Status

The NYISO also has the ability to change a market participant's permitted level of unsecured credit, if any, and the amount of the market participant's credit requirement. The NYISO tariffs provide that such amounts are subject to change, at the discretion of the NYISO, in the event that there is a material adverse change affecting the risk of nonpayment by the market participant, which includes, but is not limited to: a material change in financial status, a downgrade of an equivalency rating, a significant change in the market participant's expected default frequency as determined by Moody's KMV CreditEdge, a significant variation in the market participant's credit assessment, or a significant decline in a market participant's market capitalization.²⁰

In order to determine if market participants have undergone a material adverse change, in addition to the NYISO's regular credit monitoring, the NYISO monitors the creditworthiness of market participants granted unsecured credit through the use of a unique credit assessment methodology developed by Oliver Wyman, a global consulting firm with expertise in financial risk management. This methodology utilizes a combination of traditional financial ratios derived from market participant recent financial statement data and market-based indicators of financial performance that Oliver Wyman determined, after significant research, analysis, and statistical testing of NYISO data are most predictive of NYISO market participant default.²¹ Further, the NYISO reviews the "expected default frequency" of market participants that are public companies using Moody's CreditEdge.²² This product provides daily updates on the changes in the probability of a company's default based on the market value of the company's assets, its volatility, and its current capital structure.

v. Mechanisms to Maintain Financial Liquidity and Fulfill Payment Obligations in the Event of Default

The NYISO has never short-paid market participants. The NYISO tariffs require the NYISO, in general, to pay all net monies owed to a market participant on its invoice on the second business day after the date the NYISO receives payments from market participants for their invoices.²³ In the event of a customer payment default, the NYISO will use funds from its working capital reserve (currently \$33 million) and a revolving credit facility (currently \$50

²⁰ See Services Tariff Section 26.13.

²¹ See Services Tariff Section 26.5.3 (generally) and Section 26.5.3.5.

²² See Services Tariff Section 26.13(c).

²³ See Services Tariff Section 7.2.2.4.

million) to offset temporary imbalances in cash flow, fulfill its payment obligations, and maintain liquidity.²⁴ The NYISO uses these reserves to temporarily cover payment shortfalls until the NYISO recovers the past due amount from the defaulting market participant or from the remaining market participants through its loss mutualization procedures. The NYISO follows the same collection and payment procedures regardless of the type of transaction underlying the defaulting market participant's payment obligation, including TCC market losses.²⁵ This \$83 million reserve provides the NYISO with more than sufficient funds available to cover the largest potential default based on historical data (i.e., 25% of the largest single invoiced amount in NYISO history).

D. Regulatory Oversight

As discussed extensively in the Petition and the attachments thereto, and as recognized by the Commission in the Proposed Order, the NYISO is subject to a long-standing, comprehensive regulatory regime under the FERC. All transactions in the NYISO-administered markets are monitored by the NYISO and subject to its tariffs. All of the above-mentioned credit requirements are specifically detailed and required by NYISO tariffs. Notably, those tariffs cannot be amended without FERC approval. Any such amendments are subject to stringent regulatory procedures and standards, including that they be just and reasonable and not unduly discriminatory or preferential.²⁶

As required by its tariffs, the NYISO maintains an internal market monitoring department and an external market monitor (Potomac Economics) that reports to the NYISO Board of Directors.²⁷ Both the internal and external market monitoring units use various tools and metrics to perform market surveillance to detect potential market distorting behavior and devote significant resources to ensuring market participant activities are consistent with the market rules established in the NYISO tariffs.

E. Potential Impact to the New York Markets

The Affected Market Participants include generators, load-serving entities, marketers, and demand response providers. These market participants provide significant, benefits to the efficiency and liquidity of the NYISO markets, including the following:

i. New York State Retail Access Program

New York State maintains a robust retail access program in accordance with state energy policy through which load-serving entities compete to offer end-use customers competitive energy prices and services. The withdrawal of Affected Market Participants would undermine this program by substantially diminishing the number of participants competing in the NYISO

²⁴ See OATT Section 28.6.2.

²⁵ *Id.*

²⁶ See 18 C.F.R § 35 *et seq.* (2012); *see also* 18 C.F. R. § 385.205 (2012).

²⁷ See Service Tariff Section 30 (generally) and Section 30.4.2.

markets to offer customers service at competitive costs. The Affected Market Participants represent at least 10% of the load-serving entities in the NYISO markets.

ii. Virtual Transactions

Virtual (or convergence) bidding allows a market participant to bid to buy or sell energy in the NYISO's day-ahead forward market and to buy or sell back that energy in the NYISO's real-time spot market without physically producing or consuming energy. Virtual transactions improve the efficiency and predictability of the NYISO markets by increasing the liquidity in the markets and arbitraging the price differences between the day-ahead and real-time markets. The withdrawal of Affected Market Participants would diminish efficiency and predictability of the NYISO energy markets by decreasing liquidity and increasing price divergence between the day-ahead and real-time markets, resulting in unnecessary volatility and less economically efficient wholesale electricity prices. The Affected Market Participants represent at least 17% of the dollar volume of virtual transactions in the NYISO markets.

iii. Demand Response

Through its demand response programs, the NYISO makes payments to market participants that reduce their use of electricity at the NYISO's request to maintain the reliability of the transmission grid during peak usage periods. The demand response programs enable the NYISO to address emergency shortfalls in electricity and to minimize the need to build or use additional generators that would only operate under peak or emergency conditions at very high cost. If Affected Market Participants withdraw from the demand response program, the NYISO will have less flexibility in maintaining the reliability of the New York transmission grid and will have to rely on expensive generation with resulting higher costs to ratepayers. There is very little financial risk associated with the demand response program as the NYISO, with limited exceptions, only *makes* payments to market participants providing demand response. The Affected Market Participants represent at least 8% of the dollar volume of demand response.

F. Cost Benefit Analysis

The Commission should conclude that all persons who are authorized to transact in the NYISO's markets are Appropriate Persons, for the limited purpose of participating in the NYISO's markets, because they must satisfy the NYISO's financial requirements and because of the applicability of "appropriate regulatory protections" outlined in the Joint Comments and above. The Commission has discretion to determine that such persons qualify as Appropriate Persons "in light of their financial or other qualifications, or the applicability of appropriate regulatory protections."²⁸ The benefit of Commission regulation of smaller NYISO market participants is unclear, but an increase in costs to the NYISO, its market participants, and ultimately electric ratepayers as a result of Commission regulation is certain. Subjecting even one NYISO market participant to Commission regulation in effect subjects the NYISO to Commission regulation and arguably defeats the purpose of the requested exemption. Additional consequences of the Commission not concluding that all participants authorized to transact in

²⁸ 7 U.S.C. 6(c)(3)(K).

NYISO's markets are Appropriate Persons are (1) conflicting and inconsistent regulatory requirements of FERC and the Commission for participating in the NYISO's markets; (2) general regulatory uncertainty; and (3) potential exclusion of a significant number of market participants from the NYISO's markets notwithstanding that those market participants meet stringent participation criteria and are subject to comprehensive regulatory and market oversight designed to ensure the financial integrity of market transactions, minimize systemic risk, promote fair and liquid markets, and protect both market participants and, ultimately, electric ratepayers.

The Commission should consider the efficacy of its rules when imposing them on smaller market participants in the NYISO's markets. In addition to the consequences described above, the Commission's resources will be taxed with the additional regulatory burden of regulating NYISO markets and the NYISO will have to increase its resources to respond to the regulatory and compliance requirements that would result from CFTC oversight. As NYISO's operating costs are recovered through a tariff rate schedule and ultimately passed on to New York electricity consumers, it would be consumers who would ultimately pay for this increased, unnecessary and duplicative regulation.