Exempting Inter-SC Trades from CFTC Jurisdiction

Draft Final Proposal

May 11, 2012

1 Introduction and Background

This paper presents a draft final proposal to modify inter-SC trades such that the ISO's markets will not be subject to Commodity Futures Trading Commission (CFTC) oversight, allowing the ISO to continue to offer inter-SC trades.

On February 7, 2012, ISOs and RTOs filed a joint application with the CFTC seeking an exemption from CFTC oversight. Although the proposed order would, if granted, exempt nearly all of the ISO's products and services from CFTC oversight, it does not cover inter-SC trades or the ISO New England's similar product – internal bilateral transactions or "IBTs" – because those products, as currently structured, would not qualify for an exemption.

Inter-SC trades are a feature of ISO settlements that enables parties to bilateral transactions to allocate certain ISO costs and charges between them via the ISO settlement system, rather than through a separate transaction outside ISO settlements. The main purpose of inter-SC trades in the day-ahead market is to reverse the effects of a "double energy settlement," whereby the supplier receives payment both through the ISO settlement system and under the bilateral contract. Inter-SC trades can also facilitate the allocation of charges for losses, congestion, ancillary services capacity and IFM load uplift calculation.

As currently structured, inter-SC trades could be considered "swaps" under the Commodity Exchange Act, as amended by the Dodd-Frank Wall Street Reform Act. This would pose a significant problem for the ISO and market participants, because offering even one product regulated by the CFTC would require the ISO to comply with the full range of requirements imposed by the Commodity Exchange Act.

Based on communications with CFTC staff, the ISO expects that the CFTC would expand the requested exemption to include inter-SC trades if certain additional conditions are imposed on the transactions. Essentially, scheduling coordinators would have to represent, by entering the inter-SC trades in the ISO system, that there is a corresponding bona fide bilateral contract, and retain records to establish that. This condition, which is explained in more detail below, would have to be included in the ISO tariff. Stakeholders at ISO New England recently approved a similar tariff amendment.

2 The Stakeholder process

Based on interviews with eight scheduling coordinators representing different sectors of the market, ISO staff believes that the additional conditions discussed with CFTC staff are consistent with how inter-SC trades are currently used, and thus would not require significant changes to current business practices. If others believe this understanding is erroneous or if further refinement of the requirement might reduce the associated administrative burdens, feedback along these lines would be particularly helpful.

The ISO plans to hold a stakeholder call on May 18 from 1:00 to 3:00 PST. Written comments on this draft final proposal will be due May 25. Please submit comments to exemptintersctrades@caiso.com.

The ISO plans to seek Board approval in July and shortly thereafter submit tariff amendments to FERC, while pursuing the exemption with the CFTC on a parallel track.

3 Modifications to Inter-SC Trades

As explained above, to support a case for exempting inter-SC trades from CFTC jurisdiction, the ISO must modify its tariff to impose certain formal requirements on inter-SC trades. The changes, described below, boil down to a rule that, by entering an inter-SC trade, the scheduling coordinator represents to the ISO that the transaction is tied to a bona fide contract for electricity that was formed outside the ISO or, for inter-SC trades entered on behalf of a scheduling coordinator's customer, that the customer has made this representation. The tariff amendment would provide that, by entering an inter-SC trade, the scheduling coordinator would represent that:

- There is a related transaction – a spot, forward, or derivatives contract – that involves a transfer of electricity or a MW obligation physically to or from the seller to the buyer, with performance taking place within a reasonable time,
- The related transaction is not cleared with the ISO,
- The related transaction is between separate parties,
- The related transaction is bona fide – i.e., it is not a sham entered as a pretext for the inter-SC trade in the ISO market.

These representations would be deemed to have been made simply by entering the inter-SC trade in the ISO's systems; no separate attestation would be required. Scheduling coordinators would be required to retain records, or require their customers to retain records, demonstrating compliance including records associated with the related transaction, which must separately identify the inter-SC trade and the related transaction. The CFTC standard is that these records must be retained for five years and readily accessible for two years. Again, based on its informal survey of market participants, ISO staff believes that these record-keeping requirements duplicate existing requirements that market participants already follow.