

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel & Chief Administrative Officer

Date: July 5, 2012

Re: Decision on Conditions for Inter-SC Trades

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management proposes to amend the tariff by imposing certain conditions on a market feature known as an “inter-SC trade” that allows parties to bilateral transactions to allocate between them certain costs and charges generated by ISO settlements. This amendment is necessary to implement a proposed exemption for inter-SC trades from the jurisdiction of the Commodity Futures Trading Commission. Stakeholders support the proposed tariff amendment, which would not substantially alter their current business practices.

Management recommends the following motion:

Moved, that the ISO Board of Governors approves the proposed tariff change regarding inter-SC trades, as described in the memorandum dated July 5, 2012; and

Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change.

DISCUSSION AND ANALYSIS

On February 7, 2012, ISOs and RTOs filed a joint application with the CFTC seeking an exemption from CFTC oversight for most products and services offered in their markets. The only relevant omission from this request was the inter-SC trade service offered by the ISO and an essentially identical service offered by ISO New England. These services as currently provided would not qualify for an exemption from the CFTC.

Inter-SC trades are a feature of ISO settlements that, in effect, enables parties to bilateral transactions to allocate certain ISO costs and charges between them through

the ISO settlement system, rather than through a separate transaction outside ISO settlements. The main use of inter-SC trades is to reverse the effects of a “double energy settlement,” whereby a supplier of energy receives two payments for a single transaction – one through the ISO settlement system and a second under the bilateral contract. The contracting parties can use an inter-SC trade to reverse the market payment to the supplier through the ISO’s settlement system, leaving them both in the financial positions contemplated by their agreement. Without this service, the parties would have to enter into a separate transaction outside the ISO’s market to true up the settlements between them. In addition to reversing the double energy settlement, market participants can also use inter-SC trades to allocate charges for transmission losses, congestion, ancillary services capacity and integrated forward market load uplift.

The ISO has been advised that inter-SC trades, as currently offered, could be deemed “swaps” under the Commodity Exchange Act, as amended by the Dodd-Frank Wall Street Reform Act. In that case, absent exemptive relief from the CFTC, the ISO would have to comply with all of the applicable requirements imposed by the Commodity Exchange Act with respect to offering inter-SC trades. This would undermine completely the utility of the relief sought in the joint application.

Accordingly, similar to ISO New England, Management has pursued an additional exemption request for inter-SC trades. The exemption request to the CFTC is premised, in part, upon the ISO imposing certain conditions on the transactions. Essentially, scheduling coordinators will have to represent that they are in fact party to a corresponding bilateral contract, such that the inter-SC trade is not simply entered as a stand-alone swap, and will have to commit to retain records to show this. The ISO discussed this proposal informally with a number of stakeholders and then held a formal stakeholder process. Stakeholders indicated that the proposed conditions would not interfere with their business practices or their use of inter-SC trades, and that they favor the exemption request for inter-SC trades based on these conditions.

On the basis of this feedback, Management filed a request for exemption with the CFTC on May 31, 2012, which was essentially identical to an earlier filing made by ISO New England. The requested exemption is drafted on the assumption that the ISO has imposed through its tariff the additional conditions on inter-SC trades, and thus could be effective only if the tariff is so amended.

The tariff amendment would provide that, by entering an inter-SC trade in the ISO’s systems, a scheduling coordinator is representing that:

- There is a related transaction – a spot, forward, or derivatives contract – that involves a transfer of electricity or a MW obligation;
- The related transaction is not cleared with the ISO;
- The related transaction is between separate parties; and

- 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.

Scheduling coordinators would be required to retain records, or require their customers to retain records, demonstrating compliance with these requirements. The records would be subject to audit by the ISO.

Management aims to have an exemption in place before the CFTC implements the relevant portions of the Dodd Frank Act. Accordingly, Management seeks approval of the proposed tariff amendment now, even though it is not certain that the CFTC will approve the requested exemption for inter-SC trades, because it may become necessary to file the tariff amendment with FERC on short notice. However, the ISO does not intend to file the proposed tariff amendments unless and until it is clear the CFTC will grant the requested exemption.

STAKEHOLDER PROCESS

ISO staff discussed the proposal informally with nine scheduling coordinators representing different sectors of the market. Based on those discussions, staff concluded that the additional conditions described above are consistent with how inter-SC trades are actually used, and thus would not require significant changes to current business practices.

Following these informal discussions, staff posted a written proposal and conducted a stakeholder call. After the call, three stakeholders submitted written comments: Calpine, Pacific Gas & Electric and Southern California Edison. All three support the proposal.

CONCLUSION

Management requests that the Board approve the proposed tariff amendment, which is necessary to implement a proposed exemption from CFTC jurisdiction for inter-SC trades.