

Memorandum

To: ISO Board of Governors

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

Date: July 3, 2013

Re: **Decision on Minimum Criteria for Direct Participation**

This memorandum requires Board action.

To fulfill a condition of the exemption that the Commodity Futures Trading Commission (CFTC) has granted for transactions in the ISO market, Management proposes to amend the tariff to require that market participants meet the requirements to be “appropriate persons,” as defined by the CFTC. Stakeholders do not oppose the amendment, which amounts to a minor tightening of the ISO’s currently-effective eligibility requirements relating to credit.

Management recommends the following motion:

Moved, that the ISO Board of Governors approves the proposed tariff change to require market participants that transact with the ISO to be “appropriate persons”, as described in the memorandum dated July 3, 2013; 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

The Dodd-Frank Wall Street Reform and Consumer Protection Act expanded the authority of the CFTC in a way that could be construed to include certain transactions in the ISO market. In response, a group of ISOs and RTOs, including the California ISO, jointly petitioned the CFTC in February 2012 to exempt transactions in their markets from the CFTC’s regulatory oversight.

The CFTC issued a final order in response to the ISOs and RTOs’ petition on March 28, 2013, that granted the exemption on certain conditions. The ISO has satisfied all but one of these conditions. The exemption for the ISO market and related activities from

CFTC jurisdiction covers only transactions by market participants that qualify as “appropriate persons,” as the CFTC defines that term. Accordingly, to qualify for the exemption, the ISO must exclude market participants that do not meet the CFTC’s criteria.

To qualify as an “appropriate person,” a market participant must meet one of various criteria that relate to credit, the nature of the entity, or its activities. For example, a market participant could qualify by attesting to any one the following:

- A net worth of \$1 million;
- Total assets of \$5 million;
- Credit support from another entity that qualifies as an “appropriate person”; or
- Being in the business of “generating, transmitting or distributing electric energy.”

The CFTC’s order also clarified that demand response providers may participate in physical markets – i.e., markets other than congestion revenue rights and virtual transactions – regardless of whether they meet the criteria for a general exemption. Thus, the tariff amendment would not prevent demand response providers that cannot meet the “appropriate person” criteria from participating in the ISO’s physical markets.

The CFTC’s requirements provide a minimum standard for direct participation in the ISO market. Once satisfied, a market participant must still meet the ISO’s existing minimum capitalization requirements which include a tangible net worth of \$1 million or total assets of \$10 million. A market participant that does not meet this minimum capitalization requirement may still participate in the ISO market by posting a certain amount of financial security which cannot be used to back its open positions.

The amendment will require each market participant to certify that it qualifies as an “appropriate person” and to notify the ISO immediately and cease transacting in the ISO market if it no longer qualifies. These certifications must be renewed annually, and the ISO may verify the certifications of randomly selected market participants, as part of its existing program for verifying compliance with its minimum participation requirements.

The ISO explained these requirements to stakeholders in a paper posted May 24, 2013. The ISO received only one written comment on the proposal and the accompanying draft tariff language, which was supportive. The ISO also held a call on June 7 to review the proposal and answer questions about the CFTC’s order. No stakeholders objected to the proposal.

CONCLUSION

To fulfill the final requirement of the exemption from the CFTC's regulatory oversight, Management requests that the Board approve the proposed tariff change requiring that market participants must qualify as "appropriate persons," as described above.