

## COMMODITY FUTURES TRADING COMMISSION

### Notice of Proposed Order and Request for Comment on an Application for an Exemptive Order From Southwest Power Pool, Inc. From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in Section 4(c)(6) of the Act

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed order and request for comment.

**SUMMARY:** The Commodity Futures Trading Commission (“CFTC” or “Commission”) is requesting comment on a proposed exemption issued in response to an application from Southwest Power Pool, Inc. to exempt certain Transmission Congestion Rights, Energy Transactions, and Operating Reserve Transactions from the provisions of the Commodity Exchange Act and Commission regulations.

**DATES:** Comments must be received on or before June 22, 2015.

**ADDRESSES:** You may submit comments by any of the following methods:

- *CFTC Web site:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Comments Online process on the Web site.
- *Mail:* Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as Mail, above.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one of these methods.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in 145.9 of the Commission’s regulations, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or

remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

#### FOR FURTHER INFORMATION CONTACT:

Robert Wasserman, Chief Counsel, 202–418–5092, [rwasserman@cftc.gov](mailto:rwasserman@cftc.gov), or Alicia Lewis, Special Counsel, 202–418–5862, [alewis@cftc.gov](mailto:alewis@cftc.gov), Division of Clearing and Risk; David P. Van Wagner, Chief Counsel, 202–418–5481, [dvannwagner@cftc.gov](mailto:dvannwagner@cftc.gov), or Riva Spear Adriance, Senior Special Counsel, 201–418–5494, [radriance@cftc.gov](mailto:radriance@cftc.gov), Division of Market Oversight, in each case at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.

#### SUPPLEMENTARY INFORMATION:

##### Overview

The Commission is requesting comment on a proposed exemption (the “Proposed Exemption”) issued in response to an application (“Exemption Application”) <sup>1</sup> from Southwest Power Pool, Inc. (“SPP” or “Applicant”) to exempt certain Transmission Congestion Rights, Energy Transactions, and Operating Reserve Transactions (collectively, the “Covered Transactions”) from the provisions of the Commodity Exchange Act (“CEA” or “Act”) <sup>2</sup> and Commission regulations. The Proposed Exemption would exempt contracts, agreements and transactions for the purchase or sale of the limited electric energy-related products that are specifically described within the Proposed Exemption from the provisions of the CEA and Commission regulations, with the exception of the Commission’s general anti-fraud and anti-manipulation authority, and scienter-based prohibitions, under sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13 of the Act, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4 and part 180. To 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 SPP, pursuant to SPP’s tariff (“Tariff”), for the purposes of allocating SPP’s physical resources, and the Tariff would be required to have been approved or permitted to have taken effect by the Federal Energy Regulatory Commission (“FERC”). The exemption as proposed would extend to any person or class of persons entering into the Covered Transactions or rendering services with respect to the Covered Transactions, including offering the Covered Transactions or rendering advice with respect to the Covered Transactions. The contract, agreement or transaction would be required to be offered or entered into by persons who are “appropriate persons,” as defined in sections 4(c)(3)(A) through (J) of the Act,<sup>3</sup> “eligible contract participants,” as defined in section 1a(18) of the Act and Commission regulation 1.3(m),<sup>4</sup> or persons who are in the business of: (i) Generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system. Finally, the exemption would be subject to other conditions set forth therein. Authority for issuing the exemption is found in section 4(c)(6) of the Act.<sup>5</sup>

The Commission seeks comment on the Exemption Application, the Proposed Exemption and related questions. A copy of the Exemption Application is available on the Commission’s Web site at: <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=CommissionOrdersandOtherActionsAD&Key=29485>.

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<sup>4</sup> 7 U.S.C. 1a(18); 17 CFR 1.3(m). *See also*, “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” 77 FR 30596, May 23, 2012.

<sup>5</sup> 7 U.S.C. 6(c)(6).

<sup>1</sup> In the Matter of the Application for an Exemptive Order Under Section 4(c) of the Commodity Exchange Act by Southwest Power Pool, Inc., Oct. 17, 2013, as amended Aug. 1, 2014.

<sup>2</sup> 7 U.S.C. 1 *et seq.*

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## I. The Exemption Application

On October 17, 2013, SPP filed an Exemption Application<sup>6</sup> with the Commission requesting that the Commission exercise its authority under section 4(c)(6) of the CEA<sup>7</sup> and section 712(f) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>8</sup> to exempt certain contracts, agreements and transactions for the purchase or sale of specified electric energy products, that are offered pursuant to a FERC-approved Tariff, from most provisions of the Act.<sup>9</sup> SPP is a Regional Transmission Organization (“RTO”) subject to regulation by FERC. As described in greater detail below, FERC encouraged the formation of RTOs to administer the electric energy transmission grid on a regional basis.<sup>10</sup>

SPP specifically requests that the Commission exempt from most provisions of the CEA certain “transmission congestion rights,” “energy transactions,” and “operating reserve transactions,” as those terms are defined in the Exemption Application, if such transactions are offered or entered into pursuant to a Tariff under which SPP operates that has been approved by FERC, as well as any persons (including SPP, its members and its market participants) offering, entering into, rendering advice, or rendering other services with respect to such transactions.<sup>11</sup> SPP asserts that each of the transactions for which an exemption is requested is: (a) Subject to a long-standing, comprehensive regulatory framework for the offer and sale of such transactions established by FERC, and (b) part of, and inextricably linked to, SPP’s delivery of electric energy and the organized wholesale electric energy markets that are subject to regulation and oversight by FERC.<sup>12</sup> SPP expressly excludes from the Exemption Application any request for relief from the Commission’s general

anti-fraud and anti-manipulation authority, and scienter-based prohibitions, under sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13 of the Act, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4 and part 180,<sup>13</sup> and such provisions explicitly have been carved out of the Proposed Exemption. SPP asserts that it is seeking the requested exemption in order to provide greater legal certainty with respect to the regulatory requirements that apply to the transactions that are the subject of the Exemption Application.<sup>14</sup>

As discussed further below, the relief that SPP is requesting is substantially similar to the relief the Commission granted other RTOs and Independent System Operators (“ISOs”) in April of 2013.<sup>15</sup>

## II. Statutory Background<sup>16</sup>

On July 21, 2010, President Obama signed the Dodd-Frank Act. Title VII of the Dodd-Frank Act amended the CEA<sup>17</sup> and altered the scope of the Commission’s exclusive jurisdiction.<sup>18</sup> In particular, it expanded the Commission’s exclusive jurisdiction, which had included futures traded, executed, and cleared on CFTC-regulated exchanges and clearinghouses, to also cover swaps traded, executed, or cleared on CFTC-regulated exchanges or clearinghouses.<sup>19</sup> As a result, the Commission’s exclusive jurisdiction now includes swaps as well as futures.<sup>20</sup>

<sup>13</sup> See *id.* at 1.

<sup>14</sup> See *id.* at 11.

<sup>15</sup> Final Order in Response to 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 Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act, 78 FR 19880, April 2, 2013 (“RTO-ISO Order”); see also *infra* section III.C.

<sup>16</sup> For a fuller discussion, see 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 Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act, 77 FR 52138, 52139–52140, Aug. 28, 2012.

<sup>17</sup> 7 U.S.C. 1 *et seq.*

<sup>18</sup> Section 722(e) of the Dodd Frank Act.

<sup>19</sup> See 7 U.S.C. 2(a)(1)(A). The Dodd-Frank Act also added section 2(h)(1)(A), which requires swaps to be cleared if required to be cleared and not subject to a clearing exception or exemption. See 7 U.S.C. 2(h)(1)(A).

<sup>20</sup> See *id.*

The Dodd-Frank Act also added a savings clause that addresses the roles of the Commission, FERC, and state regulatory authorities as they relate to certain agreements, contracts, or transactions traded pursuant to the tariff or rate schedule of an RTO that has been approved by FERC or the state regulatory authority.<sup>21</sup> Toward that end, paragraph (I) of CEA section 2(a)(1) repeats the Commission’s exclusive jurisdiction, clarifies that the Commission retains its authorities over agreements, contracts or transactions traded pursuant to FERC- or state-approved tariff or rate schedules,<sup>22</sup> and explains that the FERC and state agencies preserve their existing authorities over agreements, contracts, or transactions “entered into pursuant to a tariff or rate schedule approved by [FERC] or a State regulatory agency,” that are “(I) not ‘executed, traded, or cleared on’ an entity or trading facility subject to registration” or “(II) executed, traded, or cleared on a registered entity or trading facility owned or operated by” an RTO.<sup>23</sup>

The Dodd-Frank Act granted the Commission specific powers to exempt certain contracts, agreements, or transactions from duties otherwise required by statute or Commission regulation by adding, as relevant here, new section 4(c)(6)(A) to the CEA, providing for exemptions for certain transactions entered into pursuant to a tariff or rate schedule approved or permitted to take effect by FERC.

The Commission must act “in accordance with” sections 4(c)(1) and (2) of the CEA, when issuing an exemption under section 4(c)(6). Section 4(c)(1) grants the Commission the authority to exempt any agreement, contract, or transaction or class of transactions, including swaps, from certain provisions of the CEA, in order to “promote responsible economic or financial innovation and fair competition.”<sup>24</sup> Section 4(c)(2)<sup>25</sup> of the Act further provides that the Commission may not grant exemptive relief unless it determines that: (1) The exemption would be consistent with the public interest and the purposes of the CEA; (2) the transaction will be entered into solely between “appropriate persons,” as that term is defined in section 4(c);<sup>26</sup> and (3) the exemption

<sup>21</sup> See 7 U.S.C. 2(a)(1)(I).

<sup>22</sup> See 7 U.S.C. 2(a)(1)(I)(i) and (ii).

<sup>23</sup> 7 U.S.C. 2(a)(1)(I)(i)(II).

<sup>24</sup> 7 U.S.C. 6(c)(1).

<sup>25</sup> 7 U.S.C. 6(c)(2).

<sup>26</sup> Section 4(c)(3) of the CEA further outlines who may constitute an appropriate person for the purpose of a particular 4(c) exemption and

<sup>6</sup> SPP filed an amended Exemption Application on August 1, 2014. Citations herein to “Exemption Application” are to the amended Exemption Application.

<sup>7</sup> 7 U.S.C. 6(c)(6).

<sup>8</sup> See Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>9</sup> See Exemption Application at 1.

<sup>10</sup> See *id.* at 2 n. 7.

<sup>11</sup> See *id.* at 11–15.

<sup>12</sup> See *id.* at 17.

will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the CEA.<sup>27</sup> In enacting section 4(c), Congress noted that the purpose of the provision is to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.<sup>28</sup>

### III. Background

#### A. Introduction

SPP is subject to regulation by FERC.<sup>29</sup> SPP asserts that the regulatory framework administered by FERC, as applicable to its RTO market, would apply to the transactions for which an exemption has been requested.<sup>30</sup>

#### B. FERC

In 1920, Congress established the Federal Power Commission ("FPC").<sup>31</sup> The FPC was reorganized into FERC in 1977.<sup>32</sup> FERC is an independent agency that regulates the interstate transmission of electric energy, natural gas and oil.<sup>33</sup> FERC's mission is to "assist consumers in obtaining reliable, efficient and sustainable energy services at a reasonable cost through appropriate regulatory and market means."<sup>34</sup> This mission is accomplished by pursuing two primary goals. First, FERC seeks to ensure that rates, terms and conditions for wholesale transactions and transmission of electric energy and natural gas are just, reasonable and not unduly discriminatory or preferential.<sup>35</sup> Second, FERC seeks to promote the development of safe, reliable and efficient energy infrastructure that serves the public interest.<sup>36</sup> Both Congress and FERC, through a series of

legislative acts and FERC orders, have sought to establish a system whereby wholesale electric energy generation and transmission in the United States is governed by two guiding principles: Regulation with respect to wholesale electric energy transmission,<sup>37</sup> and competition when dealing with wholesale generation.<sup>38</sup>

In 1996, FERC issued FERC Order 888, which promoted competition in the generation market by ensuring fair access and market treatment by transmission customers.<sup>39</sup> Specifically, FERC Order 888 sought to "remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access."<sup>40</sup> FERC Order 888 encouraged the formation of ISOs as a potentially effective means for accomplishing non-discriminatory open access to the transmission of electric energy.<sup>41</sup>

In addition, FERC has issued orders that address areas such as increased RTO participation by transmission utilities, increased use of long-term firm transmission rights, increased investment in transmission infrastructure, reduced transmission congestion, and the use of demand-response.<sup>42</sup> According to SPP, the roles,

<sup>37</sup> See 16 U.S.C. 796(24) (stating that "'wholesale transmission services' means the transmission of electric energy sold, or to be sold, at wholesale in interstate commerce.").

<sup>38</sup> See generally, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61 FR 21540, Apr. 24, 1996 ("FERC Order 888"). See also FERC's discussion of electric competition, available at <http://www.ferc.gov/industries/electric/indus-act/competition.asp> (stating that "[FERC]'s core responsibility is to 'guard the consumer from exploitation by non-competitive electric power companies.'").

<sup>39</sup> See FERC Order 888.

<sup>40</sup> FERC Order 888 at 21541.

<sup>41</sup> FERC Order 888 at 21594. Under the old system, one party could own both generation and transmission resources, giving preferential treatment to its own and affiliated entities. See generally, FERC Order 888.

<sup>42</sup> See, e.g., FERC Order No. 2000, 65 FR 809 (2000) ("FERC Order 2000") (encouraging transmission utilities to join RTOs); FERC Order No. 681, 71 FR 43294 (2006), FERC Stats. & Regs. ¶ 31,222 (2006), order on reh'g, Order No. 679-A, 72 FR 1152, Jan. 10, 2007, FERC Stats. & Regs. ¶ 31,236, order on reh'g, 119 FERC ¶ 61,062 (2007) (finalizing guidelines for ISOs to follow in developing proposals to provide long-term firm transmission rights in organized electric energy markets); FERC Order No. 679, 71 FR 43294 (2006) (finalizing rules to increase investment in the nation's aging transmission infrastructure, and to promote electric energy reliability and lower costs for consumers, by reducing transmission congestion); FERC Order No. 890, 72 FR 12266 (2007) (modifying existing rules to promote the nondiscriminatory and just operation of transmission systems); FERC Order No. 719-A, 74

responsibilities, and services of ISOs and RTOs under FERC's Order 888, Order 2000, and other applicable FERC orders and requirements, are substantially similar.<sup>43</sup> The end result of this series of FERC orders is that a regulatory system has been established that requires RTOs and ISOs to comply with numerous FERC rules designed to improve both the reliability of the physical operations of electric transmission systems as well as the competitiveness of electric energy markets. The requirements imposed by the various FERC orders seek to ensure that FERC is able to accomplish its two main goals; ensuring that rates, terms and conditions are just, reasonable and not unduly discriminatory or preferential, while promoting the development of safe, reliable and efficient energy infrastructure that serves the public interest.

#### C. Prior Commission Order

On April 2, 2013, the Commission issued the RTO-ISO Order which exempts specified transactions of particular RTOs and ISOs from certain provisions of the CEA and Commission regulations.<sup>44</sup> Under the RTO-ISO Order, a transaction may be covered by the scope of the RTO-ISO Order so long as the transaction falls within the definitions of "Financial Transmission Rights," "Energy Transactions," "Forward Capacity Transactions," or "Reserve or Regulation Transactions,"<sup>45</sup> is offered or sold in a market administered by one of the petitioning RTOs or ISOs<sup>46</sup> pursuant to a tariff, rate schedule, or protocol that has been approved or permitted to take effect by FERC or the Public Utility Commission of Texas, and complies with all other

FR 37776 (2009) ("FERC Order 719") (implementing the use of demand-response (the process of requiring electric energy consumers to reduce their electric energy use during times of heightened demand), and encouraging the use of long-term electric energy contracts and strengthening the role of market monitors).

<sup>43</sup> See Exemption Application at 2-3 n. 7.

<sup>44</sup> See RTO-ISO Order. The RTO-ISO Order does not, however, provide an exemption from sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13 of the Act, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4 and part 180.

<sup>45</sup> While the RTO-ISO Order included "Forward Capacity Transactions" in the scope of transactions for which the exemption was granted, the Commission notes that SPP's markets do not include such transactions. See Exemption Application at 11 n. 50.

<sup>46</sup> SPP was not one of the RTOs or ISOs that petitioned for the RTO-ISO Order.

includes, as relevant to this Proposed Exemption: (a) any person that qualifies for one of ten defined categories of appropriate persons; or (b) such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections. 7 U.S.C. 6(c)(3).

<sup>27</sup> 7 U.S.C. 6(c)(2).

<sup>28</sup> H.R. Rep. No. 102-978, 102d Cong. 2d Sess. at 82-83 (1992).

<sup>29</sup> See Exemption Application at 2-3.

<sup>30</sup> See *id.* at 17.

<sup>31</sup> Federal Power Act, 16 U.S.C. 791a *et se.*

<sup>32</sup> The Department of Energy Organization Act, Public Law 95-91, section 401, 91 Stat. 565, 582 (1977) (codified as amended at 42 U.S.C. 7171 (1988)).

<sup>33</sup> See 42 U.S.C. 7172.

<sup>34</sup> See FERC Strategic Plan for Fiscal Years 2009-2014, 3 (Feb. 2012), available at <http://www.ferc.gov/about/strat-docs/FY-09-14-strat-plan-print.pdf>.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

enumerated terms and conditions in the RTO-ISO Order.<sup>47</sup>

In the RTO-ISO Order, the Commission excepted certain CEA provisions pertaining to fraud and manipulation, and scienter-based prohibitions, from the exemption.<sup>48</sup> Neither the proposed nor the final RTO-ISO Order discussed, referred to, or mentioned CEA section 22,<sup>49</sup> which provides for private rights of action for damages against persons who violate the CEA, or persons who willfully aid, abet, counsel, induce, or procure the commission of a violation of the Act.

By enacting CEA section 22, Congress provided private rights of action as a means for addressing violations of the Act alternative to Commission enforcement action. It would be highly unusual for the Commission to reserve to itself the power to pursue claims for fraud and manipulation—a power that includes the option of seeking restitution for persons who have sustained losses from such violations or a disgorgement of gains received in connection with such violations<sup>50</sup>—while at the same time denying private rights of action and damages remedies for the same violations. Moreover, if the Commission intended to take such a differentiated approach (*i.e.*, to limit the rights of private persons to bring such claims while reserving to itself the right to bring the same claims), the RTO-ISO Order would have included a discussion or analysis of the reasons therefore. Thus, the Commission did not intend to create such a limitation, and believes that the RTO-ISO Order does not prevent private claims for fraud or manipulation under the Act. For the avoidance of doubt, the Commission notes that this view equally applies to SPP's Proposed Exemption. Therefore, the Proposed Exemption also would not preclude such private claims.

<sup>47</sup> Such terms and conditions include a requirement that, to be eligible for the exemption, the transactions must be entered into by persons who are: (1) "appropriate persons," as defined in section 4(c)(3)(A) through (J) of the CEA; (2) "eligible contract participants," as defined in section 1a(18) of the CEA and in Commission regulation 1.3(m); or (3) in the business of (i) generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system (collectively, "Appropriate Persons Requirement"). RTO-ISO Order at 19913.

<sup>48</sup> See *supra* note 44.

<sup>49</sup> See 7 U.S.C. 25.

<sup>50</sup> See 7 U.S.C. 13a-1(d)(3).

#### IV. Scope of the Exemption

##### A. Transactions Subject to the Exemption

After due consideration, the Commission proposes to exempt certain Transmission Congestion Rights ("TCRs"), Energy Transactions, and Operating Reserve Transactions, each as defined below, pursuant to section 4(c)(6) of the Act.<sup>51</sup>

A TCR<sup>52</sup> is a transaction, however named, that entitles one party to receive, and obligates another party to pay, an amount based solely on the difference between the price for electric energy, established on an electric energy market administered by SPP, at a specified source (*i.e.*, where electric energy is deemed injected into SPP's grid) and a specified sink (*i.e.*, where electric energy is deemed withdrawn from SPP's grid).<sup>53</sup> As more fully described below, the Proposed Exemption applies only to TCRs where each TCR is linked to, and the aggregate volume of TCRs for any period of time is limited by, the physical capability (after accounting for counterflow) of SPP's electric energy transmission system for such period; SPP serves as

<sup>51</sup> SPP represents that the terms "Transmission Congestion Right," "Energy Transactions," and "Operating Reserve Transactions" are SPP's equivalent of the following terms set forth in the RTO-ISO Order: "Financial Transmission Right," "Energy Transactions," and "Reserve or Regulation Transactions," respectively. SPP also avers that its transactions are defined in a manner consistent with the terms set forth in the RTO-ISO Order. Exemption Application at 12–15. In addition, SPP states that these classes of contracts, agreements, and transactions for the purchase and sale of a product or service that is directly related to, and a logical outgrowth of, any of SPP's core functions as an RTO and all services related thereto comprise the Covered Transactions. *Id.* at 15.

<sup>52</sup> SPP's markets will also include Auction Revenue Rights ("ARRs"). ARRs are allocated to transmission customers based on historical network load or transmission service reservations (or equivalent service taken under a grandfathered agreement between a SPP transmission owner and a customer). ARRs are granted exclusively to transmission service customers (*i.e.*, not to other market participants or speculators) based on their transmission service (or grandfathered service) and are subject to SPP's simultaneous feasibility analysis of the capability of the SPP Transmission System. ARRs are not traded in SPP's market; instead, ARRs entitle the holder to a share of revenues from SPP-administered transmission congestion right auctions or may be "self-converted" at the customer's election into a transmission congestion right. Exemption Application at 12 n. 54.

<sup>53</sup> Exemption Application at 12. SPP represents that the definition of TCR is similar to the definition of financial transmission right ("FTR") in the RTO-ISO Order. However, the Commission notes that the definition of TCR does not include TCR options whereas the RTO-ISO Order's definition of FTR includes such rights in the form of options. *Id.*; cf. RTO-ISO Order at 19913 (defining the term FTR to include FTRs and FTRs in the form of options).

the market administrator for the market on which the TCRs are transacted; each party to the transaction is a market participant of SPP (or is SPP itself) and the transaction is executed on a market administered by SPP; and the transaction does not require any party to make or take physical delivery of electric energy.<sup>54</sup>

"Energy Transactions" are transactions in the SPP "Day-Ahead Market" or "Real-Time Balancing Market," as those terms are defined in the Proposed Exemption, for the purchase or sale of a specified quantity of electric energy at a specified location (including virtual bids and offers) where the price of electric energy is established at the time the transaction is executed.<sup>55</sup> Performance occurs in the Real-Time Balancing Market by either the physical delivery or receipt of the specified electric energy or a cash payment or receipt at the price established in the Day-Ahead Market or Real-Time Balancing Market; and 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 electric energy transmission system operated by SPP for that period of time.<sup>56</sup>

"Operating Reserve Transactions" allow SPP to purchase through auction or otherwise as permitted in its Tariff, for the benefit of load serving entities ("LSEs") and resources, the right, during a period of time specified in SPP's Tariff, to require the seller to operate electric facilities in a physical state such that the facilities can increase or decrease the rate of injection or withdrawal of a specified quantity of electric energy into or from the electric energy transmission system operated by SPP with a Reserve Transaction (meaning physical performance by the seller's facilities within a response interval specified in SPP's Tariff) or an Area Control Error Regulation Transaction (meaning prompt physical performance by the seller's facilities as specified in SPP's Tariff).<sup>57</sup> In

<sup>54</sup> See Exemption Application at 12–13. As noted above, the definition of TCR is similar to the FTR definition used by the Commission in the RTO-ISO Order. See RTO-ISO Order at 19912.

<sup>55</sup> See Exemption Application at 13. The definition of Energy Transactions is similar to the definition used by the Commission in the RTO-ISO Order. See RTO-ISO Order at 19913; see also *infra* section VI.

<sup>56</sup> See Exemption Application at 13–14; see also *infra* section VI.

<sup>57</sup> See Exemption Application at 14–15. The RTO-ISO Order refers to "Reserve or Regulation Transactions." SPP's markets refer to such

consideration for such delivery, or withholding of delivery, the seller receives compensation of the type specified in section VI below.<sup>58</sup> In all cases, the value, quantity and specifications of such Transactions for SPP for any period of time are limited to the physical capability of the electric transmission system operated by SPP for that period of time.<sup>59</sup> These Transactions are typically used to address unforeseen fluctuations in the level of electric energy demand experienced on the electric transmission system.

#### B. Conditions

The Proposed Exemption would be subject to certain conditions that are consistent with the RTO-ISO Order. First, all parties to the agreements, contracts or transactions that are covered by the Proposed Exemption must be “appropriate persons,” as such term is defined in sections 4(c)(3)(A) through (J) of the Act, “eligible contract participants,” as such term is defined in section 1a(18)(A) of the Act and in Commission regulation 1.3(m),<sup>60</sup> or persons who are in the business of: (i) Generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system.<sup>61</sup>

Second, the agreements, contracts or transactions that are covered by the Proposed Exemption must be offered or sold pursuant to SPP’s Tariff, which has been approved or permitted to take effect by FERC.

Third, neither SPP’s Tariff nor other governing documents may include any requirement that SPP notify a member prior to providing information to the Commission in response to a subpoena or other request for information or documentation.

transactions collectively as “Operating Reserve.” See RTO-ISO Order at 19913–14. See also *infra* section VI.

<sup>58</sup> See Exemption Application at 14–15; see also *infra* section VI.

<sup>59</sup> See *id.*; see also RTO-ISO Order at 19914.

<sup>60</sup> That is, the Commission is proposing to use its authority pursuant to CEA section 4(c)(3)(K) to include eligible contract participants as appropriate persons for the purposes of this Order. See *infra* note 75 and accompanying text; see also 7 U.S.C. 1a(18) and “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” 77 FR 30596, May 23, 2012.

<sup>61</sup> Consistent with the RTO-ISO Order, the Commission is also proposing to use its authority pursuant to CEA section 4(c)(3)(K) to include persons who are in the business of: (i) Generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system. See RTO-ISO Order at 19899, 19913.

Finally, information-sharing arrangements that are satisfactory to the Commission between the Commission and FERC must remain in full force and effect.<sup>62</sup> This condition also requires that SPP comply with the Commission’s requests on an as-needed basis for related transactional and positional market data.

#### C. Additional Limitations

As discussed above, the Commission proposes to exempt the Transactions pursuant to section 4(c)(6) of the Act based upon representations made in the Exemption Application and in the supporting materials provided by SPP and its counsel, and any material change or omission in the facts and circumstances that alter the grounds for the Proposed Exemption might require the Commission to reconsider its finding that the exemption is appropriate and/or in the public interest and consistent with the purposes of the CEA (these limitations are, again, consistent with the RTO-ISO Order).<sup>63</sup> As represented in the Exemption Application, the exemption requested by SPP relates to Covered Transactions that are primarily entered into by commercial participants that are in the business of generating, transmitting and distributing electric energy.<sup>64</sup> In addition, the Commission notes that it appears that SPP was established for the purpose of providing affordable, reliable electric energy to consumers within its geographic region.<sup>65</sup> Critically, these Covered Transactions are an essential means, designed by FERC as an integral part of its statutory responsibilities, to enable the reliable delivery of affordable electric energy.<sup>66</sup> The Commission also notes that each of the Covered Transactions taking place on SPP’s markets is monitored by both a market administrator (SPP) and an independent market monitor (“SPP Market Monitor”) responsible to FERC.<sup>67</sup> Finally, as discussed above, each Covered Transaction is directly tied to the physical capabilities of SPP’s electric

energy grid.<sup>68</sup> As more fully described below,<sup>69</sup> and on the basis of the aforementioned representations, the Commission proposes to find that the Proposed Exemption for the Covered Transactions would be in the public interest. To be clear, however, financial transactions that are not tied to the allocation of the physical capabilities of an electric transmission grid would not be suitable for exemption because such activity would not be inextricably linked to the physical delivery of electric energy.

#### V. Section 4(c) Analysis

##### A. Overview of CEA Section 4(c)

##### 1. Sections 4(c)(6)(A) and (B)

The Dodd-Frank Act amended CEA section 4(c) to add sections 4(c)(6)(A) and (B), which provide for exemptions for certain transactions entered into: (a) Pursuant to a tariff or rate schedule approved or permitted to take effect by FERC, 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, as eligible for exemption pursuant to the Commission’s 4(c) exemptive authority.<sup>70</sup> Indeed, section 4(c)(6) provides that “[i]f the Commission determines that the exemption would be consistent with the public interest and the purposes of this chapter, the Commission *shall*” issue such an exemption.<sup>71</sup> However, any exemption considered under section 4(c)(6)(A) and/or (B) must be done “in accordance with [CEA section 4(c)(1) and (2)].”<sup>72</sup>

<sup>68</sup> See *id.* at 12–15.

<sup>69</sup> See discussions *infra* sections V.B., V.D., and V.E.

<sup>70</sup> The exemption language in section 4(c)(6) states: If the Commission determines that the exemption would be consistent with the public interest and the purposes of this Act, the Commission shall, in accordance with paragraphs (1) and (2), exempt from the requirements of this Act 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; (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; or (C) between entities described in section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).

<sup>71</sup> *Id.* (emphasis added).

<sup>72</sup> CEA section 4(c)(6) explicitly directs the Commission to consider any exemption proposed under 4(c)(6) “in accordance with [CEA section 4(c)(1) and (2)].”

<sup>62</sup> As discussed in section VI.A. below, the CFTC and FERC signed a Memorandum of Understanding (“MOU”) on January 2, 2014, which addresses the sharing of information in connection with market surveillance and investigations into potential market manipulation, fraud or abuse. The MOU is available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcfercismou2014.pdf>.

<sup>63</sup> See RTO-ISO Order at 19914–15.

<sup>64</sup> See Exemption Application at 17.

<sup>65</sup> See *id.* at 2, 17.

<sup>66</sup> See generally, FERC Order 888; FERC Order 2000; 18 CFR 35.34(k)(2); see also Exemption Application at 17.

<sup>67</sup> Exemption Application at 17.

## 2. Section 4(c)(1)

CEA section 4(c)(1) requires that the Commission act “by rule, regulation or order, after notice and opportunity for hearing.” It also provides that the Commission may act “either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively or both” and that the Commission may provide exemption from any provisions of the CEA except subparagraphs (C)(ii) and (D) of section 2(a)(1).

## 3. Section 4(c)(2)

CEA section 4(c)(2) requires the Commission to determine that: To the extent an exemption provides relief from any of the requirements of CEA section 4(a), the requirement should not be applied to the agreement, contract or transaction; the exempted agreement, contract, or transactions will be entered into solely between appropriate persons;<sup>73</sup> and the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA.<sup>74</sup>

## 4. Section 4(c)(3)

CEA section 4(c)(3) outlines who may constitute an appropriate person for the purpose of a 4(c) exemption, including as relevant to this Proposed Exemption: (a) Any person that fits in one of ten defined categories of appropriate persons; or (b) such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.<sup>75</sup>

<sup>73</sup> See CEA 4(c)(2)(B)(i) and the discussion of CEA section 4(c)(3) below.

<sup>74</sup> CEA section 4(c)(2)(A) also requires that the exemption would be consistent with the public interest and the purposes of the CEA, but that requirement duplicates the requirement of section 4(c)(6).

<sup>75</sup> Section 4(c)(3), 7 U.S.C. 6(c)(3), provides that the term “appropriate person” shall be limited to the following persons or classes thereof: (A) A bank or trust company (acting in an individual or fiduciary capacity); (B) A savings association; (C) An insurance company; (D) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*); (E) A commodity pool formed or operated by a person subject to regulation under this Act; (F) A corporation, partnership, proprietorship, organization, trust, or other 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 by any such entity or by an entity referred to in subparagraph (A), (B), (C), (H), (I), or (K) of this paragraph; (G) An employee benefit plan with assets exceeding \$1,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser registered

## B. Proposed CEA Section 4(c) Determinations

In connection with the Proposed Exemption, the Commission has considered the request to exempt the Covered Transaction from most provisions of the Act, and proposes to determine that: (i) The Proposed Exemption is consistent with the public interest and the purposes of the CEA; (ii) CEA section 4(a) should not apply to the Covered Transactions or entities eligible for the Proposed Exemption, (iii) the persons eligible to rely on the Proposed Exemption are appropriate persons pursuant to CEA section 4(c)(3); and (iv) the Proposed Exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA.

### 1. Consistent With the Public Interest and the Purposes of the CEA

As required by CEA section 4(c)(2)(A), as well as section 4(c)(6), the Commission proposes to determine that the Proposed Exemption is consistent with the public interest and the purposes of the CEA. Section 3(a) of the CEA provides that transactions subject to the CEA affect the national public interest by providing a means for managing and assuming price risk, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.<sup>76</sup> Section 3(b) of the CEA identifies the purposes of the CEA:

It is the purpose of this Act to serve the public interests described in subsection (a) through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission. To foster these public interests, it is further the purpose of this Act to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk; to protect

under the Investment Advisers Act of 1940 (15 U.S.C. 80a–1 *et seq.*), or a commodity trading advisor subject to regulation under this Act; (H) Any governmental entity (including the United States, any state, 4–1 or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing; (I) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) acting on its own behalf or on behalf of another appropriate person; (J) A futures commission merchant, floor broker, or floor trader subject to regulation under this Act acting on its own behalf or on behalf of another appropriate person; (K) Such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.

<sup>76</sup> 7 U.S.C. 5(a).

all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.<sup>77</sup>

SPP asserts that the Proposed Exemption would be consistent with the public interest and purposes of the CEA,<sup>78</sup> stating generally that: (a) The Covered Transactions have been, and are, subject to a long-standing, comprehensive regulatory framework for the offer and sale of the Transactions established by FERC; and (b) the Covered Transactions administered by SPP are part of, and inextricably linked to, the organized wholesale electric energy markets that are subject to FERC regulation and oversight.<sup>79</sup> For example, SPP explains that FERC Order 2000 (which, along with FERC Order 888, encouraged the formation of RTOs and ISOs to operate the electronic transmission grid and to create organized wholesale electric markets) requires an RTO to demonstrate that it has four minimum characteristics: (1) Independence from any market participant; (2) a scope and regional configuration which enables the RTO to maintain reliability and effectively perform its required functions; (3) operational authority for its activities, including being the security coordinator for the facilities that it controls; and (4) short-term reliability.<sup>80</sup> In addition, SPP states that an RTO must demonstrate to FERC that it performs certain self-regulatory and/or market monitoring functions.<sup>81</sup> SPP also represents that it

<sup>77</sup> 7 U.S.C. 5(b).

<sup>78</sup> See Exemption Application at 17.

<sup>79</sup> See *id.*

<sup>80</sup> See Exemption Application at 18; 18 CFR 35.34(j).

<sup>81</sup> SPP states that the Covered Transactions will take place on markets that are monitored by both a market administrator (SPP) and an independent market monitor (the “SPP Market Monitor”). See Exemption Application at 17. SPP also states that it “must employ a transmission pricing system that promotes efficient use and expansion of transmission and generation facilities; develop and implement procedures to address parallel path flow issues within its region and with other regions; serve as a provider of last resort of all ancillary services required by FERC Order No. 888 including ensuring that its transmission customers have access to a Real-Time balancing market; be the single OASIS (Open-Access Same-Time Information System) site administrator for all transmission facilities under its control and independently calculate Total Transmission Capacity and Available Transmission Capability; provide reliable, efficient, and not unduly discriminatory transmission service, it must provide for objective monitoring of markets it operates or administers to identify market design flaws, market power abuses and opportunities for efficiency improvements; be responsible for planning, and for directing or arranging, necessary transmission expansions, additions, and upgrades; and ensure the integration

is “responsible for ensur[ing] the development and operation of market mechanisms to manage transmission congestion”<sup>82</sup> and to establish “market mechanisms [that] must accommodate broad participation by all market participants, and must provide all transmission customers with efficient price signals that show the consequences of their transmission usage decisions.”<sup>83</sup>

SPP also explains that the Covered Transactions are entered into by commercial participants that are in the business of generating, transmitting, and distributing electric energy,<sup>84</sup> and that SPP was established for the purpose of providing affordable, reliable electric energy to consumers within their geographic region.<sup>85</sup> Furthermore, the Covered Transactions that take place on SPP’s markets are overseen by a market monitoring function, required by FERC to identify manipulation of electric energy on SPP’s markets.<sup>86</sup>

Fundamental to the Commission’s “public interest” and “purposes of the [Act]” analysis is the fact that the Covered Transactions are inextricably tied to SPP’s physical delivery of electric energy, as represented in the Exemption Application.<sup>87</sup> Another important factor is that the Proposed Exemption is explicitly limited to Covered Transactions taking place on markets that are monitored by the SPP Market Monitor, SPP, or both, and FERC. In contrast, an exemption for transactions that are not so monitored, or not related to the physical capacity of an electric transmission grid, or not directly linked to the physical generation and transmission of electric energy, or not limited to appropriate persons,<sup>88</sup> is unlikely to be in the public interest or consistent with the purposes of the CEA and would be outside the scope of this exemption.

Finally, and as discussed in detail below, the extent to which the Proposed Exemption is consistent with the public interest and the purposes of the Act can, in major part, be assessed by the extent to which the Tariff and activities of SPP,

and supervision by FERC, are congruent with, and sufficiently accomplish, the regulatory objectives of the relevant core principles (“Core Principles”) set forth in the CEA for derivatives clearing organizations (“DCOs”) and swap execution facilities (“SEFs”). Specifically, ensuring the financial integrity of the Covered Transactions and the avoidance of systemic risk, as well as protection from the misuse of participant assets, are addressed by the core principles for DCOs. Providing a means for managing or assuming price risk and discovering prices, as well as prevention of price manipulation and other disruptions to market integrity, are addressed by the core principles for SEFs. Deterrence of price manipulation (or other disruptions to market integrity) and protection of market participants from fraudulent sales practices is achieved by the Commission retaining and exercising its jurisdiction over these matters. Therefore, the Commission has incorporated its DCO and SEF core principle analyses, set forth below, into its consideration of the Proposed Exemption’s consistency with the public interest and the purposes of the Act. In the same way, the Commission has considered how the public interest and the purposes of the CEA are also addressed by the manner in which SPP complies with FERC’s Credit Reform Policy.<sup>89</sup>

Based on this review, the Commission proposes to determine that the Proposed Exemption is consistent with the public interest and the purposes of the CEA,<sup>90</sup> and the Commission is specifically requesting comment on whether the Proposed Exemption is consistent with the public interest and the purposes of the Act.

## 2. CEA Section 4(a) Should Not Apply to the Transactions or Entities Eligible for the Proposed Exemption

CEA section 4(c)(2)(A) requires, in part, that the Commission determine that the Covered Transactions described in the Proposed Exemption should not be subject to CEA section 4(a)—generally, the Commission’s exchange trading requirement for a contract for the purchase or sale of a commodity for future delivery. Based in major part on SPP’s representations, the Commission has reviewed the Covered Transactions, SPP, and its markets using the CEA Core Principle requirements applicable to a DCO and to a SEF as a framework for

its public interest and purposes of the CEA determination.<sup>91</sup> As further support for this determination, the Commission also is relying on the public interest and the purposes of the Act analysis in subsection V.B.4 below. In so doing, the Commission proposes to determine that, due to the FERC regulatory scheme and the RTO market structure applicable to the Covered Transactions, the linkage between the Covered Transactions and that regulatory scheme, and the unique nature of the market participants that would be eligible to rely on the Proposed Exemption,<sup>92</sup> CEA section 4(a) should not apply to the Covered Transactions under the Proposed Exemption.<sup>93</sup>

The Commission is requesting comment on whether its Proposed Exemption of the Covered Transactions from CEA section 4(a) is appropriate.

## 3. Appropriate Persons

Section 4(c)(2)(B)(i) of the CEA requires that the Commission determine that the Proposed Exemption is restricted to Covered Transactions entered into solely between “appropriate persons,” as that term is defined in section 4(c)(3) of the Act. Section 4(c)(3) defines the term “appropriate person” to include: (1) Any person that falls within one of the ten categories of persons delineated in sections 4(c)(3)(A) through (J) of the Act; or (2) such other persons that the Commission determines to be appropriate pursuant to the limited authority provided by section 4(c)(3)(K).<sup>94</sup> The Commission may determine that persons that do not meet the requirements of sections 4(c)(3)(A) through (J) are “appropriate persons” for purposes of section 4(c) only if it determines that such persons “are appropriate in light of their financial or other qualifications, or the applicability of regulatory protections.”<sup>95</sup>

SPP asserts that its market participants fit within the “appropriate person” requirement under CEA section 4(c)(3) and as set forth in the RTO-ISO Order, relying primarily on two categories of appropriate persons. The first category includes those entities that have a net worth exceeding \$1,000,000

of reliability practices within an interconnection and market interface practices among regions).” Exemption Application at 18; 18 CFR 35.34(k).

<sup>82</sup> See Exemption Application at 18.

<sup>83</sup> See Exemption Application at 18–19; 18 CFR 35.34(k)(2).

<sup>84</sup> See generally, Exemption Application at 17.

<sup>85</sup> See *id.*

<sup>86</sup> See *id.*

<sup>87</sup> See *id.* at 12–15, 17 (describing the Covered Transactions and noting that each of them “is part of, and inextricably linked to, the organized wholesale electric energy markets that are subject to FERC regulation and oversight”).

<sup>88</sup> See appropriate persons discussion *infra* section V.B.3.

<sup>89</sup> See FERC Credit Reform Policy discussion *infra* section V.C.

<sup>90</sup> The Commission notes that such a determination would be consistent with a similar determination made in the RTO-ISO Order. See RTO-ISO Order at 19895.

<sup>91</sup> See DCO core principle analysis *infra* section V.D.; see also SEF core principle analysis *infra* section V.E.

<sup>92</sup> See appropriate persons analysis *infra* section V.B.3.

<sup>93</sup> The Commission notes that such a determination would be consistent with a similar determination made in the RTO-ISO Order. See RTO-ISO Order at 19895.

<sup>94</sup> See *supra* note 75.

<sup>95</sup> *Id.*

or total assets exceeding \$5,000,000, as identified in CEA section 4(c)(3)(F).<sup>96</sup> The second group of appropriate persons would fall within a grouping under CEA section 4(c)(3)(K), which includes persons deemed appropriate by the Commission “in light of their financial or other qualifications, or the applicability of appropriate regulatory protection.”<sup>97</sup>

SPP explains that FERC has instructed all RTOs and ISOs subject to FERC supervision to create minimum standards for market participants. SPP states that:

In FERC Order No. 741, FERC directed each RTOs and ISOs to establish minimum criteria for market participants. FERC did not specify the criteria the RTOs or ISOs should apply, but rather directed them to establish criteria through their stakeholder processes.<sup>98</sup>

SPP further states that its Tariff includes minimum capitalization criteria that require market participants to have at a minimum: (a) A tangible net worth of \$1,000,000; (b) assets of \$10,000,000; (c) a credit rating of BBB- or its equivalent; (d) a guaranty through which the Guarantor is used to meet alternatives (a) through (c); or (e) a minimum deposit of \$200,000 in financial security, plus, if the participant’s estimated market exposure is greater than \$100,000, double the amount of any financial security required under the SPP Tariff.<sup>99</sup>

Consistent with CEA section 4(c)(3), the Commission is proposing to limit the Proposed Exemption to persons who are “appropriate persons,” as defined in sections 4(c)(3)(A) through (J) of the Act,<sup>100</sup> “eligible contract participants,” as defined in section 1a(18) of the Act and in Commission regulation 1.3(m),<sup>101</sup>

or persons who are in the business of: (i) Generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system.<sup>102</sup>

The Commission is requesting comment on whether such limitation on the Proposed Exemption is appropriate.

#### 4. Effect on the Commission’s or Any Contract Market’s Ability To Discharge Its Regulatory or Self-Regulatory Duties Under the CEA

CEA section 4(c)(2)(B)(ii) requires the Commission to make a determination whether the Covered Transactions subject to the Proposed Exemption will have a material adverse effect on the ability of the Commission or any contract markets to perform regulatory or self-regulatory duties.<sup>103</sup> In making this determination, the Commission should consider such regulatory concerns as “market surveillance, financial integrity of participants, protection of customers and trade practice enforcement.”<sup>104</sup> These considerations are similar to the purposes of the CEA as defined in section 3, initially addressed in the public interest and purposes of the CEA discussion.

SPP contends that the Proposed Exemption will not have a material adverse effect on the Commission’s or any contract market’s ability to discharge its regulatory function,<sup>105</sup> asserting that:

Under Section 4(d) of the Act, the Commission will retain authority to conduct investigations to determine whether SPP is in compliance with any exemption granted in response to this request. . . . [T]he requested exemptions would also preserve the Commission’s existing enforcement jurisdiction over fraud and manipulation. This is consistent with section 722 of the Dodd-Frank Act, the existing MOU between the FERC and the Commission and other protocols for inter-agency cooperation. SPP will continue to retain records related to the Transactions, consistent with existing obligations under FERC regulations.

The regulation of exchange-traded futures contracts and significant price discovery contracts (“SPDCs”) will be unaffected by the requested exemptions. Futures contracts based on electricity prices set in SPP’s markets that are traded on a designated contract market and SPDCs will continue to be regulated by and subject to the requirements of the Commission. No current requirement or practice of SPP or of a

contract market will be affected by the Commission’s granting the requested exemptions.<sup>106</sup>

These factors appear to support the Proposed Exemption. In addition, the limitation of the Proposed Exemption to Covered Transactions between certain appropriate persons avoids potential issues regarding financial integrity and customer protection.

Moreover, the Proposed Exemption does not exempt SPP from certain CEA provisions, including, but not limited to, sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13 of the Act, and any implementing regulations promulgated thereunder including, but not limited to, Commission regulations 23.410(a) and (b), 32.4, and part 180, to the extent that those sections prohibit fraud or manipulation of the price of any swap, contract for the sale of a commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market. Therefore, the Commission retains authority to pursue fraudulent or manipulative conduct.<sup>107</sup>

In addition, it appears that granting the Proposed Exemption for the Covered Transactions would not have a material adverse effect on the ability of any contract market to discharge its self-regulatory duties under the Act. With respect to TCRs and Operating Reserve Transactions, these transactions do not appear to be used for price discovery or as settlement prices for other transactions in Commission-regulated markets. Therefore, the Proposed Exemption should not have a material adverse effect on any contract market carrying out its self-regulatory function.

With respect to Energy Transactions, these transactions do have a relationship to Commission-regulated markets because they can serve as a source of settlement prices for other transactions within Commission jurisdiction. Granting the Proposed Exemption, however, should not pose regulatory burdens on a contract market because, as discussed in more detail below, SPP has market monitoring systems in place to detect and deter manipulation that takes place on its markets. Also, as a condition of the Proposed Exemption, the Commission would be able to obtain data from FERC with respect to activity on SPP’s markets that may impact trading on Commission-regulated markets.

Finally, the Commission notes that if the Covered Transactions ever could be used in combination with trading

<sup>96</sup> CEA section 4(c)(3)(F) provides that the following entities are “appropriate persons” that the Commission may exempt under CEA section 4(a). The relevant text of 4(c)(3)(F) provides: “A corporation, partnership, proprietorship, organization, trust, or other 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 by any such entity or by an entity referred to in subparagraph (A), (B), (C), (H), (I), or (K) of this paragraph.” 7 U.S.C. 6(c)(3)(F).

<sup>97</sup> 7 U.S.C. 6(c)(3)(K).

<sup>98</sup> Exemption Application at 20 (citations omitted).

<sup>99</sup> *Id.* SPP represents that its Tariff contains the Appropriate Person Requirement set forth in RTO–ISO Order. See Exemption Application at 21; Exemption Application Attachments at 11–12; see also RTO–ISO Order at 19913.

<sup>100</sup> 7 U.S.C. 6(c)(3)(A)–(J).

<sup>101</sup> 7 U.S.C. 1a(18); see also “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” 77 FR 30596, May 23, 2012.

<sup>102</sup> The Commission notes that the proposed limitation on the Proposed Exemption is consistent with the RTO–ISO Order. RTO–ISO Order at 19913.

<sup>103</sup> 7 U.S.C. 6(c)(2)(B).

<sup>104</sup> See H.R. No. 978, 102d Cong. 2d Sess. 79 (1992).

<sup>105</sup> See Exemption Application at 22.

<sup>106</sup> See *id.*

<sup>107</sup> Nor did SPP seek an exemption from these provisions. See *id.* at 1.

activity or in a position in a DCM contract to conduct market abuse, both the Commission and DCMs have sufficient independent authority over DCM market participants to monitor for such activity.<sup>108</sup> Typically, cross-market abuse schemes will involve a reportable position in the DCM contract involved. In such cases, Commission regulation 18.05 requires the reportable trader to keep books and records evidencing all details concerning cash and over-the-counter positions and transactions in the underlying commodity and to provide such data to the Commission upon demand. Likewise, Commission regulation 38.254(a) requires that DCMs have rules that require traders to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets, and make such records available, upon request, to the DCM.<sup>109</sup> Similar recordkeeping requirements apply to swaps.<sup>110</sup>

The CFTC is requesting comment as to whether the Proposed Exemption will have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act, and, if so, what conditions can or should be imposed on the Order to mitigate such effects.

### C. FERC Credit Reform Policy

On October 21, 2010, FERC amended its regulations to encourage clear and consistent risk and credit practices in

the organized wholesale electric markets to, *inter alia*, “ensure that all rates charged for the transmission or sale of electric energy in interstate commerce are just, reasonable, and not unduly discriminatory or preferential.”<sup>111</sup>

In effect, FERC Order 741 requires those RTOs that are subject to FERC supervision to implement the following reforms: “shortened settlement timeframes, restrictions on the use of unsecured credit, elimination of unsecured credit in all [FTRs] or equivalent markets, adoption of steps to address the risk that RTOs . . . may not be allowed to use netting and set-offs, establishment of minimum criteria for market participation, clarification regarding the organized markets’ administrators’ ability to invoke ‘material adverse change’ clauses to demand additional collateral from participants, and adoption of a two-day grace period for ‘curing’ collateral calls.”<sup>112</sup>

As discussed in more detail below, particularly in section V.D., the requirements set forth in FERC Order 741 appear to achieve goals similar to the regulatory objectives of the Commission’s DCO Core Principles.

FERC regulation 35.47(c) calls for the elimination of unsecured credit in the FTR markets and equivalent markets.<sup>113</sup> This requirement appears to be congruent with Core Principle D’s requirement that each DCO limit its exposure to potential losses from defaults by clearing members. Because, according to FERC, risks arising out of the FTR markets are “difficult to quantify,”<sup>114</sup> eliminating the use of unsecured credit in these markets may help avoid the unforeseen and substantial costs for an RTO in the event of a default.<sup>115</sup> Thus, the requirement set forth in regulation 35.47(c) appears to advance the objectives of Core

Principle D by reducing risk and minimizing the effect of defaults through the elimination of unsecured credit in the FTR and equivalent markets.

In addition, FERC regulation 35.47(a) requires RTOs to have tariff provisions that “[l]imit the amount of unsecured credit extended by [an RTO] to no more than \$50 million for each market participant.”<sup>116</sup> This requirement appears to be congruent with one of the regulatory objectives of Core Principle D, as implemented by Commission regulation 39.13, specifically the requirement that each DCO limit its exposure to potential losses from defaults by clearing members. In capping the use of unsecured credit at \$50 million, FERC stated its belief that RTOs “could withstand a default of this magnitude by a single market participant,”<sup>117</sup> thereby limiting an RTO’s exposure to potential losses from defaults by its market participants. Thus, it seems both Core Principle D and FERC regulation 35.47(a) help protect the markets and their participants from unacceptable disruptions, albeit in different ways and to a different extent.

FERC regulation 35.47(b) mandates that RTOs have billing periods and settlement periods of no more than seven days.<sup>118</sup> While this mandate does not meet the standards applicable to registered DCOs,<sup>119</sup> it supports Core Principle D’s requirement that each DCO have appropriate tools and procedures to manage the risks associated with discharging its responsibilities. In promulgating FERC regulation 35.47(b), FERC found a shorter cycle necessary to promote market liquidity and a necessary change “to reduce default risk, the costs of which would be socialized across market participants and, in certain events, of market disruptions that could undermine overall market function.”<sup>120</sup> Recognizing the correlation between a reduction in the length of the “settlement cycle” and a reduction in costs attributed to a default, FERC stated that shorter cycles reduce the amount of unpaid debt left outstanding, which, in turn, reduces “the size of any default and therefore reduces the likelihood of

<sup>108</sup> The Commission notes that its authority to prosecute market abuses involving the Covered Transactions would not be limited to instances where the Covered Transactions were part of some cross-market scheme involving DCM trading activity.

<sup>109</sup> Final Rulemaking—Core Principles and Other Requirements for Designated Contract Markets, 72 FR 36612, June 19, 2012.

<sup>110</sup> See Commission regulations 20.6, 20.7, 37.404, 37.500, 37.502, 37.503, and 45.2, which were adopted following the Dodd-Frank Act’s expansion of the Commission’s jurisdiction to cover swaps; see 7 U.S.C. 2(a)(1)(A); see also *supra* note 19 and accompanying text. For physical commodity swaps, Commission regulations 20.6 and 20.7 require a reportable trader to keep books and records evidencing all details concerning cash and over-the-counter positions and transactions in the underlying commodity and to provide such data to the Commission upon demand. Regulation 45.2 requires certain reporting entities, as denominated in the regulation, to keep full, complete, and systematic records, together with all pertinent data and memoranda, of all activities related to the business of such entity or persons with respect to swaps and available to the Commission via real time electronic access. In addition, under regulations 37.404, 37.500, 37.502 and 37.503, SEFs must have rules that require their swap participants to keep books and records evidencing all details concerning cash and over-the-counter positions and transactions in the underlying commodity, to allow examination of those books and records, and the provision of such information to the Commission upon demand.

<sup>111</sup> 75 FR 65942, 65942, Oct. 21, 2010 (the “FERC Original Order 741”). These requirements were later slightly amended and clarified in an order on rehearing. See 76 FR 10492, Feb. 25, 2011 (“FERC Revised Order 741,” and together with Original Order 741, “FERC Order 741”).

<sup>112</sup> FERC Revised Order 741 at 10492–93.

<sup>113</sup> 18 CFR 35.47(c).

<sup>114</sup> Specifically, FERC stated that “the risk associated with the potentially rapidly changing value of FTRs warrants adoption of risk management measures, including the elimination of unsecured credit. Because financial transmission rights have a longer-dated obligation to perform which can run from a month to a year or more, they have unique risks that distinguish them from other wholesale electric markets, and the value of a financial transmission right depends on unforeseeable events, including unplanned outages and unanticipated weather conditions. Moreover, financial transmission rights are relatively illiquid, adding to the inherent risk in their valuation.” FERC Original Order 741 at 65950.

<sup>115</sup> *Id.* at 65949.

<sup>116</sup> In addition, FERC regulation 35.47(a) states that “where a corporate family includes more than one market participant participating in the same [RTO], the limit on the amount of unsecured credit extended by that [RTO] shall be no more than \$50 million for the corporate family.” 18 CFR 35.47(a).

<sup>117</sup> FERC Original Order 741 at 65948.

<sup>118</sup> 18 CFR 35.47(b).

<sup>119</sup> See 17 CFR 39.14(b) (requiring daily settlements).

<sup>120</sup> FERC Original Order 741 at 65946.

the default leading to a disruption in the market such as cascading defaults and dramatically reduced market liquidity.”<sup>121</sup> Thus, FERC regulation 35.47(b) appears to aid RTOs in managing the risks associated with their responsibilities, which also appears to support Core Principle D’s goals.

FERC regulation 35.47(d) requires RTOs to ensure the enforceability of their netting arrangements in the event of the insolvency of a member by doing one of the following: (1) Establish a single counterparty to all market participant transactions, (2) require each market participant to grant a security interest in the receivables of its transactions to the relevant RTO, or (3) provide another method of supporting netting that provides a similar level of protection to the market that is approved by FERC.<sup>122</sup> In the alternative, the RTOs would be prohibited from netting market participants’ transactions, and required to establish credit based on each market participant’s gross obligations. Congruent to the regulatory objectives of Core Principles D and G, FERC regulation 35.47(d) attempts to ensure that, in the event of a bankruptcy of a participant, RTOs are not prohibited from offsetting accounts receivable against accounts payable. In effect, this requirement attempts to clarify an RTO’s legal status to take title to transactions in an effort to establish mutuality in the transactions as legal support for set-off in bankruptcy.<sup>123</sup> This clarification, in turn, would appear to limit an RTO’s exposure to potential losses from defaults by market participants.

FERC regulation 35.47(e) limits the time period within which a market participant must cure a collateral call to no more than two days.<sup>124</sup> This requirement appears to be congruent with Core Principle D’s requirement that each DCO limit its exposure to potential losses from defaults by clearing members. In Original Order 741, FERC stated that a two day time period for curing collateral calls balances (1) the need for granting market participants sufficient time to make funding arrangements for collateral calls with (2) the need to minimize uncertainty as to a participant’s ability to participate in the market, as well as the risk and costs of a default by a participant. By requiring each RTO to include this two

day cure period in the credit provisions of its tariff language, FERC regulation 35.47(e) appears to both promote the active management of risks associated with the discharge of an RTO’s responsibilities, while at the same time limiting the potential losses from defaults by market participants.

FERC regulation 35.47(f) imposes minimum market participant eligibility requirements that apply consistently to all market participants and, as set forth in the preamble to Original Order 741, requires RTOs to engage in periodic verification of market participant risk management policies and procedures.<sup>125</sup> The Commission believes that the requirements set forth in FERC regulation 35.47(f) appear congruent with some of the regulatory objectives of DCO Core Principle C, as implemented by Commission regulation 39.12. In general, DCO Core Principle C requires each DCO to establish appropriate admission and continuing eligibility standards for members of, and participants in, a DCO that are objective, publicly disclosed, and permit fair and open access.<sup>126</sup> In addition, Core Principle C also requires that each DCO establish and implement procedures to verify compliance with each participation and membership requirement, on an ongoing basis.<sup>127</sup> Similarly, while FERC regulation 35.47(f) does not prescribe the particular participation standards that must be implemented, as suggested in the preamble to Original Order 741, these standards should address “adequate capitalization, the ability to respond to RTO direction and expertise in risk management”<sup>128</sup> and ensure that proposed tariff language “is just and reasonable and not unduly discriminatory.”<sup>129</sup> Moreover, FERC specifically stated that these participation standards “could include the capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification, to make sure that each market participant has adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole.”<sup>130</sup> Thus, both DCO Core Principle C and Order 741 appear to promote fair and open access for market participants as well as impose compliance verification requirements.

FERC regulation 35.47(g) requires RTOs to specify in their tariffs the conditions under which they will request additional collateral due to a material adverse change.<sup>131</sup> FERC, however, noted that the examples set forth in each RTO’s tariffs are not exhaustive and that ISOs and RTOs are permitted to use “their discretion to request additional collateral in response to unusual or unforeseen circumstances.”<sup>132</sup> The Commission believes that the requirements set forth in FERC regulation 35.47(g) appear congruent with the following DCO Core Principle D requirements: (1) That DCOs have appropriate tools and procedures to manage the risks associated with discharging its responsibilities, and (2) that DCOs limit their exposure to potential losses from defaults by clearing members.<sup>133</sup> By requiring RTOs to actively consider the circumstances that could give rise to a material adverse change, FERC appears to be encouraging RTOs to actively manage their risks to “avoid any confusion, particularly during times of market duress, as to when such a clause may be invoked.”<sup>134</sup> Moreover, such clarification could prevent a market participant’s ability to “exploit ambiguity as to when a market administrator may invoke a ‘material adverse change,’ or a market administrator may be uncertain as to when it may invoke a ‘material adverse change,’ ”<sup>135</sup> thereby avoiding potentially harmful delays or disruptions that could subject the RTOs to unnecessary damage.

SPP represents that it has complied with, and fully implemented, the requirements set forth in Order 741.<sup>136</sup>

#### D. DCO Core Principle Analysis

##### 1. DCO Core Principle A: Compliance With Core Principles

DCO Core Principle A requires a DCO to comply with each core principle set forth in section 5b(c)(2) of the CEA, as well as any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act for a DCO to be registered and maintain its registration.<sup>137</sup> In addition, Core Principle A states that a DCO shall have reasonable discretion in establishing the manner by which it complies with each core principle

<sup>121</sup> *Id.*

<sup>122</sup> 18 CFR 35.47(d).

<sup>123</sup> See 11 U.S.C. 553; see generally, *In re SemCrude, L.P.*, 399 B.R. 388 (Bankr. D. Del. 2009), *aff’d*, 428 B.R. 590 (D. Del. 2010).

<sup>124</sup> 18 CFR 35.47(e).

<sup>125</sup> 18 CFR 35.47(f).

<sup>126</sup> 7 U.S.C. 7a–1(c)(2)(C).

<sup>127</sup> *Id.*

<sup>128</sup> FERC Original Order 741 at 65956.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> 18 CFR 35.47(g).

<sup>132</sup> FERC Original Order 741 at 65957.

<sup>133</sup> 7 U.S.C. 7a–1(c)(2)(D).

<sup>134</sup> FERC Original Order 741 at 65958.

<sup>135</sup> *Id.*

<sup>136</sup> See Exemption Application at 3–4; FERC Order 741 Implementation Chart.

<sup>137</sup> 7 U.S.C. 7a–1(c)(2)(A)(i).

subject to any rule or regulation prescribed by the Commission.<sup>138</sup>

SPP represents that, although it is principally regulated by FERC and that there are differences between it and registered DCOs, SPP's practices are consistent with the core principles for DCOs.<sup>139</sup> SPP represents that, though its methods are different than those employed by a registered DCO, its practices and the comprehensive regulatory regime of FERC achieve the goals of, and are consistent with, the policies of the Act.<sup>140</sup> Based upon SPP's representations and the Core Principle discussions below, and in the context of SPP's activities with respect to the Covered Transactions within the scope of this Proposed Exemption, SPP's practices appear congruent with, and to accomplish sufficiently, the regulatory objectives of each DCO Core Principle. The Commission seeks comment with respect to this preliminary conclusion.

## 2. DCO Core Principle B: Financial and Operational Resources

DCO Core Principle B requires a DCO to have adequate financial, operational, and managerial resources to discharge each of its responsibilities.<sup>141</sup> In addition, a DCO must have financial resources that, at a minimum, exceed the total amount that would: (i) Enable the DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions; and (ii) enable the DCO to cover its operating costs for a period of 1 year, as calculated on a rolling basis.<sup>142</sup>

### a. Financial Resources

SPP represents that it maintains sufficient financial resources to meet its financial obligations to its members notwithstanding a default by the member creating the largest financial exposure for that organization in extreme but plausible market conditions.<sup>143</sup> As an initial matter, SPP must take the following steps to address the outstanding obligation: (i) Segregate funds held by SPP with respect to the defaulting market participant; (ii) draw on collateral provided by the defaulting market participant; (iii) seek to recover from any guarantor of the defaulting market participant; (iv) seek to exercise other remedies under the credit support

documents provided by the defaulting market participant; and (v) pursue other available remedies for defaults, including, without limitation, initiating a filing with FERC to terminate the Service Agreement of the defaulting market participant.<sup>144</sup> Further, if these steps are inadequate to cover the obligation, SPP represents that its Tariff permits SPP to mutualize the loss among the non-defaulting market participants to whom SPP would otherwise be obligated.<sup>145</sup> Therefore, SPP will then make reduced payments to the non-defaulting market participants receiving revenues for market services associated with the outstanding obligation.<sup>146</sup> SPP represents that the payment to a non-defaulting market participant will be reduced in amount equal to such non-defaulting market participant's pro-rata share of the outstanding obligation.<sup>147</sup> This process is often referred to as "short-paying."<sup>148</sup> SPP further represents that once SPP deems the obligation as uncollectible, the short-pay would be "uplifted" or "socialized" more broadly across the market, with the losses reallocated among *all* non-defaulting market participants.<sup>149</sup>

On the basis of these representations, the Commission believes that SPP's financial resource requirements appear to be congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle B in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### b. Operational Resources

SPP represents that it has sufficient operational resources to cover its operating costs through a Tariff Administration Charge ("Charge")

<sup>144</sup> *Id.*

<sup>145</sup> See Exemption Application Attachments at 4; Letter from SPP to the Commission dated October 7, 2014 Providing Clarifying Information in Support of Amended Application for Exemptive Order ("October 2014 Supplemental Letter") at 3.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> See Notice of 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 Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act, 77 FR 52138, 52149, Aug. 28, 2012.

<sup>149</sup> See Exemption Application Attachments at 4. SPP states that the loss would be allocated pro-rata to all non-defaulting market participants who conducted business in the market during the period covered by the invoice(s) associated with the loss, including those market participants who had not been owed revenues. See also October 2014 Supplemental Letter at 3.

allocated to its participants and set forth in Schedule 1–A of its Tariff.<sup>150</sup> SPP represents that the amount of the Charge is not subject to annual approval by FERC, but SPP submits an informational filing to FERC on an annual basis outlining its budget and this Charge.<sup>151</sup> SPP further represents that the Charge is based on expected costs for the following year.<sup>152</sup> Under the regulatory structure in the wholesale electric industry, market participants are obligated to pay the fees required by SPP,<sup>153</sup> and are thus, in a sense, a "captive audience." SPP also represents that to the extent that an SPP member terminates its membership, its Bylaws and Membership Agreement require that the member pay its share of SPP's outstanding financial obligations, including principal and interest on SPP debt obligations.<sup>154</sup> These provisions protect SPP and its remaining members from increased financial exposure due to a member's termination of its participation in SPP. SPP further represents that the Bylaws also provide SPP with the ability to assess a charge to all SPP members to recover any SPP costs that SPP is not otherwise able to collect under its Tariff and other governing documents, which further insures that SPP will have sufficient operational resources to satisfy its obligations.<sup>155</sup> Therefore, these policies and procedures appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle B in the context of the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### c. Managerial Resources

SPP represents that it has adequate managerial resources to discharge its responsibilities as an organized wholesale electric energy market.<sup>156</sup> The Commission notes that FERC Order 888 sets forth the principles used by FERC to assess ISO proposals and requires that ISOs have appropriate incentives for efficient management and administration.<sup>157</sup> This requirement

<sup>150</sup> See Exemption Application Attachments at 6–7. SPP states that the charge is allocated to their market participants based on each megawatt of transmission capacity reserved during the year. *Id.*

<sup>151</sup> *Id.* at 7.

<sup>152</sup> *Id.* at 6–8.

<sup>153</sup> *Id.* at 7.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> See *id.* at 9.

<sup>157</sup> See generally, FERC Order 888 at 21540. In addition to establishing ISOs, FERC Order 888 mandated that all public utilities file open access transmission tariffs that contain minimum terms and conditions for non-discriminatory service. As a public utility transmission provider, SPP is

<sup>138</sup> 7 U.S.C. 7a–1(c)(2)(A)(ii).

<sup>139</sup> Exemption Application Attachments at 1.

<sup>140</sup> *Id.*

<sup>141</sup> 7 U.S.C. 7a–1(c)(2)(B)(i).

<sup>142</sup> 7 U.S.C. 7a–1(c)(2)(B)(ii).

<sup>143</sup> See Exemption Application Attachments at 3.

provides that ISOs should procure the services needed for such management and administration in an open competitive market, similar to how Core Principle B requires a DCO to possess managerial resources necessary to discharge each responsibility of the DCO. In addition, FERC Order 2000 requires that RTOs have an open architecture so that the RTO and its members have the flexibility to improve their organizations in the future in terms of structure, geographic scope, market support and operations in order to adapt to an environment that is rapidly changing and meet market needs.<sup>158</sup>

SPP represents that it has sufficient human resources to fulfill its obligations to its members, market participants, and customers.<sup>159</sup> SPP represents that it employs more than 500 employees with experience in engineering, market operations, legal and regulatory compliance, finance and credit, and other disciplines, that carry out SPP market and services and support the various SPP member organizational groups.<sup>160</sup> Based on these representations, SPP's managerial resources appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle B in the context of the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### 3. DCO Core Principle C: Participant and Product Eligibility

DCO Core Principle C requires each DCO to establish appropriate admission and continuing eligibility standards for member and participants (including sufficient financial resources and operational capacity), as well as to establish procedures to verify, on an ongoing basis, member and participant compliance with such requirements.<sup>161</sup> The DCO's participant and membership requirements must also be objective, be publicly disclosed, and permit fair and open access.<sup>162</sup> In addition, Core Principle C obligates each DCO to establish appropriate standards for determining the eligibility of agreements, contracts, or transactions submitted to the DCO for clearing.<sup>163</sup>

obligated to comply with the open access requirements of FERC Order 888, which includes the requirement for appropriate incentives for efficient management and administration. See Exemption Application at 2–3 n. 7.

<sup>158</sup> FERC Order 2000 at 502.

<sup>159</sup> See Exemption Application Attachments at 8–9.

<sup>160</sup> *Id.* at 8.

<sup>161</sup> 7 U.S.C. 7a–1(c)(2)(C).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* As set forth above, the exemption that would be provided by the Proposed Exemption

### a. FERC Credit Policy Requirements

As discussed above, the FERC Credit Policy appears to impose participant eligibility requirements that are consistent with regulatory objectives of DCO Core Principle C.<sup>164</sup> In the FERC Credit Policy, FERC notes that “[h]aving minimum criteria in place can help minimize the dangers of mutualized defaults posed by inadequately prepared or under-capitalized participants.”<sup>165</sup> Specifically, FERC regulation 35.47(f) requires organized wholesale electric markets to adopt tariff provisions that require minimum market participant eligibility criteria.<sup>166</sup> Though the regulation does not prescribe the particular participation standards that must be implemented; in the rule's preamble, FERC suggests that such standards should address “adequate capitalization, the ability to respond to RTO direction and expertise in risk management.”<sup>167</sup> Regarding risk management, FERC further suggests that minimum participant eligibility criteria should “include the capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification.”<sup>168</sup> Although market participant criteria may vary among different types of market participants, all market participants must be subject to some minimum criteria.<sup>169</sup> An RTO subject to FERC's supervision is obligated to establish market participant criteria, even if the RTO applies vigorous standards in determining the creditworthiness of its market participants.<sup>170</sup>

would be available only with respect to the transactions specifically delineated therein. Accordingly, the DCO Core Principle C analysis is limited to a discussion of SPP's participant eligibility requirements.

<sup>164</sup> See *supra* note 128.

<sup>165</sup> FERC Original Order 741 at 65955.

<sup>166</sup> 18 CFR 35.47(f).

<sup>167</sup> FERC Original Order 741 at 65956.

<sup>168</sup> *Id.*

<sup>169</sup> Although the FERC Credit Policy states that FERC “directs that [the market participation criteria] apply to all market participants rather than only certain participants,” FERC clarified this comment in its Order of Rehearing by stating that its intent “was that there be minimum criteria for all market participants and not that all market participants necessarily be held to the same criteria” based upon, for example, the size of the participant's positions. See FERC Revised Order 741 at n. 43. This approach appears to be consistent with Commission regulation 39.12, which implements Core Principle C and requires that participation requirements for DCO members be risk-based.

<sup>170</sup> See FERC Original Order 741 at 65956 (noting that “An . . . RTO's ‘ability to accurately assess a market participant's creditworthiness is not infallible’ and ‘[w]hile an analysis of creditworthiness may capture whether the market participant has adequate capital, it may not capture other risks, such as whether the market participant

Because the minimum participation criteria adopted by SPP is included in its Tariff, which is publicly available on SPP's Web site, such criteria is publicly disclosed. In addition, FERC notes that it reviews proposed tariff language “to ensure that it is just and reasonable and not unduly discriminatory,”<sup>171</sup> which practice would appear to be consistent with DCO Core Principle C's directive that market participation standards permit fair and open access.

### b. SPP's Representations

SPP represents that it has adopted minimum participant eligibility criteria that include capitalization requirements (which permits participation by less-well-capitalized members if they post additional collateral), as well as certain minimum eligibility qualifications.<sup>172</sup> The minimum capitalization requirements state that a market participant must possess either: (i) A tangible net worth of \$1,000,000; (ii) assets of \$10,000,000; (iii) a credit rating of BBB- or its equivalent; or (iv) a guaranty where the guarantor meets one of those requirements. Alternatively, if the market participant cannot meet one of those requirements, it may provide a deposit of \$200,000, which is segregated and unavailable to be used as financial security for market transactions. If, under this alternative provision, the market participant's expected market exposure exceeds \$100,000, it must also provide twice the amount of financial security otherwise required pursuant to the SPP Tariff.<sup>173</sup> The capitalization requirements appear to be risk-based in that the requirements may vary by type of market and/or type or size of participant.<sup>174</sup>

SPP represents that its Tariff includes minimum eligibility requirements consistent with the RTO–ISO Order's Appropriate Persons Requirement.<sup>175</sup> Specifically, in order to participate in SPP's markets, each market participant must demonstrate to SPP that it qualifies as (a) an appropriate person as that term is defined under section 4(c)(3)(A) through (J) of the CEA; (b) an eligible contract participant (“ECP”) as that term is defined in Section 1a(18) of the CEA and in Commission regulation 1.3(m); or (c) a person or entity that is in the business of: (i) Generating transmitting or distributing electric energy or (ii) providing electric services

has adequate expertise to transact in an RTO . . . market.”).

<sup>171</sup> *Id.*

<sup>172</sup> See Exemption Application Attachments at 11–12.

<sup>173</sup> *Id.* at 12.

<sup>174</sup> See *id.*

<sup>175</sup> *Id.*; see also Exemption Application at 21.

that are necessary to support the reliable operation of the transmission system.<sup>176</sup>

In addition, SPP requires that its market participants satisfy specified credit requirements<sup>177</sup> and provide an attestation of their risk management capabilities.<sup>178</sup> SPP represents that its Tariff contains requirements that enable SPP to periodically review and verify a market participant's risk management policies, practices, and procedures pertaining to its activities in SPP's markets.<sup>179</sup> SPP may select market participants for review on a random basis and/or based upon identified risk factors such as, but not limited to, the SPP markets in which the market participant is transacting, the magnitude of the market participant's transactions, or the volume of the market participant's open positions.<sup>180</sup> SPP further represents that successful completion of SPP's verification is required for a selected market participant's continued eligibility to participate in SPP's markets.<sup>181</sup> In addition to requiring a market participant to describe its risk management capabilities and procedures, SPP represents that the attestation requires a market participant to describe whether it is engaged in hedging, describe the employees who perform the risk management procedures, define the special training, skills, experience, and industry tenure of those employees, and provide any additional information in determining the risk management capabilities of the market participant.<sup>182</sup> Market participants also are required to notify SPP of material adverse changes in their financial conditions.<sup>183</sup> It appears from the foregoing that SPP's arrangements with respect to participant eligibility requirements are congruent with, and sufficiently accomplish, the regulatory objectives of Core Principle C in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 4. DCO Core Principle D: Risk Management

DCO Core Principle D requires each DCO to demonstrate the ability to manage the risks associated with discharging the responsibilities of a DCO through the use of appropriate

tools and procedures.<sup>184</sup> As amended by the Dodd-Frank Act, Core Principle D also requires a DCO to: (1) Measure and monitor its credit exposures to each clearing member daily; (2) through margin requirements and other risk control mechanisms, limit its exposure to potential losses from a clearing member default; (3) require sufficient margin from its clearing members to cover potential exposures in normal market conditions; and (4) use risk-based models and parameters in setting margin requirements that are reviewed on a regular basis.<sup>185</sup>

##### a. Risk Management Framework

SPP represents that the risk management provisions set forth in SPP's Tariff provide SPP with appropriate tools and procedures to manage the risk associated with operating its wholesale and related markets.<sup>186</sup> As part of the tools and procedures that RTOs use to manage the risks associated with their activities, FERC regulation 35.47(b) mandates that RTOs have billing periods and settlement periods of no more than seven days.<sup>187</sup> As discussed above, FERC found a shorter cycle necessary to promote market liquidity and a necessary change "to reduce default risk, the costs of which would be socialized across market participants and, in certain events, of market disruptions that could undermine overall market function."<sup>188</sup> Recognizing the correlation between a reduction in the "settlement cycle" and a reduction in costs attributed to a default, FERC stated that shorter cycles reduce the amount of unpaid debt left outstanding, which, in turn, reduces "the size of any default and therefore reduces the likelihood of the default leading to a disruption in the market such as cascading defaults and dramatically reduced market liquidity."<sup>189</sup> SPP represents that it has a Tariff in place that limits billing periods and settlement periods to no more than seven days.<sup>190</sup>

In addition, an RTO's participation standards can include the supervision of a market participant's risk management program.<sup>191</sup> As discussed in section V.C., FERC Order 741 states that an RTO could include periodic verification of

market participant's capability to engage in risk management or hedging or to out-source that capability "to make sure each market participant has adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole."<sup>192</sup> SPP represents that it has a verification program in place.<sup>193</sup> On the basis of the representations contained in the Exemption Application, it appears that these policies and procedures, are congruent with, and will sufficiently accomplish, the regulatory objectives of DCO Core Principle D with respect to SPP's risk management framework. The Commission seeks comment with respect to this preliminary conclusion.

##### b. Measurement and Monitoring of Credit Exposure

SPP represents that its risk management procedures measure, monitor, and mitigate its credit exposure to market participants.<sup>194</sup> In addition, SPP states that it calculates credit exposure daily.<sup>195</sup> SPP further states that it uses a highly customized system that collects data from multiple SPP systems to provide accurate and up-to-date credit exposures for each market participant.<sup>196</sup> It appears that, for the most part, given the unique characteristics of the wholesale electric markets, and particularly those of the TCR and equivalent markets, the practices specified in the Exemption Application appear congruent with, and to accomplish sufficiently, with respect to SPP, DCO Core Principle D's objective that a DCO measure its credit exposure to each of its clearing members. The Commission seeks comment with respect to this preliminary conclusion.

##### c. Unsecured Credit

SPP represents that a market participant is required to have credit that is sufficient to support its market activities or total potential exposure.<sup>197</sup>

<sup>192</sup> See FERC Original Order 741 at 65946.

<sup>193</sup> Exemption Application Attachments at 16; see FERC Order 741 Implementation Chart at 8–9.

<sup>194</sup> See Exemption Application Attachments at 11, 18–20.

<sup>195</sup> *Id.* at 18. For TCR auctions, SPP represents that its system calculates credit exposure for each bid or offer in real-time and compares the market participant's credit limit available. Bids and offers are systematically rejected if they contribute to exceeding the market participant's available credit. See *id.*

<sup>196</sup> See *id.*

<sup>197</sup> See *id.* SPP indicates that a market participant's total potential exposure is a calculated value applied to assure that the market participant engages in activities within its total credit limit as determined by SPP. The total potential exposure is based on the market participant's estimated

<sup>176</sup> Exemption Application Attachments at 12; see also RTO-ISO Order at 19913.

<sup>177</sup> *Id.* at 11.

<sup>178</sup> *Id.* at 11–12.

<sup>179</sup> *Id.* at 12.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> 7 U.S.C. 7a–1(c)(2)(D).

<sup>185</sup> *Id.*

<sup>186</sup> See Exemption Application Attachments at 15–27.

<sup>187</sup> 18 CFR 35.47(b).

<sup>188</sup> FERC Original Order 741 at 65946.

<sup>189</sup> *Id.*

<sup>190</sup> Exemption Application Attachments at 17; see FERC Order 741 Implementation Chart at 3.

<sup>191</sup> See *supra* note 127.

SPP further represents that this credit can either be in the form of (i) unsecured credit granted by SPP, and/or (ii) financial security<sup>198</sup> provided by the market participant to SPP.<sup>199</sup> FERC regulation 35.47(a) requires RTOs to have tariff provisions that “[l]imit the amount of unsecured credit extended by [an RTO] to no more than \$50 million for each market participant.” As mentioned above,<sup>200</sup> in capping the use of unsecured credit at \$50 million, FERC stated its belief that RTOs “could withstand a default of this magnitude by a single market participant,” thereby limiting an RTO’s exposure to potential losses from defaults by its market participants. SPP represents that its Tariff limits the amount of unsecured credit extended to any market participant to no more than \$25 million and therefore, complies with FERC regulation 35.47(a).<sup>201</sup> Moreover, FERC regulation 35.47(c) prohibits the use of unsecured credit in the FTR markets and equivalent markets because, according to FERC, risks arising out of the FTR markets are “difficult to quantify,” and eliminating the use of unsecured credit in these markets avoids the unforeseen and substantial costs for an RTO in the event of a default. SPP states that unsecured credit is unavailable for TCR activity and that its Tariff complies with FERC regulation 35.47(c).<sup>202</sup> SPP further states that a market participant is required to

provide financial security to support all of its TCR activity.

Since FERC regulations 35.47(a) and 35.47(c) appear to be designed to manage risk and limit an RTO’s exposure to potential losses from a market participant, SPP’s compliance with these requirements would appear to be congruent with, and to accomplish sufficiently, the regulatory objectives of Core Principle D, with respect to unsecured credit, in the context of SPP’s activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### d. Limiting Exposure to Potential Losses Through Use of Risk Control Mechanisms and Grace Period To Cure

SPP represents that it requires a market participant to either pay SPP invoices to reduce its credit exposure and/or post additional financial security (collateral) whenever there is a total potential exposure violation, specifically (1) the participant’s total potential exposure equals or exceeds that participant’s unsecured credit and posted financial security (excluding any financial security provided for TCR activity), and/or (2) the credit required for a market participant’s TCR activity exceeds the financial security provided by the market participant to support the activity.<sup>203</sup> Moreover, FERC regulation 35.47(e) limits the time period by which a market participant must cure a collateral call to no more than two days. In Original Order 741, FERC stated that a two day time period for curing collateral calls balances the need for granting market participants sufficient time to make funding arrangements for collateral calls with the need to minimize uncertainty as to a participant’s ability to participate in the market as well as the risk and costs of a default by a participant. By requiring each RTO to include this two day cure period in its tariff provisions, FERC regulation 35.47(e) appears to both promote the active management of risks associated with the discharge of an RTO’s responsibilities, while at the same time limiting the potential losses from defaults by market participants. SPP represents that it has implemented this requirement.<sup>204</sup> If a market participant fails to pay SPP invoices and/or post additional financial security within the requisite two day period, SPP represents that this failure to cure is considered a default and SPP has a wide

array of remedies available, including remedies available at law or in equity<sup>205</sup> and assessing a variety of sanctions against the market participant.<sup>206</sup> Depending on the timing and number of events of defaults, SPP will suspend any unsecured credit allowances, and if an event of default is not cured within in the requisite two day period, SPP may terminate the market participant’s rights under the SPP credit policy and may terminate service in accordance with the SPP Tariff and applicable law. If the event of default is that the market participant is in bankruptcy or has commenced bankruptcy proceedings, SPP will immediately suspend the market participant’s unsecured credit and may terminate the market participant’s rights under the SPP credit policy, and SPP may terminate service in accordance with the SPP Tariff and applicable law. The SPP Tariff also sets forth procedures to close out and liquidate TCRs held by a defaulting market participant.<sup>207</sup>

On the basis of these representations, it appears that the requirements to post additional financial security and cure collateral calls in no more than two days help SPP manage risk and limit its exposure against potential losses from a market participant. These requirements appear to be congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle D, with respect to limiting exposure to potential losses through the use of risk control mechanisms and the grace period to cure, in the context of SPP’s activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### e. Calls for Additional Collateral Due to a Material Adverse Change

FERC regulation 35.47(g) requires RTOs to specify in their tariffs the conditions under which they will request additional collateral due to a material adverse change. However, as stated by FERC, this list of conditions is not meant to be exhaustive, and RTOs are permitted to use “their discretion to request additional collateral in response to unusual or unforeseen circumstances.”<sup>208</sup> SPP represents that

cumulative financial obligation under the SPP Tariff or otherwise to SPP, excluding TCR activity. SPP calculates a market participant’s potential exposure to nonpayment separately for each category of service (except TCR activity) and then sums this information to obtain the amount of total potential exposure. *See id.* at 19.

<sup>198</sup> SPP represents that it only accepts financial security that is in the form of cash deposits or irrevocable letters of credit, or if the market participant is a Federal Power Marketing Agency, a Federal Power Marketing Agency Letter executed by an officer of the agency that includes an attestation that the agency is lawfully allowed to participate in the SPP TCR market and that any debt the agency incurs from such participation is a debt of the United States, and that identifies the current appropriations for the agency from the United States Congress and verifies that such amount meets or exceeds the amount required to satisfy the credit requirements set forth in the SPP Credit Policy. SPP further represents that it requires financial security for any activity where a market participant’s total potential exposure is greater than the unsecured credit granted to the market participant. *See id.* at 18–19.

<sup>199</sup> A market participant’s total credit limit is the amount of any unsecured credit allowance approved by SPP plus the amount of any financial security the market participant has provided to SPP. *Id.*

<sup>200</sup> *See supra* note 116.

<sup>201</sup> *See* FERC Order 741 Implementation Chart at 2; Exemption Application Attachments at 19–20.

<sup>202</sup> *See* FERC Order 741 Implementation Chart at 3; Exemption Application Attachments at 18–19.

<sup>203</sup> *See* Exemption Application Attachments at 20–21.

<sup>204</sup> *See* FERC Order 741 Implementation Chart at 5; Exemption Application Attachments at 21.

<sup>205</sup> SPP states that such remedies include, but are not limited to, bringing suit or otherwise initiating monetary damages, injunctive relief, specific performance, and relief available under the Federal Power Act, except to the extent such remedy is limited under the SPP Credit Policy. *See* Exemption Application Attachments at 22.

<sup>206</sup> *See* Exemption Application Attachments at 21; *see* DCO Core Principle G discussion *infra*.

<sup>207</sup> *See id.*

<sup>208</sup> FERC Original Order 741 at 65957.

its Tariff complies with these requirements.<sup>209</sup> Since SPP does not appear to be limited in its ability to call for additional collateral in unusual or unforeseen circumstances, FERC regulation 35.47(g) appears to support some of DCO Core Principle D's objectives, namely that a DCO have appropriate tools and procedures to manage the risks associated with discharging its responsibilities, and that a DCO limit its exposure to potential losses from defaults by clearing members. FERC has noted that information regarding when an RTO will request additional collateral due to a material adverse change may help to "avoid any confusion, particularly during times of market duress, as to when such a clause may be invoked,"<sup>210</sup> while at the same time preventing a market participant from "exploit[ing] ambiguity as to when a market administrator may invoke a 'material adverse change.'"<sup>211</sup> As such, this policy appears to help avoid potentially harmful delays or disruptions that could subject SPP to unnecessary damage, and thus is congruent with, and appears to accomplish sufficiently, the regulatory objectives of Core Principle D, with respect to calls for additional collateral due to a material adverse change, in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### f. Margin Requirement and Use of Risk-Based Models and Parameters in Setting Margin

As discussed previously, SPP represents that it requires a market participant to maintain unsecured credit and/or post financial security (collectively, "margin") that is sufficient to support its market activities or total potential exposure at all times.<sup>212</sup> As represented by SPP, these practices appear to be congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle D, with respect to a margin requirement and the use of risk-based models and parameters in setting margin, in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### g. Ability To Offset Market Obligations

FERC regulation 35.47(d) requires RTOs to either (1) establish a single counterparty to all market participant transactions, (2) require each market participant to grant a security interest in the receivables of its transactions to the relevant RTO, or (3) provide another method of supporting netting that provides a similar level of protection to the market that is approved by FERC. Otherwise, RTOs are prohibited from netting market participants' transactions and required to establish credit based on market participants' gross obligations. FERC regulation 35.47(d), which attempts to ensure that, in the event of a bankruptcy, RTOs are not prohibited from offsetting accounts receivable against accounts payable, is congruent with the regulatory objectives of Core Principle D. In effect, this requirement appears to attempt to clarify an RTO's legal status to take title to transactions in an effort to establish mutuality in the transactions as legal support for set-off in bankruptcy.<sup>213</sup> This clarification, in turn, would seem to limit an RTO's exposure to potential losses from defaults by market participants.

SPP represents that it is a central counterparty and that its Tariff indicates that SPP is the counterparty to the Covered Transactions.<sup>214</sup> SPP has submitted a memorandum of outside counsel that states that SPP's counterparty arrangements will provide SPP with enforceable rights of set off against a market participant in the event of the market participant's bankruptcy.<sup>215</sup>

Compliance with FERC regulation 35.47(d) appears to be congruent with, and to accomplish sufficiently, Core Principle D's regulatory objectives, with respect to the ability to offset market obligations, in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

<sup>213</sup> See *supra* note 123.

<sup>214</sup> Exemption Application Attachments at 23; see FERC Order 741 Implementation Chart at 4–5.

<sup>215</sup> As part of the Exemption Application, SPP provided the Commission with a legal opinion that, provided the Commission with assurance that the netting arrangements contained in the approach selected by SPP to satisfy the obligations contained in FERC regulation 35.47(d) will, in fact, provide SPP 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. See Memorandum regarding Enforceability of Netting Practices from Hunton and Williams to SPP dated December 2, 2013.

#### 5. DCO Core Principle E: Settlement Procedures

Among the requirements set forth by Core Principle E are the requirements that a DCO (a) have the ability to complete settlements on a timely basis under varying circumstances, and (b) maintain an adequate record of the flow of funds associated with each transaction that the DCO clears.<sup>216</sup>

SPP represents that it has policies and procedures that contain detailed procedures regarding data and record-keeping, and that it has billing periods and settlement periods of no more than seven days each (for a total of 14 days).<sup>217</sup> Specifically, the SPP Tariff requires SPP to invoice market participants for market transactions on a weekly basis detailing all charges and payments.<sup>218</sup> Market participants are required to make payments equal to the net charge on the invoice by 5:00 p.m. on the third business day following the date of the invoice, while SPP makes payments to the market participants equal to the net credit on the invoice by 5:00 p.m. on the fifth business day following the date of the invoice.<sup>219</sup> In addition, SPP represents that it maintains records concerning the flow of funds involved in the settlements by market participants.<sup>220</sup> While this approach does not meet the standards applicable to registered DCOs,<sup>221</sup> it appears to be congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle E in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment on this preliminary conclusion.

#### 6. DCO Core Principle F: Treatment of Funds

DCO Core Principle F requires a DCO to have standards and procedures designed to protect and ensure the safety of member and participant funds, to hold such funds in a manner that would minimize the risk of loss or delay in access by the DCO to the funds, and to invest such funds in instruments with minimal credit, market, and liquidity risks.<sup>222</sup>

SPP represents that it has Tariff provisions that accomplish the regulatory goals of DCO Core Principle F.<sup>223</sup> SPP maintains separate accounts

<sup>216</sup> 7 U.S.C. 7a–1(c)(2)(E)(i) and (iv).

<sup>217</sup> See Exemption Application Attachments at 28–29.

<sup>218</sup> *Id.* at 28.

<sup>219</sup> *Id.* at 28–29.

<sup>220</sup> *Id.* at 29.

<sup>221</sup> See 17 CFR 39.14(b) (requiring daily settlements).

<sup>222</sup> 7 U.S.C. 7a–1(c)(2)(F).

<sup>223</sup> See Exemption Application Attachments at 30.

<sup>209</sup> See FERC Order 741 Implementation Chart at 7–8.

<sup>210</sup> FERC Original Order 741 at 65958.

<sup>211</sup> *Id.*

<sup>212</sup> See Exemption Application Attachments at 22–23.

for the funds it receives or holds from market participants that are invoiced for market transactions.<sup>224</sup> In addition, SPP represents that the SPP Tariff requires SPP to deposit cash collateral received from a market participant/customer in a segregated, interest bearing account in SPP's name, with all of the interest accruing to the benefit of the market participant/customer.<sup>225</sup> As represented by SPP, these practices appear congruent with, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle F in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 7. DCO Core Principle G: Default Rules and Procedures

DCO Core Principle G requires a DCO to have rules and procedures designed to allow for the efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the DCO.<sup>226</sup> Core Principle G also requires a DCO to clearly state its default procedures, make publicly available its default rules, and ensure that it may take timely action to contain losses and liquidity pressures and to continue meeting each of its obligations.<sup>227</sup>

##### a. General Default Procedures

SPP represents that it has Tariff procedures that address events surrounding the insolvency or default of a market participant.<sup>228</sup> For example, SPP represents that its Tariff identifies events of default (e.g., failure to post any financial security required under the SPP credit policy, failure to pay in full amounts payable, unless cured, events of insolvency, defaults under the credit policy, and failure to provide information under the credit policy in a timely manner), describes the cure period associated with an event of default, and describes the actions to be taken in the event of default and detail the remedies available to SPP—which may include, among other things, suspension of unsecured credit allowances, termination of services in accordance with the SPP Tariff,

termination of market activity, and close out and liquidation of TCRs held by a defaulting market participant.<sup>229</sup> As detailed above, in the event that the remedies outlined in SPP's Tariff are insufficient to timely cure a default, SPP has the right to socialize losses from the default among other market participants by, for example, “short-paying” such other participants.<sup>230</sup>

##### b. Setoff

Generally speaking, it is a well-established tenet of clearing that a DCO acts as the buyer to every seller and as the seller to every buyer, thereby substituting the DCO's credit for bilateral counter-party risk. As such, when a DCO is involved, there is little question as to the identity of a counterparty to a given transaction. However, because an RTO can act as agent for its participants, there could be ambiguity as to the identity of a counterparty to a given transaction. As a result, in the event of a bankruptcy of a market participant and in the event of a lack of the mutuality of obligation required by the Bankruptcy Code,<sup>231</sup> an RTO may be liable to pay a bankrupt market participant for transactions in which that participant is owed funds, without the ability to offset amounts owed by that participant with respect to other transactions. Stated differently, although the defaulting market participant may owe money to the RTO, if the RTO also owes money to such participant, the RTO may be required to pay the defaulting participant the full amount owed without being able to offset the amounts owed by that participant to the RTO, which latter amounts may be relegated to claims in the bankruptcy proceedings. As more fully described in section V.D.4.g., the memorandum of counsel provided by SPP addresses this issue.

The foregoing arrangements appear congruent to, and to accomplish sufficiently, the regulatory objectives of DCO Core Principle G in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 8. DCO Core Principle H: Rule Enforcement

DCO Core Principle H requires a DCO to (1) maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules and for resolution of disputes, (2) have the authority and ability to discipline, limit, suspend, or terminate a clearing member's activities for violations of those rules, and (3) report to the Commission regarding rule enforcement activities and sanctions imposed against members and participants.<sup>232</sup>

SPP represents that it maintains a Tariff or other procedures that accomplish the regulatory goals of DCO Core Principle H.<sup>233</sup> SPP maintains that its Bylaws, Membership Agreement and Tariff contain substantial rules governing member, customer, and market participant conduct, and provide SPP with the ability to discipline such conduct and report certain conduct to FERC.<sup>234</sup> SPP has, e.g., the power to take a range of actions against participants that fail to pay, pay late, or fail to comply with SPP's credit policy.<sup>235</sup> In addition, SPP's Bylaws, Membership Agreement and Tariff establish dispute resolution procedures.<sup>236</sup>

Based on SPP's representations, it appears that these practices are congruent with, and sufficiently accomplish, the regulatory objectives of DCO Core Principle H in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 9. DCO Core Principle I: System Safeguards

DCO Core Principle I requires a DCO to demonstrate that: (1) It has established and will maintain a program of oversight and risk analysis to ensure that its automated systems function properly and have adequate capacity and security, and (2) it has established and will maintain emergency procedures and a plan for disaster recovery and will periodically test backup facilities to ensure daily processing, clearing and settlement of transactions.<sup>237</sup> Core Principle I also requires that a DCO establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of the DCO's

<sup>224</sup> *Id.* As discussed above, SPP represents that pursuant to the SPP tariff, market participants pay amounts they owe by the third business day after being invoiced, and SPP pays amounts owed to market participants pertaining to market transactions by the fifth business day after the invoice is issued.

<sup>225</sup> *Id.*

<sup>226</sup> 7 U.S.C. 7a–1(c)(2)(G)(i).

<sup>227</sup> 7 U.S.C. 7a–1(c)(2)(G)(ii).

<sup>228</sup> See Exemption Application Attachments at 32–35.

<sup>229</sup> *Id.* at 32–33. SPP states that these remedies are without prejudice to other remedies. SPP also may exercise any rights or remedies it may have at law or in equity, including, but not limited to, bringing suit or otherwise initiating monetary damages, injunctive relief, specific performance, and relief available under the Federal Power Act, except to the extent such remedy is limited under the SPP Credit Policy. *Id.* at 33.

<sup>230</sup> See *supra* notes 148 and 149 and accompanying text.

<sup>231</sup> See 11 U.S.C. 553.

<sup>232</sup> 7 U.S.C. 7a–1(c)(2)(H).

<sup>233</sup> Exemption Application Attachments at 36–40.

<sup>234</sup> *Id.* at 36.

<sup>235</sup> *Id.* at 38–39.

<sup>236</sup> *Id.* at 36, 40.

<sup>237</sup> 7 U.S.C. 7a–1(c)(2)(I)(i)–(ii).

operations and the fulfillment of each of its obligations and responsibilities.<sup>238</sup>

SPP represents that it has policies and procedures that accomplish the regulatory goals of DCO Core Principle I,<sup>239</sup> albeit in a manner that is somewhat different than the way in which a DCO complies with DCO Core Principle I. This is because SPP is also responsible for managing power reliably and, thus, requires additional operational safeguards to specifically address that function. For example, SPP is subject to reliability rules established by the North American Electric Reliability Corporation.<sup>240</sup> In order to comply with these rules, SPP has procedures in place to address emergency situations and maintains redundant communication and computer systems, and redundant primary and back-up control centers in separate secured locations.<sup>241</sup> SPP also has implemented on- and off-site data storage and back-up.<sup>242</sup> SPP has emergency preparedness, business continuity, and disaster recovery plans, which are reviewed and updated on a regular basis.<sup>243</sup> SPP also conducts periodic emergency drills and mock disaster scenarios to ensure the readiness of back-up facilities and personnel. Multiple SPP business units, including SPP's Internal Audit Department, work to review, test, and update SPP's business continuity plans.<sup>244</sup> In addition, SPP has a business continuity plan to provide for the calculation of market prices in the event of Day-Ahead Market or Real-Time Balancing Market system failures or isolation of portions of the SPP market from the rest of the market footprint.<sup>245</sup>

Based on SPP's representations, it appears that these system safeguard practices are congruent with, and accomplish sufficiently, the regulatory objectives of DCO Core Principle I in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 10. DCO Core Principle J: Reporting

DCO Core Principle J requires a DCO to provide to the Commission all information that the Commission determines to be necessary to conduct oversight of the DCO.<sup>246</sup> SPP represents that it has adopted substantial data and

information disclosure provisions, which enables SPP to provide information to the Commission, including information deemed confidential by market participants.<sup>247</sup> Moreover, pursuant to SPP's Tariff and FERC regulations, FERC has access to the information that it would need to oversee SPP.<sup>248</sup> With respect to the disclosure of confidential information received from market participants, SPP states that it has adopted procedures to allow for disclosure of such information to FERC and state regulatory agencies.<sup>249</sup> These procedures apply both to SPP and the SPP Market Monitor. SPP represents that its Tariff permits the disclosure of confidential information to the Commission.<sup>250</sup> In addition, when SPP receives a request that involves a market participant's confidential information, SPP is not required to provide notice to such market participant(s), where the Commission or FERC, or their respective staffs, are the party requesting the confidential information.<sup>251</sup>

Based on the foregoing, including SPP's representations, it appears that these practices are congruent with, and sufficiently accomplish, the regulatory objectives of Core Principle J in the context of Petitioners' activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 11. DCO Core Principle K: Recordkeeping

DCO Core Principle K requires a DCO to maintain records of all activities related to its business as a DCO in a form and manner acceptable to the Commission for a period of not less than five years.<sup>252</sup>

SPP represents that its practices satisfy the regulatory goals of DCO Core Principle K because it has adequate recordkeeping requirements or systems.<sup>253</sup> SPP represents that it complies with FERC's comprehensive regulations governing public utility recordkeeping, many of which require retention of data for at least five years.<sup>254</sup> In addition, under SPP's Standards of Conduct, SPP is required to maintain records showing the

transactions under the SPP Tariff for a period of 5 years unless otherwise provided in the Tariff or by law or regulation.<sup>255</sup> SPP retains such records in either electronic or paper format. SPP further represents that its Market Monitoring Plan requires all market data and information held by SPP or the SPP Market Monitor to be retained for a minimum period of three years, and requires market participants to retain such data in their possession for a minimum period of three years.<sup>256</sup>

Based on these regulations and SPP's representations, it appears that these practices are congruent with, and sufficiently accomplish, the regulatory objectives of DCO Core Principle K in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 12. DCO Core Principle L: Public Information

DCO Core Principle L requires a DCO to make information concerning the rules and operating procedures governing its clearing and settlement systems (including default procedures) available to market participants.<sup>257</sup> Core Principle L also requires a DCO to provide market participants with sufficient information to enable them to identify and evaluate accurately the risks and costs associated with using the DCO's services, and to disclose publicly and to the Commission information concerning: (1) The terms and conditions of each contract, agreement, and transaction cleared and settled by the DCO; (2) the fees that the DCO charges its members and participants; (3) the DCO's margin-setting methodology, and the size and composition of its financial resources package; (4) daily settlement prices, volume, and open interest for each contract the DCO settles or clears; and (5) any other matter relevant to participation in the DCO's settlement and clearing activities.<sup>258</sup>

SPP represents that it makes its Tariff and related governing documents, such as the SPP Bylaws, Membership Agreement, and the IM Protocols, publicly available on its Web site, which, in turn, allows market participants (and the public) to access information about the rules and operations of the SPP markets, including among other things, participant and product eligibility requirements, credit requirements for

<sup>238</sup> 7 U.S.C. 7a-1(c)(2)(I)(iii).

<sup>239</sup> See generally, Exemption Application Attachments at 41-43.

<sup>240</sup> See *id.* at 41.

<sup>241</sup> See *id.*

<sup>242</sup> See *id.*

<sup>243</sup> See *id.* at 42.

<sup>244</sup> See *id.*

<sup>245</sup> See *id.*

<sup>246</sup> 7 U.S.C. 7a-1(c)(2)(I).

<sup>247</sup> See Exemption Application Attachments at 44-46.

<sup>248</sup> *Id.*

<sup>249</sup> *Id.* at 44.

<sup>250</sup> See Exemption Application at 22; Exemption Application Attachments at 44-45.

<sup>251</sup> See Exemption Application Attachments at 44-45.

<sup>252</sup> 7 U.S.C. 7a-1(c)(2)(K).

<sup>253</sup> Exemption Application Attachments at 48.

<sup>254</sup> Exemption Application Attachments at 47; see 18 CFR part 125.

<sup>255</sup> Exemption Application Attachments at 47.

<sup>256</sup> *Id.*

<sup>257</sup> 7 U.S.C. 7a-1(c)(2)(L)(i)-(ii).

<sup>258</sup> 7 U.S.C. 7a-1(c)(2)(L)(iii).

market participants, default procedures and default allocations, settlement procedures, SPP fees, and extensive data regarding market and transmission system operations, policies, and procedures.<sup>259</sup>

Based on SPP's representations, it appears that these practices are congruent with, and sufficiently accomplish, the regulatory objectives of DCO Core Principle L in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### 13. DCO Core Principle M: Information Sharing

DCO Core Principle M requires a DCO to enter into and abide by the terms of all appropriate and applicable domestic and international information-sharing agreements, and use relevant information obtained from the agreements in carrying out the DCO's risk management program.<sup>260</sup>

SPP represents that it has policies and procedures that allow it to share information with, and receive information from, other entities as necessary to carry out its risk management functions.<sup>261</sup> SPP represents that its Tariff, Bylaws, Membership Agreement, and Standards of Conduct set forth rules for SPP's information sharing with SPP members, market participants, regulatory agencies, and other stakeholders.<sup>262</sup> SPP further represents that it has executed "Joint Operating Agreements," with interconnected electric transmission providers, such as (among others) the Midcontinent Independent System Operator, to provide for the sharing of certain transmission system planning and operational information between SPP and the counterparty.<sup>263</sup> Moreover, SPP represents that its Tariff contains procedures to allow for disclosure to the Commission, FERC and state regulatory agencies of confidential information it receives from a market participant.<sup>264</sup> SPP states that notice of such request is not provided to the market participant when the Commission, FERC or their respective staffs are the party requesting the confidential information.<sup>265</sup>

Based on the foregoing and SPP's representations, it appears that these

practices are congruent with, and sufficiently accomplish, the regulatory objectives of Core Principle M in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### 14. DCO Core Principle N: Antitrust

DCO Core Principle N requires a DCO to avoid, unless necessary or appropriate to achieve the purposes of the CEA, adopting any rule or taking any action that results in any unreasonable restraint of trade, or imposing any material anticompetitive burden.<sup>266</sup>

As discussed above, the formation of SPP and other RTOs and ISOs was encouraged by FERC (pursuant to FERC Orders 888 and 2000) in order to foster greater competition in the electric energy generation sectors by allowing open access to transmission lines.<sup>267</sup> In addition, SPP represents that its rules and actions are subject to continued oversight by FERC and the SPP Market Monitor.<sup>268</sup> Such oversight could detect activities such as undue concentrations or market power, discriminatory treatment of market participants or other anticompetitive behavior.<sup>269</sup>

Based on SPP's representations, it appears that SPP's existence and practices are congruent with, and sufficiently accomplish, the regulatory objectives of Core Principle N. The Commission seeks comment with respect to this preliminary conclusion.

### 15. DCO Core Principle O: Governance and Fitness Standards

DCO Core Principle O requires a DCO to establish governance arrangements that are transparent to fulfill public interest requirements and to permit the consideration of the views of owners and participants.<sup>270</sup> A DCO must also establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the DCO, any other individual or entity with direct access to the settlement or clearing activities of the DCO, and any party affiliated with any of the foregoing individuals or entities.<sup>271</sup>

SPP represents that its Tariff, governing documents, and applicable state law set forth specific governance standards that are consistent with the regulatory goals which address, for example, director independence and

fitness requirements.<sup>272</sup> In addition, SPP asserts that FERC Orders 719 and 2000 set out certain minimum governance structures for RTOs. SPP states that Order 719 requires sets forth minimum standards for RTO governance regarding responsiveness to stakeholders. Specifically, Order 719 directed RTOs to adopt means for direct access to their boards of directors for customers and stakeholders and established obligations for RTOs to increase responsiveness to customers and stakeholders using four responsiveness criteria: (1) Inclusiveness; (2) fairness in balancing diverse interests; (3) representation of minority positions; and (4) ongoing responsiveness.<sup>273</sup> SPP asserts that FERC Order 2000 likewise identified minimum characteristics that RTOs must exhibit, including, independence from all market participants.<sup>274</sup>

Based on SPP's representations, it appears that SPP's governance structure is congruent with, and sufficiently accomplishes, the regulatory objectives of DCO Core Principle O in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### 16. DCO Core Principle P: Conflicts of Interest

Pursuant to DCO Core Principle P, each DCO must establish and enforce rules to minimize conflicts of interest in the decision-making process of the DCO.<sup>275</sup> In addition, each DCO must establish a process for resolving conflicts of interest.<sup>276</sup>

SPP represents that it has adopted stringent conflict of interest requirements as well as a process for resolving such conflicts in its Standards of Conduct for members of its board of

<sup>272</sup> See Exemption Application Attachments at 57–61.

<sup>273</sup> See FERC Order 719. SPP represents that FERC has determined that SPP has met the governance criteria for stakeholder responsiveness set forth in FERC Order 719. See Exemption Application Attachments at 58.

<sup>274</sup> See Exemption Application Attachments at 57 (citing to FERC Order 2000). SPP represents that all SPP Officers and employees are required to execute a statement certifying they have read the SPP Standards of Conduct (which outline the independence requirements for all SPP employees) upon employment and annually thereafter, and to complete an annual review of the Standards of Conduct and certification thereof. The Standards of Conduct govern and limit employee conduct regarding: (1) Involvement in marketing of electric energy; (2) handling and disclosure of confidential information and transmission system information; (3) access to facilities; (4) implementation of the SPP Tariff; (5) recordkeeping; (6) investments; (7) relationships with other parties; (8) reporting of violations of the Standards of Conduct; and (9) conflicts of interest. *Id.* at 61.

<sup>275</sup> 7 U.S.C. 7a–1(c)(2)(P)(i).

<sup>276</sup> 7 U.S.C. 7a–1(c)(2)(P)(ii).

<sup>259</sup> See Exemption Application Attachments at 49–50.

<sup>260</sup> 7 U.S.C. 7a–1(c)(2)(M).

<sup>261</sup> See generally, Exemption Application Attachments at 52–55; see also DCO Core Principle J discussion *supra*.

<sup>262</sup> See *id.* at 52.

<sup>263</sup> See *id.* at 53.

<sup>264</sup> See Exemption Application Attachments at 54.

<sup>265</sup> *Id.*

<sup>266</sup> 7 U.S.C. 7a–1(c)(2)(N).

<sup>267</sup> See FERC Order 888; FERC Order 2000.

<sup>268</sup> See Exemption Application Attachments at 56.

<sup>269</sup> See *id.*

<sup>270</sup> 7 U.S.C. 7a–1(c)(2)(O)(i).

<sup>271</sup> 7 U.S.C. 7a–1(c)(2)(O)(ii).

directors and its employees (including officers).<sup>277</sup> The Standards of Conduct for board members and employees require such individuals to, among other things, avoid activities that are contrary to the interests of SPP.<sup>278</sup> SPP further represents that members of the SPP Board of Directors are also subject to conflict of interest and independence standards set forth in the SPP Bylaws.<sup>279</sup>

In addition to the Standards of Conduct, SPP asserts that the SPP Market Monitor and all of its employees must comply with additional independence and ethics standards set forth in the SPP Tariff, including prohibiting: (a) Material affiliation with any market participant or any affiliate of a market participant; (b) serving as an officer, employee, or partner of a market participant; (c) material financial interest in any market participant or any affiliate of a market participant (allowing for such potential exceptions as mutual funds and non-directed investments); (d) engaging in any market transactions other than the performance of their duties under the Tariff; (e) receiving compensation, other than by SPP, for any expert witness testimony or other commercial services to SPP or to any other party in connection with any legal or regulatory proceeding or commercial transaction relating to SPP; and (f) acceptance of anything of value from a market participant in excess of a *de minimis* amount.<sup>280</sup>

Based upon SPP's representations, it appears that the conflict of interest policies SPP has adopted and that the requirements SPP is subject to are congruent with, and sufficiently accomplish, the regulatory objectives of DCO Core Principle P in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 17. DCO Core Principle Q: Composition of Governing Boards

DCO Core Principle Q provides that each DCO shall ensure that the composition of the governing board or committee of the derivatives clearing organization includes market participants.<sup>281</sup>

FERC regulations require that an RTO "must have a decision making process that is independent of control by any market participant or class of participants."<sup>282</sup> However, FERC also requires that each RTO "adopt business practices and procedures that achieve Commission-approved independent system operator and regional transmission organization board of directors' responsiveness to customers and other stakeholders and satisfy [specified] criteria."<sup>283</sup> SPP represents that its Bylaws require members of its board of directors to be independent of any member, and that board members may not be a director, officer, or employee of, or have a direct business relationship or affiliation with or a financial interest in a member or customer of services provided by SPP.<sup>284</sup> SPP further represents that the composition of its board of directors is influenced by SPP's members through the nomination and election process.<sup>285</sup> In addition, SPP asserts that its members and market participants have ample opportunity to express their viewpoints to the board of directors through member committees, market participant committees, taskforces, and working groups.<sup>286</sup>

Based on SPP's representations, and the regulations and supervision of FERC, it appears that these practices are congruent with, and sufficiently accomplish, the regulatory objectives of DCO Core Principle Q in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 18. DCO Core Principle R: Legal Risk

DCO Core Principle R requires a DCO to have a well-founded, transparent, and enforceable legal framework for each aspect of its activities.<sup>287</sup>

SPP asserts that it operates under a transparent and comprehensive legal framework that is grounded in the Federal Power Act and administered by FERC.<sup>288</sup> Indeed, SPP asserts that it is subject to FERC orders rules and regulations and that SPP operates pursuant to a Tariff that has been

reviewed and approved by FERC.<sup>289</sup> SPP further asserts that its Tariff states that SPP is the counterparty to the Covered Transactions.<sup>290</sup> Moreover, with respect to eligibility for setoff in bankruptcy, SPP has submitted a separate legal memorandum of outside counsel that SPP's counterparty arrangements will provide SPP with enforceable rights of set off against a market participant in the event of the market participant's bankruptcy.<sup>291</sup>

Based on SPP's representations, it appears that this framework is congruent with, and sufficiently accomplishes, the regulatory objectives of Core Principle R in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### E. SEF Core Principle Analysis

##### 1. SEF Core Principle 1: Compliance With Core Principles

SEF Core Principle 1 requires a SEF to comply with the Core Principles described in part 37 of the Commission's Regulations.<sup>292</sup> SPP represents that, although that there are differences between it and registered SEFs and it is principally regulated by FERC, SPP's practices are consistent with the SEF core principles.<sup>293</sup> In addition, SPP represents that, though its methods are different than those employed by a registered SEF, its practices and the comprehensive regulatory regime of FERC achieve the goals of, and are consistent with, the policies of the Act.<sup>294</sup>

As demonstrated by the following analysis, based upon SPP's representations and the Core Principle discussions below, and in the context of SPP's activities with respect to the Covered Transactions within the scope of this Proposed Exemption, the Commission has made a preliminary determination that in the context of SPP's activities with respect to the Covered Transactions within the scope of this Proposed Exemption, SPP's practices appear congruent with, and to accomplish sufficiently, the regulatory objectives of each SEF Core Principle. The Commission requests comment with respect to this preliminary determination.

<sup>277</sup> See Exemption Application Attachments at 62–64; see, e.g., sections 9.3–9.5 of Attachment to the October 2014 Supplemental Letter.

<sup>278</sup> See Exemption Application Attachments at 62–64.

<sup>279</sup> See *id.* at 62; October 2014 Supplemental Letter at 4.

<sup>280</sup> See Exemption Application Attachments at 63–64.

<sup>281</sup> 7 U.S.C. 7a–1(c)(2)(Q).

<sup>282</sup> See 18 CFR 35.34(j)(1)(ii).

<sup>283</sup> See 18 CFR 35.28(g)(6).

<sup>284</sup> See Exemption Application Attachments at 65. SPP also notes that except for the President of SPP, no other board member may be an employee of SPP.

<sup>285</sup> See *id.* SPP states that its Corporate Governance Committee, which includes member representatives, nominates candidates for board positions.

<sup>286</sup> See *id.*

<sup>287</sup> 7 U.S.C. 7a–1(c)(2)(R).

<sup>288</sup> See Exemption Application Attachments at 68.

<sup>289</sup> See *id.*

<sup>290</sup> See *id.*

<sup>291</sup> See *id.*; see discussion *supra* section V.D.4.g.

<sup>292</sup> 7 U.S.C. 7b–3(f)(1).

<sup>293</sup> See Exemption Application Attachments at 70–71.

<sup>294</sup> *Id.*

## 2. SEF Core Principle 2: Compliance With Rules

SEF Core Principle 2 requires a SEF to establish and enforce compliance with any rule of the SEF.<sup>295</sup> A SEF is also required to (1) establish and enforce rules with respect to trading, trade processing, and participation that will deter market abuses and (2) have the capacity to detect, investigate and enforce those rules, including a means to (i) provide market participants with impartial access to the market, and (ii) capture information that may be used in establishing whether rule violations have occurred.<sup>296</sup>

According to SPP, each of the Covered Transactions takes place on markets that are monitored by both SPP and the SPP Market Monitor (its independent market monitor responsible to FERC). In addition, SPP states that an RTO must demonstrate to FERC that it performs certain self-regulatory and/or market monitoring functions.<sup>297</sup>

SPP asserts that FERC Order Nos. 719 and 2000 require RTOs to employ a Market Monitor to monitor the conduct of both the RTO and its market participants with regard to all RTO markets and services, stating that the SPP Market Monitor is an independent department within SPP that reports directly to the SPP Board of Directors, except that the President of SPP (a member of the Board of Directors) is excluded from participating in oversight of the Market Monitor. Moreover, according to SPP, it is obligated to ensure that the Market Monitor is appropriately staffed and provided with sufficient resources and access to data to carry out its duties under the Tariff.<sup>298</sup>

SPP represents that it has transparent rules for its market, including rules to deter abuses, market monitoring and mitigation plans aimed at discovering and addressing potential and actual abuses, and has enforcement mechanisms that allow SPP and the SPP

Market Monitor to, among other things, monitor its markets, investigate suspected Tariff violations, take actions against violators and refer potential violations to FERC.<sup>299</sup>

Based on the foregoing, it appears that SPP's practices are consistent with, and sufficiently accomplish, the regulatory goals of SEF Core Principle 2 in the context of SPP's activities with respect to the Covered Transactions. The Commission requests comment with respect to this preliminary determination.

## 3. SEF Core Principle 3: Swaps Not Readily Susceptible to Manipulation

SEF Core Principle 3 requires a SEF submitting a contract to the Commission for certification or approval to demonstrate that the swap is not readily susceptible to manipulation.<sup>300</sup> SPP represents that it has detailed rules in its Tariff and IM Protocols to deter, detect, and prevent market manipulation in the SPP markets, and a staffed and resourced Market Monitor to implement the rules.<sup>301</sup> SPP also makes specific representations regarding its cash-settled energy transactions, transmission congestion rights and capacity and reserve transactions to demonstrate that they are consistent with the Commission's focus in the RTO-ISO Order.<sup>302</sup> SPP also indicated that the Covered Transactions for which SPP is seeking an exemption under Section 4(c) of the CEA include the three categories of transactions mentioned above, as well as any product or any modifications that are offered in the future pursuant to the FERC-approved Tariff that do not alter the characteristics of the transactions in a way that would cause them to fall outside of the definitions in the RTO-ISO Order.<sup>303</sup>

### a. Cash-Settled Energy Transactions

SPP defines Energy Transactions as transactions in the SPP Day-Ahead-Market or Real-Time Balancing Market for the purchase or sale of a specified quantity of electric energy at a specified location (including virtual bids and offers) where among other conditions, 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 electric energy transmission system

operated by SPP for that period of time.<sup>304</sup> SPP further indicates that the purpose of the virtual transactions in the Day-Ahead-Market is to promote convergence between the Day-Ahead-Market and Real-Time Balancing Market prices, which reduces price volatility normally found in electric markets.<sup>305</sup>

SPP indicates that its representations to the Commission are similar to that of other RTOs and ISOs to which the RTO-ISO Order was issued with respect to SEF Core Principle 3.<sup>306</sup> The Commission understands that the SPP Market Monitor operated by SPP has been organized in such a way that both the Real-Time Balancing and Day-Ahead markets are monitored to identify suspicious trading activity and that the SPP Market Monitor notifies FERC of suspicious activity, including transactions that involve repeated losses.<sup>307</sup> Furthermore, SPP represents that they are obligated to ensure that the SPP Market Monitor is appropriately staffed and provided with sufficient resources and access to data to carry out its duties under its Tariff.<sup>308</sup>

Based on SPP's representations regarding the surveillance carried out by its SPP Market Monitor and the method by which the Day-Ahead and Real-Time Balancing auctions are conducted, it appears that SPP's policies and procedures to mitigate the susceptibility of Energy Transactions to manipulation are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 3 in the context of SPP's activities with respect to the Energy Transactions. The Commission seeks comment with respect to this preliminary conclusion.

### b. Transmission Congestion Rights

SPP represents that a Transmission Congestion Right ("TCR") is a transaction that entitles one party to receive, and obligates another party to pay, an amount based solely on the difference the price of electric energy, established on an electric energy market administered by SPP, at a specified source and a specified sink.<sup>309</sup> Based

<sup>295</sup> 7 U.S.C. 7b-3(f)(2).

<sup>296</sup> SEF Core Principle 2 also requires a SEF to establish rules governing the operation of the facility, including trading procedures, and provide rules that, when a swap is subject to the mandatory clearing requirement, hold swap dealers and major swap participants responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act.

<sup>297</sup> According to SPP, it is required to satisfy four minimum characteristics as a FERC-approved RTO: (1) Independence from any market participant; (2) a scope and regional configuration which enables the RTO or ISO to maintain reliability and effectively perform its required functions; (3) operational authority for its activities, including being the security coordinator for the facilities that it controls; and (4) short-term reliability, as well as other requirements FERC imposes on RTOs. Exemption Application at 18.

<sup>298</sup> Exemption Application Attachments at 73-74.

<sup>299</sup> See Exemption Application at 17; see also Exemption Application Attachments at 72-76.

<sup>300</sup> 7 U.S.C. 7b-3(f)(3).

<sup>301</sup> See Exemption Application Attachments at 77-79.

<sup>302</sup> See Exemption Application Attachments at 79-81.

<sup>303</sup> See Exemption Application at 11.

<sup>304</sup> See Exemption Application at 13-14. SPP represents that its definition is similar to the definition for energy transactions used by the Commission in the RTO-ISO Order (see RTO-ISO Order at 19913, Order section VI.5.b(1), (2) and (3), which, according to SPP, contain the same provisions as SPP's definition).

<sup>305</sup> See Exemption Application Attachments at 79.

<sup>306</sup> Exemption Application Attachments at 80.

<sup>307</sup> *Id.*

<sup>308</sup> *Id.* at 78, 83.

<sup>309</sup> As noted above, TCRs are SPP's equivalent transaction to what was referred in the RTO-ISO Order as "Financial Transmission Rights" or "FTRs." See Exemption Application at 1 n. 3; see

upon SPP's representations, the Commission understands TCRs to be cash-settled contracts that entitle the holder to a payment equal to the difference in the price of electric energy between the specified source and the specified sink. The difference in price between the two then represents the settlement price. The price at each node (source or sink) is established through auctions conducted on the Day-Ahead market of SPP. The Commission notes that in the RTO-ISO Order, it made a preliminary determination that the Real-Time Balancing and Day-Ahead markets, which set energy transaction prices on SPP's platform, appears to be consistent with SEF Core Principle 3. The Commission seeks comment regarding whether this preliminary conclusion is correct.

As previously discussed, SPP and the SPP Market Monitor conduct market surveillance of both the Real-Time Balancing and Day-Ahead markets to identify manipulation of the price of electric energy. In the event unusual trading activity is detected by the SPP Market Monitor, the SPP Market Monitor will immediately contact FERC's Office of Enforcement, so that an investigation into the unusual activity may begin.<sup>310</sup> Although the price of TCRs may be altered by the manipulation of the Real-Time Balancing or Day-Ahead markets, FERC requires that the Applicant have systems to monitor for such activity.

The Commission believes that SPP's policies and procedures should mitigate the susceptibility of TCRs to manipulation and that they are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 3 in the context of SPP's activities with respect to TCRs. The Commission seeks comment with respect to this preliminary conclusion.

#### c. Reserve Transactions Market

SPP has proposed a Reserve Transactions Market.<sup>311</sup> Reserve Transactions are entered into pursuant to auctions carried out by SPP.<sup>312</sup> However, unlike the auctions for the Real-Time Balancing and Day-Ahead markets, the auctions for reserve transactions simply allow SPP to accept bids submitted by market participants that have the ability to inject electric

energy into SPP's electric energy transmission system.<sup>313</sup>

The Commission notes that SPP would apply the same oversight policies and procedures to Reserve Transactions that it applies to Energy Transactions and FTRs. The Commission believes that these measures appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of SEF Core Principle 3 in the context of SPP's activities with respect to Reserve Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 4. SEF Core Principle 4: Monitoring of Trading and Trade Processing

SEF Core Principle 4 requires a SEF to establish and enforce rules or terms and conditions defining trading procedures to be used in entering and executing orders traded on or through the SEF and procedures for the processing of swaps on or through the SEF.<sup>314</sup> SEFs are also required to establish a system to monitor trading in swaps to prevent manipulation, price distortion and disruptions of the delivery or cash settlement process through surveillance, compliance and disciplinary practices and procedures. The main goal of this Core Principle is to monitor trading activity to detect or deter market participants from manipulating the price or deliverable supply of a commodity.

##### a. Energy Transactions

Generally, SPP's Tariff lists how Energy Transactions are to be entered into the trading platform.<sup>315</sup> Using these procedures, the SPP Market Monitor is able to track the Energy Transactions submitted by market participants and identify trading activity that could be manipulative. As a result, SPP's policies and procedures regarding monitoring of trading and trade processing appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of SEF Core Principle 4 in the context of SPP's activities with respect to Energy Transactions. The Commission seeks comment with respect to this preliminary conclusion.

##### b. TCRs<sup>316</sup>

The process by which the TCR allocation and auction takes place provides SPP with a basic system that

allows SPP to determine which market participants hold TCRs. According to SPP's Tariff, and similar to other RTOs, SPP offers ARR to eligible transmission customers to address their exposure to transmission congestion costs, which is based on their transmission service or network load, with SPP performing a simultaneous feasibility analysis to ensure that ARR awards do not exceed physical system capability. SPP then conducts auctions for TCRs, and also oversees a secondary TCR market. SPP systems track ownership of ARRs and TCRs, including transfers of TCR ownership in the secondary market and SPP verification that secondary TCR owners qualify under SPP's TCR creditworthiness requirements. SPP applies to this market the market monitoring and mitigation plans that SPP has developed for all markets and services under the SPP Tariff.<sup>317</sup>

Based on the foregoing representations, it appears that SPP's policies and procedures regarding the monitoring of trading and trade processing are consistent with, and to accomplish sufficiently, the regulatory objectives of SEF Core Principle 4 in the context of SPP's activities with respect to TCRs. The Commission seeks comment with respect to this preliminary conclusion.

##### c. Reserve Transactions

As discussed above, the auction process used for Reserve Transactions differs from the process used in the Real-Time Balancing and Day-Ahead markets.<sup>318</sup> Furthermore, Reserve Transactions are not used to limit exposure to price volatility, discover prices or engage in arbitrage. The transactions are predominantly bilateral agreements between SPP and certain of SPP's market participants for the provision of electric energy in order to meet the technical requirements necessary to operate the electric transmission system. The contracts are not readily susceptible to manipulation and there is no market trading that must be monitored to prevent manipulation or congestion of the physical delivery market. As a result, SPP's policies and procedures regarding the monitoring of trading and trade processing appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of SEF Core Principle 4 in the context of SPP's activities with respect to Capacity and Reserve Transactions. The

also, Exemption Application at 12 n. 54 and accompanying text.

<sup>310</sup> See Exemption Application Attachments at 81.

<sup>311</sup> The Commission notes that while the RTO-ISO Order also addressed Forward Capacity Transactions Market, SPP's Exemption Application does not propose such transactions.

<sup>312</sup> See Exemption Application at 14–15.

<sup>313</sup> See *id.*

<sup>314</sup> 7 U.S.C. 7b–3(f)(4).

<sup>315</sup> See generally, Exemption Application Attachments at 82–86.

<sup>316</sup> As noted above, the RTO-ISO Order used the term FTRs. See Exemption Application at 12 n. 54 (noting that TCR is SPP's equivalent of FTR in the RTO-ISO Order).

<sup>317</sup> See generally, Exemption Application Attachments at 82–86.

<sup>318</sup> The Commission notes that SPP does not propose a Forward Capacity Market.

Commission seeks comment with respect to this preliminary conclusion.

#### 5. SEF Core Principle 5: Ability To Obtain Information

SEF Core Principle 5 requires a SEF to establish and enforce rules that will allow it to obtain any necessary information to perform the functions described in section 733 of the Dodd-Frank Act, provide information to the Commission upon request, and have the capacity to carry-out such international information-sharing agreements as the Commission may require.<sup>319</sup> As discussed above,<sup>320</sup> SPP represents that it has rules in place that require market participants to submit information to SPP upon request so that SPP may conduct investigations and provide or give access to such information to the SPP Market Monitor and FERC.<sup>321</sup> On the basis of these representations, it appears that SPP's practices are consistent with, and sufficiently accomplish, the regulatory goals of SEF Core Principle 5. The Commission seeks comment with respect to this preliminary determination.

#### 6. SEF Core Principle 6: Position Limits or Accountability

SEF Core Principle 6 requires SEFs that are trading facilities, as that term is defined in CEA section 1a(51), to establish position limits or position accountability for speculators, as is necessary and appropriate, for each swap traded on the SEF in order to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month.<sup>322</sup> While the markets administered by SPP are subject to the SPP Market Monitor (as discussed above in section IV.C.), SPP does not have position limits or position accountability thresholds for speculators in order to reduce the potential threat of market manipulation or congestion.

The Commission notes that in the RTO-ISO Order, it did not impose position limits on the transactions covered by the Order. Instead, without making any determinations regarding the merits of the concerns regarding position limits raised in comments responding to that proposal, the Commission stated that it accepted the

Requesting Parties' representations that the physical capability of their transmission grids limits the size of positions that any single market participant can take at a given time.<sup>323</sup> Furthermore, the Commission stated that as the RTO-ISO Order limited each transaction category it covered to the physical capability of the transmission grid, the Commission stated its belief that imposing position limits on the transactions covered by that Order was not necessary at that time in order to make the requisite public interest and purposes of the CEA determinations.<sup>324</sup>

According to SPP's Exemption Application, each category of transactions for which SPP is requesting relief would be limited by the physical capability of the transmission grid and that the physical capability of its transmission grid limits the size of positions that any single market participant can take at a given time.<sup>325</sup> On the basis of SPP's representations, and consistent with the RTO-ISO Order, the Commission is preliminarily determining that it is not necessary, when considering the requisite public interest and purposes of the CEA determinations, to impose position limits on SPP's Integrated Marketplace. The Commission seeks comment with respect to this preliminary determination.

#### 7. SEF Core Principle 7: Financial Integrity of Transactions

SEF Core Principle 7 requires a SEF to establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the SEF, including the clearance and settlement of swaps pursuant to section 2(h)(1) of the CEA.

##### a. Risk Management Requirements and Credit Policies

SPP represents that its risk management provisions provide it with appropriate tools and procedures to manage risk associated with operating its wholesale and related markets.<sup>326</sup> According to SPP, the credit policy contained in its Tariff includes, in compliance with FERC's Order No. 741, minimum capitalization requirements and an attestation of a market participant's risk management capabilities.<sup>327</sup> The attestation requires that the market participant describe its risk management capabilities and

procedures and whether it is engaged in hedging, describe the employees who perform the risk management procedures, define the special training, skills, experience, and industry tenure of those employees, and provide any additional information in determining the risk management capabilities of the market participant. Market participants also are required to notify SPP of material adverse changes in their financial conditions.<sup>328</sup>

SPP represents that its credit policy provides the process by which SPP will periodically review and verify a market participant's risk management policies, practices, and procedures pertaining to its activities in SPP, as well as procedures for SPP to complete credit assessments. Successful completion of SPP's verification is required for a selected market participant's continued eligibility to participate in the SPP markets.<sup>329</sup>

##### b. Minimum Financial Standards and Ongoing Monitoring for Compliance

In addition, based on SPP's representations, it appears that SPP's policies and procedures include minimum financial standards and creditworthiness standards for their market participants.<sup>330</sup> Moreover, SPP represents that its policies and procedures, require SPP to monitor, on an ongoing basis, their market participants for compliance with such standards.<sup>331</sup>

##### c. Establishment of a Central Counterparty

As discussed in section V.C. above, FERC regulation 35.47(d) requires RTOs

<sup>319</sup> *Id.*

<sup>320</sup> See Exemption Application Attachments at 95.

<sup>321</sup> See, e.g., Exemption Application Attachments at 10–14, 96–100. SPP requires market participants to demonstrate and maintain the certain minimum financial requirements. The Commission notes that SPP has represented that it has market participants that may not meet the definition of eligible contract participant as defined by the CEA, but are “appropriate persons” for purposes of the 4(c) exemption. See Exemption Application Attachments at 11–12, 16–17, 60, 95. The Commission proposes to condition the granting of the 4(c) request on all parties to the agreement, contract or transaction being (1) “appropriate persons,” as defined sections 4(c)(3)(A) through (J) of the Act; (2) “eligible contract participants” as defined in section 1a(18)(A) of the Act and in Commission regulation 1.3(m); or (3) a person who actively participates in the generation, transmission, or distribution of electric energy,” as defined in paragraph 5(h) of the Proposed Exemption. See provision 2.b. of the Proposed Exemption.

<sup>322</sup> See, e.g., Exemption Application Attachments at 12–14, 16–20, 24–25, 96–97, 99–100. For example, according to SPP, it completes credit assessments annually and has access to and reviews multiple rating agency and industry advisories on market participant activities. *Id.* at 95.

<sup>323</sup> RTO-ISO Order at 19902.

<sup>324</sup> *Id.*

<sup>325</sup> See Exemption Application at 12–15, 17; Exemption Application Attachments at 90–93.

<sup>326</sup> See Exemption Application at 17–20; Exemption Application Attachments at 94–100.

<sup>327</sup> See Exemption Application Attachments at 94.

<sup>319</sup> 7 U.S.C. 7b–3(f)(5).

<sup>320</sup> See generally, discussions *supra* in sections V.D.10. and V.D.13.

<sup>321</sup> See generally, Exemption Application Attachments at 87–89.

<sup>322</sup> Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant’ and ‘Eligible Contract Participant,’ 77 FR 30596, May 23, 2012.

and ISOs to (1) establish a single counterparty to all market participant transactions, (2) require each market participant to grant a security interest in the receivables of its transactions to the relevant RTO or ISO, or (3) provide another method of supporting netting that provides a similar level of protection to the market that is approved by FERC.<sup>332</sup>

According to SPP, in compliance with FERC Order No. 741's requirement to establish the ability to net and offset market obligations in bankruptcy, SPP is the counterparty to certain market transactions that are pooled within the Integrated Marketplace.<sup>333</sup> SPP also is the counterparty with each market participant for that market participant's Integrated Marketplace agreements and transactions in the TCR Market, Day-Ahead Market, and Real-Time Balancing Market, with specified exclusions regarding bilateral transactions between market participants, and self-committed, self-scheduled, and self-supplied arrangements.<sup>334</sup> SPP also is the counterparty to TCR and ARR instruments held by market participants.

As noted in section V.D.4.g. above, SPP submitted a legal memorandum from outside counsel that states that SPP's counterparty arrangements will provide SPP with enforceable rights of set-off in the event of the market participant's bankruptcy.

#### d. Conclusion

Issues regarding risk management requirements, financial standards, and the use of a central counterparty are also addressed within the context of DCO Core Principle D. The Commission's preliminary conclusion that SPP's policies and procedures are congruent with, and sufficiently accomplish, the regulatory objectives of Core Principle D in the context of SPP's activities with respect to the Covered Transactions is relevant in considering SEF Core Principle 7.

Based on the foregoing analysis, including the representations and submissions of SPP, SPP's policies and

procedures appear to be consistent with, and to accomplish sufficiently, the regulatory objectives of SEF Core Principle 7 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 8. SEF Core Principle 8: Emergency Authority

SEF Core Principle 8 requires that SEFs adopt rules to provide for the exercise of emergency authority.<sup>335</sup> The SEF should have procedures and guidelines for decision-making and implementation of emergency intervention in the market. The SEF should have the authority to perform various actions, including without limitation: Liquidating or transferring open positions in the market, suspending or curtailing trading in any swap, and taking such market actions as the Commission may direct. In addition, SEFs must provide prompt notification and explanation to the Commission of the exercise of emergency authority.<sup>336</sup>

SPP represents that its Tariff generally provides a wide range of authorities to address emergency situations, and that its emergency authority provisions are similar to those of the RTOs/ISOs covered by the RTO-ISO Order.<sup>337</sup> According to SPP, its Tariff and applicable law includes provisions to address a market participant's default on its obligations, including the ability, in the event of default, to suspend any unsecured credit allowances, terminate the market participant's rights under the SPP credit policy, terminate service, liquidate a market participant's TCR positions in the Integrated Marketplace, as well as the authority to suspend or curtail trading in its markets.<sup>338</sup>

Just as the SEF's have rules in place that require them to take emergency actions to protect the markets by "including imposing or modifying position limits, imposing or modifying

price limits, imposing or modifying intraday market restrictions, imposing special margin requirements, ordering the liquidation or transfer of open positions in any contract, ordering the fixing of a settlement price," SPP represents that it may take actions to protect its markets. SPP states that if the SPP Market Monitor discovers any weaknesses or failures in market design that requires immediate corrective action, the SPP Market Monitor may request that the president of SPP authorize an immediate FERC filing to implement a corrective action while the appropriate SPP organizational group considers a solution, and that SPP has additional Tariff provisions to govern the calculation of market prices in the event of a failure of either the Day-Ahead Market or Real-Time Balancing Market systems, as well as calculation of prices in the event that a portion of the SPP system becomes isolated from the remainder of the market.<sup>339</sup>

Based on the foregoing representations, it appears that SPP's policies and procedures regarding the exercise of emergency authority are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 8 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 9. SEF Core Principle 9: Timely Publication of Trading Information

SEF Core Principle 9 requires a SEF to make public timely information on price, trading volume, and other data on swaps to the extent prescribed by the Commission.<sup>340</sup> In addition, SEFs are required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the SEF.<sup>341</sup>

SPP represents that its Tariff requires the timely publication of trading information, and SPP is subject to FERC's Open Access Same-Time Information System ("OASIS") regulations and publishes market operation and grid management data on the SPP OASIS.<sup>342</sup> SPP also asserts that it is able to publicly release market operations and grid management information using their OASIS program.<sup>343</sup> This system transmits information which includes market

<sup>335</sup> 7 U.S.C. 7b-3(f)(8).

<sup>336</sup> Final Rulemaking—Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476, 33536, June 4, 2013.

<sup>337</sup> See Exemption Application Attachments at 101–103.

<sup>338</sup> *Id.* SPP notes that its Tariff also provides for SPP's response to transmission system emergency conditions related to the physical operation of the system. See also system safeguards discussion *infra* section V.E.14. In addition, SPP notes that it is revenue neutral with respect to all market transactions and services that SPP provides, and that shortfalls resulting from a failure of one or more market participants to pay market service invoices are socialized among the market participants receiving revenues for the market services associated with the unpaid obligations. For discussion of financial integrity of transactions, see section V.E.7 for SEF Core Principle 7, Financial Integrity of Transactions discussion.

<sup>332</sup> 18 CFR 35.47(d).

<sup>333</sup> SPP represents that it has become a central counterparty and that its Tariff indicates that SPP will be the counterparty to certain market transactions that are pooled in SPP's market. See Exemption Application Attachments at 95 n. 450; see generally, Exemption Application at 19–21, Exemption Application Attachments at 94–100, and FERC Order 741 Implementation Chart at 4.

<sup>334</sup> See Exemption Application Attachments at 96 n. 453 and accompanying text. SPP represents that it is not the counterparty to agreements and transactions for transmission service and certain ancillary services, which are not agreements and transactions in the Integrated Marketplace. *Id.*

<sup>339</sup> Exemption Application Attachments at 103.

<sup>340</sup> 7 U.S.C. 7b-3(f)(9)(A).

<sup>341</sup> 7 U.S.C. 7b-3(f)(9)(B).

<sup>342</sup> See Exemption Application Attachments at 104–106. See, e.g., *id.* at 104, n. 492; see also *id.* at 106.

<sup>343</sup> See *id.* at 104.

results, the market clearing price and volume.<sup>344</sup>

Based on the foregoing representations, it appears that SPP's policies and procedures regarding the publication of trading information are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 9 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 10. SEF Core Principle 10: Recordkeeping and Reporting

SEF Core Principle 10 requires a SEF to maintain records of all activity relating to the business of the SEF, report such information to the Commission and to keep swaps information open to inspection by the Commission.<sup>345</sup> SPP represents that it has adopted data retention and disclosure policies and is required to comply with FERC regulations regarding data retention and disclosure.<sup>346</sup> In addition, SPP represents that its Tariff requires its market participants to provide the SPP Market Monitor with certain information on a regular and *ad hoc* basis for use in its market monitoring activities.<sup>347</sup> SPP further represents that it is required to comply with FERC regulations regarding the maintenance of information by public utilities.<sup>348</sup>

Based on SPP's representations and the discussion regarding DCO Core Principles J and K above,<sup>349</sup> it appears that these practices are congruent with, and sufficiently accomplish the regulatory objectives of SEF Core Principle 10 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 11. SEF Core Principle 11: Antitrust Considerations

SEF Core Principle 11 prevents a SEF from adopting any rule or taking any action that results in any unreasonable restraint of trade, or imposes any material anticompetitive burden, unless necessary or appropriate to achieve the

purposes of the Act.<sup>350</sup> As discussed above, FERC established the RTO/ISO system to promote competition in the electric energy market.<sup>351</sup> SPP represents that its rates and actions are subject to the oversight of FERC.<sup>352</sup> SPP further represents that FERC and the SPP Market Monitor review trading activity to identify anticompetitive behavior and market design flaws.<sup>353</sup>

Based on SPP's representations and the discussion of DCO Core Principle N above,<sup>354</sup> it appears that SPP's existence and practices are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 11 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment on this preliminary conclusion.

#### 12. SEF Core Principle 12: Conflicts of Interest

Core Principle 12 requires a SEF to establish and enforce rules to minimize conflicts of interest and establish a process for resolving conflicts of interest.<sup>355</sup> FERC Order 888 requires ISOs to adopt or enforce strict conflict of interest policies.<sup>356</sup> Similarly, FERC Order 2000 requires RTOs to be independent of any market participant, and to include in their demonstration of independence that the RTO, its employees, and any non-stakeholder directors do not have financial interests in any market participant.<sup>357</sup>

SPP represents that it meets the requirements of FERC's Order No. 2000. Moreover, it represents that it has developed extensive standards of conduct and conflict of interest provisions for members of the Board of Directors and employees (including officers).<sup>358</sup> SPP's Standards of Conduct

for board members and employees require such individuals to, among other things, avoid activities that are contrary to the interests of SPP.<sup>359</sup> In addition to the Standards of Conduct, SPP asserts that the SPP Market Monitor and all of its employees must comply with additional independence and ethics standards set forth in the SPP Tariff, including prohibiting: (a) Material affiliation with any market participant or any affiliate of a market participant; (b) serving as an officer, employee, or partner of a market participant; (c) material financial interest in any market participant or any affiliate of a market participant (allowing for such potential exceptions as mutual funds and non-directed investments); (d) engaging in any market transactions other than the performance of their duties under the Tariff; (e) receiving compensation, other than by SPP, for any expert witness testimony or other commercial services to SPP or to any other party in connection with any legal or regulatory proceeding or commercial transaction relating to SPP; and (f) acceptance of anything of value from a market participant in excess of a *de minimis* amount.<sup>360</sup>

Based on SPP's representations and the discussion of DCO Core Principle P above,<sup>361</sup> it appears that SPP's conflict of interest policies and the requirements SPP is subject to are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 12 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 13. SEF Core Principle 13: Financial Resources

SEF Core Principle 13 requires a SEF to have adequate financial, operational and managerial resources to discharge each responsibility of the SEF.<sup>362</sup> In addition, the financial resources of a SEF are considered to be adequate if the value of the financial resources exceeds the total amount that would enable the SEF to cover the operating costs of the SEF for a 1-year period, as calculated on a rolling basis.<sup>363</sup>

SPP represents that it has adopted provisions to ensure adequate financial, operational and managerial resources to

<sup>344</sup> See *id.*; see also October 2014 Supplemental Letter at 3.

<sup>345</sup> 7 U.S.C. 7b-3(f)(10).

<sup>346</sup> See generally, Exemption Application Attachments at 107-111; see also, October 2014 Supplemental Letter at 3.

<sup>347</sup> See generally, Exemption Application Attachments at 107 n. 503 and accompanying text; see also *id.* at 111.

<sup>348</sup> See, e.g., *id.* at 111.

<sup>349</sup> See discussions *supra* sections V.D.10. and V.D.11.

<sup>350</sup> 7 U.S.C. 7b-3(f)(11).

<sup>351</sup> See generally, discussion in section III.B, including consideration of FERC Orders 888 and 2000; see also Exemption Application Attachments at 112; see also discussion *supra* section V.D.14.

<sup>352</sup> See generally, Exemption Application Attachments at 112.

<sup>353</sup> *Id.*

<sup>354</sup> See also, discussion *supra* section V.D.14.

<sup>355</sup> 7 U.S.C. 7b-3(f)(12).

<sup>356</sup> See FERC Order 888 at 281.

<sup>357</sup> See FERC Order 2000 at 709; 18 CFR 35.34(j)(1).

<sup>358</sup> See Exemption Application Attachments at 113-115, and October 2014 Supplemental Letter at 4-5 (see, e.g., SPP representation that "[m]embers of the SPP Board of Directors are subject to Conflict of Interest and Independence standards set forth in the SPP Bylaws," and that "SPP Officers are required to execute the Standards of Conduct upon employment. SPP staff members are required to execute the Standards of Conduct upon employment and annually thereafter." In addition, SPP represents "SPP's discussion of DCO Core Principles O and P also supports SPP's discussion of SEF Core Principle 12." October 2014 Supplemental Letter at 4-5. See also discussion *supra* section V.D.16, DCO Core Principle P.

<sup>359</sup> Exemption Application Attachments at 113-115; October 2014 Supplemental Letter at 4-5.

<sup>360</sup> *Id.*

<sup>361</sup> *Id.* See also DCO Core Principle P discussion *supra* section V.D.16.

<sup>362</sup> 7 U.S.C. 7b-3(f)(13)(A).

<sup>363</sup> 7 U.S.C. 7b-3(f)(13)(B).

discharge its responsibilities.<sup>364</sup> For example, SPP states that it is revenue neutral with respect to all market transactions and services that it provides, that it has rules in place that allow it to collect revenue from market participants sufficient for each of their operations, that it imposes strict creditworthiness and collateral requirements on market participants to reduce the possibility of a market participant's default and mitigate the impact of such a default on SPP's ability to meet its obligations to other market participants, and has authority to terminate a market participant's ability to transact in the market in situations of default or bankruptcy.<sup>365</sup> SPP further represents to it has sufficient operational resources to fulfill its obligations, and has adequate managerial resources to operate its systems.<sup>366</sup> In addition, SPP states that FERC Orders 888 and 2000 provides RTOs with incentives and imposes requirements to promote effective management of RTOs.<sup>367</sup> SPP represents that it has sufficient staff necessary for its operations, and has sufficient human resources to fulfill its obligations to its members, market participants, and customers.<sup>368</sup>

Based on SPP's representations and the discussion regarding DCO Core Principle B above,<sup>369</sup> it appears that SPP's practices are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 13 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 14. SEF Core Principle 14: System Safeguards

SEF Core Principle 14 requires a SEF to establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that are reliable and secure, and have adequate scalable capacity.<sup>370</sup> Moreover, a SEF must establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of operations, and the fulfillment of the

responsibilities and obligations of the SEF.<sup>371</sup> The SEF must also conduct tests to verify that the backup resources of the SEF are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.<sup>372</sup>

SPP represents that it has developed and adopted system safeguard controls and procedures to identify and minimize operational risk, including back-up facilities, emergencies and disaster.<sup>373</sup> Indeed, SPP states that as a North American Electric Reliability Corporation registered entity, it is required to comply with mandatory electric reliability standards that include (among other things) protecting against risk to control centers, information systems and communications, thus, requires additional operational safeguards to specifically address that function.<sup>374</sup>

For example, SPP represents that in order to comply with these requirements, it has computer systems that incorporate adequate business continuity and disaster recovery functionality.<sup>375</sup> SPP has installed and maintains redundant communications and computer systems, has redundant primary and back-up control centers in separate secured locations, and has implemented on- and off-site data storage and back-up.<sup>376</sup> Furthermore, SPP states that it has emergency preparedness, business continuity and disaster recovery plans that are regularly reviewed and updated, and it conducts periodic emergency drills and mock disaster scenarios to ensure the readiness of backup facilities and personnel.<sup>377</sup> Multiple SPP business units, including SPP's Internal Audit Department, work to review, test, and update SPP's business continuity plans. In addition, SPP has a business continuity plan to provide for the calculation of market prices in the event of Day-Ahead Market or Real-Time Balancing Market system failures or isolation of portions of the SPP market from the rest of the market footprint. Separately, if the SPP Market Monitor discovers any weakness or failures in market design that requires immediate

corrective action, the Market Monitor may request authorization for an immediate FERC filing to implement a corrective action while a solution is being considered.<sup>378</sup>

Based on SPP's representations as well as the discussion regarding DCO Core Principle I above,<sup>379</sup> it appears that SPP's practices are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 14 in the context of SPP's activities with respect to the Covered Transactions. The Commission seeks comment with respect to this preliminary conclusion.

#### 15. SEF Core Principle 15: Designation of Chief Compliance Officer

SEF Core Principle 15 requires that a SEF designate an individual as Chief Compliance Officer, with specific delineated duties.<sup>380</sup> The Chief Compliance Officer for a SEF would be responsible for reporting to the board and ensuring that the SEF is in compliance with the SEF rules.

SPP represents that it has a Chief Compliance Officer, who is responsible for overseeing compliance, internal audit and market monitoring.<sup>381</sup> In addition, SPP's Board of Director's Oversight Committee is responsible for overseeing the process of monitoring compliance with SPP and NERC policies, including market monitoring and internal compliance with NERC Operating Standards, while its Finance Committee oversees SPP's compliance with financially-based legal and regulatory requirements.<sup>382</sup>

Based on SPP's representations, it appears that SPP's practices are congruent with, and sufficiently accomplish, the regulatory objectives of SEF Core Principle 15 in the context of SPP's activities with respect to the Covered Transactions. The Commission

<sup>378</sup> See *id.* at 122–123.

<sup>379</sup> See *id.* at 121–123; see also discussion *supra* section V.D.9.

<sup>380</sup> See 7 U.S.C. 7b–3(f)(15). This provision requires that the chief compliance officer (i) report directly to the board or to the senior officer of the facility; (ii) review compliance with the core principles in this subsection; (iii) in consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise; (iv) be responsible for establishing and administering the policies and procedures required to be established pursuant to this section; (v) ensure compliance with this Act and the rules and regulations issued under this Act, including rules prescribed by the Commission pursuant to this section; and (vi) establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

<sup>381</sup> See Exemption Application Attachments at 124–125. SPP also has a compliance department.

<sup>382</sup> See *id.*

<sup>364</sup> See Exemption Application Attachments at 116.

<sup>365</sup> *Id.* at 116–120.

<sup>366</sup> *Id.* at 118–119.

<sup>367</sup> *Id.* at 119.

<sup>368</sup> *Id.* at 118–120; see also DCO Core Principle B analysis *supra*.

<sup>369</sup> *Id.* at 116–120; see also DCO Core Principle B discussion *supra* section V.D.2.

<sup>370</sup> 7 U.S.C. 7b–3(f)(14)(A).

<sup>371</sup> 7 U.S.C. 7b–3(f)(14)(B).

<sup>372</sup> 7 U.S.C. 7b–3(f)(14)(C).

<sup>373</sup> See generally, Exemption Application Attachments at 41–43, 121–123.

<sup>374</sup> See Exemption Application Attachments at 121–123; see also, *supra* notes 239–245 and accompanying text.

<sup>375</sup> See Exemption Application Attachments at 41–43, 121–123.

<sup>376</sup> See *id.*

<sup>377</sup> See *id.* at 42, 122.

seeks comment with respect to this preliminary conclusion.

## VI. Proposed Exemption

### A. Discussion of Proposed Exemption

Pursuant to the authority provided by section 4(c)(6) of the CEA,<sup>383</sup> in accordance with CEA sections 4(c)(1) and (2), and consistent with the Commission's determination that the statutory requirements for granting an exemption pursuant to section 4(c)(6) of the Act have been satisfied, the Commission is proposing to issue the exemption described in the Proposed Exemption set forth below. The Proposed Exemption would exempt, subject to the limitations and conditions contained therein, contracts, agreements and transactions for the purchase and sale of certain electric energy-related products, including specifically-defined "transmission congestion rights," "energy transactions," and "operating reserve transactions," from most provisions of the CEA. The Commission is proposing to explicitly exclude from the exemption relief the Commission's general anti-fraud and anti-manipulation authority, and scienter-based prohibitions, under CEA sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4 and part 180.<sup>384</sup> The preservation of the Commission's anti-fraud and anti-manipulation authority provided by these provisions generally is consistent with both the scope of the exemption requested in the Exemption Application<sup>385</sup> and recent Commission practice.<sup>386</sup>

The particular categories of contracts, agreements and transactions to which the Proposed Exemption would apply correspond to the types of transactions for which relief was explicitly requested in the Exemption Application.<sup>387</sup> SPP requested relief for three specific types of transactions and the Proposed Exemption would exempt those transactions. With respect to those transactions, the Exemption Application also included the parenthetical "(including convergence or virtual bids and offers)."<sup>388</sup> The Commission notes that such transactions would be included within the scope of the exemption if they would qualify as the transmission congestion rights, energy transactions, or operating reserve transactions for which relief is explicitly provided within the exemption. SPP also has requested relief for "the purchase and sale of a product or service that is directly related to, and a logical outgrowth of, any of SPP's core functions as an RTO and all services related thereto."<sup>389</sup> The Commission has determined that it would be inappropriate, and, accordingly, has declined to propose that the exemption be extended beyond the scope of the transactions that are specifically defined in the Proposed Exemption. As noted above, the authority to issue an exemption from the CEA provided by section 4(c) of the Act may not be automatically or mechanically exercised. Rather, the Commission is required to affirmatively determine, *inter alia*, that the exemption would be consistent with the public interest and the purposes of the Act.<sup>390</sup> With respect to the three groups of transactions explicitly detailed in the Proposed Exemption, the Commission's proposed finding that the Proposed Exemption would be in the public interest and would be consistent with the purposes of the CEA was grounded, in part, on certain transaction characteristics and market circumstances described in the Exemption Application that may or may not be shared by other, as yet undefined, transactions engaged in by SPP or other RTO market participants.<sup>391</sup> Similarly, unidentified transactions might include novel features or have market implications or risks that are not present in the specified transactions. Such elements may impact the Commission's

required section CEA 4(c) public interest analysis or may warrant the attachment of additional or differing terms and conditions to any relief provided. Due to the potential for adverse consequences resulting from an exemption that includes transactions whose qualities and effect on the broader market cannot be fully appreciated absent further specification, it does not appear that the Commission can justify a conclusion that it would be in the public interest to provide an exemption of the full breadth requested. The Commission notes, however, that it has requested comment on whether the proposed scope of the exemption is sufficient to allow for innovation and, if not, how the scope could be expanded, without exempting products that may be substantially different from those reviewed by the Commission. The Commission also notes that it stands ready to review promptly any additional applications for an exemption pursuant to section 4(c)(6), in accordance with CEA sections 4(c)(1) and (2), of the CEA for other precisely defined products.

The scope of the Proposed Exemption is limited by two additional factors. First, it is restricted to agreements, contracts or transactions where all parties thereto are either: (1) Entities described in section 4(c)(3)(A) through (J) of the CEA;<sup>392</sup> (2) "eligible contract participants," as defined in section 1a(18) of the Act<sup>393</sup> or in Commission regulation 1.3(m);<sup>394</sup> or (3) a person who actively participates in the generation, transmission, or distribution of electric energy.<sup>395</sup> Although SPP has requested an exemption pursuant to section 4(c)(6) of the CEA, any exemption pursuant to this subsection must be issued "in accordance with" sections 4(c)(1) and 4(c)(2).<sup>396</sup> Section 4(c)(2) prohibits the Commission from issuing an exemption pursuant to section 4(c) unless the Commission determines that the agreement, contract or transaction "will be entered into solely between 'appropriate persons.' " Appropriate persons include those entities explicitly delineated in sections 4(c)(3)(A) through (J) of the Act as well as others that the Commission, under the discretionary authority provided by

<sup>383</sup> 7 U.S.C. 6(c).

<sup>384</sup> 17 CFR 23.410(a)–(b), 32.4, and part 180.

<sup>385</sup> See Exemption Application at 1. SPP requested relief from "all provisions of the CEA and Commission rules thereunder, except the Commission's general anti-fraud and anti-manipulation authority, and scienter-based prohibitions, under CEA sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13 of the Act, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a)–(b), 32.4 and part 180." The Proposed Exemption simply would preserve the Commission's authority under the delineated provisions and their implementing regulations without caveat, in order to avoid ambiguity as to what conduct remains prohibited.

<sup>386</sup> See, e.g., Order (1) Pursuant to Section 4(c) of the Commodity Exchange Act, Permitting the Kansas City Board of Trade Clearing Corporation To Clear Over-the-Counter Wheat Calendar Swaps, (2) Pursuant to Section 4d of the Commodity Exchange Act, Permitting Customer Positions in Such Cleared-Only Swaps and Associated Funds To Be Commingled With Other Positions and Funds Held in Customer Segregated Accounts, 75 FR 34983, 34985 (2010), and (3) RTO–ISO Order at 19880.

<sup>387</sup> Exemption Application at 11–15.

<sup>388</sup> *Id.* at 12.

<sup>389</sup> *Id.* at 15.

<sup>390</sup> 7 U.S.C. 6(c).

<sup>391</sup> For example, the transactions that are included within the scope of the Proposed Exemption appear to be limited to those tied to the physical capacity of SPP's electric energy grid. Exemption Application at 11–15.

<sup>392</sup> 7 U.S.C. 6(c)(3)(A)–(J).

<sup>393</sup> 7 U.S.C. 1a(18).

<sup>394</sup> 17 CFR 1.3(m).

<sup>395</sup> Consistent with the RTO–ISO Order, the term "a person who actively participates in the generation, transmission, or distribution of electric energy" is defined as a person that is in the business of: (1) Generating, transmitting, or distributing electric energy or (2) providing electric energy services that are necessary to support the reliable operation of the transmission system. RTO–ISO Order at 19897.

<sup>396</sup> 7 U.S.C. 6(c).

section 4(c)(3)(K), deems to be appropriate persons “in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.”<sup>397</sup> As noted above, the Commission has proposed to determine that eligible contract participants, as defined in section 1a(18) of the Act or in Commission regulation 1.3(m), and persons that “active[ly] participat[e] in the generation, transmission or distribution of electric energy”<sup>398</sup> should be considered appropriate persons for purposes of the Proposed Exemption.<sup>399</sup>

Second, in order to be eligible for the exemption that would be provided by the Proposed Exemption, the agreement, contract or transaction also must be offered or sold pursuant to SPP’s “Tariff” and the tariff must have been approved by FERC. This requirement reflects the range of the Commission’s authority as set forth in section 4(c)(6)<sup>400</sup> of the CEA and is consistent with the scope of the relief requested.<sup>401</sup>

Consistent with the range of the statutory authority explicitly provided by CEA section 4(c), the Proposed Exemption would extend the exemption to the agreements, contracts or transactions set forth therein and “any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to” such transactions. In addition, for as long as the Proposed Exemption would remain in effect, SPP would be able to avail itself of the Proposed Exemption with respect to all three expressly-identified groups of products, regardless of whether or not SPP offers the particular product at the present time. That is, SPP would not be required to request future supplemental relief for a product that it does not currently offer, but that qualifies as one of the three types of transactions in the Proposed Exemption. SPP’s Exemption Application requested an exemption of the scope provided and the Exemption Application was analyzed accordingly.<sup>402</sup>

The Proposed Exemption indicates that, when a final order is issued, it

would be made effective upon publication. The Proposed Exemption also contains two information-sharing conditions. First, the Proposed Exemption is expressly conditioned upon the continuation of information sharing arrangements between the Commission and FERC. The Commission notes that the CFTC and FERC have executed several MOUs since 2005, pursuant to which the agencies have shared information successfully. Most recently, the Commission and FERC signed an MOU on January 2, 2014 which provides for the sharing of information for use in analyzing market activities and protecting market integrity.<sup>403</sup> The terms of this MOU provide that FERC will furnish information in its possession to the CFTC upon its request and will notify the CFTC if any information requested by it is not in FERC’s possession. Moreover, the Proposed Exemption requires SPP to comply with the Commission’s requests through FERC to share, on an as-needed basis and in connection with an inquiry consistent with the CEA and Commission regulations, positional and transactional data within SPP’s possession for products in its markets that are related to markets that are subject to the Commission’s jurisdiction, including any pertinent information concerning such data.<sup>404</sup> Second, the Proposed Exemption includes an information-sharing condition that requires that neither SPP’s Tariff nor any other SPP governing documents shall include any requirement that SPP notify its members prior to providing information to the Commission in response to a subpoena or other request for information or documentation.<sup>405</sup> The Commission specifically requests comment on this condition and as to whether there may be an alternative condition that the Commission might use to achieve the same result.

Finally, the Proposed Exemption expressly notes that it is based upon the representations made in the Exemption Application, including those representations with respect to compliance with FERC regulation 35.47. It is also based on supporting materials

provided to the Commission by SPP and its counsel, including a legal memorandum that, in the Commission’s sole discretion, provides the Commission with assurance that the netting arrangements contained in the approach selected by SPP to satisfy the obligations contained in FERC regulation 35.47(d) will, in fact, provide SPP 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. Any material change or omission in the facts and circumstances pursuant to which the Proposed Exemption is granted might require the Commission to reconsider its finding that the exemption contained therein is appropriate and/or in the public interest. The Commission has also explicitly reserved the discretionary authority to suspend, terminate or otherwise modify or restrict the exemption provided. The reservation of these rights is consistent with prior Commission practice and is necessary to provide the Commission with the flexibility to address relevant facts or circumstances as they arise.

#### B. Proposed Exemption

Upon due consideration and consistent with the determinations set forth above, the Commission hereby proposes to issue the following order (“Order”):

Pursuant to its authority under section 4(c)(6) of the Commodity Exchange Act (“CEA” or “Act”) and in accordance with sections 4(c)(1) and (2) of the Act, the Commodity Futures Trading Commission (“CFTC” or “Commission”)

1. Exempts, subject to the conditions and limitations specified herein, the execution of the electric energy-related agreements, contracts, and transactions that are specified in paragraph 2 of this Order and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect thereto, from all provisions of the CEA, except, in each case, the Commission’s general anti-fraud and anti-manipulation authority, and scienter-based prohibitions, under CEA sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4, and part 180.

2. *Scope.* This exemption applies only to agreements, contracts and transactions that satisfy each of the following requirements:

<sup>397</sup> 7 U.S.C. 6(c)(3).

<sup>398</sup> See *supra* note 395.

<sup>399</sup> See discussion *supra* section V.B.3.

<sup>400</sup> See discussion *supra* section V.A.

<sup>401</sup> Exemption Application at 1.

<sup>402</sup> SPP requests that “the exemptive Order it seeks apply to each relevant class of contracts, agreements or transactions offered or entered into under SPP’s FERC-approved Tariff that will be in effect . . . as well as any product or any modifications that are offered in the future pursuant to the FERC-approved Tariff that do not alter the characteristics of the Transactions in a way that would cause them to fall outside of the definitions.” Exemption Application at 11.

<sup>403</sup> MOU, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcfercismou2014.pdf>.

<sup>404</sup> SPP further represents that it will comply with the Commission’s requests for related transactional and positional market data. See Exemption Application at 22.

<sup>405</sup> SPP represents that its Tariff permits the sharing of information with the Commission without prior notice to market participants. See Exemption Application at 22; Exemption Application Attachments at 52, 54.

a. The agreement, contract or transaction is for the purchase and sale of one of the following electric energy-related products:

(1) “Transmission Congestion Rights” defined in paragraph 5(a) of this Order, except that the exemption shall only apply to such Transmission Congestion Rights where:

(a) Each Transmission Congestion Right is linked to, and the aggregate volume of Transmission Congestion Rights for any period of time is limited by, the physical capability (after accounting for counterflow) of the electric energy transmission system operated by SPP for such period;

(b) SPP serves as the market administrator for the market on which the Transmission Congestion Rights are transacted;

(c) Each party to the transaction is a member of SPP (or is SPP itself) and the transaction is executed on a market administered by SPP; and

(d) The transaction does not require any party to make or take physical delivery of electric energy.

(2) “Energy Transactions” as defined in paragraph 5(b) of this Order.

(3) “Operating Reserve Transactions” as defined in paragraph 5(c) of this Order.

b. Each party to the agreement, contract or transaction is:

(1) An “appropriate person,” as defined sections 4(c)(3)(A) through (J) of the CEA;

(2) an “eligible contract participant,” as defined in section 1a(18)(A) of the CEA and in Commission regulation 1.3(m); or

(3) a “person who actively participates in the generation, transmission, or distribution of electric energy,” as defined in paragraph 5(f) of this Order.

c. The agreement, contract or transaction is offered or sold pursuant to SPP’s Tariff and that Tariff has been approved by the Federal Energy Regulatory Commission (“FERC”).

3. *Applicability to SPP.* Subject to the conditions contained in the Order, the Order applies to SPP with respect to the transactions described in paragraph 2 of this Order.

4. *Conditions.* The exemption provided by this Order is expressly conditioned upon the following:

a. Information sharing: Information sharing arrangements between the Commission and FERC that are acceptable to the Commission continue to be in effect, and SPP’s compliance with the Commission’s requests through FERC to share, on an as-needed basis and in connection with an inquiry consistent with the CEA and

Commission regulations, positional and transactional data within SPP’s possession for products in SPP’s markets that are related to markets that are subject to the Commission’s jurisdiction, including any pertinent information concerning such data.

b. Notification of requests for information: Neither the Tariff nor any other governing documents of SPP shall include any requirement that SPP notify its members prior to providing information to the Commission in response to a subpoena or other request for information or documentation.

5. *Definitions.* The following definitions shall apply for purposes of this Order:

a. A “Transmission Congestion Right” is a transaction, however named, that entitles one party to receive, and obligates another party to pay, an amount based solely on the difference between the price for electric energy, established on an electric energy market administered by SPP, at a specified source (*i.e.*, where electric energy is deemed injected into the grid of SPP) and a specified sink (*i.e.*, where electric energy is deemed withdrawn from the grid of SPP).

b. “Energy Transactions” are transactions in a “Day-Ahead Market” or “Real-Time Balancing Market,” as those terms are defined in paragraphs 5(d) and 5(e) of this Order, for the purchase or sale of a specified quantity of electric energy at a specified location (including virtual bids and offers), where:

(1) The price of the electric energy is established at the time the transaction is executed;

(2) Performance occurs in the Real-Time Balancing Market by either:

(a) Delivery or receipt of the specified electric energy, or

(b) A cash payment or receipt at the price established in the Day-Ahead Market or Real-Time Balancing Market (as permitted by SPP in its Tariff); 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 electric energy transmission system operated by SPP for that period of time.

c. “Operating Reserve Transactions” are transactions:

(1) In which SPP, for the benefit of load-serving entities and resources, purchases, through auction, the right, during a period of time as specified in SPP’s Tariff, to require the seller of such right to operate electric energy facilities in a physical state such that the facilities can increase or decrease the rate of injection or withdrawal of a specified quantity of electric energy into

or from the electric energy transmission system operated by SPP with:

(a) Physical performance by the seller’s facilities within a response time interval specified in SPP’s Tariff (Reserve Transaction); or

(b) prompt physical performance by the seller’s facilities (Area Control Error Regulation Transaction);

(2) For which the seller receives, in consideration, one or more of the following:

(a) Payment at the price established in SPP’s Day-Ahead or Real-Time Balancing Market, as those terms are defined in paragraphs 5(d) and 5(e) of this Order, price for electric energy applicable whenever SPP exercises its right that electric energy be delivered (including “Demand Response,” as defined in paragraph 5(g) of this Order);

(b) Compensation for the opportunity cost of not supplying or consuming electric energy or other services during any period during which SPP requires that the seller not supply energy or other services;

(c) An upfront payment determined through the auction administered by SPP for this service;

(d) An additional amount indexed to the frequency, duration, or other attributes of physical performance as specified in SPP’s Tariff; and

(3) In which the value, quantity, and specifications of such transactions for SPP for any period of time shall be limited to the physical capability of the electric energy transmission system operated by SPP for that period of time.

d. “Day-Ahead Market” means an electric energy market administered by SPP on which the price of electric energy at a specified location is determined, in accordance with SPP’s Tariff, for specified time periods, none of which is later than the second operating day following the day on which the Day Ahead Market clears.

e. “Real-Time Balancing Market” means an electric energy market administered by SPP on which the price of electric energy at a specified location is determined, in accordance with SPP’s Tariff, for specified time periods within the same 24-hour period.

f. “Person who actively participates in the generation, transmission, or distribution of electric energy” means a person that is in the business of: (1) Generating, transmitting, or distributing electric energy; or (2) providing electric energy services that are necessary to support the reliable operation of the transmission system.

g. “Demand Response” means the right of SPP to require that certain sellers of such rights curtail consumption of electric energy from the

electric energy transmission system operated by SPP during a future period of time as specified in SPP's Tariff.

h. "SPP" means Southwest Power Pool, Inc. or any successor in interest to Southwest Power Pool.

i. "Tariff." Reference to a SPP "Tariff" includes a tariff, rate schedule or protocol.

j. "Exemption Application" means the application for an exemptive order under 4(c)(6) of the CEA filed by SPP on October 17, 2013, as amended August 1, 2014.

6. *Effective Date.* This Order is effective upon publication in the **Federal Register**.

7. *Delegation of Authority.* The Commission hereby delegates, until such time as the Commission orders otherwise, to the Director of the Division of Market Oversight ("Division") and to such members of the Division's staff acting under his or her direction as he or she may designate, in consultation with the General Counsel or such members of the General Counsel's staff acting under his or her direction as he or she may designate, the authority to request information from SPP pursuant to sections 4(a)(1) and 4(a)(2) of this Order.

This Order is based upon the representations made in the Exemption Application for an exemptive order under 4(c) of the CEA filed by SPP,<sup>406</sup> including those representations with respect to compliance with FERC regulation 35.47. It is also based on supporting materials provided to the Commission by SPP and its counsel, including a legal memorandum that, in the Commission's sole discretion, provides the Commission with assurance that the netting arrangements contained in the approach selected by SPP to satisfy the obligations contained in FERC regulation 35.47(d) will, in fact, provide SPP 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. Any material change or omission in the facts and circumstances pursuant to which this Order is granted might require the Commission to reconsider its finding that the exemption contained therein is appropriate and/or consistent with the public interest and purposes of the CEA. Further, the Commission reserves the right, in its discretion, to revisit any of the terms and conditions of the relief provided herein, including

but not limited to, making a determination that certain entities and transactions described herein should be subject to the Commission's full jurisdiction, and to condition, suspend, terminate or otherwise modify or restrict the exemption granted in this Order, as appropriate, upon its own motion.

## VII. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the Proposed Exemption will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>407</sup> The Commission believes that the Proposed Exemption will not have a significant economic impact on a substantial number of small entities. The Proposed Exemption includes entities that qualify as (1) "appropriate persons" pursuant to CEA sections 4(c)(3)(A) through (J), (2) "eligible contract participants," as defined in CEA section 1a(18)(A) and Commission regulation 1.3(m), or (3) persons who are in the business of: (i) generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system. The Proposed Exemption also would include any person or class of persons offering, entering into, rendering advice or rendering other services with respect to the transactions set forth above.<sup>408</sup> The Commission previously determined that ECPs are not "small entities" for purposes of the RFA.<sup>409</sup> In addition, the Commission believes that SPP should not be considered a small entity based on the central role it plays in the operation of the electronic transmission grid and the creation of organized wholesale electric markets that are subject to FERC regulatory oversight,<sup>410</sup>

<sup>407</sup> 5 U.S.C. 601 *et seq.*

<sup>408</sup> Under CEA section 2(e), only ECPs are permitted to participate in a swap subject to the end-user clearing exception.

<sup>409</sup> See *Opting Out of Segregation*, 66 FR 20740, 20743, Apr. 25, 2001.

<sup>410</sup> See *Enhancement of Electricity Market Surveillance and Analysis Through Ongoing Electronic Delivery of Data from Regional Transmission Organizations and Independent System Operators*, 77 FR 26674 at 26685–26686, May 7, 2012 (RFA analysis as conducted by FERC regarding six RTOs and ISOs, including SPP).

Commission staff also performed an independent RFA analysis based on Subsector 221 of Sector 22 (utilities companies) of the SBA which defines any small utility corporation as one that does not have more than 250 employees. See 13 CFR 121.201 (1–15 Edition). Staff concludes that SPP is not a small entity, since SPP represents that it employs

analogous to functions performed by DCMs and DCOs, which the Commission has determined not to be small entities.<sup>411</sup>

Accordingly, the Commission does not expect the Proposed Exemption to have a significant impact on a substantial number of entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the Proposed Exemption would not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on whether the entities covered by the Proposed Exemption should be considered small entities for purposes of the RFA, and, if so, whether there is a significant impact on a substantial number of entities.

### B. Paperwork Reduction Act

The purposes of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501 *et seq.* ("PRA") are, among other things, to minimize the paperwork burden to the private sector, ensure that any collection of information by a government agency is put to the greatest possible uses, and minimize duplicative information collections across the government. The PRA applies to all information, "regardless of form or format," whenever the government is "obtaining, causing to be obtained [or] soliciting" information, and includes and requires "disclosure to third parties or the public, of facts or opinions," when the information collection calls for "answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons." The Proposed Exemption provides that the exemption is expressly conditioned upon information sharing arrangements between the Commission and FERC that are acceptable to the Commission continue to be in effect. The PRA would not apply in this case given that the exemption would not impose any new recordkeeping or information collection requirements, or other collections of information on ten or more persons that require approval of the Office of Management and Budget ("OMB").

more than 500 employees. See Exemption Application Attachments at 8.

<sup>411</sup> See *A New Regulatory Framework for Clearing Organizations*, 66 FR 45604 at 45609, Aug. 29, 2001 (DCOs); Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 at 18618–18619, Apr. 30, 1982 (DCMs).

<sup>406</sup> In the Matter of the Application for an Exemptive Order Under Section 4(c) of the Commodity Exchange Act by Southwest Power Pool, Inc., amended Aug. 1, 2014.

### C. Cost-Benefit Considerations

#### 1. Consideration of Costs and Benefits

##### a. Introduction

Section 15(a) of the CEA<sup>412</sup> requires the Commission to “consider the costs and benefits” of its actions before promulgating a regulation under the CEA or issuing certain orders. In proposing this exemption, the Commission is required by section 4(c)(6) to ensure the same is consistent with the public interest. In much the same way, section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

As discussed above, in response to an Exemption Application from SPP, the Commission is proposing to exempt certain transactions from the provisions of the CEA and Commission regulations with the exception of those prohibiting fraud and manipulation (*i.e.*, sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9, and 13, and any implementing regulations promulgated under these sections including, but not limited to, Commission regulations 23.410(a) and (b), 32.4 and part 180). The Proposed Exemption is transaction-specific—that is, it would exempt contracts, agreements and transactions for the purchase or sale of the limited set of electric energy-related products that are offered or entered into in a market administered by SPP pursuant to SPP’s Tariff for the purposes of allocating its physical resources.

More specifically, the Commission is proposing to exempt from most provisions of the CEA certain “transmission congestion rights,” “energy transactions,” and “operating reserve transactions,” as those terms are defined in the Proposed Exemption (collectively referred to as Covered Transactions), if such transactions are offered or entered into pursuant to a Tariff under which SPP operates that has been approved or permitted to take effect by FERC. The Proposed Exemption would extend to a person who is: (1) An “appropriate person,” as

defined in CEA sections 4(c)(3)(A) through (J); (2) an “eligible contract participant,” as defined in CEA section 1a(18)(A) and in Commission regulation 1.3(m); or (3) a person who actively participates in the generation, transmission, or distribution of electric energy.<sup>413</sup> The Proposed Exemption also would extend to any person or class of persons offering, entering into, rendering advice or rendering other services with respect to the Covered Transactions. Important to the Commission’s Proposed Exemption is SPP’s representation that the aforementioned transactions are: (i) Tied to the physical capacity of SPP’s electric energy grids; (ii) used to promote the reliable delivery of electric energy; and (iii) are intended for use by commercial participants that are in the business of generating, transmitting and distributing electric energy.<sup>414</sup> In other words, these are not purely financial transactions; rather, they are inextricably linked to, and limited by, the capacity of the grid to physically deliver electric energy.<sup>415</sup>

In the discussion that follows, the Commission considers the costs and benefits of the Proposed Exemption to the public and market participants generally, including the costs and benefits of the conditions precedent that must be satisfied before SPP may claim the exemption.

##### b. Proposed Baseline

The Commission’s proposed baseline for consideration of the costs and benefits of this Proposed Exemption are the costs and benefits that the public and market participants (including SPP) would experience in the absence of this proposed regulatory action. In other words, the proposed baseline is an alternative situation in which the Commission takes no action and exercises jurisdiction, meaning that the transactions that are the subject of this Exemption Application would be required to comply with all of the CEA and Commission regulations, as applicable. In such a scenario, the public and market participants would experience the full benefits and costs related to the CEA and Commission regulations, but as discussed in detail above, the transactions would still be subject to the congruent regulatory regime of FERC.

The Commission also considers the regulatory landscape as it exists outside the context of the Dodd-Frank Act’s enactment. In this instance, it also is important to highlight SPP’s

representation that each of the transactions for which an exemption is requested is already subject to a long-standing, comprehensive regulatory framework for the offer and sale of such transactions established by FERC.<sup>416</sup> For example, the costs and benefits attendant to the Commission’s condition that transactions be entered into between “appropriate persons” as described in CEA section 4(c)(3) has an analog outside the context of the Dodd-Frank Act in FERC’s minimum criteria for RTO market participants as set forth in FERC Order 741. Moreover, the Commission has granted similar relief to other RTOs and ISOs regulated by either FERC or the Public Utility Commission of Texas.<sup>417</sup>

In the discussion that follows, where reasonably feasible, the Commission endeavors to estimate quantifiable dollar costs of the Proposed Exemption. The benefits and costs of the Proposed Exemption, however, are not presently susceptible to meaningful quantification. Most of the costs arise from limitations on the scope of the Proposed Exemption, and many of the benefits tied to those limitations arise from avoiding defaults and their implications that are clearly large in magnitude, but impracticable to estimate. Where it is unable to quantify, the Commission discusses proposed costs and benefits in qualitative terms.

##### c. Costs

The Proposed Exemption is exemptive and would provide “appropriate persons” engaging in the Covered Transactions relief from certain of the requirements of the CEA and attendant Commission regulations. As with any exemptive rule or order, the Proposed Exemption is permissive, meaning that SPP was not required to request it and is not required to rely on it. Accordingly, the Commission assumes that SPP would rely on the Proposed Exemption only if the anticipated benefits to SPP outweigh the costs of the exemption. Here, the Proposed Exemption identifies certain conditions to the grant of the Proposed Exemption. The Commission is of the view that, as a result of the conditions, SPP, market participants and the public would experience minimal, if any, ongoing costs as a result of these conditions because, as SPP certifies pursuant to CFTC Rule 140.99(c)(3)(ii), the attendant conditions are substantially similar to requirements that SPP and its market participants

<sup>413</sup> See *supra* note 395.

<sup>414</sup> See Exemption Application at 17.

<sup>415</sup> *Id.*

<sup>416</sup> *Id.*

<sup>417</sup> RTO-ISO Order. See *supra* section III.C.

<sup>412</sup> 7 U.S.C. 19(a).

already incur in complying with FERC regulations.

The condition that all parties to the agreements, contracts or transactions that are covered by the Proposed Exemption must be (1) an “appropriate person,” as defined in sections 4(c)(3)(A) through (J) of the CEA; (2) an “eligible contract participant,” as defined in section 1a(18)(A) of the CEA and in Commission regulation 1.3(m); or (3) a “person who actively participates in the generation, transmission, or distribution of electric energy”<sup>418</sup>—is not likely to impose any significant, incremental costs on SPP because its existing legal and regulatory obligations under the FPA and FERC regulations mandate that only eligible market participants may engage in the Covered Transactions, as explained above.<sup>419</sup>

The second condition is that the Covered Transactions must be offered or sold pursuant to SPP’s Tariff—which has been approved or permitted to take effect by FERC. This is a statutory requirement for the exemption set forth in CEA section 4(c)(6) and therefore is not a cost attributable to an act of discretion by the Commission.<sup>420</sup> Moreover, requiring that SPP not operate outside its Tariff requirements derives from existing legal requirements and is not a cost attributable to this proposal.

As discussed above, FERC imposes on SPP, and its market monitor, various information management requirements.<sup>421</sup> These existing requirements are not materially different from the condition, in the Proposed Exemption, that neither SPP’s Tariff nor other governing documents may include any requirement that SPP notify a member prior to providing information to the Commission in response to a subpoena, special call, or other request for information or documentation. SPP indicated in its Exemption Application that on March 1, 2014, FERC accepted a revision to SPP’s Tariff governing the sharing of information that meets this proposed condition.<sup>422</sup> The Commission requests comment as to whether a provision in the Proposed Exemption that effectively requires SPP continues to meet this condition imposes a significant burden or increase in cost on SPP, and whether there are alternative conditions that may be used to achieve a similar result. Further, SPP has agreed

to provide any information to the Commission upon request that will further enable the Commission to perform its regulatory and enforcement duties. While the Commission is mindful that the process of responding to subpoenas or requests for information involves costs, the requirement to respond to such subpoenas and requests for information, and thus the associated costs, is independent of the current Proposed Exemption.

Finally, the condition that information sharing arrangements that are satisfactory to the Commission between the Commission and FERC must be in full force and effect is not a cost to SPP or to other members of the public and has been an inter-agency norm since 2005.<sup>423</sup> Moreover, the condition that SPP comply with the Commission’s requests on an as-needed basis for related transactional and positional market data will impose only minimal costs on SPP to respond because the Commission contemplates that any information requested will already be in SPP’s possession.<sup>424</sup>

#### d. Benefits

In proposing this exemption, the Commission is required by section 4(c)(6) to ensure that it is consistent with the public interest. In much the same way, CEA section 15(a) requires that the Commission consider the benefits to the public of its action. In meeting its public interest obligations under both 4(c)(6) and 15(a), the Commission in sections V.B.1., V.D., and V.E. proposes a detailed consideration of the nature of the transactions and FERC’s regulatory regime, including whether the protections provided by that regime is, at a minimum, congruent with the Commission’s oversight of DCOs and SEFs.

This exercise is not rote; rather, in proposing that this exemption is in the public interest, the Commission’s comprehensive action benefits the public and market participants in several substantial ways, as discussed below. First, the parameters for the Covered Transactions set forth in the Proposed Exemption limit the financial risk that may impact the markets. The mitigation of such risk inures to the benefit of SPP, market participants and

the public, especially SPP’s members and electric energy ratepayers.

The condition that only “appropriate persons” may enter the Covered Transactions benefits the public and the entities that fall under the “appropriate persons” definition themselves, by ensuring that (1) only persons with resources sufficient to understand and manage the risks of the transactions are permitted to engage in the same, and (2) persons without such resources do not impose credit costs on other participants (and the ratepayers for such other participants). Further, the condition requiring that the Covered Transactions only be offered or sold pursuant to a FERC-approved tariff benefits the public by, for example, ensuring that the Covered Transactions are subject to a regulatory regime that is focused on the physical provision of reliable electric energy, and also has credit requirements that are designed to achieve risk management goals congruent with the regulatory objectives of the Commission’s DCO and SEF Core Principles. Absent these and other similar limitations on participant- and financial-eligibility, the integrity of the markets at issue could be compromised and members and ratepayers left unprotected from potentially significant losses resulting from purely financial, speculative activity.

Finally, the Commission’s retention of its authority to redress any fraud or manipulation in connection with the Covered Transactions protects market participants and the public generally, as well as the financial markets for electric energy products. For example, the Proposed Exemption is conditioned upon effective information sharing arrangements between the FERC and the Commission being in place. Through such an arrangement, the Commission expects that it will be able to request information necessary to examine whether activity on SPP’s markets is adversely affecting the Commission-regulated markets. Further, the Proposed Exemption is conditioned upon the Commission’s ability to obtain certain data within SPP’s possession from SPP. Through this condition, the Commission expects that it will be able to continue discharging its regulatory duties under the CEA. Further, the condition that SPP may not, in the future, maintain any Tariff provisions that would require SPP to notify members prior to providing the Commission with information will help maximize the effectiveness of the Commission’s enforcement program.

<sup>418</sup> See *supra* notes 393–395.

<sup>419</sup> See *supra* section V.B.3.

<sup>420</sup> See 7 U.S.C. 6(c)(6)(A), (B).

<sup>421</sup> See *supra* section V.B.1.

<sup>422</sup> SPP represents that its Tariff requires the sharing of information with the Commission without prior notice to market participants. See Exemption Application Attachments at 52, 54.

<sup>423</sup> The CFTC and FERC first signed an MOU on October 12, 2005. On January 2, 2014, as directed by Congress under the Dodd-Frank Act, the Commission and FERC entered into an MOU, which superseded the 2005 MOU and provided for the sharing of information for use in analyzing market activities and protecting market integrity. See *supra* note 62.

<sup>424</sup> See *supra* section IV.B.

#### e. Consideration of Alternatives

The Commission considered alternatives to the proposed rulemaking. For instance, the Commission could have chosen: (i) Not to propose an exemption or (ii), as SPP requested, to provide relief for “the purchase and sale of a product or service that is directly related to, and a logical outgrowth of, any of SPP’s core functions as an RTO . . . and all services related thereto.” Regarding this latter request, the Commission understands the Exemption Application as requesting relief for transactions not yet in existence. In this exemption, the Commission proposes what it considers a measured approach—in terms of the implicated costs and benefits of the exemption—given its current understanding of the Covered Transactions.

Regarding the first alternative, the Commission considered that Congress, in the Dodd-Frank Act, required the Commission to exempt certain contracts, agreements or transactions from duties otherwise required by statute or Commission regulation by adding a new section that requires the Commission to exempt from its regulatory oversight agreements, contracts, or transactions traded pursuant to an RTO tariff that has been approved or permitted to take effect by FERC, where such exemption was in the public interest and consistent with the purposes of the CEA. Having concluded that the Proposed Exemption meets those tests, the Commission proposes that a no exemption alternative would be inconsistent with Congressional intent and contrary to the public interest. At the same time, however, the Commission believes it would also be inappropriate to adopt the second alternative.

The second alternative would extend the Proposed Exemption to future products that are “logical outgrowths” of the Covered Transactions. The Commission proposes that such alternative would be contrary to the Commission’s obligation under section 4(c) of the Act. As noted above, the authority to issue an exemption from the CEA provided by section 4(c) of the Act may not be automatically or mechanically exercised. Rather, the Commission is required to affirmatively determine, *inter alia*, that the exemption would be consistent with the public interest and the purposes of the Act.

The Commission is concerned that such an open-ended definition could present risks beyond those contemplated. At the same time, the Commission believes that any new transactions that fall within the Covered

Transactions, which are explicitly defined in the Proposed Exemption, and any modifications to existing transactions that do not alter the Covered Transactions’ characteristics in a way that would cause them to fall outside those definitions, that are offered by SPP pursuant to a FERC-approved Tariff, are intended to be included within the Proposed Exemption. This provides a benefit in that no supplemental relief for such products would be required, which is a cost mitigating efficiency gain for SPP. Moreover, unidentified transactions might include novel features or have market implications or risks that are beyond evaluation at the present time, and are not present in the specified transactions.

#### 2. Consideration of CEA Section 15(a) Factors

##### a. Protection of Market Participants and the Public

In proposing the exemption as it did, the Commission endeavored to provide relief that was in the public interest. A key component of that consideration is the assessment of how the Proposed Exemption protects market participants and the public. As discussed above, market participants and the public are protected by the existing regulatory structure that includes congruent regulatory goals, and by the four conditions placed upon the proposed relief by requiring, *inter alia*, that: (i) Only those with the financial wherewithal are permitted to engage in the transactions; (ii) the transactions at issue must be within the scope of SPP’s FERC-approved Tariff; (iii) no advance notice to members of information requests to SPP from the Commission; and (iv) the Commission and FERC, must continue to have an information sharing arrangement in full force and effect. In addition, the Proposed Exemption is limited to the transactions identified and defined herein. In this way, the Commission eliminates the potential that as-yet-unknown transactions not linked to the physicality of the electric system may be offered or sold under this Proposed Exemption, protecting market participants and the public from risk that might arise from sale of such unknown transactions.

##### b. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

In this Proposed Exemption, the Commission considered its effect on the efficiency, competitiveness, and financial integrity of the markets subject to the Commission’s jurisdiction. As

means of increasing competition and efficiency, the Commission recognizes that entities falling under the “appropriate persons” definition will benefit from increased competition among RTOs benefiting from this type of exemption with the addition of SPP to the existing ones and will be able to engage in the Covered Transactions in a more efficient manner. Further, the Commission’s retention of its full enforcement authority will help ensure that any misconduct in connection with the exempted transactions does not jeopardize the financial integrity of the markets under the Commission’s jurisdiction.

##### c. Price Discovery

As discussed above in section V.B.4, with respect to TCRs and Operating Reserve Transactions, these transactions do not appear to directly impact transactions taking place on Commission-regulated markets—they are not used for price discovery and are not used as settlement prices for other transactions in Commission-regulated markets.

With respect to Energy Transactions, these transactions have a relationship to Commission-regulated markets because they can serve as a source of settlement prices for other transactions subject to the Commission’s jurisdiction. Granting the Proposed Exemption, however, does not mean that these transactions will be unregulated. To the contrary, as explained in more detail above, SPP has a market monitoring system in place to detect and deter manipulation that takes place on its markets. Further, as noted above, the Commission retains all of its anti-fraud and anti-manipulation authority as a condition of the Proposed Exemption.

##### d. Sound Risk Management Practices

As with the other areas of cost-benefit consideration, the Commission’s evaluation of sound risk management practices occurs throughout this release, notably in sections V.D.4.a. and V.E.7.a. which consider SPP’s risk management policies and procedures, and the related requirements of FERC (in particular, FERC Order 741 on Credit Policies), in light of the Commission’s risk management requirements for DCOs and SEFs.

In addition, the Commission believes that the Proposed Exemption will allow market participants who are eligible for this exemption to more effectively manage their operational risk arising from the non-storable nature of electric energy and fluctuating end-user demand for it.

#### e. Other Public Interest Considerations

The Commission proposes that because these transactions are part of, and inextricably linked to, the organized wholesale, physical electric energy markets that are subject to regulation and oversight of FERC, the Commission's Proposed Exemption, with its attendant conditions, requirements, and limitations, is in the public interest. The Commission recognizes that the Proposed Exemption supports eligible market participants' supply of affordable and reliable electric energy to the public by exempting their use of the Covered Transactions from CEA.

#### 3. Request for Public Comment on Costs and Benefits

The Commission invites public comment on its cost-benefit considerations and dollar cost estimates, including the consideration of reasonable alternatives. Commenters are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

#### VIII. Request for Comment

The Commission requests comment on all aspects of its Proposed Exemption. In addition, the Commission specifically requests comment on the specific provisions and issues highlighted in the discussion above and on the issues presented in this section. For each comment submitted, please provide a detailed rationale supporting the response.

1. Has the Commission used the appropriate standard in analyzing whether the Proposed Exemption is in the public interest?

2. Is the scope set forth for the Proposed Exemption sufficient to allow for innovation? Why or why not? If not, how should the scope be modified to allow for innovation without exempting products that may be materially different from those reviewed by the Commission? Should the Commission exempt such products without considering whether such exemption is in the public interest? In answering this question, please consider that SPP may separately petition the Commission for an amendment of any final order granted in this matter. In addition, please consider that the Commission has, to a certain extent, addressed these innovation questions in the RTO-ISO Order.

3. Should the Proposed Exemption be conditioned upon the requirement that SPP cooperate with the Commission in its conduct of special calls/further requests for information with respect to contracts, agreements or transactions that are, or are related to, the contracts, agreements, or transactions that are the subject of the Proposed Exemption?

4. What is the basis for the conclusion that SPP does, or does not, provide to the public sufficient timely information on price, trading volume, and other data with respect to the markets for the contracts, agreements and transactions that are the subject of the Proposed Exemption? What Tariff provisions, if any, requires it to do so or precludes it from doing so?

5. What is the basis for the conclusion that the Proposed Exemption will, or will not, have any material adverse effect on the Commission's ability to discharge its regulatory duties under the CEA, or on any contract market's ability to discharge its self-regulatory duties under the CEA?

6. What are the bases for the conclusions that SPP's Tariff, practices, and procedures do, or do not, appropriately address the regulatory goals of each of the DCO and SEF Core Principles?

7. What factors support, or detract from, the Commission's preliminary conclusion that TCRs, Energy Transactions, and Operating Reserve Transactions are not susceptible to manipulation for the reasons stated above? What is the basis for the conclusion that market participants can, or cannot, use Energy Transactions to manipulate electric energy prices without detection by the SPP Market Monitor?

8. What is the basis for the conclusion that SPP has, or has not, satisfied applicable market monitoring requirements with respect to TCRs, Energy Transactions, and Operating Reserve Transactions? What is the basis for the conclusion that the record-keeping functions performed by SPP is, or is not, appropriate to address any concerns raised by the market monitoring process? What is the basis for the conclusion that the market monitoring functions performed by SPP and the SPP Market Monitor do, or do not, provide adequate safeguards to prevent the manipulation of SPP's markets?

9. What are the bases for the conclusions that SPP does, or does not, adequately satisfy the SEF requirements for (a) recordkeeping and reporting, (b)

preventing restraints on trade or imposing any material anticompetitive burden, (c) minimizing conflicts of interest, (d) providing adequate financial resources, (e) establishing system safeguards and (f) designating a CCO? Specifically, do the procedures and principles in place allow SPP to meet the requirements of SEF core principles 10-15?

10. What is the basis for the conclusion that SPP's eligibility requirements for participants are, or are not, appropriate to ensure that market participants can adequately bear the risks associated with the Participants markets?

11. What is the basis for the conclusion that SPP does, or does not, have adequate rules in place to allow it to deal with emergency situations as they arise? What deficiencies, if any, are there with respect to SPP's emergency procedures that would prevent SPP from taking necessary action to address sudden market problems?

12. What would be the basis for the conclusion that SPP should not receive relief that is substantially similar to the relief the Commission granted other RTOs and ISOs in the RTO-ISO Order?

13. The Commission invites comment on its consideration of the costs and benefits of the Proposed Exemption, including the costs of any information requirements imposed therein. The Commission also seeks comment on the costs and benefits of this Proposed Exemption, including, but not limited to, those costs and benefits specified within this proposal. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

Issued in Washington, DC, on May 18, 2015, by the Commission.

**Christopher J. Kirkpatrick,**  
*Secretary of the Commission.*

#### **Appendix to Notice of Proposed Order and Request for Comment on an Application for an Exemptive Order From Southwest Power Pool, Inc. From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in Section 4(c)(6) of the Act—Commission Voting Summary**

On this matter, Chairman Massad and Commissioners Wetjen, Bowen, and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

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