

138 FERC ¶ 61,185
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

ISO New England Inc. and New England Power Pool Docket Nos. ER11-3953-002
ER11-3953-003

ORDER ON COMPLIANCE FILING

(Issued March 15, 2012)

1. On December 8, 2011, ISO New England Inc. (ISO-NE) and the New England Power Pool (NEPOOL) Participants Committee (together, Filing Parties) submitted a compliance filing,¹ pursuant to the Commission's order issued in this proceeding on September 15, 2011,² and which is intended to implement directives originally set forth in Order No. 741.³ The September 15, 2011 order accepted the Filing Parties' initial compliance filing to Order No. 741, effective October 1, 2011, subject to a further compliance filing. We find that the Filing Parties' proposed revisions to the Certification Form and to the verification process for risk management policies and procedures are in compliance with the September 15, 2011 Order, and we will therefore accept the proposed revisions for filing, effective February 6, 2012, and May 1, 2012, as discussed below.

¹ Part 1 of ISO-NE's Filing can be found in Docket No. ER11-3953-002 (ISO-NE Filing Part 1). Part 2 of ISO-NE's Filing can be found in Docket No. ER11-3953-003 (ISO-NE Filing Part 2).

² *ISO New England Inc. and New England Power Pool*, 136 FERC ¶ 61,191 (2011) (September 15, 2011 Order).

³ *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, FERC Stats. & Regs. ¶ 31,317 (2010), *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 (2011), *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

I. Background

2. In Order No. 741, the Commission adopted reforms to strengthen the credit policies used in organized wholesale electric power markets.⁴ Citing its statutory responsibility to 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,⁵ the Commission directed regional transmission organizations (RTO) and independent system operators (ISOs) to revise their tariffs to reflect the following reforms: implementation of shortened settlement timeframes, restrictions on the use of unsecured credit, elimination of unsecured credit in all financial transmission rights (FTR) or equivalent markets, clarification of legal status to continue the netting and set-off of transactions in the event of bankruptcy,⁶ 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 market participants, and adoption of a two-day grace period for "curing" collateral calls. The Commission directed each RTO and ISO to submit tariff changes by June 30, 2011, with an effective date of October 1, 2011.

3. On June 30, 2011, ISO-NE, joined by NEPOOL, submitted revisions to the ISO-NE Open Access Transmission Tariff (Tariff) and its Financial Assurance Policy (Policy). As part of the revisions, ISO-NE proposed to require that each applicant or customer⁷ submit, by April 30th of each year, a certificate stating that the applicant or customer: (1) has either established or contracted for risk management procedures that are applicable to participation in the New England markets; and (2) has established or contracted for appropriate training of relevant personnel that is applicable to its participation in the New England markets. ISO-NE proposed to include this information

⁴ *Credit Reforms in Organized Wholesale Electric Markets*, Order No. 741, FERC Stats. & Regs. ¶ 31,317 (2010), *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 (2011), *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

⁵ 16 U.S.C. §§ 824d, 824e (2006).

⁶ The Commission has extended the deadline for complying with this requirement to April 30, 2012. Accordingly, the Commission will address compliance with this requirement in a separate order.

⁷ The term "applicant" refers to "both applicants for Market Participant status and applicants for transmission service from the ISO" and the term "customer" refers to "both Market Participants and Non-Market Participant Transmission Customers." See ISO-NE Transmission, Markets and Services Tariff, Section II.A of Exhibit IA of the ISO-NE Financial Assurance Policy.

in a Certification Form (Form) as Attachment 3 to that Policy. As stated in that Form, a customer or applicant will certify that it has established or contracted for written policies, procedures, and controls applicable to participation in the New England markets, approved by the customer's or applicant's "governing body," which provide an appropriate, comprehensive risk management framework that, at a minimum, clearly identifies and documents the range of risks to which the customer or applicant is exposed. The Form also provides that a customer or applicant has established or contracted for appropriate training of relevant personnel and has appropriate operating procedures and technical abilities to promptly and effectively respond to all ISO-NE communications and directives. Additionally, ISO-NE proposed that the Form must be signed by a senior officer of the customer or applicant and must be notarized. Further, ISO-NE proposed that if an applicant fails to provide the Form then the applicant will be prohibited from participating in the New England markets until the Form is provided. ISO-NE also proposed that, if a customer fails to provide the Form by the close of business on April 30th of each year, then the customer will be notified and have two business days to provide the Form. If the customer still fails to provide the Form then it will be suspended from participating in the New England markets until it does so.

4. In the Initial Compliance Order, the Commission conditionally accepted ISO-NE's minimum participation criteria as consistent with the Commission's directive in Order No. 741, and as just and reasonable and not unduly discriminatory. However, the Commission found that ISO-NE's proposed Form alone was insufficient to ensure the protection of the markets, and required ISO-NE to engage in independent periodic compliance verification to minimize risk to the market.⁸ Specifically, the Commission required ISO-NE to develop a periodic verification compliance process to independently verify that risk management policies and procedures are actually being implemented by the customer and that adequate capitalization is being maintained.⁹

5. Additionally, the Commission determined that it was unclear what was meant by the term "governing body" in ISO-NE's Form. Therefore, the Commission directed ISO-NE to submit a compliance filing to clarify the term.¹⁰

⁸ Initial Compliance Order, 136 FERC ¶ 61,191 (2011) at P 48 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 131).

⁹ *Id.*

¹⁰ Initial Compliance Order at P 47. To address several market participant's concerns, ISO-NE is also proposing to remove several items from the Form, as discussed below.

II. Notice of Filing and Responsive Pleadings

6. Notice of ISO-NE's December 8, 2011 Filings were published in the *Federal Register*, 76 Fed. Reg. 77,992 (2011), with interventions and protests due on or before December 29, 2011. Motions to intervene and protests were timely filed by Morgan Stanley Capital Group Inc., Macquarie Energy LLC and DB Energy Trading LLC (collectively, Indicated Participants), Financial Institutions Energy Group and J.P. Morgan Ventures Energy Corporation (JPMVEC).

III. Discussion

A. Procedural Matters

7. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

B. Substantive Matters

1. Risk Management Verification Process

a. Filing

8. ISO-NE proposes to add two new subsections to its Tariff to establish a process for verification of risk management policies and procedures as part of its minimum criteria for market participation. ISO-NE states that the new subsections reflect identified risks, and avoid imposing burdens that create unnecessary barriers to entry to market participants.¹¹

9. First, ISO-NE proposes to require each applicant, prior to commencing activity in the financial transmission rights (FTR) market, to submit to ISO-NE or its designee the written risk management policies, procedures, and controls applicable to its participation in the FTR market that are relied upon by the senior officer of the entity signing the Form. Additionally, ISO-NE proposes, to require that, on an annual basis (by April 30th of each year), each customer with FTR transactions in any currently open month that exceed 1,000 MW re-submit to ISO-NE or its designee, such written risk management policies, procedures, and controls. If an applicant fails to submit the required information then the applicant will be prohibited from participating in the FTR market. If a customer fails to provide the required information then ISO-NE will issue a notice of such failure to the customer, and if the customer fails to submit the information to ISO-NE or its

¹¹ ISO-NE Filing Part 1 at 6.

designee within two business days after ISO-NE's issuance of a notice of such failure, then the customer will be suspended from entering into any future FTR transactions.¹²

10. In addition, ISO-NE proposes to have the ability to require any applicant or customer to submit its written risk management policies, procedures, and controls based on certain identified risk factors that include, but are not limited to, the type of markets in which the customer is transacting or in which the applicant seeks to transact (e.g. FTR market), the magnitude of the customer's or applicant's actual or potential transactions, respectively, and the volume of the customer's open positions. ISO-NE further explains that, when it notifies an applicant or customer that such a submission is required, the submission will be due within five business days of the notice. If an applicant fails to submit the required information then the applicant will be prohibited from participating in the New England markets. If a customer fails to provide the required information, then ISO-NE will issue a notice of such failure to the customer, and if the customer fails to submit the information to ISO-NE or its designee within two business days after issuance of such notice, then the customer will be suspended from participating in the New England markets.¹³

11. ISO-NE notes that the applicant's or customer's written policies, procedures, and controls shall be treated as Confidential Information under the ISO-NE Information Policy.¹⁴

12. The second new subsection states that ISO-NE or its designee will assess that the policies, procedures, and controls of an applicant or customer conform to prudent risk management practices, which include: (1) addressing market, credit, and operational risk; (2) segregating roles, responsibilities, and functions of the organization; (3) establishing delegations of authority that specify which transactions traders are authorized to enter into; (4) ensuring that traders have sufficient training in the systems and markets in which they transact; (5) placing risk limits to control exposure; (6) requiring reports to ensure that risks are adequately communicated throughout the organization; (7) establishing processes for independent confirmation of executed transactions; and (8) establishing periodic valuation or mark-to-market of risk positions as appropriate. ISO-NE notes that a customer's or applicant's written policies, procedures, and controls will be assessed for their existence and completeness.¹⁵

¹² *Id.*

¹³ *Id.* at 6-7.

¹⁴ *Id.* at 7.

¹⁵ *Id.* at 7 & n.21.

13. ISO-NE states that, if it or its designee believes that the applicant's or customer's written policies, procedures, and controls do not conform to prudent risk management practices, then ISO-NE or its designee will provide notice to the applicant or customer explaining the deficiencies. The applicant or customer will then be provided 55 days after the notice to revise and resubmit its policies, procedures, and controls to address the deficiencies identified in the notice. If the applicant's or customer's revised written policies, procedures, and controls do not adequately address the identified deficiencies, then the applicant or customer will be prohibited or suspended, respectively, from participation in the New England markets.¹⁶

b. Protest

14. Financial Institutions Energy Group and Indicated Participants argue that the Commission should exempt from verification requirements any market participant whose ISO-NE market-related risk management practices are subject to the regulation, supervision, and audit by certain banking regulators.¹⁷ They argue that the regulation undertaken by such banking regulators is more sophisticated and comprehensive than that which ISO-NE will conduct, and therefore should suffice for a determination by ISO-NE that the necessary risk policies and procedures are implemented.¹⁸ Financial Institutions Energy Group and Indicated Participants assert that the risk management processes proposed by ISO-NE would be duplicative, result in unnecessary costs for both ISO-NE and its market participants that outweigh the benefits, and create the possibility of conflicting regulation.

15. Indicated Participants also request that the Commission direct ISO-NE to adopt certain practices and minimum time periods in the compliance verification process to

¹⁶ *Id.* at 7-8.

¹⁷ Financial Institutions Energy Group refers to the Federal Reserve Board and the Office of the Comptroller of the Currency as examples of such "banking regulators." Financial Institutions Energy Group Protest at 4 and n.8 (citing *UBS AG*, 105 FERC ¶ 61,078, at P 8 & n.6 (2003)). Indicated Participants refer to the Federal Reserve Board, or a similar foreign regulator, that complies with applicable Basel Standards and/or certain exchange risk requirements. Indicated Participants Protest at 4.

¹⁸ Financial Institutions Energy Group adds that the Commission has granted regulated entities certain limited exemptions from Commission regulation because they are subject to oversight by the Federal Reserve Board and other banking regulators. *Id.* at 6 (citing *Transactions Subject to Section 203 of the FPA*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006)).

avoid potential duplication and inefficiencies. Indicated Participants contend that the Commission should direct ISO-NE to adopt a proposal similar to that proposed by the New York Independent System Operator, Inc. (NYISO). Specifically: (1) recognize that successful verification by another RTO or ISO that applies substantively similar evaluation criteria satisfies ISO-NE's verification requirement;¹⁹ and (2) once a market participant's risk management policies and procedures are verified, require subsequent verification only if the participant materially changes its risk management policies or experiences a material adverse change. Indicated Participants argue that there is no cognizable reason to require additional verification of a market participant if its policies have been verified as adequate. They argue that any duplicative verification is unnecessary and inefficient, and should be avoided.

16. In addition, Indicated Participants argue that certain time periods in the verification process should be extended. They are concerned that some of the time periods proposed by ISO-NE overly compress the window for market participants to comply with ISO-NE's directives. Specifically, Indicated Participants request that the Commission direct the ISO-NE to provide market participants with at least 14 days from the receipt of a notice requesting documentation (rather than only five days) to submit their risk management policies.

17. While Indicated Participants support ISO-NE's proposed 55-day cure period to fix any deficiencies in its risk management policies submission, the Indicated Participants argue that, similar to all of the RTOs and ISOs, ISO-NE should revise its proposal to provide a market participant that receives a negative determination regarding verification with at least an additional 14 days from the date the relevant cure period expires to appeal the negative determination to the Commission. The Indicated Participants explain that a market participant will have to file an appeal with the Commission as soon as it receives an initial negative determination notice, regardless of whether the market participant is confident that it can address the concerns identified and receive its verification prior to expiration of the cure period. The Indicated Participants argue that the Commission should direct the ISO-NE to modify their proposals to allow for additional time to file an appeal with the Commission in order to avoid unnecessary appeals and to provide market participants with certainty.

18. JPMVEC argues that the scope of the factors ISO-NE may consider when determining whether to request information related to a customer's risk management policies, procedures, and controls is unduly vague and might lead to expansive and unnecessary investigations into the business activities of ISO-NE's customers.

¹⁹ Indicated Participants asserts that the evaluation criteria proposed by each of the RTOs and ISOs is substantially similar so that each RTO and ISO could reasonably rely on a verification determination by another RTO or ISO.

Specifically, JPMVEC argues that the phrase “the markets in which the customer is transacting” is vague and unnecessarily broad. JPMVEC states that, as written, one could interpret the provision in context to mean that it applies only to the markets ISO-NE administers or alternatively to any markets regardless of who administers those markets. To provide clarity, JPMVEC requests that the Commission direct ISO-NE to limit ISO-NE’s consideration of risk factors to only those markets ISO-NE administers.²⁰

19. JPMVEC also argues that the proposal in Section II.A.2(c), where a customer must “revise its policies, procedures, and controls to address the deficiencies within fifty-five (55) days after issuance of such notice,” would grant ISO-NE the authority to amend the customer’s risk management policies without providing a process to appeal ISO-NE’s determinations. JPMVEC notes that ISO-NE’s peers have provided their customers with a specified period to appeal any determination to the Commission prior to the ISO or RTO pursuing any remedy. JPMVEC argues that such an opportunity to appeal would provide an important counterweight to the ability of ISO-NE to impose remedies, which can be as swift and severe as immediate suspension from the market. Therefore, JPMVEC requests that the Commission direct ISO-NE to modify Section II.A.2(c) to provide customers with an opportunity to appeal any determination to the Commission and to prevent ISO-NE from pursuing remedies against a market participant (including suspension of the appellant’s ability to transact in ISO-NE’s markets) for the duration of such an appeal.²¹

c. Commission Determination

20. In the September 15, 2011 Order, the Commission directed ISO-NE to develop a compliance verification process that will allow it to independently verify that risk management policies and procedures are actually being implemented and that adequate capitalization is being maintained. We find that ISO-NE’s proposed compliance verification process achieves these objectives and therefore complies with the September 15, 2011 Order. Accordingly, we will accept these proposed Tariff revisions, effective May 1, 2012.

21. The Commission rejects Financial Institutions Energy Group’s and Indicated Participants’ request for an exemption for market participants that are regulated by banking regulators, such as the Federal Reserve Board, from ISO-NE’s compliance verification policies and procedures. In Order No. 741, the Commission directed all RTOs and ISOs to adopt minimum participation criteria, but explicitly left it to each RTO and ISO and its stakeholders to develop minimum participation criteria that are applicable

²⁰ JPMVEC Protest at 4-6.

²¹ *Id.* at 6-10.

to its markets.²² In its filing, ISO-NE did not propose to wholly exempt any particular class or group of market participants from the compliance verification process based on their being regulated by banking regulators, and we are not persuaded to require it to adopt such an exemption. As we explained in the Initial Compliance Order, RTOs and ISOs are responsible for administering and otherwise overseeing their markets, and we will not require them to delegate their responsibility to verify compliance with minimum participation criteria to another entity.²³

22. Similarly, we decline to require ISO-NE to adopt Indicated Participants' proposal regarding when and how often ISO-NE will verify a market participant's compliance with risk management practices and policies. We find that ISO-NE's proposal is just and reasonable, and believe that it strikes an appropriate balance between periodically verifying that market participants are complying with risk management practices and policies without unduly burdening market participants. In addition, Indicated Participants argue that the Commission should direct ISO-NE to recognize successful verification by another RTO or ISO as satisfying its own risk management policies. Although the compliance verification processes between RTOs and ISOs may be similar, each RTO and ISO has adopted risk management policies and procedures that are appropriate for its particular market. Thus, we will not require ISO-NE to adopt Indicated Participants' proposal.

23. Further, we will not require ISO-NE to adopt certain practices and time periods as proposed by Indicated Participants and JPMVEC. We disagree that a market participant needs at least 14 days to gather information regarding its risk management policies and procedures in response to a request from ISO-NE. Although certain RTOs and ISOs have provided additional time, that does not render ISO-NE's five-day proposal here to be inconsistent with Order No. 741 or otherwise unjust and unreasonable. We expect that a market participant that has implemented its risk management policies and procedures will have the necessary documentation readily obtainable. In addition, we will not require ISO-NE to revise its proposal to include an additional 14 days from the date the cure period expires to appeal a negative determination to the Commission. If a market participant disagrees with the ISO-NE's determination, it should have sufficient information to appeal to the Commission at that time.

24. We disagree with JPMVEC that the scope of the factors ISO-NE proposes to consider when determining whether to request information related to a customer's risk management are unduly vague and might lead to expansive and unnecessary

²² Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 132-33; Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33.

²³ September 15, 2011 Order, 136 FERC ¶ 61,191 at P 46.

investigations into the business activities of ISO-NE's customers. It is reasonable for ISO-NE to look into available data in commodity, debt or equity markets in order to determine whether a customer or applicant is struggling in other markets and get an overall picture of the customer's or applicant's risk management. We find it appropriate for ISO-NE to be able to analyze applicants' or customers' transactions in all markets in which they transact or seek to transact so that ISO-NE can better manage the risk in its own market. Further, as JPMVEC notes, ISO-NE already maintains the authority to obtain "any and all information" in the custody or control of the customer that ISO-NE deems necessary to perform its obligations under the Tariff.²⁴

2. Other Issues

a. Filing

25. In compliance with the requirement that ISO-NE clarify the meaning of the term "governing body," ISO-NE proposes to remove the term "governing body" from the Form and instead require that the written risk management policies, procedures, and control that the customer or applicant has established or contracted for have been approved by the customer's or applicant's "independent risk management function."²⁵ ISO-NE explains that the new term includes appropriate corporate persons or bodies that are independent of the customer's or applicant's board or board committee, or a board or committee of the customer's or applicant's parent company. ISO-NE notes that the revision does not limit how an entity may arrange for the risk management function to be performed, so long as the person or body approving the customer's or applicant's written policies, procedures, and controls, is independent from the customer's or applicant's trading functions.²⁶

26. In response to some market participants' concerns that the list of risks in the Form was overly broad and inadvertently captured items not specifically associated with the risk management function, ISO-NE proposes to strike several items from that list. For example, ISO-NE proposes to strike legal risk, custody and investment risk, and business

²⁴ JPMVEC Protest at 6 (citing Section I.3.5 of the Tariff).

²⁵ ISO-NE states that the term "independent risk management function" was used in a similar fashion by PJM in its Order No. 741 compliance filing and it was approved by the Commission. ISO-NE Filing Part 1 at 8 & n.23 (citing *PJM Interconnection, LLC*, 136 FERC ¶ 61,190 (2011)).

²⁶ ISO-NE Filing Part 1 at 8.

risk. ISO-NE explains that this change removes uncertainty from the Form without diluting its value.²⁷

b. Commission Determination

27. We find that ISO-NE's proposal to replace the term "governing body" with the term "independent risk management function" is in compliance with the September 15, 2011.²⁸ We find that ISO-NE's proposal to strike several items from the list of risks in the Form to be just and reasonable. Accordingly, we will accept these proposed Tariff revision, effective February 6, 2012.

The Commission orders:

ISO-NE's compliance filing is hereby accepted, effective May 1, 2012 in part, and February 6, 2012 in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

²⁷ *Id.*

²⁸ *PJM Interconnection, LLC*, 136 FERC ¶ 61,190, at P 124 (2011).