138 FERC ¶ 61,187
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Southwest Power Pool, Inc. Docket Nos. ER11-3967-002
ER11-3967-003

ORDER ACCEPTING COMPLIANCE FILING

(Issued March 15, 2012)

1. On December 14, 2011, as amended on January 13, 2012,[1] Southwest Power Pool, Inc. (SPP) submitted a filing in compliance with the Commission's September 15, 2011 order in the captioned docket.[2] The Initial Compliance Order accepted SPP's proposed credit reforms filed to comply with the Commission's Order No. 741[3] subject to further compliance filing, to be effective October 1, 2011. In this order, we accept SPP's proposed compliance filing to be effective October 1, 2011.

I. Background

2. In Order No. 741, the Commission adopted reforms to strengthen the credit policies used in organized wholesale electric power markets. 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

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[1] SPP submitted an errata to designate the Annual Risk Management Certification Form as "Appendix E" to Attachment X. The Annual Risk Management Certification Form was improperly labeled as "Appendix C" to Attachment X.

[2] *Southwest Power Pool, Inc.*, 136 FERC ¶ 61,189 (2011) (Initial Compliance 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, *order denying reh'g*, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

preferential,[4] the Commission directed regional transmission organizations (RTOs) and independent system operators (ISO) 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,[5] 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. In SPP's initial compliance filing, it indicated that many of its existing billing and credit policies already complied with Order No. 714's requirements.[6] To meet all requirements, however, SPP proposed revisions to its open access transmission tariff (Tariff) that adopted minimum risk management and capitalization criteria for market participants. These revisions required that market participants submit to SPP, on an annual basis, a notarized statement by an authorized officer identifying, among other things, the market participant's risk management capabilities and procedures, employees, and training. SPP's compliance filing also proposed modifications to its list of material adverse changes and removal of existing language allowing not-for-profit market participants to request additional time to cure a violation.

4. In the Initial Compliance Order, the Commission found that SPP's existing provisions regarding the settlement cycle and the use of unsecured credit complied with the Order No. 741 requirements.[7] The Commission also accepted SPP's proposed revisions to its material adverse changes list and the removal of provisions allowing not-for-profit market participants to request an extended cure period.[8] The Commission conditionally accepted SPP's minimum participation criteria as consistent with the

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[4] 16 U.S.C. §§ 824d, 824e (2006).

[5] 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.

[6] June 30, 2011 Filing at 5-8.

[7] Initial Compliance Order, 136 FERC ¶ 61,189 at PP 10, 14, 16.

[8] *Id*. PP 49, 59.

Commission's directive in Order No. 741, and as just and reasonable and not unduly discriminatory. However, the Commission found that "[a] market participant officer-certified statement that attests to the existence of risk management policies and procedures," was insufficient to ensure the protection of the markets, and required it to engage in independent periodic compliance verification to minimize risk to the market.[9] Specifically, the Commission required SPP to develop a compliance verification process to independently verify that risk management policies and procedures are actually being implemented and that adequate capitalization is being maintained.[10]

5. The Initial Compliance Order also required that SPP submit additional revisions to adopt a standard risk management attestation form for SPP market participants, and to establish a two-day cure period for deficiencies in a market participant's risk management attestation.[11]

II. Notice of Filing and Responsive Pleadings

6. Notice of SPP's compliance filing was published in the *Federal Register*, 76 Fed. Reg. 80,356 (2011), with interventions and protests due on or before January 4, 2012. Notice of SPP's errata was published in the *Federal Register*, 77 Fed. Reg. 3758 (2012) with interventions and protests due on or before February 3, 2012. 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) and Financial Institutions Energy Group.

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.

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[9] *Id*. P 42 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at P 131).

[10] *Id.*

[11] *Id*. P 39.

B. Substantive Matters

1. Risk Management Verification Process

a. Filing

8. To comply with the Commission's directive to establish a risk management verification process, SPP proposes a new section 3.1.1.9 in Attachment X.[12] Under the proposed process, SPP may select up to 20 percent of its market participants annually for review on a random basis[13] or based on identified risk factors.[14] SPP states that once it notifies a market participant that it has been selected, the market participant must provide to SPP within 14 days a copy of its current governing risk management policies, procedures, and controls applicable to the market participant's SPP market activities and such further information or documentation SPP may reasonably request.[15] Each selected

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[12] SPP indicates that it may retain outside expertise to conduct its risk management verification. *See* Proposed SPP Tariff, Attachment X, Section 3.1.1.9.

[13] If a market participant is selected for risk management verification on a random basis and SPP is able to verify its compliance with its risk management policies successfully, the market participant will be excluded from the random selection process for the following two years. Proposed SPP Tariff, Attachment X, Section 3.1.1.9.

[14] The "identified risk factors" include, but are 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. Proposed SPP Tariff, Attachment X, Section 3.1.1.9.

[15]SPP's risk management verification will include a review of whether: (1) the market participant's risk management framework is documented in a risk policy addressing market, credit, and liquidity risks; (2) the market participant maintains an organizational structure with clearly defined roles and responsibilities that clearly segregates trading and risk management functions; (3) there is clarity of authority specifying the types of transactions into which traders are allowed to enter; (4) the market participant requires that traders have adequate training or expertise relative to their authority in the systems and SPP markets in which they transact; (5) as appropriate, the market participant has put risk limits into place to control risk exposures; (6) the market participant has reporting requirements in place to ensure that risks and exceptions are adequately communicated throughout the organization; (7) the market participant has processes in place for qualified independent review of trading activities; and (8) as appropriate, the market participant engages in periodic valuation or mark-to-market of risk positions. *Id.*

market participant's continued eligibility to participate in the SPP markets is conditioned upon SPP notifying the market participant of SPP's successful completion of its verification.[16] If SPP notifies the market participant in writing that it could not successfully complete the verification process, SPP will allow the market participant 14 calendar days to provide additional evidence for verification prior to declaring the market participant ineligible to continue to participate in SPP's markets.[17] If, prior to the expiration of the 14 calendar day period, the market participant demonstrates to SPP that it has filed an appeal of SPP's risk management verification determination with the Commission, SPP will permit the market participant to retain its transaction rights pending the Commission's determination.[18]

9. In response to the concern expressed by some SPP members that the requirement to develop a new risk management verification process could expose SPP to additional requirements and risks beyond those originally contemplated by the Commission in Order No. 2000, SPP provides some clarifications.[19] First, SPP states that implementation of a verification process will be implemented with the understanding that the Initial Compliance Order was not intended to expose SPP to additional, unintended liability. To manage this risk, SPP states that it does not intend to formally certify the sufficiency of Market Participants' risk management practices. Second, SPP asserts that it does not understand the Initial Compliance Order to require SPP audit its members. Finally, in response to members' concerns about increased costs, SPP acknowledges that it will incur implementation costs. However, SPP states that it plans to implement the proposed provisions of this compliance filing considering these concerns.

b. <u>Protest</u>

10. Financial Institutions Energy Group and Indicated Participants argue that the Commission should exempt from verification requirements any market participant whose SPP market-related risk management practices are subject to the regulation, supervision,

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[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs., Regulations Preambles 1996-2000 ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, FERC Stats. & Regs. Regulations Preambles 1996-2000 ¶ 31,092 (2000), *petitions for review dismissed sub nom. Pub. Util. Dist. No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

and audit by certain banking regulators.[20] They argue that the regulation undertaken by such banking regulators is more sophisticated and comprehensive than that which SPP will conduct, and therefore should suffice for a determination by SPP that the necessary risk policies and procedures are implemented.[21] Financial Institutions Energy Group and Indicated Participants assert that the risk management processes proposed by SPP would be duplicative, result in unnecessary costs for both SPP and its market participants that outweigh the benefits, and create the possibility of conflicting regulation. Therefore, Financial Institutions Energy Group and Indicated Participants request that the Commission require SPP to exempt entities that are subject to oversight and audit by such banking regulators from SPP's periodic verification and audit of risk management policies and procedures.

11. Indicated Participants also request that the Commission direct SPP to adopt certain minimum standards in the compliance verification process to avoid potential duplication and inefficiencies. While Indicated Participants generally support SPP's proposal to exclude for two years those market participants after they have been verified, they argue that SPP's proposal should be modified to be consistent with the proposal submitted by the New York Independent System Operator, Inc. (NYISO) in Docket No. ER11-3949-000. Specifically, Indicated Participants request that the Commission direct SPP to adopt the following approach as to the frequency of verification: (1) recognize successful verification by another RTO or ISO that applies substantively similar evaluation criteria as satisfying any applicable verification requirement; and (2) once verified, a market participant will be subject to subsequent verification only if the participant materially changes its risk management policies or experiences a material adverse change, provided that such participant must inform the RTO or ISO of any material change to its risk management policies. Indicated Participants argue that, other than the reasons listed,

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

[21] Financial Institutions Energy Group adds that the Commission has granted regulated entities certain limited exemptions from Commission regulations 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)).

there is no cognizable reason to require additional verification of a market participant. Furthermore, Indicated Participants assert 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.

12. While Indicated Participants support SPP's proposal to give market participants 14 days from the receipt of a notice to submit their risk management policies, they argue that SPP should adopt a longer cure period to fix any deficiencies in its risk management policies submission. Specifically, they argue that SPP should give market participants at least 55 days (similar to the proposal submitted by ISO New England Inc. (ISO-NE) in Docket No. ER11-3953-000). Indicated Participants argue that anything less unnecessarily compresses the time for market participants to provide substantive responses and documentation and could lead to inadvertent error or unintended tariff violations. They add that many market participants have a multi-layered internal approval process that must be satisfied prior to producing documentation, which would be hindered by an overly and unnecessarily compressed cure period.

13. Indicated Participants further argue that the Commission should direct SPP to clarify that it will include a written explanation of why it is unable to complete a satisfactory verification of the market participant's risk management policies when it first notifies the market participants of a deficiency in verification and before the cure period begins. They explain that without a written explanation, a market participant will be unable to effectively respond with additional evidence or properly characterize the basis of any appeal to the Commission. In addition, Indicated Participants further contend that SPP should revise its proposal to provide a market participant that receives a negative determination with at least an additional 14 days from the date the relevant cure period expires to appeal the negative determination to the Commission. They explain that otherwise 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. To avoid unnecessary appeals and to provide market participants with certainty, Indicated Participants argue that the Commission should direct SPP to modify its proposal to allow for this additional time to file an appeal with the Commission.

c. <u>Commission Determination</u>

14. In the Initial Compliance Order, the Commission directed SPP 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 SPP's proposed compliance verification process complies with the Initial Compliance Order and is just and reasonable and not unduly discriminatory or preferential and, therefore, we accept the proposal to be effective October 1, 2011.

15. We reject 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 SPP'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 their stakeholders to develop minimum participation criteria that are applicable to their markets.[22] In its filing, SPP 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 administrating 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.

16. Similarly, we decline to require SPP to adopt Indicated Participants' proposal regarding when and how often SPP will verify a market participant's compliance with risk management practices and policies. SPP proposes to select up to 20 percent of its market participants annually for review on a random basis or based on identified risk factors. We find that SPP's proposal is reasonable, and believe that it strikes an appropriate balance by periodically verifying that market participants are complying with risk management policies and procedures without unduly burdening market participants. In addition, Indicated Participants argue that the Commission should direct SPP to recognize successful verification by another RTO or ISO as satisfying SPP's risk management policies. Although the compliance verification processes between RTOs and ISOs may be similar, SPP has adopted risk management polices and procedures that are appropriate for its particular market. Thus, we will not require SPP to adopt Indicated Participant's proposal.

17. We will also not require SPP to adopt certain practices and time periods as proposed by Indicated Participants. Specifically, we will not require SPP to adopt a 55-day cure period for market participants to cure any deficiency in its risk management policies and procedures. The compliance verification process is to ensure that market participants have implemented the appropriate risk management procedures and remain adequately capitalized. We expect that market participants will be able to cure any deficiencies within 14 days, and thus, find that the 14-day cure period proposed by SPP is reasonable. In addition, we will not require SPP to revise its proposal to include an additional 14 days from the date the cure period expires to appeal a negative

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[22] Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 132-133, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33.

determination to the Commission. If a market participant disagrees with SPP's determination, it should have sufficient information to appeal to the Commission at that time.

18. Finally, though, we require SPP to provide a written explanation for any noted deficiencies in a market participant's risk management policies and procedures.[23]

2. Risk Management Attestation

a. Filing

19. SPP proposes to adopt a standard Annual Risk Management Certification Form as Appendix E to Attachment X in the SPP Tariff. As proposed, Appendix E requires market participants to provide information required by section 3.1.1.6, including a description of the market participant's risk management capabilities and procedures; identification of employees engaged in risk management activities and their relevant skills, training, and experience; and other information to assist SPP in reviewing the market participant's risk management capabilities. The form must be signed by a duly authorized officer of the market participant and notarized. In addition, revised section 3.1.1.6 requires market participants to submit their attestation of risk management capabilities in the form of the Annual Risk Management Certification Form in Appendix E and no later than April 30 of each year, beginning in April 2012. [24]

20. SPP also proposes to modify section 3.1.1.6 of Attachment X to indicate that a market participant will have two business days from receipt of notice from SPP that its attestation was deemed insufficient to cure any deficiency identified by SPP prior to being declined participation in SPP markets.[25]

b. Commission Determination

21. In the Initial Compliance Order, the Commission directed SPP to adopt a standard risk management attestation form for SPP market participants, since it will provide greater certainty regarding the criteria and standards SPP will use in evaluating a market

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[23] *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,183, at P 25 (2012) (accepting compliance filing in which PJM stated that it would explain any deficiencies in a market participant's risk management policies in its initial written notification and directing PJM to address this explanation in its business rules).

[24] *See* Proposed SPP Tariff, Attachment X, Appendix E.

[25] *See* Proposed SPP Tariff, Attachment X, Section 3.1.1.6.

participant's risk management capabilities.[26] The Commission also directed SPP to allow a two-day cure period for risk management attestations that it deems insufficient.[27] The proposed Annual Risk Management Certification Form is a standard attestation that will provide specific information that will assist SPP in reviewing the market participant's risk management capabilities, and SPP's revisions to section 3.1.1.6 establish a two-day cure period for insufficient risk management attestations. We therefore find that SPP's proposed standard risk management attestation provisions comply with the Initial Compliance Order and we accept the revisions.

The Commission orders:

SPP's compliance filing is hereby accepted to be effective October 1, 2011, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[26] Initial Compliance Order, 136 FERC ¶ 61,189 at P 39.

[27] *Id*.