

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Revised Public Utility Filing Requirements

Docket No. RM01-8-004

ORDER NO. 2001-F

ORDER GRANTING IN PART AND DENYING IN PART REQUEST FOR
CLARIFICATION OF ORDER NO. 2001

(Issued January 28, 2004)

1. On April 1, 2003, Reliant Resources, Inc. (Reliant) filed a motion for clarification seeking a finding by the Commission that Order No. 2001¹ does not require the reporting in Electric Quarterly Reports of power transactions cleared by the Guaranty Clearing Corporation ("GCC") and EnergyClear, Inc. ("EC"), on the grounds that such cleared transactions are purely financial and because GCC and EC are Designated Clearing Organizations ("DCOs") regulated by the Commodity Futures Trading Commission (CFTC).
2. The Commission will grant Reliant's motion, in part, because, as clarified below, electric power futures contracts that do not contain any delivery terms need not be reported in Electric Quarterly Reports. By contrast, power sales in cleared or uncleared transactions under contracts that provide for physical delivery of the power must be reported in the Electric Quarterly Reports filed by the public utilities that make these sales. This decision benefits the public by clarifying the scope of the Commission's reporting requirements under Order No. 2001.

¹Revised Public Utility Filing Requirements, Order No. 2001, 67 FR 31,043, FERC Stats. & Regs. ¶ 31,127 (2002), reh'g denied, Order No. 2001-A, 100 FERC ¶ 61,074 (2002), reh'g denied, Order No. 2001-B, 100 FERC ¶ 61,342 (2002).

Background

A. Order No. 2001 Reporting Requirements

3. On April 25, 2002, the Commission issued Order No. 2001, a final rule establishing revised public utility filing requirements. The rule requires public utilities to electronically file quarterly reports (Electric Quarterly Reports) summarizing specified pertinent data about their currently effective contracts (contract data) and data about wholesale power sales they made during the reporting period (transaction data). The transaction data required to be reported includes the reporting of "book outs," which the Commission clarified occur "when the cumulative effect of a number of separate power sales between two parties is such that they mutually agree to exchange their obligations to physically deliver power to each other, while maintaining all their other obligations, including payment."² Order No. 2001 provides, further, that details of each transaction, including transactions that are booked out, are to be separately reported and may not be reported in an aggregated format.³

4. With respect to the reporting of information regarding wholesale power sale transactions, Order No. 2001 maintained the Commission's long-standing distinction, established in the Morgan Stanley⁴ and NYMEX⁵ decisions, between "physical

² Order No. 2001 at P8, n.9. A book out occurs in a situation where one entity appears more than once in a contract path for the sale and purchase of power. Rather than have the entity end up delivering power back to itself, the parties settle the obligations in cash.

³ Order No. 2001 at P8.

⁴ Morgan Stanley Capital Group, Inc., 69 FERC ¶ 61,175 (1994), reh'g denied, 72 FERC ¶ 61,082 (1995) (Morgan Stanley). In Morgan Stanley, 69 FERC at 61,696, the Commission held that "electricity price risk management transactions (futures, options, swaps, and the like)" that did not result in the actual delivery of electricity were "purely financial" and need not be reported to the Commission.

⁵ New York Mercantile Exchange, 74 FERC ¶ 61,311 (1996) (NYMEX). In NYMEX, 74 FERC at 61,984, 61,987, the Commission held that the FPA and its reporting requirements did not apply to an electricity futures contract approved for trading by the CFTC unless the "contract goes to delivery, the electric energy sold under the contract will be resold in interstate commerce, and the seller is a public utility." The Commission defined a "futures contract" as "a contract for the purchase and sale of commodities for delivery some time in the future on an organized exchange

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and subject to the terms and conditions of the exchange," 74 FERC at 61,984, and noted that

transactions," which must be reported, and "purely financial transactions," which need not be reported.

5. In Order No. 2001, consistent with our precedent in NYMEX and Morgan Stanley, the Commission decided that book outs must be reported in Electric Quarterly Reports as power sales transactions because the underlying transactions "typically are for the sale for resale of electric energy in interstate commerce by a public utility."⁶ In Order No. 2001-A, the Commission further clarified that "purely financial transactions . . . would not be reported in Electric Quarterly Reports." Thus, while "physical transactions" must be reported in the Electric Quarterly Reports, "purely financial" transactions not need be included in such reports.

B. The Clearing Process

6. "Clearing" is a banking function that has been in use for centuries. Traditionally, banks joined together to form clearinghouses that held frequent meetings to settle the balances among members. Clearing has also been conducted by stock and commodity exchanges for many years. Since passage of the Commodity Futures Modernization Act of 2000, the CFTC has registered clearinghouses handling over the counter (OTC) energy derivative contracts as "Derivative Clearing Organizations" (DCOs). EC's application to operate as a DCO was granted by the CFTC, and GCC was registered as a DCO under the act's grandfather provisions.

7. Reliant argues that the financial nature of a Cleared Transaction at the GCC and EC clearinghouses is the same, even though the process used to clear and settle OTC Transactions varies. Reliant states that GCC and EC clear OTC transactions by novation⁷ of the OTC parties' bilateral power sale transactions. Reliant argues that, once a bilateral power transaction is accepted by the clearinghouse for clearing, the original OTC bilateral transaction (which includes the OTC parties' obligations to make and take physical power) is terminated and replaced by a new contract that is purely financial.

Congress "created the CFTC expressly to supervise futures trading" and recognized the CFTC's "exclusive jurisdiction over futures contracts."

⁶ Order No. 2001, FERC Stats. & Regs. ¶ 31,127 at 30,149.

⁷A "novation" is the act of substituting a new contract for a previous one. In the transactions at issue here, novation results in: (1) the termination of the original contract between the OTC parties and a release of their respective obligations to each other; and (2) the creation of a new transaction between the parties and the clearing entity or between members of the clearinghouse with each other.

8. Reliant further states that the Cleared Transaction can either be terminated by the establishment of an offsetting Cleared Transaction, or it can be converted into a physical delivery contract. Reliant states that, if the clearing transaction is not closed out, the Cleared Transaction is terminated and replaced (re-novated) by a contract between two OTC parties that are matched to make and take delivery of physical power.

9. With respect to GCC, Reliant states that, if the Delivering Partners decide to engage in an alternate delivery process, they forego the option of having the GCC collect collateral to cover any failure to deliver or take power, and the terms of physical delivery are governed by any executed bilateral power sales and purchase agreement between the Delivering Partners.

10. With respect to EC, Reliant states that, to clear and settle an OTC transaction, an EC Member must enter into a bilateral OTC transaction and then novate its obligations in such OTC transaction directly to EC. The obligations between the Member and EC are virtually the same as the original OTC transaction, except that they do not include the obligation of physical delivery. Reliant states that a Cleared Transaction that is a physical power product is either financially closed out or proceeds to physical delivery. Thus, if a Member holds an open Cleared Transaction at the termination of trading such product, then the position will proceed to physical delivery, and EC will match that Member with another Member for delivery.

Discussion

11. Reliant's motion recognizes that under the requirements of Order No. 2001, book outs must be reported, but seeks Commission confirmation of its view that the above-mentioned GCC and EC "clearouts" do not fall within the definition of book outs required to be reported. Reliant argues that, although the process by which Cleared Transactions are financially settled or "closed out" may appear similar to the book out process for physical transactions that are reported to FERC on a quarterly basis, these processes are distinguishable for four reasons. First, the Cleared Transactions that comprise the offset or financial close out are purely financial in nature. Second, the Cleared Transactions terminate the underlying OTC obligation to deliver power upon novation to the clearinghouse. Third, the offset or financial close out of a Cleared Transaction immediately terminates the obligations of the parties to the transaction. Fourth, Reliant argues that clearinghouse rules require that, if Cleared Positions are not offset or financially closed out, they will be transferred back to the OTC parties to

physically deliver the power. Thus, Reliant argues, the Cleared Transactions are purely financial.

12. Finally, Reliant argues that, like NYMEX, both the GCC and EC clearinghouses are DCOs regulated by the CFTC. The CFTC requires DCOs to comply with certain "core

principles" relating to financial resources, participant and product eligibility, risk management, settlement procedures, default rules and procedures, and rule enforcement and other matters. These core principles require DCOs to provide the CFTC with all information necessary for the CFTC to perform its oversight responsibilities with respect to them and to maintain records of all activities related to their businesses as DCOs in a manner acceptable to the CFTC for a period of five years. Reliant states that a DCO must obtain written CFTC certification before accepting a new product for clearing, or before implementing a new rule or amendment. This applies to products involving futures exchanges. Reliant argues that, given that the Cleared Transactions are cleared by DCOs regulated by the CFTC, the Commission should defer to the CFTC's jurisdiction with respect to these transactions for so long as they remain Cleared Transactions.

13. Consequently, Reliant argues, an OTC party should not be required to report a Cleared Transaction to the Commission unless and until the Cleared Transaction is terminated and replaced by a bilateral OTC contract that settles by physical delivery, and the electricity that is the subject of that contract is resold in interstate commerce by a public utility.

Commission Conclusion

14. The focus of this order is narrow, to clarify the reporting obligations regarding power sales that involve the use of DCOs. Consistent with the Commission's precedent in NYMEX, Morgan Stanley, and Order Nos. 2001 and 2001-A, purely financial transactions need not be reported in Electric Quarterly Reports and, to the extent that EC, GCC, and others limit their activities to purely financial transactions, their transactions need not be reported in Electric Quarterly Reports. Thus, the remaining task is to clarify which transactions fall into this category.

15. Electric Quarterly Reports are filed a month after the end of the calendar quarter in which the transactions to be reported have occurred. Consistent with our prior precedent, contract data and transaction data on any wholesale power sales contract that provides for physical delivery must be reported by public utilities in Electric Quarterly Reports, either as delivered power or as a book out. By contrast, "purely financial transactions" need not be reported in Electric Quarterly Reports. Further, any contract that terminated before the date on which service under the contract is due to start need not be reported in Electric Quarterly Reports.

16. Applying these principles to power sales cleared by a CFTC-approved DCO, when a power sales contract provides for physical delivery and has not been terminated prior to the commencement of service under the contract, transactions under the contract are to be reported in Electric Quarterly Reports. If such a contract is novated and replaced by a contract that does not provide for physical delivery of the power, consistent with our precedent on this issue, the novated contract is purely financial and need not be reported in Electric Quarterly Reports. If the financial contract is re-novated to a contract that does

provide for physical delivery, then transactions under the re-novated contract must be reported in Electric Quarterly Reports. Since a book out is a means to avoid physical delivery under a contract when a party appears twice in a delivery chain, see n.2 supra, it differs from a novation where a forward physical contract is terminated and replaced by a financial contract.

17. These findings are illustrated by the following table:

Reportable Transactions

Type of transaction	Reportable?	Reason
Wholesale power sale under bilateral power sale contract with delivery terms (no clearing)	Yes	Wholesale power sale under Part 35 of FPA
Cleared transaction novated to contract without delivery terms	No	Purely financial transaction, not reportable under Commission precedent and Order No. 2001
Cleared transaction re-novated to contract with delivery terms	Yes	Wholesale power sale under Part 35 of FPA

18. Moreover, the Commission will not allow public utilities that are required to file Electric Quarterly Reports to avoid their reporting duties by claiming that the DCOs have not made necessary data available to them. We will not exempt public utilities from the filing requirement based on a claim that the DCOs do not make all pertinent data available to enable the filing public utility to file an Electric Quarterly Report in full compliance with our filing requirements under Order No. 2001.

The Commission orders:

Reliant's motion for clarification is hereby granted in part, and denied in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.