

138 FERC ¶ 61,186  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

New York Independent System Operator, Inc.

Docket No. ER11-3949-003

ORDER ON COMPLIANCE

(Issued March 15, 2012)

1. On December 14, 2011, New York Independent System Operator, Inc. (NYISO) submitted a filing to comply with the Commission's September 15, 2011 order in the captioned docket.<sup>1</sup> The Initial Compliance Order accepted, with certain exceptions, revised tariff sheets subject to further compliance filing, to be effective October 1, 2011. As discussed in this order, NYISO's proposed verification compliance process is rejected. NYISO is directed to submit a compliance filing proposing a new verification compliance process, within 60 days of the date of this order.

**I. Background**

2. In Order No. 741, the Commission adopted reforms to strengthen the credit policies used in organized wholesale electric power markets.<sup>2</sup> 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,<sup>3</sup> the Commission directed regional transmission organizations (RTO) and independent system operators (ISO) to revise their tariffs to reflect the following reforms:

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<sup>1</sup> *New York Independent System Operator, Inc.*, 136 FERC ¶ 61,193 (2011) (Initial Compliance Order).

<sup>2</sup> *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).

<sup>3</sup> 16 U.S.C. §§ 824d, 824e (2006).

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,<sup>4</sup> 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, in Docket No. ER11-3949-000, as corrected on July 5, 2011, in Docket No. ER11-3949-001, NYISO proposed revisions to the NYISO Market Administration and Control Area Services Tariff (Services Tariff), including revisions to Services Tariff section 26 of Attachment K (Attachment K), and the NYISO Open Access Transmission Tariff (OATT) in response to the directives in Order Nos. 741 and 741-A. Also on June 30, 2011, in a Supplemental Filing in Docket No. ER11-3951-000, NYISO filed proposed corresponding revisions to its ISO Agreement in accordance with the requirements of Order No. 741. For both dockets, the proposed revisions: (i) established billing and settlement periods of no more than seven days each; (ii) limited the amount of unsecured credit extended to any one market participant or affiliated group of market participants to \$50 million; (iii) eliminated unsecured credit for financial transmission rights markets; (iv) establish minimum participation criteria for market participants related to financial risks; (v) provided examples of circumstances that may justify NYISO's invocation of the "material adverse change" provision of its creditworthiness policy; and (vi) limited to no more than two days the time period permitted for a market participant to meet a collateral call.

4. In the Initial Compliance Order, the Commission determined that NYISO's proposed revisions complied with the requirements set forth in Order Nos. 741 and 741-A with limited exceptions. The first exception was NYISO's proposal to treat as cash collateral a net receivable amount. Acceptance of this proposal was conditioned upon acceptance of NYISO's future filing regarding the ability to offset market obligations.<sup>5</sup> The Commission also conditionally accepted NYISO's minimum participation criteria, but found that an annual risk management policy certification was insufficient to ensure the protection of the markets, and therefore required NYISO to develop a periodic

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<sup>4</sup> 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.

<sup>5</sup> Initial Compliance Order, 136 FERC ¶ 61,193 at P 15.

verification compliance process to independently verify that risk management policies and procedures are actually being implemented and that adequate capitalization is being maintained.<sup>6</sup>

## **II. Notice of Filing and Responsive Pleadings**

5. Notice of NYISO's December 14, 2011 compliance filing was published in the *Federal Register*, 76 Fed. Reg. 80,357, with protests and interventions due on or before January 4, 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**

6. 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**

7. NYISO proposes to add new Section 26.1.3 to Attachment K of the Services Tariff to establish verification of market participant risk management policies and procedures.<sup>7</sup>

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<sup>6</sup> *Id.* P 47 and n.41 (stating that "The Commission will not mandate a particular form of periodic verification of attestations concerning minimum risk management policies, practices and procedures. However, such a periodic verification could include periodic review of risk management policies, practices, and procedures, and their implementation, conducted on a random basis or directed to certain market participants based on identified risk.").

<sup>7</sup> NYISO states that new Section 26.1.3 supplements its existing ability, pursuant to section 26.1.4 of Attachment K, to require market participants, at any time, to submit their risk management policies and description of internal controls to NYISO for review. Section 26.1.4 requires market participants to submit to the NYISO, upon request, "any information or documentation reasonably required for the ISO to monitor and evaluate Customer's creditworthiness and compliance with requirements set forth in the ISO

(continued...)

NYISO states that new Section 26.1.3.1 defines a subset of market participants that would categorically be subject to verification based on identified risks, consistent with the Initial Compliance Order. NYISO identifies this subset of market participants as those who are active in the NYISO-administered TCC market and hold high-risk TCC portfolios.<sup>8</sup> These market participants are identified by a two-step screening process. NYISO explains that the first screen identifies market participants with a concentration of negative or low positive TCCs (i.e., TCCs with a positive value close to zero), and who do not solely own Grandfathered Rights and/or Fixed Price TCCs. The second screen subjects those identified market participants to verification unless the market participant: (1) maintains at least \$10 million in assets or \$1 million in tangible net worth; and (2) has participated in the TCC market, or similar market of another ISO/RTO, for more than three years.

8. NYISO explains that its proposal focuses on the TCC market because the duration of TCCs creates unique risks that are difficult to quantify and that distinguish TCCs from other wholesale electric market products.<sup>9</sup> NYISO maintains that the proposal defines the scope of market participants potentially subject to verification as those that hold a concentration of negative or low positive TCCs because these TCC concentrations pose the greatest risk of payment default. NYISO states that holders of negative TCCs must make congestion payments to the NYISO, and that low positive TCCs run a disproportionately high risk of becoming negative TCCs. NYISO further states that it has further refined the scope, with stakeholder input, to make an exception to the verification requirement for market participants that are well capitalized and have more than three years of TCC market experience.

9. NYISO explains that proposed Section 26.1.3.2 of the Services Tariff establishes eight criteria that will be applied by NYISO when it subjects a market participant's risk

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Tariffs, ISO Procedures, and/or ISO Agreements related to settlements, billing, credit requirements, and other financial matters.” NYISO states that it may request a market participant to submit its risk management policies and procedures whenever, in NYISO's discretion, the request appears to be warranted regardless of whether the market participant is subject to verification under the risk management provisions in new Section 26.1.3. NYISO December 14, 2011 Compliance Filing at 4.

<sup>8</sup> In the NYISO marketplace, financial transmission rights are known as Transmission Congestion Contracts (TCC).

<sup>9</sup> NYISO December 14, 2011 Compliance Filing at 4 (citing Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 70-72).

management policies and procedures to verification.<sup>10</sup> NYISO states that continued eligibility to participate in NYISO-administered markets is conditioned upon successful completion of NYISO's verification. NYISO further notes that a market participant that is satisfactorily verified by NYISO, or other ISO/RTO with substantially similar verification standards, will be required to satisfy a subsequent verification if the market participant materially changes its risk management policies and procedures or otherwise experiences a material adverse change. NYISO states that new Section 26.1.3.2 of the Services Tariff also provides that NYISO may retain a third party to perform the review and verification function.

10. Additionally, NYISO proposes to make ministerial revisions to Section 26.1.1(d)(i) of the Services Tariff to clarify that the capitalization requirements are minimum requirements and also to clarify that market participants must provide a copy of their annual audited financial statements as evidence of their capitalization.

11. NYISO requests that its proposed tariff language become effective on June 30, 2012. NYISO states that this proposed implementation date will provide time for NYISO to identify, in coordination with other ISOs/RTOs, an independent body qualified to perform the verification process established by the proposed tariff revisions. In the event that NYISO has not engaged an independent body to perform the verification process by the proposed implementation date, NYISO requests permission from the Commission to

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<sup>10</sup> The eight criteria proposed by NYISO are: (1) Customer's risk management framework is documented in a risk policy addressing market, credit and liquidity risks that have been approved by the Customer's risk management function, which includes appropriate corporate persons or bodies that are independent of the Customer's trading functions, such as a risk management committee, a designated risk officer, a Customer's board of directors or board committee, or, if applicable, a board of directors or board committee of a Customer's parent company; (2) Customer maintains an organizational structure with clearly defined roles and responsibilities that appropriately, and to the extent practical, segregate trading functions from risk management functions (e.g, segregation of front, middle, and back office functions); (3) Customer has established delegations of authority specifying the transactions into which its traders are allowed to enter; (4) Customer ensures that its traders have adequate training and/or experience relative to their delegations of authority in the systems and markets in which they transact; (5) As appropriate, risk limits are in place to control risk exposures; (6) Reporting is in place to ensure that risks are adequately communicated throughout the organization; (7) Processes are in place for qualified independent review of trading activities; and (8) As appropriate, there is periodic valuation or mark-to-market of risk positions. NYISO December 14, 2011 Compliance Filing, Attachment II at proposed section 26.1.3.2.

defer the implementation of the proposed tariff revisions, as appropriate, upon the filing of a notice and amended tariff sections with the Commission by June 30, 2012 that indicate the revised effective date.

**b. Protest**

12. Financial Institutions Energy Group and Indicated Participants argue that the Commission should exempt from verification requirements any market participant whose NYISO market-related risk management practices are subject to the regulation, supervision, and audit by certain banking regulators.<sup>11</sup> They argue that the regulation undertaken by such banking regulators is more sophisticated and comprehensive than that which NYISO will conduct, and therefore should suffice for a determination by NYISO that the necessary risk policies and procedures are implemented.<sup>12</sup> Financial Institutions Energy Group and Indicated Participants assert that the risk management processes proposed by NYISO would be duplicative, result in unnecessary costs for both NYISO and 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 NYISO to exempt entities that are subject to oversight and audit by such banking regulators from NYISO's periodic verification and audit of risk management policies and procedures.

13. Indicated Participants support NYISO's proposal to exclude from subsequent verification those market participants that NYISO or another RTO or ISO with similar verification standards has verified unless the market participant later materially changes its risk management policies or experiences a material adverse change. However, Indicated Participants request that the Commission direct NYISO to provide market participants with at least 14 days to respond to a request for documentation of their risk

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<sup>11</sup> 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.

<sup>12</sup> 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)).

management policies. Indicated Participants argue that NYISO's proposal to require submission within 2 days would overly compress the window for market participants to gather and submit necessary materials.

14. Indicated Participants also argue that the Commission should require NYISO to adopt a 55-day cure period for market participants to fix any deficiencies in their risk management policies submission (similar to ISO-NE's proposal). They argue that anything less than 55 days unnecessarily compresses the time period 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.

15. Indicated Participants further argue that the Commission should direct NYISO 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 participant 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 contend that NYISO 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 NYISO to modify their proposals to allow for this additional time to file an appeal with the Commission.

**c. Commission Determination.**

16. In the Initial Compliance Order, the Commission directed NYISO to develop a periodic verification compliance 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. As discussed below, we reject NYISO's proposed verification compliance process. NYISO is directed to submit a new verification compliance process within 60 days of the date of this order.

17. NYISO's proposal does not comply with the Initial Compliance Order.<sup>13</sup> The group of market participants selected by NYISO for verification is inadequate. NYISO argues that this group is defined based on identified risks. However, NYISO's proposal provides a blanket exception for market participants that, at the time of verification, have both: (i) three years of experience in the TCC (or similar) market and (ii) adequate capitalization. The proposed exception is unsupported and inconsistent with the Initial Compliance Order. NYISO does not explain why the risks posed by excepted market participants are such that verification is not required. NYISO cannot independently verify that risk management policies and procedures are actually being implemented based on a market participant having three years of past experience. In the same way, NYISO cannot independently verify that adequate capitalization is being maintained based on a market participant's adequate capitalization at an earlier point in time.

18. Moreover, NYISO has not proposed an adequate periodic verification requirement because, according to NYISO's proposal, a market participant that satisfies the verification requirement once "shall only be subject to subsequent verification if the [market participant] materially changes its risk management policies and procedures or experiences a material adverse change as determined by the ISO."<sup>14</sup> NYISO's proposed requirement is not periodic.

19. For these reasons, we reject NYISO's proposal.

20. The Commission also 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 NYISO's verification compliance policies and procedures. In Order No. 741, the Commission directed all TOs and ISOs to adopt minimum participation criteria, but explicitly left it to each RTO

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<sup>13</sup> We note that, concurrent with this issuance, we are accepting periodic verification compliance proposals from other ISOs. *California Independent System Operator Corporation*, 138 FERC ¶ 61,181; *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,182; *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,183; *Midwest Independent Transmission System Operator, Inc.*, 138 FERC ¶ 61,184; *ISO New England Inc. and New England Power Pool*, 138 FERC ¶ 61,185; and *Southwest Power Pool, Inc.*, 138 FERC ¶ 61,187. As in these proposals, a just and reasonable periodic verification compliance proposal could include identification of market participants subject to verification based on such identified risks as level and type of position within the NYISO or other ISO markets.

<sup>14</sup> NYISO December 14, 2011 Compliance Filing, Attachment II, proposed section 26.1.3.2.

and ISO and its stakeholders to develop minimum participation criteria that are applicable to its markets.<sup>15</sup> In this filing, NYISO did not propose to wholly exempt any particular class or group of market participants from the verification compliance 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.

21. We will also not require NYISO to adopt certain practices and time periods as proposed by Indicated Participants. 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 NYISO. We expect that a market participant that has implemented its risk management policies and procedures and maintained adequate capitalization will have the necessary documentation readily obtainable. We also disagree that market participants need a 55-day period to cure any deficiency in the implementation of its risk management policies and procedures. The verification compliance 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 in the time period proposed by NYISO and find that the cure period is reasonable. In addition, we will not require NYISO 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 NYISO's determination, it should have sufficient information to appeal to the Commission at that time.

22. Finally, we reject as inapplicable Indicated Participant's request that we require NYISO to provide for a written explanation for any noted deficiencies in a market participants' risk management policies and procedures because NYISO has already committed that it will provide for such written verification.<sup>16</sup>

The Commission orders:

(A) NYISO's proposed verification compliance process is rejected, as discussed in the body of this order.

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<sup>15</sup> Order No. 741, FERC Stats. & Regs. ¶ 31,317 at PP 131-132, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 at P 33.

<sup>16</sup> NYISO December 14, 2011 Compliance Filing, Attachment II at proposed section 26.1.3.2.

(B) NYISO is hereby directed to submit a compliance filing proposing a new verification compliance process, within 60 days of the date of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.