Technical Conference on FERC's Connected Entity NOPR
Docket RM15-23-000
Comments by Matthew J. Picardi
For
Shell Energy North America (US), L.P.
And the Electric Power Supply Association

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On behalf of The Electric Power Supply Association ("EPSA")[1] and Shell Energy North America (US), L.P. ("Shell Energy") I am pleased to have the opportunity to provide the Commissioners and Staff of the Federal Energy Regulatory Commission ("Commission" or "FERC") with our views on the Notice of Proposed Rulemaking concerning the collection of Connected Entity data for market participants in organized electricity markets.[2] At the outset, I would like to emphasize that Shell Energy and EPSA support the goal of enhancing the ability of the Commission and Enforcement Staff to monitor and detect potential market manipulation in an efficient and productive manner. Like most market participants, we are harmed when manipulation occurs, causing markets to behave in a manner that is inconsistent with fundamental conditions. With this proposal, the Commission is attempting expand its ability to monitor market activity. It does so by proposing to obtain access to information to identify situations where a market participant is trading or performing some activity that benefits

[1] EPSA is the national trade association representing leading competitive power suppliers, including generators and marketers. Competitive suppliers, which collectively account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

[2] Notice of Proposed Rulemaking, Collected of Connected Entity Data from Regional Transmission Organizations and Independent System Operators, Docket No. RM15-23-000, 80 Fed. Reg. 58382 (Sept 29, 2015). ["NOPR"]

another entity which bears a financial or legal relationship to it. While it is important that the Commission monitor this activity when it is being conducted as a scheme to engage in manipulative behavior in markets FERC regulates, the proposal in its current state is vague, would create burdensome and duplicative filing requirements, and would add material operational and compliance risks for markets participants and others without providing meaningful tangible benefits. Specifically, much of the information the proposal could elicit will not help the Commission achieve its goals and will result in increased costs for RTO/ISOs, market participants and ultimately consumers.

I. Recommendations

Before I get into a discussion of some of the issues, I would like to highlight some recommendations that we can offer at this point in time. We will be in a position to refine these recommendations in the comments we intend to file with the Commission in January.

a. First, the definition of Connected Entity needs to be clarified and narrowed to elicit information that will be useful to the Commission and to reduce the burden and risk associated with complying with the proposal.

b. Next, we think it is a mistake to attempt to replace the current affiliate disclosure rules with the Connected Entity filing as the information sought in those filings is required for different reasons, will not always be a perfect substitute for the many functions and purposes served by affiliate disclosures pursuant to the RTOs/ISOs Tariffs. Instead, the Commission should look to preexisting reporting requirements across the RTOs/ISOs, and its own filing requirements for participants in its jurisdictional markets, to synthesize or refine specific elements of this information

and use it efficiently to discern connections that realistically could be the basis for coordinated activity. One place this could be done is through the Change in Control filings that market participants are required to make with the Commission pursuant to Order 652.[3]

c. The definition of Trader must be clarified to cover persons that truly control trading activity in the organized markets and be extremely clear so that individuals and firms participating in these markets are not exposed to unnecessary regulatory risk with respect to who is covered.

d. Any final rule covering the usage and protection of information that may be commercially sensitive, such as information that is protectable in fuel supply contracts which the NOPR treats as reportable Connected Entities must specifically identify how this will occur under RTO/ISOs' information policies and Freedom of Information Act disclosure requirements and FERC rules concerning protection of confidential information. The assertion in the NOPR that some of this information "may" be treated as confidential and protected from public disclosure is not sufficient if the RTOs/ISOs have access to new information that is commercially sensitive. Also, their information policies must spell out the purposes for which it can be used and who can have access to it.

[3] Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority, 110 FERC ¶ 61,097 (Order No. 652), order on reh'g, 111 FERC ¶ 61,413 (2005) (Order No. 652-A).

e. One of the cost and efficiency gains the Commission hopes to generate is a standardized process for Connected Entity data that will serves as a substitute for many other information requirements. Based on our experience with minimum participation requirements pursuant to FERC Order 741, RTOs/ISOs will not be able to standardize the information collection process enough across markets for there to be any benefits for entities that transact in multiple markets, and therefore the burden associated with the proposed rule for many market participants will in fact increase significantly unless the proposal is modified.

f. A Connected Entity rule should focus on situations where there is a sufficient financial interest and/or ability to control a resource to make collection of the proposed data useful to the Commission or market monitors. Currently, the NOPR posits that control is presumed even as to passive ownership or debt financing arrangements, and does not provide a forum or process for market participants to rebut the presumption of control. In addition, market participants should be able to demonstrate independence in operational and trading functions among entities as a way of managing the filing burdens efficiently and that relief should be available well in advance of any expectation that they commit resources to preparing a Connected Entity Filing. For example, the final rule should recognize the Chinese Walls that exist between marketing and trading firms and their transmission company affiliates pursuant to Commission rules and the codes of conduct in order to exclude these independently managed entities from the definition of Connected Entity.

g. Finally, depending on the complexity and scope of the final rule, the Commission should consider phasing in the reporting requirements in addition to creating criteria for safe harbors for good faith errors as it has done under the price reporting regime.

II. **Concerns with the Definition of Connected Entity**

The definition of Connected Entity does not offer an additional level of information that will be helpful to the Commission's market oversight functions, but rather will cause the Commission to collect a significant amount of information that is not useful in either assessing a market participants' actual ability to work in concert to manipulate the market or act as a measure of its financial interest in doing so. In proposed Section 35.28(g)(4)(i), the Commission discusses ownership and control. Control is the key in the overall context but it is not defined in the NOPR nor is it clear why ownership of 10 percent is appropriate when someone is trying to ascertain if one entity has <u>sufficient control over or interest in</u> another entity to influence the way it will behave in the market. It would seem that the primary concern of the Commission would be a connection that is sufficient for someone to have a financial incentive to engage in the suspect behavior and the ability to act on it. As the Commission said in discussing the need for the information, "[r]ather than performing a trade or other action that results in a direct benefit to itself, a market participant might instead *take actions that benefit another entity that bears a financial or legal relationship to it.*"[4] (emphasis added). The ownership threshold

[4] Notice of Proposed Rulemaking, *Collection of Connected Entity data from regional Transmission Organizations and Independent System Operators,* Docket No. RM15-23-000 (Sept. 17, 2015) at ¶10.

proposed does not provide a sufficient incentive to engage in this behavior and there is not a definition of control to determine if one firm could actually accomplish such behavior.

Let us take for example as situation where three market participants are co-tenants or joint owners of a 600 MW natural gas, combined cycle generator in PJM. They each own one-third of the project and one of the owners, ACME Energy, acts as the operating company and is responsible for bidding and scheduling the asset into the PJM-administered markets. It makes sense that ACME Energy has the ability influence the bidding behavior and scheduling of the generator and might have an incentive to benefit other positions it holds or entities in which it has an interest in PJM so it should have a connected entity filing obligation. The other passive owners do not have any control over the operation of the plant so they could not engage in behaviors for the benefit of other positions or entities they hold.

By providing the Commission with connected entity information that identifies a practical ability to engage in behavior that may raise concerns for staff and where there is a significant enough financial interest for a market participant to engage in such behavior, the staff will have access to a set of data that will most likely identify concerns or eliminate them as "false positives." Collecting significant volumes of data for relationships that provide a very low probability of yielding useful information is not an efficient use of Commission, RTO/ISO or market participant resources.

A more practical approach that reflects modern corporate organizational realities would be to reflect for reporting purposes a percentage of ownership of financial interests and/or control that is sufficient to merit concern. The Commodity Futures Trading Commission ("CFTC") recently recognized this in connection with its proposed position limit rules. In its

Supplemental Aggregation NOPR,[5] it proposes to revise its aggregation requirements for position limit purposes so that market participants can claim an exemption from aggregation of affiliate positions for firms with ownership between 10% and 50%, and even for ownership levels above 50% where a lack of control and separation can be shown. The Commission should consider a similar approach here.

The definition also refers to the collection of information by market participants under common control engaged in "Commission jurisdictional markets." As proposed the rules are intended to cover activities in RTO/ISO administered markets; however, in practice the rule would seem to cover markets outside of the organized markets thereby encompassing many activities that are not intended as it is overly broad. In fact, the Commission specifically proposes that Connected Entities be identified for firms not engaged in activities in the same market as the market participant. It is unclear why connections from different markets will provide useful information. Taken to its logical conclusion, does this statement mean, for example, that for a firm that is a market participant in NYISO, but has a Connected Entity in ERCOT, that NYISO firm will have to obtain and verify and provide information about the ERCOT entity?

The scope of the definition is too broad to achieve its state goal. The NOPR identifies certain types of transactions that could reasonably be reported, such as a tolling agreement. In that case, the entity tolling the asset will have enough control of the operational and market

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[5] *See* Supplemental Notice of Proposed Rulemaking, *Aggregation of Positions*, 80 Fed. Reg. 58,365 (Sept. 29, 2015), *available at* http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2015-24596a.pdf.

activity, and if it has other positions in the same market, potentially the means to influence them. In that case, it is understandable for those relationships to be reported for market monitoring purposes. In the same vein, there could be energy management agreements where the energy manager has control over bidding and scheduling or shares in performance incentives. Access to that information could shed light on the behavior of these market participants. The connections that are more remote and will pose an unnecessary burden for no benefit include fuel supply and asset management agreements or bidding and scheduling coordination service agreements that do not afford the supplier an opportunity to control the bidding or operation of its generator customer. It simply does what the customer wants. In Shell Energy's experience with these types of transactions the parties make it clear in their transactional documents who is responsible for formulating bids or scheduling a plant to run, e.g. requesting a self schedule. Absent control over the bidding activity, and assuming no other financial interest, collection of data about these agreements does not seem to serve the goal of the NOPR and will create unnecessary burdens for market participants and their fuel suppliers and managers.

As an analogue to simple fuel supply arrangements or stand alone asset management agreements, some natural gas supply firms enter into transactions to managing and/or supply natural gas to a generator and assume the administrative function of bidding and scheduling of that generator without control or authority over the formulation of the bids or scheduling of the generator. These structures arise in situations where the gas supplier is looking to the stream of revenues from the RTO/ISO for the production and sale of electricity into that market by the generator customer as financial security for the gas sale. It allows generators that do not

have strong credit to avoid the expense of posting margin to accommodate the gas purchase. These structures may be undermined by this rule to the extent that suppliers simply exit the market rather than being deemed a connected entity with a generator.

Another problem relates to the debt provisions of the definition. Many generators have financing documents that preserve the right for lenders or bond holders to take possession of the company property in the event of a bankruptcy. Under the current definition, these arrangements could trigger reporting with institutions that have no connections with RTO/ISO markets other than lending money to generators that participate in these markets

Finally, it is not clear if the connected entity definition should apply to supply arrangements with competitive retail energy service companies where the wholesale supplier manages its portfolio. Additionally, the definition is unclear with respect to distributed generation customers. To justify the burden that would be required to identify these connections it is important to understand market behavior concerns posed by these connections and if there has been a record of such relationships supporting instances of market abuse.

If the Commission definition of connected entity included in the NOPR is not extensively revised, then the Commission should establish a meaningful *de minimis* threshold for the newly proposed situations contemplated by the proposed rule.

III. The Definition of Trader Should Be Narrowed and Clarified

As written, the NOPR does not define what a “trader” is for reporting purposes. This can create significant confusion and regulatory risk for market participants. There are a variety of employees or contractors that could be covered by the rule given that their responsibilities in

some way relate to the management of a generating or even load resource, but should not be covered given the stated purpose of the proposed rule. For example, does the definition cover employees dedicated to trading in Financial Transmission Rights markets, even if they do so purely to hedge load positions? In addition, employees that do not directly participate in RTO/ISO administered markets, such as employees that purchase fuel for power plants, participate in the trading of emission credits or renewable energy credit (REC) markets or originators that are responsible for establishing long term, bi-lateral transactions or set up trading or commercial relationships should not pose concerns.

The definition of trader should be focused on persons that have the authority to formulate bids and offers that are submitted into the RTO/ISO administered markets or develop the strategies for participation in such markets. Many firms have employees that simply enter the bids and offers into RTO/ISO platforms but do not determine what the bids will be; such employees should not be designated as Traders.

IV. Confidentiality and Use of Information

If the proposed rule is adopted, it will require the provision of new information about each Connected Entity of a market participant. This new collected information could cover commercially sensitive short-term and long-term transactions as well as asset management or fuel supply transactions. The NOPR does not provide specific assurance as to how this and other commercially sensitive information will be protected from public disclosure; it only identifies provisions of federal law, FERC regulations and RTO/ISO policies that "may" provide this protection. This process must be clarified so market participants have confidence that their proprietary information will not be disclosed. In addition, the RTO/ISO information policies

should be clear that access to this information is limited to internal and external market monitor use, as it is being used only for the purpose of monitoring market behavior.

V. Burden and Ability to Standardize Across All RTOs/ISOs

The burden for market participants to assemble this information will be much greater than represented in the NOPR, especially for large market participants operating in multiple markets. The time for review of transactions potentially subject to the definition of market participant as proposed will be significant, especially given the vague nature of some of the terms. It will require more legal review than predicted in the NOPR to resolve questions over whether certain transactions, corporate structures or debt arrangements are covered. It is important to note that a market participant's lack of knowledge of certain connections or changes to tenuous connections could be considered a tariff violation. This as well as the proposed requirement for an officer certification on a yearly basis that the data is comprehensive and accurate will also generate a significant amount of internal and legal review.

In addition, we are not confident that the RTOs/ISOs will be able to standardize the form or submission process across markets. Each RTO/ISO will probably have different systems and interfaces and very likely retain different information requirements as the proposed rule is implemented. An example of this is the minimum participation criteria information filings that markets participants must make with each of the RTOs/ISOs to participate in their transmission

congestion markets. The basic requirements were set out by the Commission in Order 741[6] but each of RTO/ISO has implemented the order differently and periodically each makes changes to their respective requirements that must be reviewed and confirmed each year and then the information is assembled with the appropriate officer certification. At Shell Energy, we had to develop templates for each market because we had to obtain and confirm information for multiple markets with different trading and support groups across the company.

If the Commission issues a generic order, each RTO/ISO will engage its stakeholder process to determine how its rules should be written to comply with the order. Given differences in systems and stakeholder views on how the respective RTO/ISOs should implement such a program, differences will arise that will cannibalize any theoretical efficiencies. Additionally, it is likely that several if not all of the RTOs/ISOs will retain their existing affiliate disclosure requirements in order to support related tariff provisions and practices, undercutting the attempt to standardize informational requirements across markets.

In addition to narrowing the definition of Connected Entity, efficiencies could be captured by requiring the filing of this data as part of another filing requirement such as the change in status reporting mentioned above. The information could be sent to FERC or a single FERC reporting repository. This is the only way to ensure sufficient standardization to maintain any of the efficiencies that the Commission hopes to realize.

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[6] *Credit Reforms in Organized Wholesale Electric Markets,* Order No. 741, FERC Stats. & Regs. ¶ 31,317 (2010) at P 149, *order on reh'g*, Order No. 741-A, FERC Stats. & Regs. ¶ 31,320 (2011), reh'g denied, Order No. 741-B, 135 FERC ¶ 61,242 (2011).

The NOPR reminds me of the urban myth that has the actor Kevin Bacon connected with every other actor in Hollywood by six degrees of separation or less. As proposed, I fear the NOPR creates connections with less degrees of separation and a significant number of energy companies will find them subject to the rule and leave the Commission with a tremendous amount of information that will not help it efficiently monitor market activity.