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November 4, 2013

**By Electronic Delivery**

Kimberly D. Bose, Secretary  
Federal Energy Regulatory Commission  
888 First Street N.E.  
Washington, D.C. 20426

**Re: *New York Independent System Operator, Inc.*, Proposed Tariff Revisions  
Regarding Prohibited Investments, Docket No. ER14- -000**

Dear Ms. Bose:

Pursuant to Section 205 of the Federal Power Act,<sup>1</sup> the New York Independent System Operator, Inc. (“NYISO”) hereby submits proposed revisions to its Independent System Operator Agreement (“ISO Agreement”) and its Open Access Transmission Tariff (“OATT”) to narrow the scope of the rules restricting investments by NYISO directors, employees, their spouses, and their minor children (together, “NYISO Employees”) in securities issued by a market participant or its affiliates.

The rules restricting investments were initially developed prior to the start of NYISO operations and establish a very broad prohibition against NYISO Employees owning securities issued by a market participant or any of its affiliates. Since that time, the number of market participants has more than tripled and continues to grow. The NYISO now has nearly 400 market participants. Their affiliates include approximately 340 publicly traded companies – many of which have very little to do with the electric sector or the NYISO markets. This expanding reach was not foreseen when the rules were designed over a decade ago and is now inhibiting NYISO recruiting and retention, particularly with regard to directors.

The tariff revisions proposed in this filing establish objective, quantitative criteria for determining whether an investment by a NYISO Employee in securities issued by a market participant or any of its affiliates would create a conflict of interest. The proposed revisions will prohibit investments that would create a conflict of interest, but will allow investments in

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<sup>1</sup> 16 U.S.C. § 824d (2013).

companies that have only a *de minimis* relationship with the NYISO and the electric sector. As a result, the revisions will help address the recruiting and retention problems posed by the current rules in a manner that preserves the independence of NYISO Employees.

The NYISO requests that the proposed tariff revisions become effective on January 3, 2014, which date complies with the Commission's notice requirements.<sup>2</sup>

### **I. List of Documents Submitted**

The NYISO submits the following documents:

1. This filing letter;
2. A clean version of the proposed revisions to the OATT (Attachment I); and
3. A blacklined version of the proposed revisions to the OATT (Attachment II).

The NYISO will make a supplemental filing to submit clean and blacklined versions of the proposed revisions to the ISO Agreement. Due to technical restrictions imposed by the eTariff system, the NYISO is unable to electronically submit the proposed revisions to the ISO Agreement at the same time as it electronically submits its proposed revisions to the OATT. With the exception of this Section I, the filing letter for the supplemental filing will be identical to this filing letter.

### **II. Copies of Correspondence**

Communications regarding this pleading should be addressed to:

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<sup>2</sup> See 18 C.F.R. §35.3 (2013).

<sup>3</sup> The NYISO respectfully requests waiver of 18 C.F.R. § 385.203(b)(3) (2013) to permit service on counsel for the NYISO in both Washington, D.C. and Richmond, VA.

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### **III. Background**

#### **A. Current Prohibited Investment Rules for NYISO Employees**

Section 5.01 of the ISO Agreement and Section 12.7 of the OATT establish broad restrictions against NYISO Employees owning the securities of a market participant or its affiliates. Under these rules, a NYISO Employee holding prohibited securities generally has six months to divest those securities or, if eligible, transfer those securities to a blind trust.<sup>4</sup>

#### **B. Impact of the Evolution of the NYISO's Markets**

At the start of NYISO operations, most market participants were traditional electric sector companies. Now market participants and their affiliates comprise a wide variety of companies, including companies whose primary business activities are unrelated to the electric sector. The number of market participants has more than tripled over the past decade from approximately 120 in 1999 to nearly 400 today. These market participants have tens of thousands of corporate affiliates. Several hundred market participants and affiliates issue publicly-traded securities. Many of these companies have little, if any, direct contact with the NYISO markets.

The increasingly broad impact of the NYISO's rules regarding prohibited investments was not foreseen when those rules were implemented at the outset of NYISO operations. This issue is now posing recruiting and retention problems, particularly with regard to directors. This is a problem that will continue to grow, impairing the NYISO's ability to attract and retain top talent. In addition, these rules have the potential to cause unnecessary financial harm to a NYISO Employee who is required to divest securities that do not present any real conflict of interest concern without any consideration of potentially relevant facts and circumstances.

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<sup>4</sup> OATT Attachment F § 12.7.2.

### **C. Blind Trust Mechanism Has Proven an Incomplete Solution**

In light of this market evolution, the Commission approved revisions to the OATT and ISO Agreement last year whereby a NYISO Employee may place certain eligible securities into a blind trust as an alternative to divesting those securities.<sup>5</sup> This option is available if the company issuing the securities is not primarily engaged in the electric sector and its activity in the NYISO markets is *de minimis* in relation to its overall business activities such that its financial condition cannot be materially impacted by NYISO actions. Specifically, a company's securities qualify if: (i) the company is not classified as an electric power company under the North American Industry Classification System ("NAICS"),<sup>6</sup> and (ii) the company's (and its affiliates') total participation in the NYISO's markets during the company's most recently completed fiscal year constituted less than 0.5% of the company's gross revenues in that year.<sup>7</sup>

While a positive step, the blind trust mechanism has proven to be an incomplete solution to developing objective investment restrictions that protect the NYISO's independence but also provide the flexibility necessary to accommodate the growing NYISO market.<sup>8</sup> In practice, the blind trust mechanism can be unwieldy or unworkable, especially with actively managed investment accounts. This is especially true when an account is professionally managed using a model developed by an investment firm. While substitutions of individual stocks within these models is usually possible, excessive substitutions result in significant administrative burdens and can result in such a significant departure from an intended investment model that it becomes unworkable. A blind trust does little to reduce the number of required substitutions because it is not practicable to segregate securities between a blind trust and an account that is visible to the investor when the securities are being actively managed as a single group and traded frequently.

## **IV. Description of Proposed Tariff Revisions**

### **A. NYISO Employees May Not Invest In "Prohibited Securities"**

The NYISO proposes to revise Sections 12.7 and 12.14 of its Code of Conduct set forth in Attachment F of the OATT and Section 5.01 of the ISO Agreement to change the

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<sup>5</sup> See *New York Independent System Operator, Inc.*, 141 FERC ¶ 61,277 (2012).

<sup>6</sup> The NAICS was developed and is used by government agencies to classify businesses for multiple purposes, including collecting, analyzing, and publishing statistical data. The NAICS's "Electric Power Generation, Transmission, and Distribution" industry group (2211) includes companies that generate electric power (22111), transmit electric power (221121), distribute electric power (221122), or operate as electric power brokers or agents to arrange the sale of electric power via distribution systems (221122).

<sup>7</sup> A company's total participation in the NYISO-administered markets is equal to the sum of the absolute value of its (and its affiliates') purchases and sales during the months corresponding to the company's most recently completed fiscal year.

<sup>8</sup> The tariff revisions proposed in this filing will supplement, rather than replace, the blind trust mechanism.

rules governing prohibited investments to establish a more tailored prohibition on investments where a potential conflict of interest actually exists.<sup>9</sup> Under the proposed tariff revisions, NYISO Employees may not invest in “Prohibited Securities.”

New OATT Section 12.7.1.1 will define the term “Prohibited Securities” to mean the securities issued by any NYISO market participant that has been active in the NYISO markets in the preceding twelve months or the securities issued by any of its affiliates, if:

- the market participant or affiliate is an electric sector company as determined by its North American Industry Classification System (NAICS) code or otherwise by the NYISO;<sup>10</sup>
- the relevant market participant activity (for the corporate family) in the NYISO markets (purchases and sales) is equal to or greater than 0.5% of the publicly traded company’s gross revenues for the year; or
- the relevant market participant activity (for the corporate family) in the NYISO markets (purchases and sales) is equal to or greater than 3% of the total NYISO market purchases and sales for the year.<sup>11</sup>

The NYISO is also proposing revisions throughout OATT Sections 12.7 and 12.14 to incorporate the use of the defined term “Prohibited Securities” where appropriate.

The proposed revisions to Section 5.01 of the ISO Agreement will modify the rules governing prohibited investments by directors to mirror the rules set forth in the Code of Conduct and cross-reference the definition of Prohibited Securities.

The proposed tariff revisions build upon the framework approved last year by the Commission, but drop the requirement that a blind trust be used. The revisions also add a third screen to evaluate a company’s market share and will prohibit investment in a company

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<sup>9</sup> The NYISO is not proposing in this filing to revise the rules that restrict secondary employment or those that prohibit certain affiliations between NYISO Employees and Market Participants, or between NYISO vendors and Market Participants. *See, e.g.*, OATT Sections 12.7.4, 12.7.5, and 12.12.

<sup>10</sup> Consistent with the NYISO’s current practices, the NYISO expects to rely on a company’s NAICS classification in nearly all cases to determine whether the company is an “electric sector company.” The NYISO, however, is also proposing to reserve the right to make a supplemental determination that a company is an “electric sector company,” and thereby designate it to be a prohibited investment, based upon the NYISO’s evaluation of the company’s primary business activities, even if the company’s NAICS code is other than that of an electric sector company. The NYISO is aware of one market participant that is a demand response aggregator that it would classify as an “electric sector company,” notwithstanding its NAICS code, exercising this discretion.

<sup>11</sup> The NYISO is proposing to add this screen to prohibit investments in the securities of a market participant when the market participant’s activity is significant to the NYISO-administered markets even though the activity is relatively insignificant to the market participant based on the extent of its activities outside the NYISO markets.

whose activity in the NYISO markets represents a significant portion of the total NYISO market activity. The first two screens provide a reliable, conservative mechanism for identifying and prohibiting investments that could pose a conflict of interest between a director's or employee's obligations to the NYISO and their personal financial interests. The proposed third screen provides a further protection by establishing that a NYISO Employee may not invest in the securities of a company whose corporate family activities represent a significant share of the NYISO market.

While the NYISO has not identified directly analogous screening criteria, it has proposed a conservative threshold for this determination at 3% of total NYISO market activity.<sup>12</sup> By comparison, the Securities Exchange Commission uses a 25% ownership threshold to establish a presumption of "control" between companies.<sup>13</sup> Similarly, the Commission uses a 20% market share threshold when assessing whether an applicant for market-based rate authority has wholesale market power.<sup>14</sup> Each of these metrics is used to address concerns about an entity having significant influence or control in a given context. Setting the proposed new screen at 3% will ensure that any company whose securities are treated as permissible investments will not wield undue influence in the NYISO-administered markets.

The NYISO is also proposing to add an explicit recusal rule in new OATT Section 12.7.1.1 that stipulates that any director who owns a security that passes the Prohibited Securities screens will nevertheless make an appropriate disclosure to the Board if the director is aware that he or she, or an immediate family member, has a financial interest in a market participant or its affiliate that is the subject of a matter before the Board. Upon disclosure, the Chair of the Governance Committee and NYISO legal counsel will consult with the director to determine whether the director should be recused from Board deliberations and decision making regarding the matter.<sup>15</sup>

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<sup>12</sup> In its application, this will translate in to a threshold that is lower than 3% for many corporate families because the NYISO has no practical means to determine when a publicly traded company has only a *partial* ownership interest in one or more NYISO market participants, which is often the case. The NYISO will assume therefore that each affiliate relationship represents a 100% ownership interest, when it will frequently be less.

<sup>13</sup> *See Investment Company Act of 1940*, 15 U.S.C. §80a-2(a)(9).

<sup>14</sup> *See Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 43-44, 80 and 89, clarified, 121 FERC ¶ 61,260 (2007), order on reh'g, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268 (2008); clarified, 124 FERC ¶ 61,055 (2008), order on reh'g, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), order on reh'g, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), order on reh'g, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010).

<sup>15</sup> Factors that the Governance Committee and legal counsel may take into account when determining whether recusal would be appropriate could include, but would not be limited to, the margin by which the securities in question passed the Prohibited Securities screens, the significance of an individual director's experience with the issues before the Board, and the possibility that recusal could result in the loss of a quorum for the Board to take action.

Finally, the NYISO is proposing minor, clarifying and stylistic revisions to OATT Section 12.7 to subdivide Section 12.7.1 into three subsections, relocate the last paragraph of Section 12.7.2 to Section 12.7.1.1, eliminate text in Section 12.7.2 that is duplicative or no longer relevant, and clarify the calculation performed when assessing blind trust eligibility.

The NYISO believes that the proposed tariff revisions will provide robust protection against potential conflicts of interest arising from individual investment holdings without creating the unintended consequences of the current, overbroad rules. The proposed screens will provide a reliable, conservative mechanism for assessing the effect of a potential investment on the independence of a NYISO Employee without prohibiting investments in securities that clearly do not raise conflict of interest concerns.

**B. The Proposed Tariff Revisions are Distinguishable from a PJM Proposal Rejected by the Commission in 2011**

The NYISO's proposed tariff revisions are distinguishable from a proposal made by PJM Interconnection, L.L.C. (PJM), and rejected by the Commission, that would have allowed PJM personnel to hold financial interests in a company whose participation in PJM's markets was minimal in relation to its overall business activities.<sup>16</sup>

First, echoing the Commission's observation in its order approving the NYISO's tariff revisions establishing the blind trust mechanism, "PJM's proposal is distinguishable from this proposal because PJM proposed to apply its formula methodology to independently determine whether a company qualified as a 'market participant' pursuant to section 35.34(b)(2)(i) of the Commission's regulations. In that case, the Commission found that allowing PJM to make this determination, instead of the Commission, was inconsistent with the Commission's regulations. Here, the NYISO's proposal does not put the NYISO in the position of independently exempting companies from the definition of 'market participant.'"<sup>17</sup>

Second, the NYISO's proposal includes two elements that were missing from PJM's proposal. First, it prohibits investments in the securities of a market participant with activity that is significant to the NYISO-administered markets, even if that activity is not significant to the market participant. Second, it includes a disclosure and recusal element for directors.

Finally, PJM filed its proposal in a petition for a declaratory order seeking clarification of a regulation applicable to RTOs. Under Section 207 of the Commission's Rules of Practice and Procedure, the Commission has authority to issue a declaratory order to resolve a controversy or remove uncertainty.<sup>18</sup> In contrast, the NYISO is making this filing to revise its tariffs pursuant to the just and reasonable standard of Section 205 of the Federal Power Act,

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<sup>16</sup> See *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,036 (2011).

<sup>17</sup> See 141 FERC ¶ 61,277 at fn. 14.

<sup>18</sup> See 18 C.F.R. §385.207 (2013).

which requires the Commission to accept proposed tariff revisions that are demonstrated to be just and reasonable.

**C. The Proposed Tariff Revisions are Consistent with the Commission's Independence Principles**

In Order No. 888, the Commission established that an ISO must be independent of its market participants.<sup>19</sup> As to its ISO principle number 2, the Commission stated that: "An ISO and its employees should have no financial interest in the economic performance of any power market participant. An ISO should adopt and enforce strict conflict of interest standards."<sup>20</sup>

The NYISO's proposed tariff revisions are consistent with the Commission's independence principles for ISOs. The proposed screens for Prohibited Securities establish strict and objective conflict of interest standards that prohibit a NYISO Employee from having a financial interest in a company that (i) is a traditional market participant, (ii) has NYISO market activity that is significant to the company, or (iii) has NYISO market activity that is significant to the NYISO. Accordingly, a company that passes each of these screens would have no more than a *de minimis* interest in the NYISO market and investment in its securities would be a permitted. Indeed, as explained above, the proposed tariff revisions employ screening mechanisms substantially similar to, but more comprehensive than, those previously approved by the Commission for the blind trust mechanism.

The Commission, therefore, should accept the proposed tariff revisions as a reasonable approach to enhancing the NYISO's ability to recruit and retain the most qualified directors and employees while protecting against conflicts of interest that could compromise the independence of NYISO Employees.

**V. Proposed Effective Date**

The NYISO requests that the proposed tariff revisions become effective on January 3, 2014, which date complies with the Commission's notice requirements.<sup>21</sup>

**VI. Requisite Stakeholder Approval**

The tariff revisions proposed in this filing were discussed with stakeholders in the August 14, 2013 Business Issues Committee meeting and the August 28, 2013 Management Committee meeting. The tariff revisions were approved by the Business Issues Committee

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<sup>19</sup> See *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,730-32 (1996).

<sup>20</sup> *Id.*

<sup>21</sup> See 18 C.F.R. §35.3.



with only a single no vote, and approved unanimously by the Management Committee, with abstentions. On September 17, 2013, the NYISO Board of Directors approved the proposed tariff revisions for filing with the Commission.

**VII. Service List**

This filing will be posted on the NYISO's website at [www.nyiso.com](http://www.nyiso.com). In addition, the NYISO will e-mail an electronic link to this filing to each of its customers, to each participant on its stakeholder committees, to the New York Public Service Commission, and to the New Jersey Board of Public Utilities.

**VIII. Conclusion**

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc. respectfully requests that the Commission accept the proposed tariff changes identified in this filing.

Respectfully submitted,

/s/ Kevin W. Jones

Kevin W. Jones

Counsel for the

New York Independent System Operator, Inc.

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