



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Date: April 28, 2014

Employer Identification Number:

UIL: 501.06-00; 513.00-00

Dear :

This letter is in reference to your request from your authorized representative. You are requesting rulings whether your establishment of a central counterparty structure, pursuant to which you will become the central counterparty to transactions that take place in the markets you administer, will affect your status as an organization described in I.R.C. § 501(c)(6) or will give rise to income from an unrelated trade or business within the meaning of § 513(a).

Facts:

You are recognized as an organization exempt from federal income tax under § 501(c)(6). You are organized and operated for the purpose of improving the business conditions of the power and electricity line of business with the meaning of Treas. Reg. § 1.501(c)(6)-1. You are mandated by the Federal Energy Regulatory Committee (FERC) to ensure reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices of electricity. You are designated as a regional transmission organization (RTO) by FERC.

FERC is responsible for regulating the transmission and wholesale sale of electric energy in interstate commerce to ensure reliability of electric service, nondiscriminatory access to transmission facilities, and that rates charged are reasonable. Prior to your creation, FERC directly regulated the vertically integrated utilities that owned generation, transmission, and distribution facilities in your region.

As part of the process of deregulation and the introduction of market competition into the wholesale electricity market, FERC charged you with providing independent, open and fair access to electricity transmission systems, facilitating market-based wholesale electricity rates, and ensuring effective and reliable management and operation of the bulk power system in your region. This includes the responsibility of ensuring that rates charged for transmission and the wholesale sale of electric energy are reasonable.

In furtherance of your responsibilities, you administer markets for the wholesale purchase and sale of electric energy and related products and services. In order to cover your operating

expenses, you collect fees from the producers and wholesale purchasers of electric power in your region. These fees as well as the rules and procedures for the electricity markets you administer are set forth in your tariffs, which must be approved by FERC. The contracts, agreements or transactions offered under your FERC-approved tariffs are for the wholesale purchase and sale of electric energy and related products and services (during the first calendar quarter next year, you plan to begin offering related financial transactions, which do not involve physical delivery of electricity).

Currently, you administer a real-time energy imbalance market whereby market participants can compare real-time prices from many sources to make the most cost-effective decisions to purchase or sell energy into the market. Additionally, you settle the various positions of the market participants on an aggregate basis and both collect and remit payments to the market participants on a weekly basis. While you act as the administrator of the markets, clearing and settling purchases and sales by market participants, you currently do not take title to the electric energy or related products and services purchased and sold in the markets.

Additionally, you have been approved by FERC to develop and administer additional, more advanced markets which will provide additional benefits to current and new market participants. You are currently in the development stage and have received conditional approval from FERC of tariff changes to implement your new market.

FERC monitors the credit practices of the wholesale electric markets. In its order No. 741, *"Credit Reforms in Organized Wholesale Electric Markets,"* (Oct. 21, 2010), 133 FERC ¶61,060, and its Order No. 741-A *"Credit Reforms in Organized Wholesale Electric Markets,"* (Feb. 17, 2011), 134 FERC ¶61,126, FERC raised a question about the ability of an RTO or an independent system operator (ISO), in the event of the bankruptcy or a market participant, to set off or net the market positions of the bankrupt market participant. FERC's concern is that an ISO or RTO might not satisfy the "mutuality" requirement for setoff when those obligations are based upon different purchase and sale transactions because there is potential ambiguity as to the role of the ISO and RTO in the transactions. FERC therefore directed you (as well as other ISOs and RTOs) to submit a compliance filing with a proposed tariff revision that includes one or the following options:

1. establish yourself as a central counterparty to transactions with market participants;
2. require market participants to provide a security interest in their transactions in order to establish collateral requirements based on net exposure;
3. propose another alternative, which provides the same degree of protection as the two above-mentioned methods; or
4. choose none of the three above alternatives and instead establish credit requirements for market participants based on their gross obligations.

In response to the specific FERC orders above, you intend to pursue option 1: tariff amendments proposing to establish yourself as the central counterparty to all transactions that take place in the new market you will administer. Specifically, you will take title to the electric energy and related products purchased and sold in the markets. You represent that your role as central counterparty will not affect the clearing price, because the prices you pay to providers will exactly match the prices you receive from the sellers. You concluded that option 1 is the

best balance between (i) fostering market liquidity and efficiency; and (ii) minimizing the risk of defaults. All transactions in which you engage will be pursuant to a FERC-approved tariff. The revisions to the tariff establishing you as central counterparty will be filed with FERC and will go into effect only if approved by FERC.

You have represented that your proposed activities as the central counterparty to transactions in the markets you administer (i) will not require an amendment to any of your organizing documents or any change in your organization; (ii) will require only minor revisions to your FERC-approved tariff; (iii) will result in no net profit or loss to you; and (iv) will not directly affect market clearing prices for electric energy and related products and services in the wholesale electric markets you administer. You have also represented that you are not aware of any statute or law that prohibits a government from acting as or performing the functions of an RTO, and that your operations will not change materially following your assumption of the central counterparty role.

Rulings Requested:

1. Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions consummated through the markets you administer will not adversely affect your status as an organization exempt from federal income tax under § 501(c)(6).
2. The revenues you receive by virtue of being the central counterparty to transactions consummated through the markets you administer will not be classified as income from an unrelated trade or business within the meaning of § 513(a).

Law:

I.R.C. § 501(c)(6) provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 511(a)(1) imposes a tax on the unrelated business taxable income of organizations described in § 501(c)(6).

I.R.C. § 512(a)(1) states that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it, less the applicable deductions, and computed with the modifications in § 512(b).

I.R.C. § 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption under § 501.

Treas. Reg. § 1.501(c)(6)-1 provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Treas. Reg. § 1.513-1(d)(1) provides, in general, that gross income derives from "unrelated trade or business," within the meaning of § 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted.

Treas. Reg. § 1.513-1(d)(2) provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

#### Analysis:

##### Ruling 1

As an RTO for your particular region, you improve the business conditions of the power and electricity line of business by being responsible for administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable. Pursuant to FERC's mandate, you ensure reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices of electricity.

Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions in the markets you administer, is a response to credit reforms mandated in FERC Order Nos. 741 and 741-A. Your activities as the central counterparty will not require an amendment to any of your organizing documents, though certain revisions to your FERC-approved tariff will be required for implementation of the central counterparty structure. These revisions must be approved by FERC prior to implementation.

As central counterparty, you will take title for a brief period of time to the electric energy and related products that are the subject matter of those transactions. Your role as a central counterparty will not affect the clearing price, because the prices you pay to producers will exactly match the prices you receive from the wholesale purchasers. Apart from taking title to electric energy and related products in your capacity as central counterparty, your market administration activities will remain essentially the same. Your activities as the central counterparty will result in no net profit or loss to you.

By mandating the ISOs and RTOs revise their tariffs to implement enhanced credit



practices, FERC has established how you must conduct your market administration activities to provide for the nondiscriminatory and efficient transmission of electric energy. A default by one or more market participants could lead to a larger default in the market, disrupting services and the flow of electricity as well as raising the costs of doing business in the electricity market and a corresponding increase in rates paid. By acting as the central counterparty, you will be able to offset the obligations of a defaulting participant against payments owed to that participant, reducing the impact of one participant's default on the operations of other participants. The market participants are not able to do this themselves because of the clearing price system you use and the lack of contract privity with the defaulting party. Your sole purpose in acting as a central counterparty is to reduce the disruptions caused by a participant's default and in turn fulfill your responsibility for administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable, in line with your exempt purpose within the meaning of Treas. Reg. § 1.501(c)(6)-1. You will not generate any net income from the activity.

Accordingly, the implementation of the central counterparty structure, and your activities as the central counterparty to each transaction in the markets you administer, will not adversely affect your status as an exempt organization described in § 501(c)(6) as compared to your previous operations.

## Ruling 2

Section 513(a) defines the term "unrelated trade or business" as any trade or business which is not substantially related to the performance of an organization's exempt purpose. Treas. Reg. § 1.513-1(d)(2) states that a trade or business is substantially related to an organization's exempt purpose if it contributes importantly to the accomplishment of that purpose. As stated above, by acting as a central counterparty you will reduce the disruptions caused by a market participant's default. This contributes importantly to the accomplishment of your exempt purpose of improving the business conditions of the power and electricity line of business by administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable. Therefore, acting as a central counterparty is substantially related to your exempt purpose and will not constitute an "unrelated trade or business" within the meaning of § 513(a).

## Rulings:

Accordingly, based on the facts and circumstances discussed above, we rule as follows:

1. Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions consummated through the markets you administer will not adversely affect your status as an organization exempt from federal income tax under § 501(c)(6).
2. The revenues you receive by virtue of being the central counterparty to transactions consummated through the markets you administer will not be classified as income from

an unrelated trade or business within the meaning of § 513(a)

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon your tax status should be reported to the Service. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. § 6110(k)(3) provides that it may not be used or cited as precedent.

If there are any questions about this ruling, contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Mike Seto  
Manager, Exempt Organizations

Enclosure  
Notice 437