UNITED STATES OF AMERICA

COMMODITIES FUTURES TRADING COMMISSION

PUBLIC ROUNDTABLE TO DISCUSS

DODD-FRANK END-USER ISSUES

Washington, D.C.

Thursday, April 3, 2014

PARTICIPANTS:

MARK WETJEN, Chairman

SCOTT O'MALIA, Commissioner

PANEL ONE: REGULATION 1.35 DISCUSSION

Moderators:

KATIE DRISCOLL

DUANE ANDRESEN

DAVID STEINBERG

Panelists:

SCOTT CORDES
CHS Hedging, Inc.

JERRY JESKE
Mercuria Energy Trading, Inc.

TODD KEMP
The National Grain and Feed Association

LANCE KOTSCHWAR
Gavilon

ERIC PERRY
Scoular Company

ROBERT POWELL
Etrali Trading Solutions

JOHN RUSSO
Global Relay

ROBBY SEN
Ameriprise Financial

ERIC SMALLEY
Growmark

PARTICIPANTS (CONT'D):

STEPHEN WALDMAN
Tudor Investment

PANEL TWO: EMBEDDED VOLUMETRIC OPTIONALITY DISCUSSION

Moderators:

CARLENE KIM

DAVID ARON

JOHN PAUL ROTHENBERG

Panelists:

JAMES ALLISON
ConocoPhillips

SUSAN BERGLES
Northwest Natural and American Gas Association

CHUCK CERRIA
Hess Corporation

PATTY DONDANVILLE
Reed Smith

PAUL HUGHES
Southern Company

JERRY JESKE
Mercuria Energy Trading, Inc.

RYAN JOSEPHSON
Bonneville Power Administration

TODD KEMP
The National Grain and Feed Association

PARTICIPANTS (CONT'D):

TOM NUELLE BP DAVID PERLMAN
The Coalition of Physical Energy Companies

ERIC PERRY
Scoular Company

WALLY TURBEVILLE
Demos

PANEL THREE: "SPECIAL ENTITY" DE MINIMIS THRESHOLD FOR SWAP DEALING TO GOVERNMENT OWNED ELECTRIC UTILITIES

Moderators:

ERIK REMMLER

Panelists:

PATTY DONDNAVILLE
Reed Smith

RANDY HOWARD
Los Angeles Department of Water and Power

JERRY JESKE
Mercuria Energy Trading, Inc.

TERRY NAULTY
Owensboro Municipal Utilities

WILLIAM RUST
The Energy Authority

VIRGINIA SCHAEFFER
Bonneville Power Administration

JIM TRACY
Sacramento Municipal Utility District

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P R O C E E D I N G S

(9:33 a.m.)

MS. DRISCOLL: Good morning everyone. We're going to get started. Welcome to the CFTC's End-User Roundtable and thank you all for joining us today, particularly to our roundtable participants; thank you for agreeing to come and discuss these important issues with us.

I'm here today to lead the roundtable on Regulation 1.35, but we're also going to have a roundtable on volumetric optionality and the special entity De minimis for swap dealing. Our Chairman, Mark Wetjen wanted to say a few words before we start.

MR. WETJEN: Thanks, Katie. Thanks everyone for being here. We have a good agenda and it looks like a good list of participants and witnesses to help us talk through some of these issues and so we really appreciate everyone being here and your contributions to the process of continuing to work through some of these lingering end-user issues that have developed from some of our rule makings over the last several years. So thanks again for that.

I wanted to just make one other announcement, which is that this morning I put into circulation a rulemaking that will follow up on the no action letter we released a couple of weeks ago on the special entity de minimis threshold and it, in substance, it's by and large the same as the no action letter but we thought it was appropriate to follow up that action with an actual rule proposal.

So that is in circulation as of this morning and hopefully we can get that out for public comment relatively soon. And so, obviously, there will be a session later on that particular issue and so we're eager to hear what the participants have to say and, of course, anything said here should be, or could be anyway, followed up with a public comment letter filed in response to the proposal.

So I wanted to make that announcement and let everyone know that that's coming hopefully very, very soon and in the mean time, we look forward to today's roundtable and talking through both the special entity de minimis matter, but also 1.35 and volumetric optionality.

So thanks very much. Scott, did you want to say anything?

MR. O'MALIA: Sure. I appreciate you putting that into circulation. And you had some important -- take these roundtables and make something of them because if it's worth fixing, it's worth fixing right. And I think we're making some headway on special entity definition to make that a rule instead of a lingering no action.

I'm pleased that we're having circulation or out for comment changes to the data rules as well. So some of the other weighty issues that we're going to tackle here include 1.35, which I know we've heard from a lot of end-users the impact of that, volumetric options; I'd like to see further action to make our hedging definitions consistent and fair and consistent with current action.

I think that's something we ought to address going forward in the future and I know we've got a variety of rules that have a slightly different take on what's allowed for hedging but I'd like to have it a little more conforming and

consistent. So I look forward to today's meeting. Thank you to the Chairman for -- for, you know, initiating these meetings and I look forward to actual action once these things are finished; thanks.

MR. WETJEN: Just one other thing, Commissioner O'Malia reminded me of it when he made his remarks. We haven't made an official announcement yet, but we've begun discussions this week, after some good meetings earlier in the week with my friend Todd Kemp who's here today, but we're going to have, at some point in the near future, another session either through an Advisory Committee meeting or roundtable, but we'll have a session on anticipatory hedging, which is something that there's been a lot of interest in on the part of the end-user community.

So once the details, when and how to put that together, are sorted out, we will make an announcement concerning that. But I imagine that'll be sometime in the next week or two, and make the announcement, and hopefully have the meeting and the session itself soon thereafter. So be on the lookout for that as well.

MS. DRISCALL: So before we get to the substance, I just have a couple of instructions from our Technology Department about how the microphones and recording system work.

So please be aware that the microphones are push to talk. Please keep the microphone a few inches away when speaking, press the white button on the base before you speak. When your indicator light appears red, your microphone is on. When you finish talking please press the microphone again to turn it off.

A limited number of microphones can be active at one time. Please turn your microphone off after speaking to allow others to speak without issues. Please refrain from putting any mobile cell device on the table as they may cause audio interference. For the teleconference participants, it is listen only and for recording purposes, please be advised that this meeting is being recorded.

So this panel is here to discuss Regulation 1.35, which is one of the Commission's record keeping rules. It applies to Future's Commission's Merchants, introducing brokers,

RFEDs, and members of a DCM or SEF. It actually pre-exists Dodd-Frank. It's been in the books for a long time now. But in December 2012, the Commission amended Rule 1.35 to conform existing record keeping requirements with new record keeping requirements under Dodd-Frank that apply to swap dealers and major swap participants.

Some of the big areas of change were to put in the rule that written communications include any communications that lead to the execution of a transaction in a commodity interest or a related cash or forward and that such communications include electronic communications like emails, instant messages, and text messages.

That part of the rule applies to FCMs, IBs, and RFEDs, and all members of a DCM and per the amendments, also members of SEFs, swap execution facilities. The other major change to the rule was promulgating an oral record keeping requirement. And that's basically telephone and video recording.

That part of the rule applies to FCMs, large introducing brokers, RFEDs, and certain

members of DCMs and SEFs, who are also required to register with the Commission, with certain carve outs within that group.

Also, where the written records requirement applies to commodity interest and related cash or forward transactions, the oral record keeping rule only applies to commodity interest transactions. And a commodity interest is defined as a futures contract, an options contract, for ex transactions, and swaps. So we've heard a lot from market participants about challenges with complying with these new rule amendments and we do appreciate, even during the rulemaking process.

We had a lot of discussions and we've also had a lot of discussions since the rule was finalized and so we're here today to discuss some concerns from the end-user part of the markets. We have a couple of representatives from the Commodity Trading Advisor and Commodity Pool Operating Community, and then we also have some representatives from third party technology vendors who are actually providing some of the record keeping solutions that are available

today.

So I would just ask -- I'm just going to pose some questions to the group and if you do volunteer to respond, if you could just introduce yourselves, the entities you represent, and what status those entities have in the market, if you're registered, what your registration status is.

So the first topic that I wanted to discuss was the term related cash or forward. That applies to record keeping obligations for written communications.

Under Rule 1.35, a related cash or forward is a purchase or sale for immediate or deferred physical shipment or delivery of an asset related to a commodity interest transaction, where the commodity interest transaction and the related cash or forward transaction are used to hedge mitigate the risk of, or offset, one another. Can someone here speak to how that definition relates to your business and how it might provide some challenges with keeping records of your written communications?

MR. PERRY: Katie, thank you for the opportunity to the Commission to come and work through these issues today. My name is Eric Perry. I'm with the Scoular Company in Overland Park, Kansas and we are cash commodity merchants. Our business is buying, selling, moving, managing the supply chain on cash agricultural commodities.

So the way that 1.35 is written and the related cash or forward, captures every conversation that we have; leads to the execution, captures every conversation we have. In this space, we do not do customer business. Our entire derivatives book is to manage our own internal risk and everything that we do is buying, selling, and moving that cash commodity.

So our merchandisers, every conversation they have every day, unless they happen to be talking about, you know, to a buddy about fishing, has to do with cash commodities, purchase sale, or movement thereof.

So the dialogue that takes place from the time they hit their desk until the time they leave, is captured in 1.35. So it significantly

impacts the business that we do.

MS. DRISCOLL: Is there anyone else who wanted to comment on the definition of related cash or forward?

MR. KOTSCHWAR: Katie, this is Lance Kotschwar with Gavilon and I'm here on behalf of the Commodity Markets Council today. Just to follow up on what Eric said, thanks for having us here. We think these are important issues. It covers the whole gamut of what we're doing but I guess the -- the real challenge we have is when you -- when you look at related -- a related cash transaction and you combine that with the notion that these records needs to be index searchable.

I'll use an example. We're normally, around harvest time, we're long physical so we're short on the exchange and the days and months after that we are merchandising our grain. So in any given day we will be buying and selling it at many, many locations.

So if we're taking -- I don't know what our average volumes were for this -- this week but let's just assume that yesterday we -- we netted out being -- we sold out physical of, I don't know,

500,000 bushels. So what are we going to do? We're probably going to go, you know, reduce our position on the exchange. But that net effect is made up of hundreds, literally hundreds, of physical transactions.

So for us to be able to -- we can capture all of the -- the -- the conversations and communications, but trying to tie them back to what we do on the exchange would be, I don't know, looking for a needle in a haystack. We can do it on the aggregate, but I don't know what that gets you. You know, we have -- we have all of our contracts for our physical transactions. That's what we find in our business needs to -- and that's all we need to keep.

We don't -- we don't find it necessary from a business perspective to keep all of the chit chat, instant messaging -- well, instant messaging we are keeping actually. But we normally would not be keeping that because it's -- we don't -- we don't need that to prove our physical business.

So it would -- we're -- we're scratching our heads wondering if we really are complying

when it comes to making these things indexable and searchable. We've got them. But to tie them back to any particular transaction, we'd have to talk about that and figure out what that exactly means because it's not a transaction, it's hundreds of transactions.

MS. DRISCOLL: So Lance, just to be clear, you're referring to the requirement that records be searchable and identifiable by transaction and counterparty?

MR. KOTSCHWAR: Yes.

MS. DRISCOLL: Is that right? Thank you. So we've actually heard this issue quite a bit about concerns and challenges with complying with that part of the rule and I -- I thought perhaps Mr. Russo could speak a little bit to that as a technology vendor.

MR. RUSSO: Hi, and thank you for having me. I work for Global Relay and we are a cloud based archiving vendor and we deal with these kinds of issues every day. We've got, I'm going to say nearing 100 --

SPEAKER: John, could you pull that a little closer?

MR. RUSSO: Sure, sorry about that. We've got it close to 100 CFTC registered organizations that use our services today. And what I wanted to add, along the lines of what Lance had mentioned, was that although we can archive, and index, and serialize, and store this data in worm related storage facilities, the challenge that would come up for most organizations is how do you track down by transaction id.

So we can index the data, and we were having some conversations earlier, where you can search by the actual transaction id number and retrieve anything that's relevant to those numbers or the custodians that might have been dealing with that transaction. But it becomes complex in that the organizations would have to follow a strict template based policy within the organization to make sure they included those terms in all of their communication so that way it can be tracked.

So with respect to email or instant messaging, email might be easier if you've got a disclaimer and you're adding some sort of transaction identifier to the bottom of an email,

and that could be company policy. It may not be ideal, but when you get into the space of instant messaging and SMS, that's where you're going to come into some issues. And I think the challenge is that a lot of these member firms are going to have is trying to tie back specifically to the transaction id.

So although you can go back and say well I know these 15 custodians might have been involved in that deal, I can't necessarily pinpoint that transaction id within the communications and it becomes a bit onerous to then try to gather this large amount of data and then call it down.

So the technology is there to -- to grab, and capture, and retrieve all of that information. I think the challenge is more and lie in calling down that data and producing what's required.

MR. JESKE: Is there -- is there any way to automate the assignment of a transaction id?

MR. RUSSO: To some extent. Again, there are electronically based policies that you can implement in the technologies available

today, whereas if you're hitting on certain key words or phrases or if you're using internally published documentation as a template that you're distributing to your clients or you're using for communications, you can then apply these policies on the fly so that when -- when the communications are being archived, they're being scanned and indexed and then anything that triggers those key words or phrases or meets the rules of the criteria that identify them as a transaction that then you could pick up and capture that information to sort of do it automatically.

But my understanding of the transaction id is something that is a bit more difficult to capture versus, let's say, some sort of sales or marketing materials, you know, along those lines. There's not necessarily a consistent format to look for and that would be the challenge.

MR. JESKE: Katie, my name is Jerry Jeske and to add to what some of the other folks are saying -- I'm Chief Compliance Council from Mercuria Energy Trading. We -- we have offices and facilities in over five different continents, you know, several different countries, different

languages, dialects, and so forth within our organization, not to mention with people we deal with internationally.

We're an energy end-user. We buy, purchase physical commodities in the chain of commerce. We're not members though. We're not members of an organization. I think Mr. Russo mentioned that in connection with some of the other gentlemen that just spoke, I think the key concept here is membership.

If you go back and look into the Reg 1.35 and its iterations over time, back from December '48, 1963, 1971, and as recent as 2009, that concept has been universal throughout each one of the changes in 1.35. Membership meant something back then. Membership doesn't mean as much today.

Membership is something that was referenced in every one of these regulations that changed over time as somebody who stood in the pit, somebody who dealt with customer orders, somebody who had an obligation to keep an audit trail related to those orders.

What this new change has ensued is an

expansion, a vast expansion, past the individual who's a fiduciary responsible for the execution of that order and has gone into customer activity. Customers here are not addressed in the statute, I certainly don't believe that was congressional intent whatsoever, but somehow it's worked its way into this regulation. That now customer communications are supposed to be logged and monitored.

Let's not forget something; U.S. sentencing guidelines for corporations require not just maintaining and archiving, but surveillance. These things cost a lot of money. So do you want to be a member of a DCM or a SEF? I think that's a big dollar question as it relates to 1.35.

Some of the technology may be out there, but when is a trade a trade? When is there a meeting of minds over the phone or on an in chain? You can't get that deal id number until there's an actual deal I would assume, Mr. Russo.

MR. RUSSO: That's correct, yes. Yeah, I mean just to expand a little bit upon the supervision aspect of it because we've been in

that space for quite some time, not just while I've been with Global Relay but in the past I've worked with organizations to deploy supervision platforms. What I can say is that technologies have come a long way and that it's become much more affordable today than it has been in the past. And I agree with you that in the past you had to deploy significant infrastructure and house to manage that kind of supervision, unless you were manually going to print out emails and read them.

But today with the technologies that are available, it's quite affordable and approachable to even the smallest organization to -- to employ those technologies. With that being said, like I said, the main challenge that I see from a technology perspective is identifying the transaction ids.

And I think that language, as it stands in the documentation that was forwarded to me, would be the more challenging bit for us to meet for our own clients.

So if we go in and they say ok, how do I do this by transaction id, I can simply -- everything is indexed and I can search

for those transaction id numbers and I would assume that I would get some of it. But I -- I think it would have to be worked hand in hand with the policies that are written up in house, within the organizations, on how do they address their transactions.

So it would be a combination of the actual employees that were performing those -- those transactions. You would search for their data during the timeframe that the transaction may have occurred, maybe a few days prior, a few days after, or even longer depending on how long it takes to lead up to a transaction.

And then you would have to call through that data. But the data set is not as monumentally sized as it might have been in the past. So in the past if you were pulling all data for John Russo, for argument sake, for a period of three months, you've got this large dataset.

Today with the technologies that are available, and they are affordable, you can put some key words and some logic into your searches to say I'm searching for all of John Russo's email during this date range, but they might be

communications that are only external to the organization, and with these key words put in the transaction id number, you can put in logic, like ands and ors and proximity this word within this number of words of the other, and you can cold down your dataset.

And that is where the power of the newer available technologies comes into play and I think would be a resource for most organizations today, you know, meeting these regulatory requirements.

MR. PERRY: Katie, I -- Eric Perry. I think it's important to take a step back here, and I hate to get too far down in the weeds, but to realize that, again, as a cash commodity merchant, we have a book of derivatives that manage risk and we have a book of cash. We don't tie those two together except as net positions at the end of the day. So as we through the day, in our shop, buying and selling cash commodities, that individual merchant may or may not lay off that risk at the same time they do the trade.

They may have already had a position that wasn't even so maybe they needed to buy some

more corn or sell some more corn and that evened out their position, or maybe they actually pick up the phone and give that futures order to a central order desk that then executes it on the exchange, whether that be Minneapolis Grain Exchange or the Chicago Board of Trade.

But we do not keep that -- that commodity interest transaction and that cash or forward transaction. We don't tie those together by any number. We just -- we don't do it. We don't have the need to. We keep the pertinent economic terms of the cash trade because we'll need that in the future should we be in an arbitration case or a litigation and we have our derivatives hedging book.

But we don't match those up. I mean we don't take a 5,000 bushel corn trade that happened with (inaudible) in the middle of Nebraska and tie it to a 5,000 bushel corn contract that was executed on the Chicago Board of Trade at X price. That's -- that's not what we -- we don't need that kind of detail in our business. We don't need it to manage our business so we don't track it.

So I don't -- I think the gentlemen that

have the technology, I think capturing all of this information in aggregate can be done, but again, bringing it all together is a significant challenge for our business.

We don't need to do it; we haven't done it in the past. So it's -- it's changing the way we do business. It's going from the least efficient -- the most efficient mode of operation to a much more structured and higher cost mode of operation.

MR. KEMP: Todd Kemp with the National Grain and Feed Association. We represent about 1,000 companies nationwide, about 7,000 facilities that handle grain or feed manufacturers or seed processors and these are the traditional agricultural hedgers.

Eric's firm and a couple of others around the table happen to be members of our association as well. But you know, what Eric is describing is exactly right and it's extremely widespread.

If you think about 7,000 or 10,000 overall facilities that potentially could have been affected -- we -- we were encouraged when the

final rule was published that the majority of our member firms, you know, had their problem taken care of on the cash side. And we appreciated that but there are still a number of firms who are members of a DCM who are affected.

One of our concerns all along has been that what we're looking at here is kind of a bifurcated marketplace where we've got DCM members who are required to capture this information and then you've got other firms that are not required to capture it.

And you know, if you're a farmer and you're talking or texting to your elevator, who do you want to do business with? The guy who has to tell you hey, this is all being captured for posterity in CFTC or the guy down the road who is not?

So I don't know if that goes directly to your point, but we -- we do have some concerns about an uneven situation being created in the marketplace.

MS. DRISCOLL: So I just -- some very good points were raised in terms of different parts of the rule. So I just wanted to focus on

a couple of them. And at first we were talking about the definition of related cash or forward and I was -- but then also I think what we're talking about in connection with that is the definition of member that applies to the rule. So just to take us back to related cash or forward, do you have any suggestions for --

SPEAKER: Okay. So tell me -- so I can't minimize this screen? And how do I go back --

MS. DRISCOLL: Can someone -- can you please mute your phone?

SPEAKER: Okay. So just --

MS. DRISCOLL: Is there somebody who can help with this? Please mute your phone, whoever is on the line that we can hear; okay. So if anyone wants to speak to that.

MR. KOTSCHWAR: Katie, this is Lance with Gavilon again. I guess -- let's -- let's just assume for the moment that we can come up with something that's somewhat affordable to be able to track all of our related cash transactions back to futures.

I guess from my perspective, you know,

I know we've touched on the issue of what -- what member it is. I don't -- my company doesn't have a fiduciary duty. We're, you know, we're -- we're grain merchandisers. So even if we collect all of this, what are we going to do with it? We're not -- I don't know what you would do with it. It's not -- it's -- if you go back and look at the way the history of member is with the fiduciary duty and having, you know, responsibilities to track something for a customer, it makes perfect sense because you had two ways to do it.

As your customer, a hedger, or a speculator; if your customer is a hedger then you would expect there to be some sort of related -- paperwork related to the -- to the physical side of that. But for us, because of this application of member in this instance, we don't have that relationship and so therefore, we're -- we -- we can't pick and chose on this; we're just going to have to record everything. We're going to have to collect all of this stuff.

It's going to be -- it's useless for us. I -- I'll -- we can talk about that more later when

we talk about implementation challenges because I'm collecting -- I've been collecting instant messaging for two years; never once looked at it.

Doubt if we ever will because from our perspective, the Commission has a much better way of -- of figuring out whether they want to come ask us any questions with our large trader reports and our monthly 204 reports. We're -- we're a big company and we have lots of positions.

You can figure out from our other reporting whether or not, you know, you want to come knock on our door and give us a special call and ask us anything in particular, but I just don't see this -- even if it was affordable, I don't know why we would ever -- anyone would ever want to look at instant messaging and text messaging related to hundreds of daily transactions leading to cash contracts that are net hedged at the end of the day. I can't find -- I can't see that being useful information anytime.

MR. JESKE: I would add to that. I think the history of 1.35 is actually informative. That's why I mentioned it earlier.

And I don't think you can really bifurcate the concept of who it's aimed at from this concept of related. And this -- this related -- or the other language that sneaks in is -- leads to the execution of a transaction and a commodity interest to a related cash or forward.

So to -- to expand on your question a little bit, that language was nowhere in 1.35 before these conforming amendments so to speak. If you could look back in -- in time and back to '48, the reg said FCM and members of a contract market shall keep records of futures or cash transactions made by or through him. Him, the person in the pit.

Those are customer orders, again. So where this expansive related language comes in, to me is rather misplaced. As an energy end-user, we have people out in the field. As we all know there's a huge energy bloom right now by virtue of the fracking.

You have people out in Eagle Ford, Texas, who are texting because that's the mode of communication. They are primarily responsible for finding the crude out in the field, bringing

it to market, whether they do so by train or pipe, and the ability to be able to go out there and make deals and make transactions with those people in the field, is crucial to be able to supply the energy to America really.

But that doesn't happen seamlessly without the ability to pool that -- those resources and then bring them to market. That process requires price exposure. That price exposure, yes, it is hedged in the derivatives markets and the OTC markets. But to rest your head on related to and say all of those communications need to be captured, I think is -- is just simply overreach by the Commission and should really be looked at closely because again, it goes into the customer activities, as opposed to that which is being affected in the ring.

The ring is a dinosaur, right. Now -- now we're talking about ether space and electronic executions. I really question how this impacts SEFs more than it does probably DCMs but it impacts them both the same I suppose.

MS. DRISCOLL: So I think one of the

fundamental issues that we're hearing about is the definition of member, which is what draws in I think a lot of market participants to the written record, keeping requirement, and then fewer market participants to the oral record keeping requirement.

But I would just be curious to hear about what you all think of as a member, as opposed to what our statute says is a member and our statute includes anyone with trading privileges, which is, I believe, the part of it that sort of draws in a lot of -- a lot of market participants who wouldn't otherwise think of themselves as a member.

MR. SEN: Thank you, Katie. I'm Robby Sen at Ameriprise Financial. Our subsidiary, Columbia Management, (inaudible) CTA. We're also a member of a SEF so we're pulled into 1.35A, both for the oral and written record keeping piece. And I think, as Jerry was saying, the legislative intents of 1.35, it's never meant to take in customers or anyone who's -- who's basically a liquidity taker, not a liquidity provider, and not an intermediary.

And I think as it relates to SEFs, one of the important points is that the final rulemaking of 1.35A was published in December of 2012 before the final SEF rules were published and before the final -- first SEF rulebook was published.

So (inaudible) like us, who are registered as CTAs, had no idea that we would even be subject to this requirement because we didn't think we'd be members. And then as the SEF rulebooks came out, more and more of them had said that if you -- if you're -- if you're a market participant with trading privileges then you're a member.

Our view is that membership on a SEF with trading privileges should not make -- make us a member. We don't take customer orders, we don't deal in commodity interest and that dealing in commodity interest is highlighted in the rule. And I think we're having serious thoughts internally about whether we want to be subject to a SEF membership and it's for various reasons but 1.35A is one -- a big part of it.

The rulebooks are onerous and that's,

you know, probably a different conversation. But if -- if we're going to be subject to 1.35A, we're seriously going to consider other alternatives, trading different products, possibly using an aggregator.

And I think there's been some developments recently in the market with some of the SEFs even coming out and saying that the participant itself could be an account, so like a neutral fund and not the investment advisor would be a participant.

I think one of the main reasons is that people want to get out of 1.35A and I don't think that's one of the intents of the rule; it's to pull in, you know, people that don't take customer orders.

MR. WALDMAN: If I can just echo that. I'm Steve Waldman. I'm a Managing Director and Deputy General Counsel at Tudor Investment Corporation. We've been registered with the CFTC as a Commodity Pool Operator and a Commodity Trading Advisor since the mid '80s.

We're also registered with the SCC as an Investment Advisor. And we've also -- we're

also a member of the Managed Funds Association where we've been dealing with this issue on a regular basis over the past year.

Again, I -- just to follow up on what Jerry and Robby have said, I think the definition of, and what it means to be a member, have changed over the years. Initially when -- if you look back a few decades ago, what it meant to be a member of a DCM was if you're acting basically as a FCM or (inaudible) in some intermediary capacity. And I -- probably the trend over the last decade or so has seen more entities become members not in their capacity as an intermediary, but solely to get better rates on the exchanges. And I think that's played a big role.

And then when the SEFs -- SEFs were initially proposed and introduced, nobody really had any idea what it would be to be a member of a SEF. Nobody knew if you would have to be a member of a SEF. And then for -- when rule 1.35A was proposed, it really seemed as a nonevent for many in the industry because nobody anticipated ever becoming a member of a SEF.

So it was only after 1.35A, as Robby

mentioned, after 1.35A was adopted, that the rulebooks were finally published. And even today, it's not entirely clear if you're a participant on a SEF, if that makes you a member, if you have trading privileges does that make you a member.

And I have to say that it's probably -- it's difficult to say that anybody who was really given a reasonable opportunity to comment on 1.35A, given that the rule came out prior to SEFs, we just had no idea what it would mean. And what may have been viewed as a technical amendment, and in certain instances really turned into a substantive change to the way many of us are forced to do business.

MR. CORDES: Katie, if I can add just a little bit of clarity too. Scott Cordes with CHS Hedging. We're registered as an FCM but I also represent our parent company that has probably over 200 locations buying grain around the countryside. We also have customers that are, you know, probably a couple hundred other cooperative elevators who are buying grain as well. So they're quite interested in this

related cash, how it plays out.

And as some of my other colleagues talked about, you know, they're looking at their aggregate positions every day, typically handling customer orders. But some of those folks are members of exchanges and this is the part that causes some heartburn; what does that mean.

Typically in the past they become members to have some input around the -- the hedging and viability of those contracts in good order, but also for their volume, such for around exchange fees and what they're paying. So there was a reason for that.

Are they trading directly on those exchanges? Typically not. They're -- they're placing orders through an FCM like ourselves, but they're starting to ask themselves should I continue to be a member because now I get captured in some of these rules and with some of the areas they're operating in and the advent of technology, people want to use a lot of different social media to communicate; it's hard to comply with that on a cost structure that's cost

effective for them. So that's some of the clarity that we see on the grain side of this issue.

SPEAKER: I was going to make just one comment. I think it might be important to point out again, which I think is an obvious one, but the purpose I think, at least as I envisioned it, when this rulemaking was being considered, the real purpose behind this rule was that it -- that it enhance the capabilities of the enforcement division.

This is an enforcement rule more than anything else. So it has both a deterring effect through any of these complying, but it also has the effect of assisting, with respect to investigations, if one is initiated. So I don't think it's -- it's difficult to argue that there is any legitimate public policy purpose behind the rule.

The real question here I think is, are there other public policy objectives that are somehow forwarded given the scope of the rule and upon whom the burden lands. And to me that's really the most important question. I feel like

we're talking about that a little bit.

But I just wanted to point that out because I -- there is some utility, even if, let's say hypothetically, there's a -- there's an enormous amount of records kept, oral records, even written ones, that never get read.

I think there's still some purpose behind the mere requirement that the records be kept. Again, the better question is, is the scope correct. Is the cost benefit analysis working out in favor of the scope of the rule that's current drafted?

So I do think, you know, we're here to solve problems but even if we were to do nothing, you know, I think it is, again, important to just say that there is some -- there is some purpose or utility behind the rule even as it -- as it is written now. But -- but what we want -- what we want to make sure is whether we've got that balance right, whether we've got the scope right. So enough on that for now.

MR. O'MALIA: Can I follow up on that a little bit? Because I think what Robby mentioned -- if membership on a SEF dictates who

has to record and who does not have to record and people choose to either use alternative means or they go through an introducing broker of some sort or aggregator, then you're going to create an incentive not to record.

So is the right answer under your scenario, Mark, to apply that and have the introducing broker there for a record, all of its customers, when this was a customer rule as opposed to a membership -- this is all very, you know, we've -- we've clearly identified workarounds to avoid this thing that I don't think were contemplated or priced into the cost benefit analysis when that was done.

And then to your point, if keeping all of the data is important, how do -- how would you address the work around issue that -- that is an obvious issue?

MR. WETJEN: Yeah, I think that's a great point and it relates to what I said about, you know, whether there might be other policy objectives of the Commission that are somehow thwarted by the current scope of this. And obviously we want to see as much participation on

SEFs as possible and so to the degree the current construction of the rule is standing in the way of that, that's something we need to take a careful look at, which is part of the reason we're here.

The other thing I would add is in talking to some of the asset managers in recent weeks about this, -- and I'm not sure whether it's on the list of questions but it is something I would be curious to hear some thoughts from the group on.

If there's duplication in the record keeping in any sort of meaningful way, in other words, if we know a conversation let's say is captured by one of the participants in the conversation, so we know the conversation is recorded by someone, is it necessary that both parties are keeping the same recording. I'm not so sure.

I mean just the mere fact that you know that someone you're talking on the phone with is recording the conversation is going to have some impact on what you say; at least in my experience.

MR. O'MALIA: Well that gets back to

the customer member relationship again and that's broken down in this rule. I mean it just doesn't function the way it was supposed to function. Maybe (inaudible) can reflect on what the -- how you intended, kind of, the SEF rules to serve on this and what the appropriate membership requirements were and what you intended to capture. Maybe, David, you weren't the right guy to ask. I do note that none of the people who wrote this rule are at the table.

MR. STEINBERG: I --

MR. O'MALIA: Oh, you were there, yeah.

SPEAKER: -- follow up on and we can discuss at another time. It's certainly something we can follow up on and check with the appropriate people on that.

MR. PERRY: But I think this is a good line of conversation because it does -- and we can tie in here -- there's a bit of an inconsistency as you think about these records and you think about the carve out on the oral. So on the oral, for our organization, that's not a registrant, there's a carve out for oral recording. We're out of the oral recording piece.

But yet, we're still handcuffed to the electronic written record keeping rules. The obvious answer for us in that environment, and this is not to skirt the -- to skirt the policies because we want -- we want to work with the Commission to -- to make this rule workable and to make the market better for everybody. But the obvious answer for us is to push all of our -- all of our trade to -- to the phone; to just simply, through policy action limit the conversations that take place about the related cash or forward transaction to the phone. And there won't be any of it that will be recorded.

So there seems to be, along those two lines, the information is either important or it's not. And we've worked with the Commission in the past, specifically on the Chicago wheat and Kansas City wheat convergence issues, and we've extracted from our systems all of the cash information to help the Commission determine what was going on with convergence in those futures markets.

And I think, through working together, came up with good, you know, good answers in that

arena with relevant economic information. It's economic terms of the trades, the contract prices, the basis, contract amendments, but not this enormous amount of dialog that happens every single day. Let's get down to what really makes a difference.

MR. WALDMAN: So if I can just respond to that as well. I absolutely agree with everything that -- that Eric said and if there was a policy reason to push trading onto SEFs, this is a disincentive for people to actually do that trading.

Just to respond to the question about asset managers, there's a specific carve out that was written into the rule for exemptions for commodity pool operators. And for whatever the policy reason that the -- whatever policy the Commission is following and pursuing that exemption, it's not clear to me anyway, why a commodity trading advisor wouldn't be similarly exempt. I -- I just haven't been able to find a distinction in policy between the two.

MR. SEN: And -- and just to add to the point of duplication. I mean I think as us as a

SEF member and looking at our commodity interest trading, anything that we do on an exchange through a SEF is subject to the SEF record keeping rules and the SEFs imposed record keeping rules on their members and participants.

And every single other bilateral trade we do that's often exchange is with, presumably with a swap dealer who's subject to the part 23 rules or 1.35. So those conversations are getting recorded. And I think this -- this goes towards the interpretation of the rule.

Where the rule says provided or received and (inaudible) of execution of a transaction, I mean we're interpreting that to mean external communications. So if our portfolio manager talks to our trader about an order they want to do for an account, we don't think that should be recorded but I don't think it's clear from the rule that that's the case. And so that's just one of the challenges that assamanders face in trying to comply with the oral record keeping rules and why we -- I mean, if -- first we think there should be some exemptive relief.

If not, we think the no action relief that was provided up until May 1, should be extended because it's pretty hard for us to be able to comply and know what the costs are when we don't know what the scope of the role is.

And then if it does lead to less assamanders accessing stuff directly, I mean I think it'll go against congressional intent and the intent of the Commission to increase liquidity and transparency in the market, which was what the SEF rules were intended for.

MR. JESKE: I think the concept of cost was addressed. I don't know there was a cost benefit analysis done in this conforming amendments. It may have been done but I really don't think --

MR. WETJEN: We do one at every rule and we're required to.

MR. JESKE: Well, I guess I wonder if -- if that cost benefit analysis, given the fact that the amendment to 1.35 was driven by enforcement, was done in a way that really evaluated the cost associated. So I think you brought up a concept of if one party keeps the

communication and another party does not keep that communication, is that okay, is the redundancy necessary.

The cost of keeping isn't the end of the story. The cost is -- is much greater than that because when you're looking at archiving information for five years in some searchable format and then surveilling that information, if you're a U.S. corporation following the U.S. Corporate Sentencing Guidelines, there's a surveillance cost associated with that.

Human resource costs, systems cost; in addition, when you get that lovely letter from the enforcement that asks for that information, you have to employ council to go through all of that information. You have to search that information for that which has been requested.

Those bills are extremely expensive. So the cost associated with 1.35 doesn't just stop with archiving it and sticking it into a cloud some place. It's much greater than that. And I really don't think that that part of the cost benefit analysis was really addressed. And it would be something that I think anybody would

ultimately face if asked for that information down the road, being maintained for multiple years.

There's another point, too, with regard to SEFs and -- and the mistake that I think is occurring in Europe with the multilateral trading facilities and how a derivative contract is deemed within scope. Many folks who used to participate on electronic screens are now going to the phone as -- as Eric mentioned.

Similar to SEFs here, if the goal is to participate in SEFs, who are glorified voice brokers, there seems to be a disincentive to use their electronics matching systems, or any systems for that matter. And why not just do it the good old fashioned way and continue to speak over the phone.

Now certainly the Commission could come out with another rule amendment, which would capture audio, but I think we all know the cost associated with audio and searching and surveilling for audio, which is astronomical.

MS. DRISCOLL: Maybe Mr. Powell, this might be a good place for you to --

MR. POWELL: Good morning, Robert Powell from Etrali Trading Solutions. We provide voice recording integration for fixed line and mobile call recording. Our business on the mobile side started up in Europe a couple of years back when the FCA introduced that and actually we have cloud based solutions for both fixed line and mobile recording globally now. So based on the AT&T network over here.

I think the -- in terms of cost you make some very good points about the total cost of ownership not just being the capture. And I think there's also been some good points made about not storing for storage sake. I think that's a very important point. I think we have really witnessed some major changes in the way that the total cost of ownership has been driven down over the past few years, particularly to do with voice, which is about 12 times greater the volume of your electronic communication.

So I think the solutions that are now out there in the market give you some very good ways of accessing that data from the method data to allow you to match a conversation to a

transaction and also give you some very good ways of actually searching inside that data without a huge expense. So I think there are solutions out there now and they can range from smaller solutions to larger solutions.

MR. JESKE: So that's converting voice to text, yeah?

MR. POWELL: We -- we tend not to go down the converting voice to text route. We allowing searching inside the conversation. The conversion is problematic. Being able to search inside it is a better way of doing it.

MR. JESKE: Yeah, it's very problematic. In terms of being able to archive that information though, I think we're stuck with the same thing, when's a deal is a deal. And how do you reference a transaction id to something that isn't even a deal yet?

MR. POWELL: Yeah, I think we've heard from Mr. Russo this morning and I think there's a number of different elements of this, which I think are kind of coming together. There are a lot of conversations in the market which are not about an actual transaction.

You know, if you're -- a lot of the conversations about the relationship management, about maintaining your relationship with your customers, with your counterparties in the market. However, there are also conversations which indicate pricing or which would lead to transactions.

I think it's impossible to try and go down the road or pressing a button on your phone or on your email to say I'm just about to talk about a trade that might happen in the future. So to the extent that you are recording everything or you're capturing all of your data, I think the tools give you some very good insights into the way that you can call down very quickly to a level where that reduces your total cost of ownership, particularly for those investigations.

So if you get to the point where you've got an investigation about a particular custodian with a particular counterparty or a particular transaction, and to your point about the cost of the legal fees involved, I think you can get down to a point where the severely reduced number of conversations that you're actually going to be

giving to the legal counsel and then on to the Commission can really be called down quite quickly.

MR. RUSSO: Yeah. And I just wanted to add, you know, with respect to storing all of this data and whether it's actually useful to any organization, I -- I think with respect to litigation support, it's an asset that every organization has to have all of their data archived.

The large majority of organizations out there are not doing illegal transactions. They're not violating laws that they're getting accused for. And if you don't have the archives and you have nothing to go back to to justify your position, I think that's more costly than not storing the data and spending a few dollars a month.

Yeah, is it an extra hoop? I absolutely agree it is an extra hoop and it's probably something that -- that if you're a trader or a broker or you really don't want to deal with these complexities, but it's just a fact of life today. Everybody's got an electronic device,

whether it's a Blackberry, an Android phone, or an iphone.

That if you honestly believe that these communications are not occurring, I think we're putting blinders on. It's something that we have to address moving forward.

MR. POWELL: I'd like to add just one point to that, which is in terms of having this data and using it usefully, we're seeing quite a large emergence of what we call voice intelligence which allows you to link the data that you have and the way in which it's been collected into your CRM solutions to allow you to manage your business better. So this is not just about necessarily complying with the rules.

You can now get intelligence from that data about the cost of doing business with a particular client, how many times you have to call a particular client to get a trade. So there are other reasons why you might want to keep that data apart from -- to get for regulatory reasons.

MS. DRISCOLL: Lance, I think you wanted to say something.

MR. KOTSCHWAR: I do. I want

to -- just to reel this back in from those of us in the membership area who are really just customers and end-users. Let's take a typical conversation that Eric and I are going to have. He's a farmer. I'm a merchant. He's going to call me up and ask me what I'm paying for corn today. I'm going to tell him, he's going to offer me, say well what if I give you this many bushels, we'll arrive at a deal, right. We're having it right now. We can have that conversation on the phone. I'm going to follow it up with a contract, probably -- it'll satisfy my need to have business records.

Today, what -- and this is a challenge for us; okay. That's going to be the large part of our origination business. It's conversations with farmers. Today, most farmers, or many farmers, would prefer to have exactly that same conversation by a text. It's a lot more efficient and that's the struggle we're going to have.

If -- if we're not going to distinguish, there's -- there was a policy reason why you created an exemption for oral recording for

people like me, leaving aside for the moment how we got here with all of this membership history, but you're -- you're forcing me to do something the 20th Century way on the phone because I just -- I can't, especially with the mobile devices. Despite all of this, I'm not going to take that step yet.

You know, grain origination is a fairly low margin business. I'm not going to get this high tech about it. We're talking about exactly the same conversation and if I do it on the phone it's an oral communication.

If it happens over the same phone via text messaging, it is now a written document that I have to record and that's -- that's inconsistent and it's just -- it's one of the things that's driving us crazy.

MR. WETJEN: I agree. That seems odd.

MR. KOTSCHWAR: Very odd.

MR. SMALLEY: I'd like to add a point --

MS. DRISCOLL: Can --

MR. SMALLEY: -- similar to Lance's but from a different perspective. My name is Eric Smalley and I'm from Growmark. We're a regional

agricultural cooperative and we serve about 250,000 farmers in the Midwest and in Ontario, Canada. We also operate MIDCO commodities. We're a small non clearing FCM that serves price management needs for grain elevators and their farmers.

So we're in the smaller end of the spectrum but we have some of the similar issues. On the one hand we're very thankful that we've received some relief via a no action letter for our branch office operations because they're so small and the cost effectiveness isn't there. But then even in our home office, we -- we've got similar issues where it's changing how we do business.

We've already got record keeping requirements and our phone lines are already recorded. So to -- when -- to terms of technology and whether it's affordable, I would say it's a relative term and for a smaller firm, that bar is a lot lower for us. And so it's hard for us, as a cooperative, to justify any additional investment in technology that's not going to bring value to our customers, solely to help

enforcement issues that might or might not come down the road.

So we've been forced, at the moment anyway, that we drive all of our customers back to phone and email, things that are already captured. And so, you know, for that possibility, it's changing the way we do business, which isn't helpful for our customers.

MS. DRISCOLL: Can I just pose a question regarding the membership issue with regard to storage of written communications? There was a DMO advisory in 2009 that spoke to the written communications requirement and the fact that it was DMO staff's belief that that included emails, instant messages, and text messages, and I'm just curious to know how you all interpreted that advisory. It's five years ago, but --

MR. KOTSCHWAR: From my perspective, a better question would be was I even aware of that advisory and the answer would be -- trying to be very diplomatic here; no. This became an issue when that -- that little -- that little bit of information got rolled into the final rule, okay.

I don't want to get into a lot of the

other issues. This has given us angst and consternation over, but I would say that I don't -- I haven't talked to anybody who was even aware of it.

MR. CORDES: Katie, I would respond. As an FCM registrant, we got that advisory. We put in some changes to start recording our ims, that kind of things we looked at. But I would tell you from some of our customers' standpoint, that's a member of an exchange, I doubt they ever looked at it.

The Chairman's question about doubling up on some of this recording, I would say those folks that are a member of an exchange, they're derivatives activity, whether it's futures options or some sort of swap is going through a registrant, like ourselves, or capturing that information. So it sounds like why should they capture on the other side. There's probably some redundancy there that could be alleviated.

MR. JESKE: On page two of the advisory, the term member is footnoted, footnote four, which references 4G of the act; 4G of the act says FCMs, IBs, floor brokers, and floor

traders. Does not say customer --

(Off the record.)

MR. JESKE: -- 2009, February 5, 2009; Division of Market Oversight.

MR. PERRY: And Katie, I think -- Eric Perry. And not -- not -- clearly wasn't -- didn't have any conversation with anybody on the Commission about the 2009 advisory whatsoever. And I think to Lance's point, I think Lance is right. I think those of us in the member space, at managing our own accounts, looked at that 2009 advisory and our world of member is that person that has fiduciary responsibility and handles customer money. And right, wrong, or indifferent, I think that's probably how -- even if you were aware of it, as Jerry points out, I think most people would interpret it that way, most of us in our arena.

But I do think the footnote is telling, relative to the definition of member. And how far we've -- how far we've drifted from what the original intent of member was to where we are today in this GLOBEX screen trading world.

MR. KOTSCHWAR: Just to follow up on

that a little bit, I mean we've heard all of the elements of where we think this needs to go thrown out today. You know, fiduciary duties, customer -- dealing with other customers' funds, whether you're otherwise required to be registered.

I mean those are three elements that separate all of us who have the most heartburn about this from anybody else. We don't have -- we're not otherwise registered. We don't deal with customers. We are the customer and we have no fiduciary duty. So that's -- seems like those are common elements to everybody who's really got rash about this.

MR. KEMP: Katie, one quick comment here. You know, as we step back a little bit and look at it from an industry perspective and the grain industry, for many years our industry has relied on cash generally being excluded from CFTC jurisdiction. You know, there is a cash forward contract exclusion. The Commission's oversight mandate is really in the futures markets, right.

Our members fear that if you're taking this deep a dive into cash markets on a regular

and ongoing basis, you're really -- really blurring the lines between the two.

MS. DRISCOLL: So I'm just curious to know, I mean more from my -- the way my lawyer brain thinks, if there are places in the rule that you think could possibly be amended or if there's guidance that the Commission could give to sort of alleviate your heartburn, Lance.

MR. PERRY: So Katie, I'll go back to the 2009 guidance. I think -- I think that the term member in today's world doesn't fit anymore. I think that needs to be removed. Now I can't sit here and tell you that I have a confident answer on exactly what needs to be replaced with that; is that registrant, or is it that list of four or five that was present in the 2009 guidance relative to this kind of communication.

But I do think that's the most direct and most efficient answer to that. And to Robby's point, I -- I -- I may not be in the right spot, but I'm not exactly sure in the carve out why CPOs were carved out and CTAs weren't. I think there's a lot of issues around membership that need to be fine tuned and I think we probably

need to go to a black and white list, like the 2009 guidance did, of exactly who falls into part 1.35.

MR. WETJEN: I think the CTA exclusion was mostly based on the fact there's some semblance of a customer relationship there, unlike a CPO. And I'm not saying the analysis came out the right way, which is why we're here, but that was part of the thinking at the time.

MS. DRISCOLL: So maybe Robby or Steve, you could talk a little bit about -- I know you're both dual registered CPOs, CTOs --

SPEAKER: Katie, can I -- I'm sorry, can I --

MS. DRISCOLL: Yeah.

SPEAKER: -- it looked like you were about to -- because you touched on this earlier so I'm curious if you had a reaction.

MR. WALDMAN: Yeah, and I can't speak for obviously all in the industry because CPOs and CTAs come in all different sizes. And I think the answer would be that to the extent that you're an advisor that has discretionary control over money. I'm not sure there's such a distinction between a CPO and a CTA.

MR. O'MALIA: But you acknowledge that there is some type of a customer relationship, if you will, between the advisor, the CTA, and the customer, right?

MR. WALDMAN: Well, I would --

MR. O'MALIA: It's just the fact that there's discretion in the CTA; it makes it less -- it makes it look less like a customer relationship. Is that the point?

MR. WALDMAN: Well, that's part of the point. The other question is in that context, I have no idea what the difference between a CPO and a CTA is, just other than the nature of a CTA may have -- a CPO has discretionary authority over its funds, meaning its investment funds, a CTA has discretionary authority over its investment funds and its managed accounts. So it may be different for others. I'm just answering the question on behalf of Tudor.

MR. SEN: Yeah, I mean I think as a CTA we're -- we're acting as a fiduciary and managing money on a discretionary basis and I think that as I -- in the latest 1.35 rulemaking, the two overarching goals were customer protection and

market integrity. And I don't -- in terms of customer protection, I don't see what 1.35 does, in terms of customer protection for a CTA when we're managing money on a discretionary basis.

The only question is if we're managing it based on the investment guidelines, not what commodity we're buying or -- and any sort of external communications as we've talked about have -- are being recorded. So I don't -- I don't really see the difference between a CPA or a CTA either.

MR. CORDES: Do we also need to address the September 30, 2013, what is a member on a SEF guidance as well, which seems to -- that's the direct access? That distinguishes if you have direct access versus intermediation that automatically brings you into that obligation and makes some of these other distinctions irrelevant I assume.

MS. DRISCOLL: I -- I do think that would be helpful to address. I don't know if -- I would imagine that would be a Robby and Steve issue again, as well. And your thoughts on the guidance and how it relates to this situation.

MR. SEN: I mean I -- I still don't think it's -- it's clear what a member is and what trading privileges mean because if I'm accessing a SEF through an aggregator and I'm seeing the same view, why should I be treated differently than someone who's a direct member or if I -- or if, you know, I -- I'd tell someone else to execute the order on a SEF. Why I should be treated differently?

I mean I still think that trading privileges hasn't been defined and I think some clarity on that would help -- help the industry a lot.

MR. WETJEN: We don't have multiple definitions of the same term but, you know, another way to go about it would be defining membership as it relates to 1.35, right?

MS. DRISCOLL: Unless anyone has anything else to comment on the membership issue, I just wanted to go back to the lead to the execution of a transaction language and hear from folks on how you're viewing that language today since we did not define it in the preamble to the rule.

MR. PERRY: I'll take that, Katie.

MS. DRISCOLL: Okay.

MR. PERRY: I can tell you how we've been advised to interpret that. That it's any conversation, however it takes place. If it's in electronic written format we have to capture it. But it doesn't matter what mode it takes place in, but it's a conversation that ends up, like in Lance's example, you know, a negotiation between a merchant and a farmer buying some grain off of the farm or a negotiation between a merchant and an end-user that's buying trains to feed chickens in Alabama. But it's all of the dialogue that actually ends up resulting in the consummation of a trade of a cash commodity.

That's how we've been advised to interpret that. And back to kind of where I opened up, and it's hard to draw distinct lines, you know, in the language. We're going to quit talking about this, you know, it all kind of bleeds together. But where I started in my introduction was that basically -- there are some -- there are some conversations that take place about, you know, customer management,

customer relationships, that aren't directly related to a trade but you can't figure out which one that is or isn't when you -- when you start to write the email.

But that captures everything. So the way we've been advised to interpret that is that all of the dialogue needs to be captured. Now, in a meeting, and I'll get the date wrong, but I think it was here with the Chairman this month last year or right there thereabouts, we had just this conversation and I think what we as an industry, or the participants in that meeting heard, was well that's not exactly the intent; okay. Can we get guidance on that? And we didn't get that.

And I know that there's a massive backlog of stuff and everybody's busy. But that -- in absence of any definition or formal guidance on leads to, we've been advised that it's any conversation that takes place that ends up in the actual consummation of a cash commodity trade.

MR. KOTSCHWAR: Katie, I'd like to just go a little bit further on that. So how we are

doing exactly what he just said because we've gotten the same advise is, we are, of course, we're keeping all email for anybody who's got the ability to sign a merchandising contract on behalf of us, we're keeping all instant messaging but we're forcing all instant messaging to be originated from systems that we can capture.

So the flipside of that is we are, on purpose, specifically and very focused, none of our merchandisers are allowed to use mobile devices for anything other than phone calls. If they want -- when it comes to talking about cash commodities. That's -- those are our rules because we cannot comply with the mobile devices.

We can capture everything else, which I told you we've been doing for a long time now. Welcome to come see it; I'm sure it's gigabytes of data. But we just simply can't do it with mobile devices yet so we've complied by not using it.

MS. DRISCOLL: And Lance, is that because is prohibitively expensive for you to keep the text messages?

MR. KOTSCHWAR: Well, I'll give you a

perfect example is iphones; lots of people have iphones. The -- the -- I talk to our tech people very regularly about this and I say hey, is there any new systems out there that we can capture the imessaging. And I -- I am told that imessaging is absolutely proprietary; there's no way to copy it other than to make a copy of your screen and email it to yourself as a gif file.

So we don't know how to -- so again, that's -- there maybe some off the shelf systems to -- that we can run into with that, but it's a lot more effective for us to just say don't use them, which again, that puts us at a competitive disadvantage with our competitors who get to text with the farmers. We only get to talk to them.

MR. SMALLEY: Our issue is similar, but then also we didn't go that direction because then we -- we knew we had no way to index those conversations to a particular transaction anyway. So we -- we went the similar route, partly due to cost, but partly because we knew there was no way, currently anyway, to be able to index all of those conversations to a particular transaction.

MR. RUSSO: Yeah, what we're seeing is a lot of companies are putting in company policy to their employees saying that you can bring your own device and use it for business purposes, but it must comply to company policy and standards and right now that's mostly limited to Blackberry devices and Android devices.

As Lance had mentioned, Apple has not released its APIs to any vendor so we cannot capture ios related text messaging. So most every company that we've dealt with has basically just said you cannot use your iphone for business and you're limited to Android or Blackberry and usually it's company provided equipment so this way you could put the controls in place.

But if there's one thing I could ask, you know, the regulators to do is sort of, you know tap on Apple's shoulder and give them that extra nudge that they need to get on board because every other vendor has done what they've been required to do.

MR. POWELL: Yeah, I can -- I can really echo that. We've had dozens of conversations with Apple directly and they are fiercely

resistant of opening up this capability.

We've -- we've introduced the fact that the market is generally, and not even just the futures and commodities market, but the financial markets globally are interested in using their devices and would be delighted to be able to capture this for all of the reasons that they need to on the record keeping side and have not been able to make much headway with them so far.

MR. CORDES: Yeah, I would just echo a few of the comments too. We've put in some policy within our FCM that -- for employees using cell phones and it's not allowed for company business. Some folks need to take calls on off hours, that kind of thing. We're providing them with a separate cell phone or a tracking type device.

But really we've encouraged the business takes place in the office, well that's hard when markets are trading 24/7 and somebody wants to talk to their personal broker that they're comfortable with. It's hard to stop those conversations. But we've really had to really entrench back and -- and you're not able to use all of the tools that are available out in

the marketplace is really what's happening.

MR. KOTSCHWAR: Just one last thing and this goes back to the way Eric described -- the way he has a physical book and a derivatives book; same with us. So this notion about what does it mean to be indexable and searchable, we do hundreds of physical transactions each day.

At the end of the day, we'll probably do some derivatives transactions. We may be doing it during the day. The only thing we can do is we can capture all of that instant messaging by day and by person. We can do it by day and by person and that's as close to indexable and searchable as we can get. To try -- because of all of the challenges of trying to tie those back to a particular derivatives transaction, we don't keep our books that way so we will have all of this information by person, by day. That's it.

MS. DRISCOLL: I think we've hit most of the points in the outline that I provided to all of you but if there are some issues that you feel like we haven't covered and you'd like to raise them, please do.

MR. PERRY: Katie, I want to -- I want

to echo what Todd touched on a little bit. Relative to leads to the execution of and capturing all of that information, whether it's in a -- whether it's in an im or a text or via email, and again, this goes back to the membership thing and I think everybody gets that. But it does -- it's -- I don't think you can measure it, quantify it in dollars and cents exactly.

But in this age, with all of the, you know, what we've seen in the news over the last 12 months about phone calls being recorded and, you know, all of that sort of stuff that's been in the news, we do feel like those of us that are getting caught in this membership net are kind of at a disadvantage because we're doing business out in the country with the next three competitors that don't have to do any of this stuff, none of it.

And the -- and when those customers know and hear in the press that hey, the Scoular Company is recording everything we do; if we send an im to them, I'm not doing that anymore. Okay; well, if you -- like Lance points out, if you prefer to communicate like that, you know, you're

in the shop or you're on the combine and you want to do it then you're probably going to do it to the guy next door to us because, you know, he's not going to record it.

He's -- he doesn't have to capture it because he doesn't get caught in the net. So I - I do think that creates -- disadvantage is a strong word. It creates concerns for us in the marketplace, given how we've bifurcated the people in our business with record keeping.

MR. CORDES: I was just going to add to it and maybe it comes back to the question of, you know, what you're trying to capture or what's the end goal in this whole thing. And I look at the marketplace today and most of your derivatives transactions are taking place electronically.

There's a front end system out there that's capturing a lot of this stuff so I'm not sure what everything else is going to do other than point you where that trade is at, the time, and when it took place. But a lot of that information is already captured as far as when it traded, and how much, and that kind of thing if that's what you're after.

MR. JESKE: Well, I think it's pretty clear that the rule as it's written today is a disincentive to become a member of a DCM or a SEF. I know we're in a SEFed economy where we're dealing with (inaudible) classes that don't have anything to do with energy or grain at this point.

But if the Commission's public interest is to see participation in SEFs down the road, I think this rule needs to be amended because, you know, we have no interest in being part of a SEF at this point and if that's a public policy concern, then maybe the Commission should -- should try to address this in a constructive way to create liquidity.

MS. DRISCOLL: One of the carve outs in the amendment was for small introducing brokers and it was the only area where we applied a size limit and I'm just curious to hear if that would be effective for any other market participants. We actually ended up cutting out I think about 95 percent of our registered introducing brokers with the carve out.

MR. JESKE: Katie, I think that goes to cost. And if there's a proper cost benefit

analysis done, then that would be great. But some of the costs that I mentioned before, I highly doubt if they've been evaluated. Because -- just because you get a request letter from the Commission, there's a cost associated with that.

It doesn't mean you've done anything wrong, but you're compelled to review and search and lawyer up. And if you don't, you -- you -- you run the risk of providing reams and reams of information that haven't been thoroughly reviewed. And you know, again, query U.S. sentencing guidelines.

If you're not already reviewing that and then you do get, you know, the rogue trader so to speak or somebody in the organization that shouldn't have said what he or she said at that particular point in time, because let's be honest, that's what -- that's what's being looked for.

I don't -- and I'll do different, Scott. I don't think they're really looking for the deal execution. They're looking for more. And if -- if enforcement was the motivator behind

that, well, I think there has to be a balance and I think the pendulum swung a bit too far.

MR. KOTSCHWAR: I would just say with respect to using some kind of a size gauge that I don't think that would be effective at all for companies similarly situated to us because that's one of the reasons we are a non registered member -- non registrant member of a DCM is because of our size. Because we want to take advantage of the economy to scale of -- just kind of trading rights.

So you're going to -- all of the ones that are having this problem are going to probably be in your size. So I don't think that -- that would not be an effective way to distinguish among companies like us.

MR. SEN: Yeah, I would tend to agree as well. I mean for a CTA, you could be a one trillion dollar -- have one trillion dollars in assets under management but if you're doing ten million dollars worth of derivatives trades, that doesn't mean your call should be recorded and someone else shouldn't. So I don't really know if you could really get the proper size metric to

exclude who you should.

MS. DRISCOLL: Well, thank you everyone. I think as the Chairman mentioned at the beginning, everyone has the opportunity to comment on the topics that were covered today within the next two weeks. You can do that through our website. I believe there's a break now between this and the next panel. Thanks everyone. It convenes at 11:15.

(Off the record.)

MS. KIM: Okay. We'll now start the second session of today's roundtable, which is the regulatory treatment of forward contracts with embedded volumetric optionality. My name is Carlene Kim, Deputy General Counsel in the Office of General Council. And I'm joined on the panel today by my colleague and OGC David Aron, and my colleague in the division of market oversight, J.P. Rothenberg.

Any views that we may express today are solely owned, not those of any division or office of the CFTC or any Commissioner or the Commission. In the month leading up to and following the adoption of the seven part test, the staff met and

discussed with market participants about the various interpretive and implementation issues that they face when transacting and certain contracts with embedded volumetric optionality.

The purpose of today's session is to build on that dialogue so that we can consider the relevant issues in a meaningful and thoughtful way. To set the background for the discussion, David will provide a broad overview and then we'll go around the room and introduce the guests; David.

MR. ARON: Thanks, Carlene. I just want to give a little background on how we got where we are today. So in 2012, the Commission and the SEC jointly adopted the final swap definition. The adopting release reaffirmed that, "Commodity options are swaps under the statutory swap definition."

But it also provided an interpretation that a contract with embedded volumetric optionality satisfies the forward exclusion. If it satisfies each prong of the seven part test, and it's stated that if it fails the test, it still might be a forward under a facts and circumstances

analysis.

In the adopting release, the Commission solicited comment on the seven part test. Though some commenters supported the test, and or some of its elements, many suggested changes. Market participants raised questions regarding how to categorize contracts with embedded volumetric optionality and how to apply the adopting release -- the adopting releases guidance regarding the test.

There were many questions on the seventh prong in particular. Today we want to hear your current views and concerns on these topics to assist us in determining the latest state of play of these issues and how best to address them.

In this regard, we note that the comments received in response to the adopting release were received after the trade option exemption, but before DMO issued letter 13-08, providing further relief. So we'd like to hear the extent to which that addressed industry concerns.

And now we'd like to turn to the

panelists for you to read your opening statements and then after that we've got some questions and we can have a little back and forth and if there's more time we could -- you could just address whatever you want to. So let's start over here with Jim.

MR. ALLISON: Thank you David and Carlene. I'm Jim Allison with Conoco Phillips. I'm appearing today on behalf of the Natural Gas Supply Association and I've been actively involved in this issue since the beginning.

The industry, as David noted, remarked on concerns about the seven part test as soon as we saw it. And we were among those who filed comments on it. I will say that the problems we noted in our comments as potential problems, we now know to be real problems. So it's no longer a hypothetical.

The first one I would highlight is the problem with parts four and five of the test. A strict reading and language in four and five works for calls but does not work for puts. There is nothing in the rule that explicitly says that puts are excluded and there are other aspects of the

rule that appear to imply puts. So we have taken the view that it is a drafting error, not a policy decision.

If it is a policy decision then I think it would need to have substantially more backing than there is. Assuming it's a drafting issue, there is some language that we can provide that I think would probably fix it. As with other things, first choice would be to go back and redo the rule. Assuming that is not practical in a time frame that's important to us because this is a real problem right now, so we need a solution soon.

Interpretive guidance is probably something that would be very helpful but that assumes the interpretive guidance is actually definitive and reliable. Guidance that we can't rely upon is not actually useful.

So the -- the fix for puts would need to recognize that each party intends to satisfy its delivery obligations if the option is exercised and the respective delivery obligations are consistent with the character of the option as a put or a call. The problem with

parts four and five as I now stands again, is that it works for calls but not for puts.

More significantly, of course, as David indicated is the problems with part seven of the test. Within the industry we don't see how part seven has any bearing on the statutory test for excluding a contract from the definition of swap. So again, in an ideal world, part seven simply would not exist.

In the real world however, it does exist. It creates real, not merely hypothetical problems. And we need definitive reliable solutions. And again, first choice would be to have a new rule, second choice is reliable interpretive guidance. And it needs to clarify what's going on and how we get these problems out.

Again, we have language to propose. I don't know that everybody in the industry agrees that the language is sufficient because again, first choice is a new rule. But I think the language would at least be helpful. And I'll talk about that more in a little bit. Let me talk a bit more specifically about the problems that we're actually seeing in reality.

There's disagreement about how to apply the test. The disagreement includes disagreements with smaller companies and you might expect that because you might expect smaller companies to have been less diligent in following the evolution of Dodd-Frank and the legislative and regulatory framework.

But we also see disagreements with the largest most sophisticated counter parties. So the disagreement, the confusion, is not limited to merely those companies who were not following it as diligently. This is a deep seated disagreement.

We do, in fact, at the moment have what might be regarded as a work around. We have agreed to disagree. With the ramification that one party may report the transaction on form TO and the other party not report the transaction on form TO because the two parties have taken different interpretations of the status of the contract.

If you're happy with that inconsistent approach, you might regard that as a work around that will survive. I will note, however, that

once we get to a position limit world, if trade options are in scope for position limits, that agree to disagree approach no longer works at all.

And there is a greater concern. In some requests for proposal, where the requested contract includes volumetric optionality, we have seen the requesting party ask of respondents, whether the respondent views the contract as a trade option, and if so, whether the respondent will take on the reporting obligation.

When a respondent sees that, a respondent does not know how saying yes, we think this is a trade option will affect the probability of success on that RFP. A company that takes a conservative view of these contracts might have some concern that that conservative view puts it at a competitive disadvantage versus respondents that take a more aggressive view.

Now I do not mean to cast aspersions on anybody in the industry. I do not know how other companies are interpreting the provision when they are responding to these requests. But any respondent looking at the RFP, seen that question, has to wonder, has to be concerned, how

the answer will affect the probability of winning. And that concern is a burden that no company should have to bear in dealing with regulations.

The language that I would propose in interpretive guidance on addressing the problem would have, I think, three elements to it. First, that the optionality -- well, and again, this is assuming that parts one through six have been satisfied and that assumes in turn that parts four and five have been corrected.

But assuming all of that, the optionality of whether a put or a call exists to meet the commercial production consumption or merchandising, which is to say the entire value chain, requirements of the option owners business, where those requirements can reasonably be affected by supply or demand conditions, regardless of whether the option owners arrange for multiple alternatives to address these requirements, and including cases where business judgments exercised in selecting among alternatives where the value is driven primarily by external factors.

The concern being that it is quite rational for a company to arrange multiple ways to address problems. Depending on the nature of the problem, you may need a different supplier or a different delivery pass to address the needs.

And come the day the problem arises, you need to make a rational choice among the alternatives you've created. And the prudent policy of creating multiple alternatives and of choosing rationally among them, ought not to, in any way, disqualify a physical contract from being treated as physical contract. And let me stop there. I could continue much longer, as you know, David. But let me give my co-panelists a chance to talk.

MR. JESKE: Hello, I'm Jerry Jeske, Chief Compliance Counsel from Mercuria. Many of the comments Jim just stated we certainly concur with. But to -- to try to expedite matters abed here, focusing on a few things that are particularly problematic. Prong seven of the seven part test, the language factors outside of the control of the parties I think is incredibly ambiguous and really creates confusion in the

industry.

Jim also alluded to the agreement to disagree. I believe that's the genesis of the problem. That language needs to either be clarified or otherwise amended. I would also concur that the rule itself could -- could use a revamp. Another practical consideration that we're hopeful the Commission might take under advisement and -- and actually look at more deeply because it seems like this concept of gross notional applied to trade options is very misplaced.

I'll use the example of the heat rate option. There's the form TO that is required to be submitted to the Commission and then there's the one billion gross notional email that must be sent, or receive the punitive part 45 reporting. So folks want to be diligent about how they calculate but it's a bit of an impossibility when it comes to heat rate options.

Some folks might not be familiar with them, but a simple analysis, the numerator of the power of price times the mega watt hours, divided by the gas price creates a grossly overstated

number that should not be included in the analysis. Folks understand what a heat rate option is basically trying to determine the power of price versus the power of gas. I'm sorry, the price of gas. But when you introduce the concept of quantity into that equation, you get a skewed result.

So what are you left with to decide as a conservative party to report, but an overstated gross notional number. So if there's consistent overstating on the part of the folks that are filling out form TO and submitting it, I question what value is that data to the Commission or to anybody.

Moreover, you have that -- this inconsistency existing throughout the industry and really a problem, I think, when it comes to, you know, the concept of agreeing to disagree. You're going to have parties who just won't calculate it the same.

Jim also touched on position limits. We certainly hope that trade options are exempt from positional limits. That would be the logical smart thing to do because it's an

impossibility to bucket trade options together with swaps, together with futures, and come out with something that is manageable.

Last, I would say that we, you know, we're hopeful that the Commission does pay attention to this in a real time fashion, also as Jim has mentioned. And I'll turn it over to Todd.

MR. KEMP: Thank you. Todd Kemp with the National Grain and Feed Association. As I mentioned earlier, I remember firms include about a thousand companies nationwide. Grain elevators, feed manufacturers, processors; volumetric optionality is important to our industry in the context of cash forward contracting. I don't have a prepared statement for you but I'll look forward to participating in the Q and A with some more detail.

MR. JOSEPHSON: My name is Ryan Josephson and I work for the Bonneville Power Administration, which is a federal powered marketing agency within the U.S. Department of Energy, created by Congress in 1937 to basically market power at cost from federally owned facilities to about 142 not for profit electric

utilities.

I, too, haven't really prepared many remarks. Others just say that when Dodd-Frank was being sort of run its course, we had focused primarily on the swaps part of the legislation and really didn't pay due course to options and once we started looking into it we realized we had a slew of contracts that had immense volumetric optionality.

And given our statutory nature and our requirements, we realize that we probably should have paid a little more attention to the rulemaking around that and probably spend 99 percent of the time in providing guidance to our trade floor, mostly on options and volumetric optionality.

Facts and circumstance, you know, generally causes us to air on the side of caution and when in doubt, look at things as a trade option, versus using the forward contract exclusion for a particular transaction. So to the extent trade options become part of position limits, potentially airing on the side of caution, may ultimately cause us and entities we

do business with more issues than they currently do.

MR. PERRY: Thank you for the opportunity to meet today. My name is Eric Perry. I'm with the Scoular Company in Overland Park, Kansas. We are a cash commodity merchant in the agricultural space. And while this probably does not touch us to the extent our brother in the energy field -- does in the energy field.

As Todd pointed out, it does impact our forward cash contracting that we do. We -- we lean towards airing on the side of the cash exclusion in those contracts. So if we are going to evaluate them as trade options, we generally can satisfy all seven parts of the seven part test. But I would echo Jerry's points that the ambiguity in prong seven could leave some -- could be left open to interpretation.

And relative to position limit, that's probably where our bigger concern is in that we do view those -- those cash contracts with volumetric optionality under the cash exclusion. If trade options get rolled up into position

limits, we will have to figure out how to isolate that, report that with position limits.

And that's not actually a position that we have. We deal with those positions as they come up and roll into our derivatives book as a long or short futures positions. But will -- it will be a change of course for us to have to view those in respect of the position limit roll up.

MR. PERLMAN: Good morning. My name is Dave Perlman. I'm here today on behalf of the Coalition of Physical Energy Companies, as well as, a number of other physical energy end-users. My clients are -- I'm from the law firm of Bracewell and Giuliani, and my clients are generally hedgers.

They are a great variety of energy companies from retail marketers to large integrated oil companies to EMP companies to electric generators. And while they have a lot of variety of business models, there's one thing that they can all agree on, they can interpret the seven part test in a way that they can consistently understand it.

And the -- as Jim mentioned earlier, and

I'd like to note my agreement with Jim's proposals and comments, the mere fact that we run into a lot of issues and disagreements on whether a transaction is a trade option, among people addressing these issues in good faith, I think is -- is very real world evidence of, as Jim indicated, the concerns that we thought were out there have manifested themselves, because when we had the issue, leading up to the no action letter where we were all thinking about what are we going to do when we have to report this, we tried as an industry -- energy industry to sort of coalesce around different ways we could deal with it. And the no action letter put us into a position where we could agree to disagree.

Had we not had that situation, I think we would have had a much more fractious set of issues that we would have to deal with. Now whether that's a meaningful way to deal with things, where you have form TO where some people include it, some people don't, is a good -- good outcome. I'll leave that for you to decide.

But the bottom line is that we really can't meaningfully operationalize, this is my

word, the seventh prong. We can't make it work in a way that we can make clear to our clients. And in my clients' case, we have a lot of clients who are not really sophisticated in the CFTC world, they're busy doing what they do in their physical business and they're very good at it.

So we've tried to get things for them that are useful in sort of a -- in a -- in a bite sized desk type of operationalized set of rules. And when it comes to the seventh prong, it's just not something we can do.

So what we would like to see happen, and again, since the acting Chairman is here, I'm going to be redundant and repeat some of the things that Jim said, I'd like to see you act in a prompt fashion, maybe with a long term view of fixing this -- you have a record, that you have comments filed, as David mentioned, you have other ways to deal with it in a longer term way. But we need some relief in the short term.

And while we would prefer to have the whole thing revamped or the seventh prong repealed, that would sort of the perfect outcome, in the meantime, we think and would hope, that we

could get some clarification around what the seventh prong means. And if you'll indulge me, I'm going to sort of paraphrase what Jim said.

Because the seventh prong, as we understand it, is an attempt to say that the parties are engaged in something that is in conjunction with their business. They are actually undertaking a supply need or a merchandising need in coordination with their business and they've put the optionality in their contract so they can take action in the event of circumstances in a timely way that they have provided an opportunity to address.

It's not so they can monetize this and make a physical contract into a financial contract. That's not what we're talking about here. And if that's your concern, I'm hopeful that this language will help you. And it's -- where the optionality, inclusive for puts and calls, is intended to meet the commercial production consumption or merchandising requirements of the option (inaudible) business.

And so we're talking about physical commercial businesses, which can be reasonably

affected by supply and demand, this sort of outside the control of the parties type idea. But that gives a little more granularity to what outside control means. And it's regardless of whether the option owner has arranged for multiple alternatives to address the requirements because one of the things that we had understood was if the option owner had multiple alternatives and they may be making a decision, let's just say, in this case, based upon the best price that that would be based upon economic factors, not on factors beyond their control.

And frankly, it is rational and common that parties will have multiple supply sources for reasons that have to do with the things Jim said, including reliability of supplier, certain other characteristics of the transaction that would make it more suited to their needs at that time, and of course, places important.

But if you need something for your business and you have something where price is all that matters, you might end up not getting supply. So you need to be redundant and careful to make sure that you get your commercial needs met.

And finally, and this is related, including cases where business judgment is exercised and choosing among those alternatives, including qualitative factors. As we're saying -- is I might have multiple alternatives. One is better than the other for my needs today, one is better for the -- than the other for my needs tomorrow. I'm making a prudent business decision, given the factors and alternatives I have before me.

The other two items that I think I'd like to address, given the limited time, is first the risk of ambiguity in our minds to around what optionality means. The Commission has precedent on the definition of an option and there was some language in the -- in the order about some Commission precedent and we think it may be useful. And we can follow up with comments on this to get a little more clarity and granularity on what optionality in these contracts means.

Is it -- doesn't need to be in the test of what the Commission has said an option is. So is it an option embedded in a foreign contract, as you've stated, or is it a foreign contract

merely with different quantity opportunities in it? And we think maybe the former is the right answer.

And second, the position limits issue is a real material and really, really conceivably problematic issue. We are in the business, again, of meeting our physical needs of our businesses and we are undertaking something that is, in my mind, very hard.

If you look at the definition of a bona fide hedge that the Commission has proposed in a position limits rule to meet the test of a bona fide hedge. It isn't hedging a cash contract that has price risk. It is the cash contract.

You could maybe hedge your trade option, but your trade option is not something that you speculate in, it's not the sort of thing that has price discovery impacts, it's not the sort of thing that can be made sensibly or easily, as Jerry was saying, into futures equivalent. So we're hopeful that you'll understand and when you get to that aspect of things, not included in the position limits.

So as Jim also indicated, we'd be happy

to suggest language to you in the comment period subsequent to this conference and be happy to answer any questions that you have.

MR. HUGHES: Good morning. My name is Paul Hughes. I'm the Risk Control Manager for Southern Company and I'm here on behalf of EEI, and ya'll know EEI is the investor -- represents all of the investor end utilities in the U.S.

I wanted to make -- maybe give a different perspective from the electric utilities side. But you know, generally fuel diversity is a very important component of electric reliability. And at Southern, we've developed a diverse portfolio of generation resources.

To meet our customers' anticipated energy needs, we build generation resources ourselves and we also purchase generation capacity from third parties. When the time comes to employ this generation, the industry uses complex dispatch models to analysis a combination of operational, locational, and market factors to determine what the resource mix should be. And the goal is for our customers to have both the

lowest prices possible, while also maintaining reliability. So inherently, we build in a lot of redundancy to our processes.

Due to the current lack of -- of clarity in the rule, what we've found is that counter parties through a transaction may view the same transaction differently with some viewing it as a forward, some viewing it as a trade option, and some viewing it as a straight up plain vanilla swap.

And the willingness of the parties to agree and classify the transaction as a trade option is further complicated by the inclusion of the trade option and the new position limits rule is upcoming.

And now at Southern Company we have gone to great lengths to comply with Dodd-Frank. We've even developed software to help us evaluate all of these contracts and do they pass all of the factors of the various tests. And the result of that process and taking all of these contracts through those tests is we think there is a conflict between Section 1a(47) of the Commodity Exchange Act and the Seventh Factor of the

Volumetric Optionality Test.

And the Dodd-Frank Act states that the term swap does not include any sale of a non financial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.

However, the application of the seventh factor, by Southern Company, and we readily admit we take a very conservative view of this, has resulted in the inclusion of several contracts that can really only be settled one way physically, yet in spirit of the rules and the languages there, we really think that perhaps that's not how they should be -- they -- not shall -- how they should be graded.

So accordingly, there's a conflict between the results that we're getting from the seventh factor test and what Congress intended. This may be due to the fact that the seventh factor has a misplaced focus on the option exercise. Because at first glance, the concept of excluding optionality based on primarily physical factors, outside of our control, seems reasonable, particularly when considering the impact weather

has on demand.

However, this is problematic for the electric industry as it oversimplifies industry practice. Because the dispatch models take into account a multitude of factors when determining the resource utilization, attempting to determine the primary cause of exercise at some point in the future is impossible, even if it were a factor that is under our control. We just don't know at the time that we have to make that determination.

We think there's several solutions available to the Commission and we think simply, you know, one, remove or replace the seventh factor is one way. The other part -- the other way may be to change the focus of the seventh factor from the exercise of the option to the commercial intent of the agreement.

I would echo the same sentiments I think we've heard from Jim and David and others about some -- perhaps some -- some ways we could tweak that language to recognize that kind of physical operational intent that does exist and does not -- you know, we have -- we have activity that

does not respond to price signals.

You know, when you value an option, and typically you value an option you look and say well you're going to assume based on the economic signals that option is always going to be exercised. Well that's not the case in our industry. We have physical constraints that may prevent us from exercising that option.

We can't simply take one element and divide it and say well today it's an economics, tomorrow it's operational, the next day it's locational. For us, all of those components are inextricably linked. We can't just pull them apart.

And that's how I think what we're dealing with in trying to make determinations and that's, I think, what creates problems in the ambiguity between our commercial counterparties and leads to some of these disagreements may be a strong word, but longer conversations. I would say it's slowed down the commercial process a bit.

But that being said, I think there are several venues that the Commission could take, whether it's a change in the rule, whether it's

something like the OGC did on their infamous however clause last year. I think there are several things -- several ways to get there and we welcome really any of those. So I appreciate the opportunity to come and talk and discuss this.

MR. NUELLE: Good morning. My name is Tom Nuelle. I'm the Chief Compliance Officer for BP's marketing and trading businesses in North America. And as such, I'm also the Chief Compliance Officer for BP Energy Company, a provisionary registered swap dealer.

I don't have any prepared statements, but I do echo what my co-panelists have said. We do think that the seventh prong on the test needs to be redone so it is very clear. We have seen instances where we do disagree with parties on whether things are generated options or not and a lot of times there is an agree to disagree.

For -- and we're at kind of a unique perspective than I think others on the panel, being a swap dealer. We have a higher obligation under real time reporting that we have to get these reported to the SDRs within two hours now. And that can -- if it's vague, it generally means

that the marketers are having to come to compliance, to legal, to get definitions on -- a confirmation on whether things are trade options or not.

We can't necessarily give them just fool proof guidance where they can go out and run their business. If it would give them very little and ask them to come back -- that takes time and it takes efforts. And then the other part four is swap dealers. We need to be able to isolate these deals easily in our system to be able to efficiently report them to the SDR. Right now that's a very manual process as you can imagine from having to identify these -- these options as deals are getting done.

And since there are no standard format to put these in, a lot of them are -- are submitted manually to the SDRs, which again, takes time from the commercial staff, mid office staff, all of the way back to our confirmation staff to make sure that that happens and that is quite burdensome.

On position limits, I would agree that they do -- they shouldn't be included in the position limits. These aren't -- I think it was

David who said these aren't instruments that can really be traded in and out of and a lot of times we are doing these things for -- as a service to our customers who are looking for different ways to get molecules, who run their business on -- on stress days.

And so if they are included in a position limits, that would cause them to be physical contracts, which if the conditional limit does pan out in the new rules, we may not be able to or a company may not be able to take advantage of that if that -- the only thing they have sitting on the physical -- on delivery contracts is CTOs, which you can't just go and get out of on an easy -- on an easy basis. There's no standing market for that.

So given that, we would prefer that they not be included in the position -- position limits. And as I said, we can focus the position limit activity on the futures and the swaps and the -- over the counter swaps. Thank you.

MR. TURBEVILLE: Good morning. My name is Wally Turbeville. I'm from Demos, which is a -- a public policy think tank and advocacy

organization. And as such, I'm -- I'll have different sets of interests than anybody I see around on the table. And I understand your interests, I do.

I understand that you don't want to -- you want to do -- you want to burden your business as little as possible and I -- I really appreciate that. But our interests -- what we're -- we're -- we're focused on is the public's interest. And the public's interest is expressed in the Dodd-Frank Act and in the notion of transparency.

I don't normally do this but before I was in the business such as it is of thinking and writing about these kinds of issues, I spent well over a decade at a -- in the energy group of a major investment bank and then later for another seven years, ran a derivatives -- an energy derivatives risk business to manage that risk.

So I -- I -- I kind of think of these things maybe a little bit differently. And I think part of the -- part of the problem is almost a fundamental conceptual problem with the discourse. When you say we can't get out of these

things, what are these things? I think of these things as if -- if there's something -- if there's a risk package inside a contract that could be hedged in the marketplace, not detached and marketed, which I -- I -- I -- who -- who detaches and markets any -- any derivative. You don't -- you don't sell a derivative, you cover it.

So I think if -- I think fundamentally, if something can be detached and hedged in the marketplace, it is a derivative. I think that if there's -- there's a sophisticated party on the other side of the transaction, they view it as a derivative, they'll put it in their risk book as a derivative, they'll -- they'll -- they'll measure it as a derivative.

So -- so the -- the -- the question -- the going in question of optionality is one where is this the kind of thing that could be sui generous hedged and -- and -- and addressed in the marketplace.

I understand that these things aren't intended on your part, for most of the people who have spoken so far, to monetize or to speculate

but then neither is a conventional bilateral swap with an end-user. It's not -- I don't think it's -- I don't think it's a question of whether the -- the thing is intended to -- to -- to be monetized.

If there's -- if -- if it addresses a legitimate risk in your business, that might have some pertinence with regard to -- to position limits. I understand that, too. But -- but that doesn't change the fact that -- that -- that -- that it just can't be ignored and that this is indeed an option.

Now, also having had the experiences I've had, I understand further that when some folks in the marketplace who are very sophisticated do a contract like this with an embedded option, the pricing of that option is something to feast on because -- because the fact of the matter is, that the complexity associated with embedding an option in a physical contract is something that is the opposite of transparency.

It's -- it's -- it's the ability to obscure because -- because the quantitative

analytics associated with it can be -- can be -- can create a situation where -- where pricing is -- is -- is -- is very difficult to understand.

So in one sense, I think there's a value to the -- to the -- to the market in terms of actually getting transparency and getting reporting and -- and -- and -- and seeing what this option is -- is -- is really worth. I think that -- I think there's -- I think that's -- that's actually an advantage that -- that -- that is ignored because I understand people want to do things the way they do things and have done things in the past.

So that's where I'm coming from and where -- where -- where I'm going to be coming from in the discussion. I do want to go back to the heat rate question, the heat rate option question. And -- yes, sir; hi.

The heat rate option question is one that seems fairly straight forward. The heat rate is -- the heat rate is nothing but an evaluation of the -- of -- of the conversion from gas to electricity. And there is a -- there's a

volumetric value associated with that.

But that is no -- to me it's no different from an option or a swap in terms of the -- in terms of -- of -- of -- of -- of it's -- of its notional value, as long as you -- you're valuing -- the value you put in is the right value to start with and the quantity is the right quantity. So maybe that can be discussed. Thank you.

MR. CERRIA: Hello; okay. I'm Chuck Cerria from Hess Corporation. I've been involved in -- in trading and physical commodities since, I believe, October of 1998, from both the perspective of the -- the provision of the commodity to the -- to the commercial and industrial users who potentially end up to people such as this building and the lights on in this room now.

So I've also been exposed to the trading side of things, the structured products and everything else. And by the way, just to -- housekeeping, I'm here on behalf of Commodity Markets Council and what I'm saying are my own thoughts and not to be attributed to any other -- anybody else; okay. So I just want to

get that out.

But getting back to my opening comments, I don't know if they're prepared or not. I have kind of notes all over the place here. But I agree with all of the points. I'm not sure I understand a lot of what Wally is saying so I can't -- I don't know if I agree with Wally but I know I agree with -- with my other panelists to the extent that they've gotten into the weeds.

I -- I agree with those and we've seen some language and we're -- we're willing to work with -- with you, David and Carlene, to you know, to maybe improve upon the seventh prong as at least in intermediate step. But if I could, I'd like to just ascend a little bit and maybe go 20, 30,000 feet up and actually commend everybody and commend the Commission for being as vigilant as you have been in trying to distinguish a physical from a financial.

I -- the reason that I -- that I offered to join this panel is because I actually think that's the single most important topic in all of Dodd-Frank, okay. Because everything -- the waterfall just rushes after that determination is

made. And so getting this correct, I think, is the single most important thing that we all can do and I appreciate the effort from -- from the Commission, and even Congress, okay, because as other panelists have said, you know, let's focus on the fact that Congress expressly excluded transactions that are intended to be physically settled at the time of the transaction. That's an express exclusion and I think we should -- that's got a lot of significance and we should never water down that significance; okay.

So correctly distinguishing between what's physically settled and what's financially settled or a financial instrument so to speak is absolutely critical to getting this whole thing right; okay. And just as -- again, maybe I'll go another 5,000 feet up and say that it's significant not only within the U.S., it's also significant worldwide within the G20. And Mark, I know that you've been outreaching a lot over the last few -- few months. Thank you for that.

But you know, the EU defines financial instrument, which is I think probably close to what we're calling a swap here, and thereby

mandating clearing -- they include physically settled contracts that are traded electronically on a multilateral platform and that's -- that's different than what we're doing here.

These kinds of things have got to be ironed out and we have to have a clear division recognizing the value of a physically settled contract versus a financially settled or financial instrument. So this work is really important, okay.

Getting back to the provision of, in my case, energy, okay, or molecules. I mean they're -- they're -- they're -- we are providing an essential resource and commodity to society, okay. And I'm not going to get too dramatic or too -- too over the -- over the top here. But that's really what we're talking about.

Again, like the contract to supply, to power the lights that we're all enjoying now, okay. If we decide to switch off the lights because we're going to go on break or something, we've turned off the power. I mean that's the kind of volumetric variability, if you want to use the word variability instead of optionality,

okay, that we're talking about when you deliver a commodity; okay.

And it's the same with oil and whatever the commodity is from an energy standpoint. I can't speak for grains or metals; okay. And so we've been doing this for decades with much success.

We, you know, we -- our commercial market participants, we've established the ability to do that and society actually appreciates that and these volumetric optionalities as they're called that are embedded into these contracts, developed as a consequence of the market trying to sharpen its efficiencies so that only the amount of molecules that need to be dispensed to satisfy demand are dispensed and no more is wasted. So there -- there's a lot of public policy behind efficiency and encouraging the market to continue to develop its efficient means; okay.

So getting back to what I said earlier, now -- and by the way, I think I've come down about 20,000 feet, okay. So getting back to what I said earlier, we -- we don't please -- we -- we -- we

can't allow ourselves to -- to be persuaded to think that these are speculative financial instruments. The -- we're talking about the basic commodity contracts here. And when you deliver a commodity, you're -- you're going to have variability and volume. That's just how it is.

And so I think I've talked for a while and I'm not going to talk anymore. The only thing I want -- I want to end with is, and David has said it and -- and a lot of people have said it, what we need is we need something that's workable in the moment when these transactions are executed at the time of the transaction, something that the parties all agree either is a forward contract exclusion or is a commodity trade option or is a swap.

And you know, getting back to transparency while I do agree with you on the value of transparency, when you -- when you sit back now and look at what do we have in the SDRs and what do we have in foreign TO reporting that we've all just gone through.

We have a lot of probably

inconsistencies like everybody is seeing here and that devalues the reporting and the transparency and worst case is it actually leads us to a path of thinking we have reliable information when we really don't. So it's that false sense of security that always like nags at me; okay. And so I think I'll leave my opening comments here. Thank you.

MS. DONDNAVILLE: My name is Patty Dondnaville. I'm a partner at Reed Smith and I'm here at the request of the not for profit electric coalition, which is the coalition of rural electric cooperatives and municipals government owned utilities that are the quintessential, if you will, end-users in the marketplace.

Their job is to deliver power 24/7, 365, to their clients, their customers. They have, as Chuck and David said for years, distinguished very clearly between contracts where they intend to physically settle, which is 99 percent of what they do, and financial instruments that they use solely to hedge so they don't, as the professor was saying, speculatively trade.

They don't trade in metals or crude oil

or financial commodities of any sort in a trading sense. They use natural gas, electricity, and other energy related commodities and commodity swaps to hedge their commercial risk of operations.

To comment on the volumetric optionality, I really need to go back to Chuck's 30,000 feet. Because all of this generates from an interpretation that David Aron sited at the very beginning, which was the Commission's interpretation that the statute before it, 72,121 of the Dodd-Frank Act required it to see all commodity options as swaps.

We're not in an exercise to determine whether things fit in one of three categories here. There are two categories. Is it a swap or is it not a swap? That's the question that all of my clients are asking me on a day to day basis. Because if it's a swap it has consequences. You have to report it within two business hours, within 48 business hours if you're end-user to end-user.

So swaps have consequences. If I respond to them with a series of interpretations,

and they're not rules, they're interpretations of the CFTC. They're not joint rules with the SEC. Footnote 205 essentially says the CFTC takes no part in this section of the interpretations in the products definition release.

So there are interpretations out there and the energy industry, as Jim said, has requested since they were published that they be withdrawn.

My group has on file with the CFTC a request for reconsideration of that basic question. Are all commodity options, even if the parties intend to be physically settled, swaps? We think the answer is no and we've asked the CFTC to go back and reconsider that legal decision and we've not heard a response.

So, I think I agree with what Jim said, what David said, what Paul said. The energy industry is looking to the Commission. We're very appreciative of this dialogue. We've provided the CFTC with reams and reams of input on how these tests, these interpretations don't work in our industry, and we're asking the CFTC, first address the motion for reconsideration.

Let us brief it. Let's talk about that conclusion.

Beyond that, let's treat the symptoms of the underlying problem with please withdraw the seven part test, the test that -- the interpretation that's out there with respect to physical commodity transactions. You asked seven questions, we answer. We would like, in most instances, for you to withdraw that, but if not, let us know what you don't understand about the comments that we've submitted about how they don't work in our industry.

Let's open the dialogues. Let's see if there is a way those interpretations can be fixed so that the CFTC doesn't see what I call option ghosts because when you're seeing those option ghosts in our 200 page contracts, you must be seeing swaps because otherwise we wouldn't be here.

And if you're seeing swaps, then those should be reported. But the reason you're having such problems with your swap reporting is because there is this tremendous disagreement as to what's a swap and what's not a swap. And people

are not taking a conservative view or an aggressive view.

I have clients all along the range of that perimeter that are taking different views of the same transactions and then they're trying to, in some cases, take a conservative view and slam those puppies in to the very narrow descriptive data elements for swap reporting. And they're doing that in different ways.

We talked about not having trade options be under position limits. Well that's because they're not swaps. And what position limits are intended to do is test financially settled contracts, not physically settled contracts.

So as I say, it all goes back to the ultimate question. How can we engage with the Commission in a constructive dialogue about changing the underlying interpretation of 1a(47) and if not, how can we treat each and every one of the symptoms where that will continue to pop up in your rulemakings, in the Federal Reserve's rulemakings, once they come forward with revised rules on margin and capital? Because these

things are going to come up time and again unless we fix the underlying question of what's a swap and what's not a swap.

MS. BERGLES: Susan Bergles. I represent energy utility clients and today I am here on behalf of the American Gas Association and I'd just like to start out. I'll be brief, going last, but just thank you to Chairman and staff for holding this very important conference on this very important topic. I'm looking forward to having more in depth discussions along the lines of what folks have been talking about already today.

Briefly, the American Gas Association members are regulated energy utilities that deliver natural gas to millions of residential, commercial, industrial customers throughout the United States. These entities stand ready to meet their customers gas needs at rates, terms, and conditions that are subject to state regulatory authorities.

Again, these entities are regulated entities. They're used to being regulated. They understand regulation. They understand

compliance. What we have been talking about around the table here is entities need to have more clarity to understand what -- what is a swap and what they should be complying with.

Part of how gas utilities meet their obligations to provide gas to their customers is they develop seasonal plans, as we discussed before, including a portfolio of various supply sources, storage, and transportation. Included in these are the non financial physical commodity contracts. Because meeting customer needs is impacted by weather, which cannot be accurately predicted or forecast, a certain amount of planning goes into entering into contracts with volumetric optionality.

This is done to cover your changes in your customer need and demand fluctuations. It is also the intent when we enter into these contracts that what you're getting is the ability to confirm physical supply. The intent is that the product is going to show up upon request.

So physical delivery is the underlying intent and these transactions are viewed by the gas utilities. That's just common and necessary

tools as part of their ability to meet the reliable and cost efficient needs of their customers.

AGA does not believe that Congress or the Commission intended to include peeking or swaying contracts under the Dodd-Frank regulations as swaps. We believe that they should be excluded from the regulation as a swap, but under the seven factor test, as we have been discussing today, there remains regulatory uncertainty.

In order to alleviate that regulatory uncertainty, we propose CFTC Commission action to address the comments that have been filed in -- in the open docket, the further definition of swap, comments filed October 12, 2012. And included in that, I would echo some of the discussion that has happened -- that has gone on today, which is with respect to the seventh factor, the proper focus, we believe, and it's in AGA's comments as well, should be on -- on the -- whether or not the transaction satisfies the seventh factor at the time the transaction is entered into.

Have -- have there been compliance

challenges? Yes. I'll be happy to discuss those further in detail according to your questions today, but others have already discussed there's been disagreement, there's been confusion in the marketplace.

People are reporting on form TO probably different. Some are classifying things as a trade option. Some folks may be considering them as an exempt forward. That's why, again, we believe it's critical to have regulatory certainty.

Briefly, have there been -- one of AGA's concerns has been impacts on the physical natural gas marketplace. There has been impact on market liquidity, innovation. AGA members are seeing a decrease in the kinds of commercial offerings counterparties are willing to make. A decrease in the number of commercial counterparties willing to enter into these flexible transactions, which gas utilities rely on to serve the needs of their customers.

Again, this is impacting the robust participation and the innovation that the industry has had for the last 20 years. That's

also resulted in billions of dollars of savings to customers.

So ultimately, you know, the ultimate impact, if you need any more reason to -- to do something about this, is definitely that the impact is ultimately passed through to customers. Gas utilities, any -- increase costs in procurement of gas supplies are passed through to their customers at cost. As a result, you know, increased gas costs will ultimately lead to higher natural gas prices paid by the American Energy customers.

So again, we believe it's critically important for the Commission to provide clarification in the form of a final rule based on the comments and the clarifications requested in the docket. We believe that part of that clarification should include the focus on the intent of the -- the transaction when the transaction is entered into.

And briefly, I will just say the AGA did file comments in February of this year on position limits and consistent with folks around this table has taken a position that trade options

should not be subject to position limits. Thank you for the opportunity to speak at this roundtable.

MR. WETJEN: Susan, can I ask you a question --

MS. BERGLES: Sure.

MR. WETJEN: -- Quick question. So help me understand a little bit better if you could, the practical effect of when you have two parties that are considering entering into some kind of an agreement but they don't agree as to what kind of a contract it is, whether it's a forward or a trade option. So other than because of the disagreement, one party deciding they might not want to enter it in -- enter into the contract, what are some other things we should be mindful of or what other kind of problems does that create?

MS. BERGLES: Well, I think that this first round of reporting on form TO happened and people were looking at transactions that they had already entered into. So I think folks were more concerned about reporting for their own self and their own regulatory compliance so they were

making the best decisions they can. And probably out of an abundance of caution due to maybe a reluctance to have it fall within the seven factor test, they're going to report maybe the transaction as a trade option.

Going forward, I know some of my clients have not negotiated some of these transactions yet that will occur in the summer. They have already informed me that two of the main entities that they have done transactions for flex -- with flexible delivery terms in the past have decided to exit the natural gas business.

So that -- that -- that's going to be an impact. So those -- a lot of the new discussions, at least to my knowledge, have not taken place. I don't know if other people around the table --

MR. WETJEN: That probably -- because I think Paul had mentioned that a lot of times you're having longer conversations. It may be end up being resolved. So at the beginning of the conversation maybe there's confusion, but at the end of it perhaps there's not -- get a sense of that and whether there might be --

MR. HUGHES: Sure.

MR. WETJEN: -- other practical problems being created by all of this.

MR. HUGHES: Sure. I think -- I think -- and I think Susan alluded to it. But it does -- I think it does extend the commercial transaction time because there is this discussion of wait, is this a trade option or not a trade option, is it excluded for it, is it not.

And those parties, I think the way the rules are set up legitimately can have a different view of that because I think we -- I don't know if we mentioned it or not, if anybody here mentioned it or not, but there's kind of this underlying question. Can I rely on my counterparties rep on their representation?

So if they say I'm only going to use this commodity for something outside of my control, okay, well can I -- can I honestly accept that rep and move on? I have to be very careful before I answer that. I'm -- I'm -- I'm not an attorney.

I'm just trying to implement the rules. But I can tell you my attorneys come back and say well wait a minute, well we, in essence, kind of

turning over our compliance to a counterparty because what if there is some type of contract and insert whatever commodity you want to but there is flexible -- flexible delivery options.

And let's say you -- they can take from, I'm just going to say, zero to 500 (inaudible) megawatts, whatever you want to put in there and the first two -- say it's a 10 year agreement, long term agreement.

So those first two days, they take lots and lots and lots of volume. Day three, day four, through the rest of the term, let's say they don't take anything else, am I now in an awkward situation where I go wait you told me this is only going to be for regulation reasons. I know it was really hot outside, but nobody ever called on this. And it puts me in a very awkward situation.

I think -- so I think you find reluctance on both parties. I don't -- I don't think it's, you know, it's just -- but I think we've kind of seen and heard that. And then I think there is kind of this adherent reluctance. I know we kind of agree to disagree. I think that was in this discussion or maybe the one before

that agree to disagree is a work around. It doesn't feel good though; all right.

I mean so you agree to disagree but you know that, you know, for example I'm going to classify something as a trade option and the other party says no, that's not a trade option, well I'm going to include that in my form TO and that other party is going, hmm. So this is -- there's this -- this disagreement of contract now that's being reported on someone else's regulatory report.

If they come back, if somebody wants to look at that and the detail -- why is your -- why are you not there. And I think there is just a natural reluctance when parties can't agree to kind of absolve themselves of that and -- and it does -- it does slow down the commercial process.

MR. PERLMAN: Can I add to that? Because we have -- I have multiple clients who have dressed this all kinds of different ways. And it goes to some degree to what Patty said. They don't -- some of them are not sophisticated in this area. They're very sophisticated at their business and they've decided we don't want

any swaps. We're not going to report anything. We don't want any swaps. That's our policy.

So they had contracts of volumetric optionality until this rule came out. Now they don't have them at all. They won't do them. So they're significant natural gas entities.

They do not do contracts of volumetric optionality. They can do much more logistically difficult transactions where they can enter into multiple individual contracts that have a quantity.

So instead of having a contract that had optionality in it, where it could be moved around, they have to instead enter into daily contracts or hourly contracts for quantities, which is much more burdensome but it gets to the same outcome. Maybe that's what you meant by a workaround.

The other thing that I mentioned was that when we came towards April of 2013 and we were looking at the need to report, it was obvious that the parties in the marketplace could -- were not going to be able to agree. And as Paul said, there's discomfort on the fact that we can't.

We've run into parties that want to put

reps in agreements. This is one of the issues with reps, where all of the transactions that we will do, today, for the rest of time, will have the following characteristics. These are contracts we haven't even seen yet.

And we see a lot of people trying to put those reps in contracts, which is problematic because the lawyers work on the reps and then the business people do the trades and maybe there's a discontinuity between the trade that happens 18 months later and the rep that was made. Who knows?

MS. DONDNAVILLE: And the operations people are the ones that actually exercise the option --

MR. PERLMAN: Exactly.

MS. DONDNAVILLE: -- at some point when it's below zero across most of the mid -- middle west.

MR. PERLMAN: Right. And let me just say --

MS. DONDNAVILLE: So from -- go ahead.

MR. PERLMAN: The final thing and I'll turn it over to you, Patty. Is that because of

the way form TO works, where you can have individual reports without -- without consensus, I'm sorry, you end up with a situation where people have no need to agree.

And the freedom to decide what you think is right, in good faith that I'm assuming, and report whatever you want, is -- is really a way that the regulatory requirements of the Commission kind of fall by the wayside because nobody ever has to deal with it. We will if we have to deal with position limits.

People have -- I've gotten more questions than you would suspect where they -- people say what is the Commission's remedial authority and what kind of penalty can I have if I mischaracterize something as a trade option. That shouldn't be. Or the other way around because people are concerned that they're making a mistake in calling it a trade option.

And I tell them it's $140,000 and they -- they don't like that. I tell them that I think the Commission is at a reasonable place and the Commission is not going to penalize you and they say we -- we are conservative compliant

entities. We want to do it right. Your judgment is appreciated, but that's not the real determinate, it's the Commission's decision.

So I think you can get a level of, I'll call it, false comfort from the fact that people have not had to agree and they've had these discussions and maybe parted ways at the end. But at the end of the day, from a regulatory perspective and a true compliance perspective, there's really no true consensus or understanding of what the Commission is expecting.

MR. TURBEVILLE: I think that if you go for -- from the other direction, clarity is really good and that's an important thing and I think that -- I think it's an unfortunate thing that these discussions are going on and -- and people are taking different views. That's not -- that's not good.

But the other way to look at this is they really are options. And they -- and it's you can't do anything about it.

And -- and -- and -- and instead of -- when I read -- when I read the rules, it seemed to me that the Commission was trying very hard to be as

accommodative as possible, but underlying all of that is that these things are really options.

And there's a complete -- we're not talking about the contract of delivery and the settlement of the delivery of the natural gas or electricity, we're talking about the option that is embedded in it. And you know, if you -- if you look at how, you know, Goldman Sachs, Morgan Stanley, J.P. Morgan, built their businesses around derivatives and physical, especially in businesses like electricity, which -- where the physical -- it's not -- it's not like a bushel of corn. The physical in electricity is energized electrons.

So there's -- there's -- there's no bright line distinguishing factor when it comes to what is a -- what is a swap or an option and what is a physical. It -- it -- it -- those blend into each other over time financially.

But the other way to -- my point being, the other way to address clarity is to actually make it very clear that we recognize that these things are -- are -- are -- are options, which -- which they really are and then proceed

accordingly. And -- and -- and you know, if -- if -- if the fact is that somebody is doing options and they -- they need to report, okay, they need to report.

Somebody has made the decision, Congress, that -- that that's -- that that's overall good for everybody. And I do not believe that the lights are going to go out or natural gas is going to cease flowing if -- if the outcome is that these things are recognized as options when they can be actually hedges in the financial marketplace.

MS. DONDANVILLE: Can I come back though and point out that Congress didn't put in place in 2010 something that says options need to be reported. They put in place something that said swaps need to be reported. So again, this traces back to the question of whether if the parties intend physical settlement, which if there's one rep I think you would agree, David, and all -- all of you would agree, people are perfectly willing to put in their forward contracts. Whether or not -- is that they intend physical settlement. I've never gotten

disagreement about that.

MR. TURBEVILLE: Physical -- physical settlement is a physical or physical settlement of the option?

MR. ALLISON: No, physical settlement of the option --

MS. DONDANVILLE: Physical settlement --

MR. ALLISON: -- is precisely the question.

MS. DONDANVILLE: -- physical settlement. As the rule says, physical settlement, not of the option, not a delivery of the option contract, but physical settlement of the delivery of the commodity.

SPEAKER: I understand that.

MS. DONDANVILLE: Okay. And there's nothing -- absolutely. We're not talking about the delivery of an option contract here. What we're -- what we're talking about is what needs to be reported and what doesn't need to be reported. And the CFTC is not putting in place options reporting. What this is about is swaps reporting.

And the disagreement as to what needs to be reported is that fundamental question. Am I entering into a swap? Because it has consequences if I am. Don't give me an answer that says there's a seven part test to figure out whether you have an option. That's not the question I asked, say my clients. My clients say is it a swap or not.

MR. ALLISON: So if I can pick up on that point, Patty, it -- there are some contracts that have variable volume where there is a legitimate question about whether it's an option. And that's on the second page of the questions that were circulated for this panel.

For the most part, Wally, however, the question is not whether there are options. These are options. They are structured as puts or calls. They have a premium associated with them. We invoice for the premium and we expect to get paid. There are provisions that describe how exercise -- these are options. That's not the question.

The question is are these options intended to be physically settled because it is

that that takes it out of the definition of swap according to the statute. And everything we're talking about here, parts one through six of the seven part test, assuming you fix four and five, parts one through six speak to the question, do the parties intend for this to be physically settled.

Part seven, to my mind, doesn't even address that question and the question it does address it addresses with such ambiguity that we have all of this confusion. And Mark, I can assure you the agree to disagree is not a hypothetical. It's real.

And that means that there are contracts that we have reported on our form TO where our counter party has told us we don't think that is a trade option, we do not intend to report it, though I don't know what they actually did.

Because as Paul points out, once they know that we intend to report it, that may alter their decision about what they do. But I know that as we are preparing ours we said in our opinion this is a trade option because I cannot prove to myself that part seven is satisfied and

I don't really care what rep you're going to give me because unless -- unless the contract is such or your regulator is such, your hands are completely tied.

We know you to be a business like counter party and we expect you to operate at a businesslike manner and that causes you to fail part seven. So you can give us a rep; we're not going to believe it.

MR. WETJEN: And the reason we're all here today is to solve problems and I just was reflecting on your response, Jim, thinking about what David said. And I thought you said that market participants are entering into a number of additional contracts in place of just doing a forward of volumetric optionalities. So the question is how practical of a solution is that?

Obviously it sounds like it's a little bit more difficult because you're entering into a bunch of contracts instead of one, but help us appreciate more just how cumbersome that is. In other words, if people are doing what they need to do, are still able to do what they need to do, perhaps differently and through additional

transactions and what was done before. But is that something we -- to what degree do we need to think about that and --

MR. PERLMAN: The point is that there's a regulatory -- there's a regulatory ambiguity that we think if it is clarified would rectify the issue. And absent the clarification, if there's a business decision that's made, we don't want to be reporting anything, we don't want to engage in activities that are going to be CFTC jurisdictional. They can find ways, in this case, around it, but that is less efficient, it's less timely in able to act, it's difficult to do the overriding initial business deal that's the best economically effective business deal, and it relies -- it -- it -- it requires there to be a real time interaction that's more robust and has more documentation issues associated with it. Is it impossible to do? No, it's not. Is it a productive use of resources? No, it's not. Does it benefit society to have to go through that? My judgment is no.

I want to just say one thing in response to what Wally said because I used to be the Head

of Legal for Lehman Brothers Commodity Business. They're -- they're not around anymore and I don't know if you heard about that. But -- and we did a lot of things on Wall Street where we priced options, we understood what we were doing, everything was directed at monetizing things. They were not -- they were physical businesses, but they were very much, at the end of the day -- they had a physical component but it was very financial in a lot of ways.

That is hugely different than Paul running a power plant to serve Patty's customers and having Patty's load guy call up and say to Paul, look, our -- we lost our peaker unit, we want to increase the dispatch on your power plant because we have the right to ask you for that because we're trying to keep the lights on at our customers' house.

That's what we're talking about here. We're not talking about Goldman Sachs doing some kind of financial engineering of an option product. We're talking about in the main, commercial parties, commercial entities, that are -- require optionality in their fundamental

arrangements with their counter parties to meet their commercial needs.

So I don't quibble with what you're saying in certain circumstances, but I think that limited aspect of things -- if you look around the table, you see a lot of entities represented here who are just trying to do their commercial business and also be compliant with what the Commission requires.

MS. DONDNAVILLE: Think what an odd conversation that would be. My client would have to say to Paul, I want to call on your generation. Paul would have to say back is the sole reason or the primary reason or the principle reason you are exercising or not exercising the option your demand or am I the cheapest in your dispatch pile because you have choices as to which generation unit you ramp up. And if the answer is you're the cheapest, can -- does he have to say then I can't acknowledge your exercise?

It's -- it's at a different point in the commercial relationship that the exercise or non exercise takes place. It all needs to happen the day the execution of the contract happens because

that's when the question becomes is it a swap or not a swap? Do I report it? Do I not report it? Does it go in my position limits, intraday position limits, or not?

MR. ALLISON: And if I can come back to David's example, so the counter parties that have stopped doing option contracts and have done all of their business in the daily or hourly markets, the alternative of the daily and hourly market is something that is available to them, even if they have negotiated the option.

And the choice about whether to go into the daily market or whether to exercise the option is part of the business decision that goes into choosing whether to exercise the options.

So it's not as if they've had to -- they've created something new. That exists all of the time. So the question is, well, given it exists all of the time, why did they bother with option contracts in the first place? And there are two reasons.

One is certainty of supply. So you know who your supplier is. If you go into the daily market, you have some level of confidence

there is going to be a supplier but you may not know who the supplier is going to be. So by negotiating the option you've got security of supply. You know who your supplier is.

And there's also an element of price protection because if you are satisfying your variable needs in a daily market or an hourly market, that daily or hourly market presumably has a price that is following the changes in demand.

So if you only have access to that high frequency market, you are going to be burying all of that shifting and market price through that frequency. Whereas, the option, and Wally talked about -- the option may also have characteristics that give you some degree of price protection.

Now I'm going to argue that that degree of price protection embedded in the option is not sufficient to making a financial derivative because a financial derivative transfers price risk without transferring title to the commodity.

But these are options that yes, may transfer price risk but they also will win

exercise to transfer title to the commodity. So they failed the most basic definition of what is a financial derivative. And that's an area where I disagree with Wally.

MR. TURBEVILLE: Unless there is -- they've cut me off. Unless -- unless there is a financial settlement option.

MR. ALLISON: Yeah, but one of the other parts excluded that, so.

MR. TURBEVILLE: Yeah.

MR. ALLISON: Again, part seven isn't dealing with the issue of whether you can cash settle this. Part seven is dealing with something about the intent to exercise.

MR. TURBEVILLE: Yeah, right. That's -- that's what I'm saying. But the intent -- what I would say is clarity -- I'm suggesting a different approach. My point is that what I'm suggesting is clarity, yes, but with a presumption that it's a financial instrument under certain characteristics and then move on.

MR. ALLISON: But I think we've all already agreed that if cash settlement is an alternative then it is a financial derivative and

I don't think within the industry there is much argument about that. We're not talking about --

MR. TURBEVILLE:

Well -- there -- there -- there are a number of ways to get there with --

MR. ALLISON: I mean we're talking about instruments to settle physically.

MR. KEMP: The root of the issue is physical redundancy and physical optimization have some characteristics that look like optionality. But at the end of the day, it's not financial optionality. And I think Wally would probably agree with that.

But at the end of the day, there is not a financial swap instrument that will keep the lights on or deliver gas or get coal somewhere and -- and that's what we're kind of going back and forth; is physical instruments that we use, physical contracts that we use to meet physical purposes. So that's why we separate the two apart.

So we use financial swaps to mitigate and hedge our price risk. We use our physical contracts to mitigate and hedge, if you will, our

physical risk because we cannot just serve one side of that equation. We have to balance it and we cannot let the lights go off. The folks cannot let the gas go where it needs to go, the coal where it needs to go and so forth.

MR. TURBEVILLE: I remember the first time I heard somebody describe what you described, which is we may not -- we may actually exercise this option, even if it's against the -- the price -- I thought these people are insane. But the point being, your point is well taken there, which is the distinguishing factor.

The question is whether there's something inside the contract that can end up getting hedged, literally hedged. That couldn't be hedged and that -- what you described can't be hedged in the financial market because you're making it a non -- a non price driven decision. And I'm with you on that.

MR. KEMP: Yeah, and I'm just saying that those components who we're all talking about are so wrapped up together it's kind of hard to go back and unscramble the egg.

MR. TURBEVILLE: Well let me also

say --

MR. WETJEN: Can I ask a real quick question? So let's say we can see that there's a need for greater clarity but maybe, to Wally's point, maybe if -- this is a hypothetical.

If the clarity has the effect of making more instruments trade options so that they have to be reported, and then lets also say that in the position limits rule a trade option is not considered to be included in the spec limits because it's not something you're easily able to speculate in.

And so the only other thing left then would be if the contract is a trade option it has to be reported through the form TO. How -- help me understand how big of a deal that is -- do folks think that just the obligation to report that alone would be enough for people just to decide, you know what, I don't want to do this anymore?

SPEAKER: The -- don't --

MS. DONDNAVILLE: The way the CFTC's interpretations work right now is that --

MR. WETJEN: I'm not asking about how it works now. I'm asking --

MS. DONDNAVILLE: Okay.

MR. WETJEN: -- so what I'm getting -- trying to get to the heart of is it -- and this has been something that's been discussed, you know, since the rule was proposed is there seems to be some concern about the obligation to report a trade option. And I've -- I've never -- I've always wondered, you know, what -- I'm trying to better understand why that's such a significant issue for the reporting entity.

MR. JESKE: Because of -- because of cost. Because if you don't report, you get pulled into part 45 and you have to create systems to go on report. Many end-users don't report today or they rely on other end-users or other swap dealers to do the reporting on their behalf.

MR. WETJEN: You said if you don't report then you have to report under 45?

MR. JESKE: If you don't report -- if you don't send the one billion dollar threshold email to, I believe it's DMO, you can be pulled into part 45 reporting, is my read. I might be wrong about that.

MR. ARON: Yeah, but he's talking about sending the email and he's talking about form TO. He's talking about the simple alternatives to what if that -- I think that's what you're asking, right? It's a what if that's all you have to do plus the basic business records you keep anyway.

MR. JESKE: You have to determine what gross notional is. You've all defined it as --

MR. ARON: -- defined it as the follow up then maybe we get us some further guidance on the heat rate options if that's the one thing --

MR. JESKE: That's just an example. The whole concept of gross notional doesn't fit.

MR. ARON: Didn't we give guidance, the FAQ, that we cited in the -- for -- for physical, notional, didn't cover enough transactions? Is that the problem, or part of the -- or the problem you're talking about now? Because we cited in the 13-08, to the prior guidance that we gave on physical notional for the, what we thought was this very reason, but maybe it didn't cover enough.

MS. DONDNAVILLE: Physical notions.

MR. JESKE: It did -- absolutely not.

It did not cover close to enough.

MR. ARON: Okay.

MR. JESKE: Because the transactions -- again, we're talking about today, aren't swaps. They're not swaps. So back to Patty's point, I always use -- try to use the kiss method. I learned it from somebody who was rather -- rather intelligent and who traded Treasury bond options for many years.

And we would have complex, very complex, portfolios. We would always come back to the same thing. One thing; let's make money and use the kiss method. And that's what I would advocate here. With regard to cost --

MR. WETJEN: I'm not familiar with the kiss method.

MR. JESKE: Keep it simple.

MR. WETJEN: Did I miss that?

MR. JESKE: There is one more -- I won't say it. But in terms of -- of cost here, is really, you know, (inaudible) is -- is to the interest in people reporting. So the TO form is quite simple and straightforward. How to calculate it -- I bet there's no common agreement

whatsoever.

MS. DONDNAVILLE: Because again, you have to figure out if it's a trade option --

MR. WETJEN: Right.

MS. DONDNAVILLE: -- to begin with.

MR. WETJEN: Right.

MS. DONDNAVILLE: And if what the CFTC -- if what you're proposing is to --

MR. WETJEN: I'm not proposing anything.

MS. DONDNAVILLE: Okay. If what you're speculating about --

MR. WETJEN: I'm just trying to get a sense of the burden of filing a report. If that isn't clear, I mean I --

MR. HUGHES: Yeah.

MR. WETJEN: -- and as you can tell, it's a little bit difficult to understand that that would be a terribly burdensome thing to do, but I -- but, you know, I just want to make sure that's right or wrong.

MR. HUGHES: I think I can give you a very clear example. The -- I think in the rules it estimated that filing the form TO would take

about two hours. Filling out the form, doing all of that, that's pretty easy; takes about two hours. I mean for us, and we've got multiple regulated utilities, we realize that even trying to utilize processes we have in place for say, Sarbanes-Oxley compliance, or other, you know, contract review processes was not going to be enough.

We went so far as to go hire a developer to develop a software system for us simply for the purpose of reviewing and analyzing our contracts to see how they evaluate according to all of the different tests. So you do that, you include all of the man hours it takes to go do that, you roll it up and when you get -- when you come up with what you think is a draft, you still have to sit down with all of your legal folks and do another review.

So we -- we think the cost -- it's -- it's -- it's up there. And at the same time, these contracts that are falling out, at least in our case, it's not in everybody else's case, but I know in our case, a lot of those contracts are also being reported actually in

more detail through, you know, FERC or other required reporting aspects. So we feel like we're reporting the same information to do different agencies more than one time.

MR. PERLMAN: Well let me say, if we ended up at the end of the day with no trade options and position limits, and having to do form TO, that would be -- and we had clarity, that would be an improvement over where we are today.

The issue that we see, and my clients see, is until Dodd-Frank, they didn't think that they had to know where the CFTC was or what it did. And they have no infrastructure understanding or real need to be involved in CFTC regulation.

And they've made -- many of them have made the decision that they're not going to report anything. They weren't doing futures. They're doing swaps. So they're only dealing with swap dealers. They don't have any of that.

The more they get pulled into the CFTC universe, and maybe that's -- by implication you're saying that's just a matter of life was we know it, they're going to have to deal with it. But their preference would be to manage their

business in a way that does not include this type of thing. And fundamentally, you guys have further validated the existence of the forward contract exemption and what we're saying is that we think if it's properly applied and you -- and you really analyze the nature of the contracts we're talking about, that they will fall into the forward contract exemption and you -- you respect that. And that's all good.

Now Wally said that any contract that can be hedged with a derivative is somehow a swap or something, but fixed priced forward contracts can be hedged with a derivative. I don't think that that's a test that's meaningful in this context. I believe it's true, but --

MR. TURBEVILLE: I said an option, an embedded option.

MR. PERLMAN: Okay, but what's the difference between that and a fixed price forward? At the end of the day, the question is are these swaps or forwards? Can we have a test that would respect their true nature as forwards, as we see it, and not just sort of default trade options because it's for -- for whatever reason

we would do so?

MR. WETJEN: Yeah, and I'm sincerely not trying to signal a direction here. I'm just trying to get a sense of the merits of the different possible options available to us in terms of policy decisions. That's all.

MR. ALLISON: So as David said, certainty that these contracts had to be reported on a form TO is better than the current state. But it is still not free. The problem isn't filling out the form, the problem still is assembling the information that you need to fill out the form, which means tracking all of the contracts because the process by which the deals are created, documented, stored, tracked, is separate from the process that is used for financial derivatives.

And the systems that store these were never designed to be able to flag these as -- so there is a -- a burdensome process due to aggregate the information. With all of the work that we have done on compliance systems and reporting and everything else, even though we're not a registered entity, we've done -- we do in

fact report on part 45 and everything else for some of our counter parties.

Given all of the work we've done, the marginal cost of form TO for us, is still on the order of a full time equivalent. And my guess is that is a number that scales very, very badly as you go to smaller companies because the smaller companies will not have done the investment that we've done in understanding the rules, building the systems, investing the people. So it would cost them more not only relative to us, but more in absolute terms than it costs us.

Now, that's a very different number from what the Commission had in its cost benefit analysis. Is it a big enough number? There is also still the question -- the statute says, intended to be physically settled is out of scope. We have always argued that options that are intended to be physically settled are intended to be physically settled and therefore are out of scope as a matter of law. No shortage of lawyers in this room so you don't need my legal opinion. But yeah, certainty --

MR. WETJEN: That was actually very,

very helpful because if you factor all of that in then you have to start thinking about, again, when you're looking at number of policy options here, what are, you know, what are the benefits to us in having the report in light of the burden. So that was helpful, thanks.

MS. DONDNAVILLE: And I think Jim's right. If you take it down to the scalable by -- by entity, the 2000 municipal entities across the United States, municipal utilities, all small entities, they all enter into commodity options of some sort or forward contracts with embedded optionality of some sort, variability of some sort.

None of them have the systems to be able to report what they have always viewed as physical market transactions. Cash market transactions in a format that would be anywhere comparable to what the CFTC gets from its regulated entities.

MR. ALLISON: And that's one of the factors behind the agree to disagree; not much of a --

MS. KIM: Since we -- since we are running well past our allotted time, let me just

try to shift the discussion a little bit. As some of you pointed out, there's a range of actions that we, the staff or the Commission, can take to address these very complex interpretive issues.

And so I want to focus a little bit more on what we, at the staff of the Commission level, can do in the immediate term in providing greater clarity and what are some of the major areas that you would like to see us address in the form of a guidance, advisory, clarifying examples.

MR. ALLISON: So, I mentioned in my opening comments that -- that we have some language that we think is helpful from the perspective of interpretive guidance. But again, my request is if you're going to give us interpretive guidance, it has to be something that we can actually rely upon. So I'm not a huge fan of further examples because further examples don't really give me anything I can rely upon.

Interpretive guidance such as the guidance that was used to, at least temporarily, fix the problem with the use contracts and the infamous however paragraph, that seems to have solved that problem at least for now. So again,

we've got some language. I alluded to and David alluded to some -- that would be a path forward that I think you could implement more quickly than getting to a new rule.

MS. DONDNAVILLE: Well, and it's not a new rule. Again, the CFTC's interpretation, which is what was issued in August of 2012, can be changed by the CFTC. You can, I guess, the staff could issue guidance as to what it meant in the interpretation in a, perhaps, a quicker period of time, or they could open a rulemaking and have all of this discussion again. But I think you have the interpretation. You have the ability to issue interpretations, or fix interpretations.

MS. BERGLES: AGA did make a request for interpretive guidance on February 22, 2013, with a set of very, very specific examples, which still remains pending. But what ultimately we would like to see is the Commission respond to the comments filed by an order the comments that were filed on October 12, 2012.

We believe that that is probably the most way to achieve certainty other than further

guidance. And in terms of the OGC guidance on the storage and transportation agreements, we'd also like to see that rolled into a final rule and not sitting out there as guidance.

MR. PERLMAN: Yeah, it would seem to me that, in agreement with what the other folks had said, that something like the OGC clarification could occur in the short run and then you could wrap that and the least like component into a further rulemaking sort of similar to what's happening with the de minimis no action letter being followed up by a rulemaking. So we can have an interim solution that deals with the pressing problem, but in a legally sound and more definitive way to get the answer settled, sort of for once and for all with everybody having the notice and comment opportunity.

MS. DONDNAVILLE: And most critically, I think you have people around this table and people elsewhere who are very interested in helping work on the language so that what happens is not that the CFTC comes out with additional interpretations that don't work for our industry.

MS. KIM: Okay. Then with that, we'll

close this session. And as was mentioned earlier today, the comment -- we are receiving comments up until April 17, I believe. So each of you will have a chance to -- as well as the public, will have a chance to follow up on all of the topics that we touched on at this session. Thank you all.

SPEAKER: Thank you very much.

(Off the record.)

MR. REMMLER: Well, I see we still have one panelist we're waiting for but I think I'll get started since it's after 1:30. This is the panel three for the roundtable, special entity de minimis threshold for swap dealing to government owned electric and natural gas utilities.

My name is Erik Remmler. I am the Deputy Director in the Division of Registration -- Division of Swap Dealer Intermediate Oversight. I'm the Deputy Director for Registration and Compliance. I have with me here, Israel Goodman, who is on my staff and who is working on this issue and has helped work on the proposed rule that the Chairman announced earlier today.

Before I get started, I've been asked to remind all of the participants on the panel that -- to use their microphones they have to press the little red button to turn it on and then press it to turn it off and to please speak directly into the microphone so that your comments can get -- can be recorded.

I want to thank you all, the participants, for coming in today. I know some of you have actually come in from the West Coast, so I appreciate your making the trip. We do see this is a very important topic. What you say here today will go a long way to helping the Commission and the staff in crafting a more appropriate longer term solution for the utility special entity de minimis issue.

I'm going to briefly provide some background information on special entities and the swap dealer de minimis threshold and then summarize the history behind the development of this issue here at the Commission.

After that introduction, I'll ask the participants to introduce themselves and provide any remarks that they may have. Time permitting,

we will then ask some questions for the panel and with the desire of generating some open discussion on the topic.

So to begin, the Dodd-Frank Act for the first time required persons dealing in swaps to register with the Commission as swap dealers. The act also provides additional protections for persons categorized as special entities when dealing with swap dealers.

Specifically, Commodity Exchange Act Section 4s(h) imposes on swap dealers specific prohibitions on fraud and manipulation, with respect to special entities and subjects swap dealers to heighten business conduct standards when they advise or act as counterparties to special entities.

The term special entity generally includes federal agencies, state and local governments, and their agencies and instrumentalities. The definition captures state and certain federally owned energy and natural gas operations.

As the Commission has noted in adopting the rules, special entities that assume risk

through the use of swaps also expose the citizen beneficiaries of their activities to the risks from the swaps. When a special entity suffers a loss from a swap, the special entities' beneficiaries, therefore ultimately bear the burden of any losses that are incurred.

Consistent with the congressional intent of creating a special entity category and promulgating the swap dealer definitional rule, the Commission set a lower de minimis level of dealing activity with special entities for purposes of de minimis exception to swap dealer -- to the swap dealer registration requirement. That level, as I'm sure all of you know, is -- was set at 25 million of the gross notional amount of dealing activities with these entities. Any dealer who deals at that level or higher with special entities must register as a swap dealer.

A de minimis exception by its nature will deprive counterparties of the protections provided by dealer registration and regulation. And implementing the de minimis exception, the Commission stated that it sought to balance the

interests advanced by the exception against the risk that if applied in an overbroad manner, the exception could undermine the regulatory protections and specifically, with respect to special entity counterparties, the special protections as such entities warrant, as determined by Congress.

Following the adoption of the special -- of the swap dealer definition rule, a number of organizations representing government owned electric and natural gas utilities submitted a petition requesting that the Commission amend the de minimis exception, to exclude certain utility operation related swaps entered into with utility special entities from the 25 million dollar de minimis amount. Many of the petitioners are represented here today on the panel.

In effect, the change requested would allow dealers to treat those swaps like swaps with non special entities for purposes of determining whether they need to register. The petition stated that the amendment was necessary to increase the number of potential counterparties

for these entities and preserve cost effective access to customize non financial commodity swaps that utility special entities need to hedge and mitigate their commercial risks.

Since some of the petitioners are represented here, I'll let you describe the reasons why this change is needed and hopefully provide some background as to why it's appropriate given the nature of your activities.

In response to the petition and to subsequent requests for no action relief, the Division of Swap Dealer and Intermediary Oversight issued staff letter 12.18 granting no action relief. The relief generally created an $800 million de minimis level for swap dealers entering into utility commodity swaps with the utility special entities.

The letter also imposed a number of additional conditions for entities seeking to rely on the relief. Subsequent to issuing the letter, the Commission staff heard from the petitioners and others that potential counterparties were still not making themselves available to transact with utility special

entities.

Among potential reasons provided, was that the requirements imposed on counterparties in the staff letter were still deemed too burdensome for the relevant dealers to continue dealing.

In response to these concerns, the Division recently issued staff letter 14.34, which supersedes and broadens the relief. The new letter, in effect, subjects utility operations related swaps with utility special entities to the $8 billion general de minimis threshold and remove the number of conditions that were in the first staff letter.

Letter 14.34 provides that the relief granted will remain effective until any final Commission action is taken, with respect to the petition that was received by the Commission.

The purpose of this roundtable is to highlight the need to address the issues utility special entities are experiencing so that a longer term and workable solution can be implemented. As Chairman Wetjen announced, the Commission is considering a proposed rule

amendment to address this issue and the discussion we have here today will help inform the Commission and the staff in that effort.

Before I turn to the panelists, I noticed that Commissioner O'Malia joined us. I don't know, Commissioner, if you want to make any remarks at this point or?

MR. O'MALIA: Thank you. Well, I'm pleased to have this discussion and I'm pleased to have in circulation a rule change because that's the appropriate way to address this. The abuse no action process is -- doesn't afford anybody the comment period or cost benefit analysis. So I'm glad that we're taking the right steps to fix the rules where they need fixing and I'm supportive of not distinguishing between special entity utilities and any other end-user and to put them on a level playing field to make sure that they're -- they're able to do their business in the same direct manner everybody else is and not burden them with an additional set of rules that has thus far limited their counterparties to mainly swap dealers and to free them up to the regional players that they

deal with on -- that they had been dealing with on a regular basis to deal with their, you know, regional utility concerns.

I'm mindful that markets aren't -- there's not a global or a national market for energy. It is a regional market and trading around that is essential to meet, you know, regional players in those markets. So I look for -- I haven't read the proposed rule that just landed on my desk today so I look forward to reading that and turning around very quickly a document that is responsive to the concerns of the end-users.

MR. REMMLER: Thank you. I think that at this point we'll start with the panelists; starting on my left with -- with Bill Rust.

MR. RUST: Good afternoon. My name is William Rust and I am the Compliance Director for the Energy Authority. I appreciate the opportunity to be a member of this special entity de minimis threshold panel this afternoon. But also I would like to thank the CFTC and acting Chairman Wetjen for the March 21 no action letter, as well as the proposed rule that was just

announced today. We certainly would like to see the relief made permanent and do appreciate that.

Headquartered in Jacksonville, Florida, the Energy Authority is a nonprofit corporation owned by eight public power electric and natural gas utilities across the United States. We provide risk management service to our owners, as well as contract customers.

The Energy Authority provides front, back, and mid office services to 40 plus public power clients, representing approximately 29,000 megawatts of electric generation, which includes clients as small as 50 megawatts of load up to larger systems closer to 6,000 megawatts of load.

Our business model at the Energy Authority allows us to provide the same level of service to both the smaller and the larger clients. Our clients serve both electric and natural gas end-users and the Energy Authority's primary corporate objective is to partner with public power to hedge risks by giving our clients access to wholesale power and natural gas markets across the United States.

To manage risk, we transact both

physical and financial products, primarily in electric power and natural gas from next hour out through multiple years. We partner exclusively with public power clients and offer our clients access to a broad spectrum of counterparties, including banks, major oil companies, marketers, producers, RTOs, ISOs, investor owned utilities, as well as other public power entities.

Our clients use natural gas a fuel to generate electricity and also sell fixed price natural gas and electricity to end-use customers such as residential, retail, commercial, and industrial load.

Our clients strive to provide reliable low cost energy to their customers and the swaps used on the wholesale side help manage the inputs that ultimately determine the price paid by the household purchasing electricity or natural gas.

Our clients are geographically dispersed across the United States, but yet all depend on liquid markets to implement the best possible risk management program. The nature of our business requires that we take different approaches, depending on the region and the

individual client.

For example, our clients in the Pacific Northwest have found that bilateral electric power swaps meet their needs most effectively, while clients in the East can use natural gas futures combined with swaps to meet their hedging needs. We have found that liquidity for long term transactions greater than three years is much higher in the bilateral swap market, relative to the futures market.

The $25 million de minimis threshold for swap transactions with special entities has negatively affected our clients' businesses. For example, our -- our clients in the Pacific Northwest have lost over half of their bilateral swap counterparties. We have been able to continue to hedge but remain concerned about the increased costs associated with a less liquid swap market.

We appreciate the need to ensure that unsophisticated non utility governmental entities should be protected from aggressive swap transactions. However, the Energy Authority was created for the purpose of helping out our clients

in helping them manage their risks. Our business model depends on sound risk control practices that are implemented to protect our clients while affording them access to the best possible risk management program. Thank you.

MR. TRACY: Good afternoon. My name is Jim Tracy. I'm the CFO for SMUD, which is Sacramento Municipal Utility District. We certainly appreciate the opportunity to be able to address this panel this afternoon.

SMUD is a special district that serves most of Sacramento County and we have about 600,000 retail customers. SMUD has always ranked real near the top in the country in terms of customer satisfaction over the last several years, you know, J.D. Powers surveys. But one element of that has been our ability to set rates for two years and basically be able to tell our customers ahead of time, almost a year in advance, what the change is going to be.

Many of our very large commercial accounts run businesses that require very large amounts of power. So an example, Intel, Aerojet, air products type companies, internet servers,

and light manufacturing. Having the ability to see what their price is going to be and having it fixed for two years is really important to their business models.

So about 50 percent of SMUD's power is produced with our own gas fire generation. And in order to achieve the rate cycle that we do, and we do this every two years, we set the rates, we really need to fix the price of gas for about a three year period. And so at today's prices, for us, that amounts to about $600 million of gas that we would be contracting for. When prices were up closer to $8, that would have been like $1.2 billion.

Also important to know is that each one dollar change in the price of gas, for that three year period, results in about $150 million change in our overall cost, which is about four percent of the retail rates. So trying to hedge this through exchanges poses two problems.

The first, which will be discussed here and has been discussed, is that the products actively traded on an exchange are imperfect hedges. The price of gas in Louisiana doesn't

change and lockstep with the gas in California. You are out there in the -- during the energy crisis, you knew this in spades.

But the second is the higher cost of collateral. And I want to explain how that figures into our business model. With our strong balance sheet and our ability to set fixed prices for the recovery of whatever we entered into in the swaps, so it's basically matching fixed retail prices with fixed wholesale cost of gas.

We're able to negotiate contracts with our counterparties that allow for up to $15 million of credit for market to market. We have had in the past like 16 active counterparties. And by spreading our exposure over the 16 different parties, we had almost $250 million of credit before collateral posting was required. Of course, exchanges require 100 percent posting.

So over the last year, half of our counterparties have stopped trading with us. This has reduced our available credit by almost $120 million. I have stepped up -- I have told our Board that we're fast reaching the point where the cost of just maintaining additional

collateral would become too expensive to maintain the level of hedging that we're doing. So whether we have actually posted collateral or not, we have to have the cash on the balance sheet or we have to have letters of credit ready if the market prices change so that we can meet the collateral posting requirements.

To put it in perspective, each $100 million of reserved cash right now is equal to about $400 million a year in cost. That's about $10 million overall, which it could end up costing us. So the alternative is to go to our Board and talk to them about passing through the changing fuel prices to our customers using a fuel cost adjustment.

This, of course, would have an impact on our local business in Sacramento County, not to mention the approximately 25 percent of residential customers who are on low income discount rates.

We on a regular basis report significant risks to our Board. And we do this once a month. And I'll tell you that our Board -- we just reported earlier this week and

our elected Board was very appreciative of the no action letter recently granted.

The ideal, of course, would be to have a permanent fix. And I'd say that SMUD, again, certainly appreciates the opportunity to provide some of the detail of how special entity rule has impacted our customers.

MS. SCHAEFFER: Good afternoon. My name is Virginia Schaeffer and I'm with the Bonneville Power Administration and an attorney with the Office of General Council and based out of Portland, Oregon. And I too want to add my thanks to the Commission staff and most especially to Chairman Wetjen for the most recent no action letter and then -- I've not had a chance to review it, but the proposed rule that's come out this morning. And as others have mentioned, join in with the recommendation that we all have that -- that we need some permanent solutions to the special entity de minimis threshold issue.

So with regards to the adverse impact of the special entity de minimis issue, for Bonneville there has not been quite a direct impact. Instead, what Bonneville has seen

though is an overall drop in the number of counterparties, especially counterparties for longer term physicals and swaps in general.

So there's -- we've just seen an overall drop in the liquidity of the market. I'm not quite certain if that is necessarily tied to the concerns over the special entity issues, and or, just the overall regulatory burden that Dodd-Frank, in some part, is imposing on the lot of counterparties.

So at this point I'd like to take the opportunity to tell you more about what a diverse group the special entities are because Bonneville is a bit unique compared to some of our other special entities that are represented here today.

We're one of four federal power marketing agencies within the Department of Energy. We're self funded through our rate payers, not taxpayer funded. And Bonneville is -- markets wholesale electric power from 31 federal hydroelectric projects on the Columbia and Snake Rivers. We also market the electricity from one non federal and nuclear plant and from several other small non federal sources. And

while Bonneville does not actually own any of the generation, we do supply about one third of the electric power used in the Pacific Northwest.

Now, Bonneville also operates and maintains about percent of the region's high voltage transmission system and our geographical area service covers Oregon, Washington, Idaho, Western Montana, and small parts of Wyoming, Utah, Nevada, California, and Eastern Montana. So we have a fairly large footprint.

And as I noted earlier, Bonneville is self funded. We recover our cost through our rates and obviously it's in our best interest and our customers' best interest to keep our costs low, which includes working to mitigate our risks and in -- in the most efficient way possible. And to give you an idea, one other item I wanted to pass on, but in terms of our overall operating revenues for fiscal 2013, was $3.35 billion. So we're -- we do have a rather sizeable energy and transmission business.

So Bonneville's statutory responsibilities are to meet the power needs of its preference customers. And those are the

consumer owned utilities in our region, and that includes the public utility districts, the people's utility districts, cooperatives, tribal utilities, municipalities, and other federal agencies. And again, as I said, within that large geographical area.

Bonneville also sells power to investor owned utilities and some direct service industries in the region and when there is a surplus of power in the Northwest, then we sell to marketers and utilities in Canada, as well as elsewhere in the Western United States.

Now, Bonneville's challenge, of course, is that we're primarily a hydro base system. It's 80 percent of our generation is hydro sourced. And consequently, we're very much subject to a supply issue, as it were, of our fuel. And -- and the timing of when that fuel is available is something that we can't control, unlike many others that utilize either coal or natural gas or other types of generation.

In addition, there are many competing interests for the water. There's irrigation, transportation, flood control, recreation,

conservation, such as ensuring that there's sufficient instream flows to permit the passage of fish up and down the river, and with rare exceptions, pursuant to the various federal statutory provisions, these competing interests take precedence over the -- our ability to generate electricity. So all of those things mean that we have some real -- a lot of balls to juggle in order to be able to make sure we have sufficient generation on hand to meet our load demands when it is needed.

So -- because spring time comes, we get a lot of snow melt and get a lot of water but there isn't always a lot of demand. So whereas, come late summer, the snow melt is gone, it's hot, people have their air conditioning on, all of those things we tend to then, of course, start having the increased demands for electricity but have less fuel available.

So consequently, we are always out there looking for ways balance our system, both -- well primarily we have to balance it physically, but that can be done through lots of different tools as others have mentioned already.

And again, to also reiterate some of the other shortcomings of our -- of our system is that we have very little storage capacity and so consequently, Bonneville has, for decades, made extensive use of short term and long term purchase and sales, contracts, by using -- for generation, by using instruments such as forwards, and futures, and swaps, and options to make sure that we can meet our customer demands.

And we have successfully used these instruments to hedge and mitigate both our supply and price risks in an effort to keep our costs low, because again, we are a not for profit agency and we also want to minimize the price volatility for our rate payers.

We have also participated and continue to participate in financial instruments. But as Jim was mentioning like with SMUD, we do have the issue of being very costly in terms of posting margin. Most of our transactions we are bilateral and we generally don't need to post collateral for -- in fact, I'm not aware of a situation where we do post collateral for our customers, our counterparties.

And obviously that's not the case when we are dealing with going through clear transactions where we do have to post margin and it does impose a much greater burden in terms of monitoring our cash flow and ensuring that we can meet those margin calls as they come.

So to wrap it up, I guess as the Commission evaluates its rules and regulations for the utility special entities engaged in utility related swaps for the operational hedging or risk mitigation purposes, what we're trying to make clear -- I'm trying to make clear is that all of us have been involved in this for years and we have very significant core competencies in this area.

This is not an area where there have been a history or any particular problems, unlike the issues surrounding other types of financial derivatives. Interest rate swaps, of course, are things that come to mind with regards to municipal entities in the past.

So we respectfully request that utility special entities be allowed to compete on a level playing field with the other utilities that are

out there and, you know, let us do our business as usual as we always have and as we have done it well. So thank you.

MR. NAULTY: Good afternoon. My name is Terry Naulty. I'm the General Manager and CEO of Owensboro Municipal Utility. We're the largest municipal utility in Kentucky; provide electric, water, and telecom services to the third largest city in the state.

I'm going to provide a quick summary of how the special entity threshold has impacted OMU. First, I want to thank the Commission, and especially Chairman Wetjen for the March 21 no action letter. We've already seen benefits from this policy change and applaud the Commission in its efforts to -- to make permanent the change and to just announced rulemaking.

My participation on this panel is an indication of the importance of this issue to smaller utilities, unlike my colleagues here who represent some of the larger public power entities in the country.

We generate electric power with multiple coffered units and we have significant

surplus capacity that's hedged in forward markets to provide revenue certainty, offsetting fixed and variable cost associated with that surplus. This operational hedging activity insulates our rate payers from wholesale power, market priced volatility, and enables OMU to provide low and stable electric rates.

A number of factors that affect our need and ability to hedge operational risks, but I don't focus my comments on two aspects; the physical nature of the electrical grid in the Midwest and Southeast, and secondly, how we've been impacted in our -- in our actual hedging transactions.

The grid in the Midwest and Southeast was originally designed to allow individual utilities to move electric power from their generating stations to their customers. There was a very -- there is -- excuse me. There was very limited interconnectivity between companies, but there has been significant investments made to improve that interconnectivity, especially for those companies that are located inside of a regional

transmission operator market such as PJM and MISO.

OMU, like -- like many public power entities in the Southeast and in the West, were not part of an RTO. Geography, physics, and economics dictate that the only true interconnection between utilities are with our neighbors. Swap dealers provide limited liquidity for standard products at liquid trading points that are remote to the physical delivery points where we buy and sell wholesale power.

Prior to the special entity threshold, these inexact hedges were not the only option available to OMU because regional utilities and their trading affiliates were willing to enter into swaps with OMU at points that were at or near our physical delivery points. Like us, these non swap dealer counterparties are physical players in our markets. They share our need to hedge at points in the grid that are not the most liquid trading hubs and thus recognize that standard products are not optimal hedging mechanisms.

So prior to the March 21 letter ruling, these non swap dealer counterparties have not

been willing to enter into hedging transactions with OMU due to the risk that they'd be draw into the swap dealer classification. This has had two significant affects.

First, we lost about a third of our counterparties. But that third of our counterparties represented 70 percent of our historical hedging activity. This resulted in a substantial loss of term liquidity that my colleagues have talked about. Traditionally, bilateral trades with regional (inaudible) whose term positions offset OMU's short versus long positions, created an incentive for entering into term transactions.

These relationships were enhanced by our bilateral credit agreements. The move to swap dealers and exchanges as a result of the special entity threshold, coupled with the winter's polar vortex, has been extremely detrimental to OMU because those swap dealers have been focused on the near term markets and managing the volatility in those near term markets and have lost interest in the long term markets.

Second, OMU has incurred increased collateral on credit costs. And Jim talked about this but I'll give you another example. With the loss of trading counterparties, our two options for executing term hedging with swap dealers was with either swap dealers or on the exchanges.

In reality, the swap dealers from which -- with which we had (inaudible) in place, widened their bid as spreads, knowing that our regional counterparties were no longer trading with us. As a result, executing the hedges on the exchange was a better option for OMU. But still, at a significant incremental cost.

We had to pay fees for execution and for the first time, we had to provide cash margining. Previously negotiated collateral agreements with counterparties permitted hedging without cash margining based upon the strengths of our respective balance sheets.

Over the last 18 months, our margin requirements have ranged from 4 million to over 10 million, with less term hedging than we would -- what we believe is optimal. For utilities serving just 26,000 customers, it's a

significant cost.

Additionally, stress testing of the positions has resulted in additional reserve requirements to ensure that we have adequate cash liquidity to meet margin calls in high volatile markets. These are all extra costs that we have to pass through the right payers with no benefit relative to the pre special entity rules.

Finally, I want to ensure the Commission that OMU and the public power industry have the expertise and the risk management systems in place to understand these markets, the property value -- to properly evaluate the credit price and operational risks associated with our operational hedging activity. It's a core competency of all power -- public power companies with marketing commodity risk exposure.

Despite the ups and downs for -- of for profit energy traders, not a single public power entity has defaulted since 1998. Likewise, related swaps -- operations related swaps of public power utilities pose really no systemic risks. And I thank you for your attention.

MR. HOWARD: So you have to turn it on.

Good afternoon. Chairman Wetjen, Commissioner O'Malia, staff, thank you for the opportunity to participate today. My name is Randy Howard. I'm with Los Angeles Department of Water and Power and I've been here a number of times on this topic meeting with staff. And so I appreciate the willingness to continue meeting with us and working through these -- these issues.

Los Angeles Department of Water and Power is a Department of the City of Los Angeles. We're the country's largest municipal utility. We serve about four million people. I'm going to try not to repeat some of the things you've heard hear but just go over some of the specific impacts related to Los Angeles.

So our annual fuel and purchase power budget is approximately $1.5 billion per year. So as you can imagine a $25 million de minimis level is a very small quantity for us as a utility. We have physical facilities in seven Western states feeding into the City of Los Angeles.

Our customers are our owners. We don't have a group of shareholders that we can turn the risk and the burden to. So Mr. Tracy spoke about

something they're contemplating at SMUD as to how they might move to -- move the risk onto the rate payers. Due to this particular rule and the loss of some of our counterparties, the City of Los Angeles moved forward with taking the risk for some of our hedging and moving it onto the burden of our rate payers.

They -- the governance went forward with a rate action and quarterly we take all of the risk related to the cost of -- of our fuel and we impose it in a rate onto our rate payers. This is had a significant impact to them. Having that many customers, we have 300,000 low income and lifeline customers, we have many customers that are fixed income, and having those types of adjustments on their bills have a direct impact -- they have no ability to risk -- I mean to hedge themselves.

And so we have had that impact related to this rule and we appreciate right now the no action letter and then the proposed change in the rule because that will have a very significant ability to go back and have the counterparties necessary to hedge.

We all here have that obligation of keeping the lights on 24 hours a day, 365 days a year, regardless of the climate conditions. This winter was an extreme winter for Los Angeles as it was for the East with the polar vortex. We're going through an unprecedented drought. That drought is impacting our hydro abilities.

We don't have the reserve, water, behind the reservoirs and the damns, to meet some of our needs. Therefore, we need to burn more fuel. This year, our fuel usage is up dramatically, as well as our emission profiles associated with that and so there's a great uncertainty to our rate payers as to some of the costs associated with that.

The other issue that's hitting us more recently is the ground is shaking. We have earthquakes in Southern California, underneath of our building in L.A. We were able to hedge and have more options available to us previously that were some of our risk mitigation related to the potential of earthquakes and droughts. Many of those positions we have let go as a result of not having the appropriate counterparties.

So we're hopefully to get the permanent oil change. We do appreciate the no action letter and think it will have a direct impact on our ability to transact again with our counterparties. And going forward, we would like to continue working with the staff and the Commissioners associated with this activity.

MS. DONDNAVILLE: Thank you and good afternoon. I appreciate the opportunity to be here. My name is Patty Dondnaville. I'm a partner at Reed Smith and I have worked with the not for profit electric group since 2010 and written more than 45 substantive comment letters to the CFTC on various topics.

I'm on this panel because I drafted the petition for rulemaking in 2012, asking the Commission to exclude from the $25 million sub threshold, a very narrow category of operations related swaps that these entities across the United States that are special entities need to run their electric businesses. And it would also impact those who have special entity gas utilities as well.

What the petition is not is it is not

in any way to affect the $25 million sub threshold as it would impact interest rate swaps. So a counterparty who has not yet registered as a swap dealer would still have to consider those interest rate swaps with the utility special entity in considering whether or not it exceeded the threshold.

Another thing that the petition is not is an exclusion to allow the utility special entities to speculate, deal, or trade in those types of utility operations related swaps. It is specifically to allow them to do what they do, which is deliver power 24/7 at affordable rates. The best way to hedge that, and in that context, would mean hedge or mitigate commercial risks.

Those commercial risks exist. These are not risks that these utilities assume by entering into these swaps. The swaps that we're talking about are risk mitigating swaps. But to allow them to enter into those swaps as part of their core competency and to have access to non registered swap dealers in the these regional markets in order to continue to provide their electric service to their constituents.

I'm happy to answer any questions about the petition. I look forward to reading the proposed rules and I'm sure that we will be commenting. Thank you.

MR. CAMPBELL: Good afternoon. I'm Lael Campbell, Director of Government and Regulatory Affairs for Exelon Corporation. Exelon is the nation's leading generator and supplier of electricity in the competitive power markets. Exelon's consolation business provides physical energy products and services to approximately 100,000 business and public sector customers and more than a million residential customers.

I'm here today on behalf of the Edison Electrical Institute. EEI is a trade organization for all of the investor owned utilities in the United States and EEI's members serve over 70 percent of all electric customers in the U.S.

EEI members are physical commodity markets participants that rely on swaps primarily to hedge and mitigate their commercial risk. At the outset today, Commissioner O'Malia spoke

about, you know, turning the discussions today into action and in this case, the Commission a week or so ago already took action, which we greatly appreciate and it was great to hear acting Chairman Wetjen talk about taking the next step of formalizing some of these -- some of this into a formal rule.

EEI appreciates the issuance of the March 21 no action letter on the de minimis limit applicable to utility special entities, which recognizes the lower risk of swap transactions that occur between end-users. Many EEI members have longstanding commercial relationships with municipalities, such as the ones at this table, power authorities, and other special entities as part of our core electric generation supply businesses.

Although swap transactions with these special entities are not the most common form of transaction we would engage in. The no action letter, the recent no action letter addresses some of the material concerns that prevented EEI members from engaging in those swap transactions over the course of the last few years.

The March 24 no action letter is a great improvement and it is appreciated, but there are some remaining concerns. Most notably, there remains some uncertainty as to whether a person meets the definition of a utility special entity.

Without clarification from the Commission, that a person can in good faith rely on a representation from the counterparty, that they do indeed meet that definition, EEI members may believe that it is their burden to make that determination themselves. And more importantly, that the -- that the member bears the significant risk of getting that determination wrong.

So hopefully the Commission could clarify to some extent that -- that counterparties can rely on the representation from -- from -- from their counterparty that they do meet the definition of the special entity. That would alleviate a lot of the risk that -- that -- that we still feel remains to some extent.

Finally, I would also like to discuss the concerns of EEI members and other end-users

with the general de minimis special and the current transition from eight billion to three billion in 2017, this going to occur absent Commission action. This sudden arbitrary drop impacts the ability of utilities to engage in long term planning. Commodity prices are unstable and vary considerably over time. And the certainty of a stable consistent de minimis threshold will assist EEI members in managing their risks.

Also, given the variable nature of commodity prices, the Commission can't know or even meaningly evaluate what the cost benefit impact of such a dramatic reduction in the de minimis threshold will be five years from now. The current proposed drop in the de minimis threshold also will have an impact on the recent Commission no action letter from March 21, as these swaps are now included in the eight billion general de minimis threshold that is going to drop to three billion.

Having the Commission provide additional certainty on this issue by clarifying the Commission action with the opportunity for

comment, will be taken prior to a reduction. The de minimis limit will provide additional helpful certainty to the market. Thanks again and I look forward to the discussion.

MR. REMMLER: Thank you. Jerry, and I see you came in a little late.

MR. JESKE: Yes, Jerry Jeske, Chief Compliance Council from Mercuria Energy Trading. I'll make it brief. We come at this from a little bit different angle and we -- we are not a participant today because of the rule. And the cap that was put on, and as many folks have been speaking up here today, would take us out of the equation because we're an end-user that has no interest in becoming a swap dealer.

So I just want to say a heartfelt thank you to Commissioners Wetjen, Commissioner O'Malia, and staff for issuing the March 24 no action 14.34. I think it was well reasoned and just really appreciate the attention to this -- to this matter.

We can, you know, try to serve the greater public interest of creating liquidity for what is obviously an essential business across

the United States. We can fill that void, we can be part of the process. But as I think Lael was mentioning, there is this looming three billion threshold ratcheting down, so to speak, that everyone is going to have to take into consideration.

So effectively, with that looming out there, folks will create at, again, an arbitrary level because we can't just focus on electricity. We also have to look at the gamut of energy, fuel oil, oil, natural gas, across the board and if you are going to manage your business in a way that's going to be arbitrarily limited at some point in the future, you really have to put that cap in now, which will again, reduce liquidity unfortunately and so we're hopeful that the Commission can not only address this as -- as Commissioner Wetjen said in terms of formal rulemaking, but also pay attention to this potential ratcheting down. But thank you again and we really appreciate the no action.

MR. WETJEN: Lael, I'm glad you raised the issue you did about the reps. Is there anything else along those lines that we should

anticipate comment letters pointing out in response to the proposal, assuming we can get it released?

MR. CAMPBELL: You know, the other issue we've explored is -- well, there's a few things, right. We've spent a lot of time and energy putting in internal policies to prevent swap transactions with special entities since it was, as part of our Dodd-Frank implementation, our biggest risk. So in order to use, for our company, in order to use a no action letter, we're going to have to actually change some of our internal policies. And also the reps themselves, you know, I think the Commission should consider whether all of the reps are necessary.

It is going to involve changing agreements with counterparties to a certain extent. Right now, you know, we were talking with the ICE folks earlier. ICE eConfirm is probably the most common platform used by energy market participants. Right now the confirmation process is sort of automated for regular swaps.

It's going to, again, force -- this is

going to force a potential change to that process. We can't rely on the eConfirm, current eConfirm, process to get these reps in place. We're going to have to long form it so to speak. Yeah, those -- those are relatively small burdens so I wouldn't -- certainly doesn't -- don't outweigh the benefits that the relief provides.

But the risk I noted about, you know, making sure that we can rely on a rep, that the counterparty is a utility special entity I think would be the most important one for us as we -- as we look to potentially engage in these transactions.

MR. JESKE: I would also add that the no action turning into a rule I think is a wonderful development. It does particularly focus on a couple asset classes. I think that might need to be expanded.

Certainly many generation relies on coal, fuel oil, and I think the focus on natural gas as an input is certainly helpful, but it may need to be expanded. If a utility is going to make a rep that they are receiving inputs to generate power, that should be, you know, pretty

broad I would hope.

To me -- I think Randy was mentioning there's some -- you don't know when the water is going to be there or not and you might have to burn other sources of fuel to be able to provide the power that's necessary. So I think that might need to weigh in as well.

MS. DONDNAVILLE: Well I think in the petition we did talk about energy and energy related swaps and we talked about essentially any fuel for generation. We also talked about emissions or environmental attributes, swaps, as well as -- energy credit, swaps, or other types of swaps that would be directly, again, related to the utility operations, would not allow them to trade metals, to trade crude oil, different crude, or literally anything other than things intrinsically related to the operation of the utility.

One other thing I wanted to talk briefly about. You asked if there were any other sort of embedded landmines in this, and not to beat a dead horse from this morning, but remember that it's utility operations related swaps.

I represent counterparties that transact with utility special entities, as well as utility special entities and that discussion about what's a swap and what's a trade option or what's a forward with embedded optionality, all of which are, I think non swaps, plays into this as well because as Lael said, the hurdle, the $25 million sub threshold was an issue because you don't want to go close to that unless you know darn well you are -- you want to be a swap dealer. You have a choice of the people that you transact with, you have a choice of the markets that you trade in.

Utility special entities don't have that choice. They need these products to hedge or mitigate there commercial risks. And for that reason, to the extent that utility special entities can't enter into long term forward contracts with embedded optionality, that raises any specter that that transaction is going to be treated as a swap. That too restricts their ability to hedge their risks.

MR. REMMLER: During the panel, there was some mention of core competency in swaps and

as I mentioned in my opening remarks, special entities -- Congress said to treat special entities a little bit differently. Here we're being asked to treat a particular category of special entities basically as non special entities for particular types of swaps.

So I was wondering if some of the -- some of the representatives of utility special entities here, if you could speak to perhaps how long you've been using swaps, how frequently you use swaps, what you mean when you say it's a core competency?

MR. HOWARD: Sir, Randy Howard, LADWP. We have been in business for about 100 years right now, serving the City of Los Angeles, and I think, again, what's the definition of a swap. But I mean from the optionality perspective, we've probably been utilizing various types of optionality from the very beginning.

And again, early in LADWP's history, hydro was a big issue, but fuel oil and various motors and other things came along the way and so you needed to hedge based on potential weather issues and potential outages of pieces of

equipment, unplanned outages.

You have major transmission lines that at any point could have a failure and you need to have an option for an alternate source and those need to be in place ahead of time. You don't wait until the event occurs. That's the same with planning for droughts and earthquakes.

So I would say it's been a core competency from the very beginning to keep the reliability high and we -- we see that we have a skill set very capable of managing both at risk and the hedging operation that goes on.

MR. NAULTY: I've personally been involved in the trading market since (inaudible) 888 came out in 1988, or 1998 and you know, we employ people in our power marketing group that are experienced traders, most of whom have worked in -- for a for profit or for utility subsidies -- a subsidiary trading companies.

We've used swaps, fix for float swaps, both just outright swaps at different points, trading hubs, since the markets offered them. So when -- in MISO, that would have been in the Midwest -- so that would have been 2003 in PJM it

would have been before that. I can't remember the exact date. Maybe Lael knows.

But ever since they've been available we've used them. They also use swaps for day ahead versus real time power as well in those RTO markets. So we've been doing it for a number of years.

MR. TRACY: In California, SMUD has really, I would say, one of the demarcations was when we went to deregulation. That's where -- where SMUD established energy risk management as a -- as sort of a corporate goal. And I mean we went through the whole energy crisis. We did not have a big issue with our -- our supply cost.

And it's basically because we were able to do hedging while the private utilities were not able to do hedging. And I -- it's very well developed in our company. We have an executive group that basically provides the boundaries within which our buyers have to stay. And it's basically -- these are matching retail load with our OCL obligations.

So I think the term trader is a misnomer

for us anyway; 95 percent of what our folks do is actually just matching up the portfolio of resources with our retail load. The only trading, so to speak, that they really do is probably on a daily or a weekly basis when we actually have power plants that aren't fully utilized and we sell that into the market or we buy some, you know, buy some economy energy.

MR. RUST: So for the energy -- oh, sorry. So for the Energy Authority, we do represent quite a varied set of clients who had been in the business for many years. Our corporation itself was started in 1997 as a result of third quarter 888889. I have been in the power marketing business since that time, almost 18 years. And the Energy Authority was created to manage -- to manage those risks or for our clients.

We started off with three original clients, three original owners. They developed our organization to build those competencies. We have a comprehensive risk management policy. We identify risks. We control risks and we limit risks with those -- with that policy and it's

certainly something that is -- is the focus of our organization.

MS. SCHAEFFER: And I guess I was just going to follow up, again, with what I mentioned when I spoke earlier. Our system being hydro based and the fuel being something that we don't have as much control over as other types of fuel sources for other utilities, it's been adherent in our business from the get go, from 1937, that there would have been -- usually what we had done in the past certainly were just either long term purchase or sale arrangements just to ensure that we had sufficient generation available to us when we might not expect to have sufficient water and or generation.

And just going back, I have a copy, for example, of our -- our -- the FY 2013 financial report and the annual report and we have the whole section that deals with our risk management and derivative instruments. We have a -- excuse me, Transacting Risk Management Committee that helps, again, sets the sideboards on what kinds of things folks can do.

Again, you know, we're very careful,

especially given the nature of the kind of entity that we are that definitely there is no speculative trading period. It's always meant to serve our needs. The trades are not -- the traders are not supposed to go out and trade because they think the price is good. It -- it -- there are more specific criteria that is involved.

And again, I said, even just in our annual reports, talking about the risk management and the -- how we model the different types of risk using the Monte Carlo simulations and so on. Looking at our credit risk with regards to our other customers and, you know, we have also used interest rate swaps in the past, those kinds of things just to hold variety.

But again, you know, we go out there. We make sure we either have the people who have that capability and or we seek the advice to make sure that we have protected ourselves in the best way that we can.

MR. REMMLER: I'd like to ask a question about the nature of the counterparties that are affected by the rule or have been

affected. You know, Terry, you mentioned that you lost about a third of your regional counterparties. In this area we have the financial entity, swap dealers, we also have entities such as Exelon and Mercuria. Are there other types of entities that you have been trading with who are -- are counterparties and not just Terry, or any of the other members of the panelists; just sort of to help fill out our understanding of who the counterparties are that were affected.

MR. NAULTY: Specifically, you know, all of the counterparties that we were enabled with that came to us after the sub threshold was set, said they would no longer take our name, are utility affiliated trading companies, without exception.

And we're a little unique in that most of my colleagues here are, you know, talking about balancing their supply portfolio with their demand by their customers. We're a seller, generally, and so if Exelon wanted to buy power from us, they couldn't because we're a special entity and we've traditionally been a supplier to

companies like Exelon, for example.

MR. REMMLER: So -- so in effect are you saying that you, yourselves are -- and to some degree doing dealing and you're affected by this rule, is that --

MR. NAULTY: Well, obviously we have to have counterparties to trade with. So by being classified as a special entity, that kind of tainted us from our ability to be able to monetize the value of the excess or the surplus capacity and energy that we had.

MR. TRACY: I would add to that because we deal a lot with the natural gas to fuel our power plants; that some of the oil, gas, physical folks are the ones that have dropped trading with us.

MS. DONDNAVILLE: I can -- because I represent a variety of different counterparties to special entities, I can give you general categories of -- of types of entities, regional gas producers who would ordinarily transact with the utility special entities in their region. They have shut that down.

A natural gas utility located in the

Central Northern United States; they do not transact with utility special entities. The retail group Mid-Atlantic, who used to have customers who were electric, retail, municipalities, they no longer enter into anything that smacks of volumetric optionality with utility special entities.

So a whole variety of counterparties in different regions of the country have excluded that counterparty class because of the $25 million threshold.

MR. TRACY: I just wanted to add one thing. And basically, our remaining counterparties are financial firms. And one of the, you know, as the enterprise risk person at SMUD, I always have to think of all of the bad things that could happen. And one of the things that would concern me is, you know, there is some talk of limiting the ability of banks and investment banks from owning physical assets like power plants and pipelines and such, and obviously if that came to pass under, you know, what the -- we would think that a lot of the financial companies would drop out of that sector

of trading at that point.

MR. RUST: So for the Energy Authority, the clients that we have lost have included utilities, marketers, producers, as well as we lost some oil and gas companies in -- in the beginning.

MR. HOWARD: For Los Angeles Department of Water and Power, some of our counterparties that we lost were more natural gas producers. We own a number of firm pipeline rights so we also own a gas field ourselves in Wyoming. So there are other parties, smaller players, regional players that determine the risk were too high. We also have had a number of EEI type of utility counterparties that have determined that it's probably just easier not to conduct or transact directly with us.

MR. REMMLER: I just wanted to follow up on something you mentioned, Terry. You said that you're already seeing an effect in the market due to the recent no action letter. What have people expressed to you in terms of what's changed when compared with the previous no action letter 12.18, to the current action letter?

What -- what do you think has caused that change? And if anyone else has any other thoughts --

MR. NAULTY: I think clearly the answer is the no action letter that was issued, since its issuance, we've already done a swap with one of the counterparties that had previously not traded with us. So we -- we have seen at least one of our counterparties come back to us. And that was, again, because of the regional nature of our market, it was -- it was a transaction that made sense for them and for us as well. And we were effectively excluded from that as a result of the previous sub threshold issue.

MS. DONDANVILLE: Can I say that different counterparties were concerned about different ones of the conditions that were included in the prior no action letter. Some were very concerned about the requirement to take a firm position as to whether or not you were a financial entity. That definition as most people know is not clear. And the intrusion of that definition from another part of the CFTC's rulemaking, where it's already been questioned, created an ambiguity in the no action letter.

Similarly, there was -- it had to be -- the transaction had to hedge the physical risk of the utility swap entity of the -- sorry, of the utility special entity. The hedging physical assets test is in the swap dealer rule. Most of the utility special entities not being swap dealers haven't come to grips with that rule. They could have represented that they were hedging or mitigating commercial risk, 50/50, because they've read that. They understand that. So that was another ambiguity in the middle of that no action letter.

Probably the most -- the one I heard the most from counterparties who were just saying it's easier not to deal with it; is the requirement to report yourself to the CFTC.

That you had gone over the 25 million during the particular quarter, that you were comfortable that you were not a financial entity, that you were comfortable that the utility special entity was hedging their physical risk, that you were comfortable you met all of the conditions because if you didn't or you made the wrong determination, you were subject to audit

and potentially having inadvertently tripped yourself into registration as a swap dealer.

MR. REMMLER: So just to clarify, the issue that group of people was having was specifically making the -- essentially notifying the CFTC that they were relying on the -- on the relief or was it the -- the fact that they had to make a representation to that effect?

MS. DONDNAVILLE: No, it's -- it's essentially saying I'm relying on the no action letter, which means you had better be sure that you're comfortable that you have relied on the no action letter and I went over the 25 million, with this special entity, on this date, with this trade. If you made any of those determinations wrong and you had reported yourself to the CFTC as having been rock solid certain, than you may have, in 20/20 regulatory hindsight, had been required to register as a swap dealer. Most of the counterparties that I spoke to were not ever intending to become a registered swap dealer.

They paid attention to making sure that they had characterized everything absolutely correctly and for one of these transactions, you

can go over 25 million with one swap, or certainly with one long term forward contract with a special entity with any type of questionable volumetric optionality.

MR. REMMLER: Do you think that -- that -- that issue would be somewhat addressed if we -- if we were to address the issue that Lael read regarding reliance and representations?

MS. DONDNAVILLE: The issue that Lael raised, which is still a requirement in the March 21 no action letter, can easily be fixed it seems in the rules. The swap dealer rules in many parts indicate that the counterparty can rely on a representation of their counterparty. And I guess I would encourage you to have that type of a -- of a requirement there. But bringing back the variety of other conditions that were in the March -- or in the 12.18 no action letter, I think would again, reengage the problems that this group experienced with that no action letter.

MR. REMMLER: Let me ask -- with regard to the -- I think what I'm hearing you saying with regard to the representation is, I think, that the

letter says that representation can be made but it doesn't say anything about the counterparty relying on the representation. Is that --

MS. DONDNAVILLE: No it says something about a representation can be made in another place; that they are hedging or mitigating commercial risk. It says if there. It does not say it in the -- in the line where it says the counterparty is a utility special entity. So if you are amending Rule 1.3(ggg)(4), that same provision that would allow the counterparty to rely on a representation of the utility special entity is what Lael is requesting.

MR. REMMLER: As I'm sure you know, Patty, a lot of the other rules that talk about relying on a representation say you can rely on a representation unless of course you have knowledge.

MS. DONDNAVILLE: Not a problem.

MR. REMMLER: That's not a problem?

MS. DONDNAVILLE: Not a problem.

MR. REMMLER: Okay; good, good. Getting back to the notice issue, there was one question that came to my mind. One of our

concerns is that if we create this special category in a rule, the utility special entities are still special entities with regard to interest rate swaps and other types of swaps that are not in your core competency.

And as such, if there are dealers trading in those areas or in any area, frankly with you, it may be difficult for us to distinguish which swaps that are being to us through the swap data repositories and so forth should be counted by the dealers when determining whether they need to register or not.

So one thought was to have entities that are going to rely on this kind of relief, simply notify us that they are relying on the relief, not that -- not necessarily get to any specific conditions, which I understood was a big concern for them. I want to ask the panelists, do you think that's a reasonable request, a onetime notification?

MS. DONDNAVILLE: If the LEIs are on a swap and the LEI for one entity is a utility special entity and the LEI for the other entity is not, then that data, it would seem, would

already be in the swap data repository, yes?

MR. REMMLER: But it's possible the swap could be something other than the type of swap.

MS. DONDNAVILLE: They're always going to be in the other commodity asset category, right? They're always going to be a product -- unique product identifier that would identify them as energy related.

MR. REMMLER: I suppose it would depend on how specific the unique product identifier is, yeah -- yeah. That may be another way to go about it; okay. I think that's all we have and I think we're right about at the time. I don't know if anyone else has any other statements they want to make or if not, at this point I think we'll close the panel. Thank you very much for your attendance, appreciate your coming here.

MR. HOWARD: I want to thank you again; just your willingness to hear from the utilities and continue this effort on working with us. We appreciate it. Thank you.

MR. REMMLER: Thank you.

(Whereupon, the HEARING was

adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017