From: Barron, Melody R. <MBarron@schiffhardin.com>
Sent: Tuesday, December 28, 2010 5:40 PM
To: Recordkeeping <Recordkeeping@CFTC.gov>
Cc: Dondanville, Patricia <pdondanville@schiffhardin.com>
Subject: Pre-NOPR Comment Letter to Data Record-Keeping and Reporting
Attach: Data Record-Keeping and Reporting Pre-NOPR Comment Letter -- 11-16-2010.pdf

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Ladies and Gentlemen:

Attached please find a comment letter filed on behalf of the following entities as transmitted on November 16, 2010:

- National Rural Electric Cooperative Association;
- American Public Power Association; and
- Large Public Power Council.

Thank you.

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DATA RECORD-KEEPING AND REPORTING TASK FORCES

November 16, 2010

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Submitted electronically pursuant to the CFTC website protocol

Re: Pre-NOPR Comments to CFTC Data Recordkeeping and Reporting Task Forces (XVII and XVIII) under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Mr. Stawick:

The trade associations comprising the "Not-For-Profit Electric End User Coalition" (the "Coalition") respectfully submit these comments to the Commodity Futures Trading Commission (the "CFTC") Task Forces XVII and XVIII (the "Data Task Forces") established as part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Given the nature of our members' commercial enterprises, [1] our comments focus on those aspects of the Data Task Forces' rule-makings that will affect "end users" of energy and energy-related commodities and "swaps."[2]

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[1] The comments contained in this filing represent the comments and recommendations of the organizations comprising the "Coalition," but not necessarily the views of any particular member with respect to any issue.

[2] We have footnoted this term, and direct the reader to the comments submitted by the Not-For-Profit Energy End User Coalition dated September 20, 2010, submitted in response to the "Definitions ANOPR," and in particular to the comments on the definition of "swap" in that

As the CFTC (along with the Securities and Exchange Commission and the prudential regulators) embarks on the complex and interrelated rule-makings necessary to implement the Act, the Coalition respectfully requests that the regulators keep in mind at each step along the way how these rule-makings will ultimately impact the commercial enterprises that are "end users" of commodities and swaps. These are not financial entities, and they have not previously been regulated by the CFTC.

On the day after the effective date of the Act, each of these end users will still have a business to run, commercial risks to manage and customers to serve. The Act was intended by Congress to regulate the financial markets more effectively, and to provide regulatory oversight to financial entities. The rule-makings must not leave commercial enterprises uncertain as to which of their ongoing activities will now be regulated by the CFTC. Nor should the rule-makings impose on these enterprises new and unnecessary regulatory costs and burdens.

I. THE COALITION MEMBERS[3]

The Coalition is comprised of three trade associations representing the interests of not-for-profit, consumer-owned electric utilities in the United States (collectively, the "NFP Electric End Users"). The primary business of these NFP Electric End Users has been for well over 75 years, and still is today, to provide reliable electric energy to their retail consumer customers every hour of the day and every season of the year, keeping costs low and supply predictable, while practicing environmental stewardship. The NFP Electric End Users are public service entities, owned by and accountable to the American consumers they serve.

A. NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION ("NRECA")

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all

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letter. A copy is attached for convenience of reference. Given the broad definition of "swap" and the fact that everyday commercial transactions of the NFP Electric End Users may arguably fall within that definition, the regulatory burdens of data record-keeping and reporting with respect to "swaps" are of significant concern to NFP Electric End Users.

[3] The Coalition is grateful to the following organizations and associated entities who are active in the legislative and regulatory policy arena in support of the NFP Electric End Users, and who have provided considerable assistance and support in developing these comments. The Coalition is authorized to note the involvement of these organizations and associated entities to the CFTC, and to indicate their full support of these comments and recommendations: the Transmission Access Policy Study Group (an informal association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other under take and pay "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative owner-members, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members.

The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act ("SBREFA"). 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. SBREFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (the "SBA"). The SBA's small business size regulations state that entities which provide electric services are "small entities" if they dispose of 4 million MWh or less per year. 13 C.F.R. §121.201, n.1.

B. AMERICAN PUBLIC POWER ASSOCIATION ("APPA")

APPA is the national service organization representing the interests of publicly-owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. These systems take various forms, including departments of a municipality; a utility board or a public utility district formed under state or local law; a joint action agency or joint power agency formed under state law to provide wholesale power supply and transmission service to distribution entity members; a state agency, authority or instrumentality; or other type of political subdivision of a state. Like the members of NRECA, the vast majority of APPA's members are considered "small entities" under SBREFA.

Public power utilities perform a variety of electric utility functions. Some generate, transmit, and sell power at wholesale and retail, while others purchase power and distribute it to retail customers, and still others perform all or a combination of these functions. All these systems work together pursuant to their common statutory and regulatory mandates. Some are "vertically integrated" electric utilities (engaging in generation, transmission, distribution and retail sales), while others are vertically integrated by contract with other "201(f) entities" (entities that are exempt from full Federal Power Act rate regulation under Section 201(f) of that statute), or by contract with third parties.

Public power utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a public power utility is to provide reliable, safe electricity service, keeping costs low and predictable for its customers, while practicing environmental stewardship.

C. LARGE PUBLIC POWER COUNCIL ("LPPC")

The Large Public Power Council is an organization representing 24 of the largest locally owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly 90% of the transmission investment owned by non-federal public power entities in the U.S. Our member utilities supply power to some of the fastest growing urban and rural residential markets in the country. Members are located in 11 states and Puerto Rico -- and provide power to some of the largest cities in the country including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando and Austin.

Members of the LPPC are also members of APPA. LPPC members are larger in size than other APPA members due to the size and population density of the communities to which they provide power. LPPC members often require larger, more complex and more diverse types of resources to serve their communities as well, and therefore LPPC members own and operate more complex generation and transmission assets than many other APPA members. However, despite being larger in size and resources, LPPC members' public service mission remains the same -- to provide reliable, safe electricity service, keeping costs low and predictable for its customers while practicing environmental stewardship.

D. THE COALITION'S MEMBERS ARE UNIQUE, AS ARE THE "MARKETS" IN WHICH THEY TRANSACT AND THE TRANSACTIONS IN WHICH THEY ENGAGE.

The NFP Electric End Users represented by the Coalition include public power utilities and rural electric cooperatives. Some are quite large, but most of these NFP Electric End Users are very small, reflecting the communities they serve, the success of those communities in providing reliable essential services for their citizens at the lowest reasonable rates and, in the case of rural electric cooperatives, the contribution to Americans' quality of life of the Rural Electrification Act of 1936.

Some NFP Electric End Users generate, transmit and sell electric energy to their fellow public power systems and cooperatives and to third parties at wholesale, while others purchase electric energy (from associated public power systems and cooperatives or from third parties), and distribute it to retail consumers. Still others perform all or a combination of these commercial functions. The Coalition's members are unique among "end users" whose transactions are potentially subject to CFTC regulation as "swaps" (even among those who are "end users" of energy and energy-related commodities and swaps) in that the public power entities which are NFP Electric End Users have no stockholders and are accountable to elected and/or appointed officials, and ultimately to the consumers of their services. Similarly, the electric cooperatives which are NFP Electric End Users are directly accountable to their consumer-members and boards. Any gains or losses on an NFP Electric End User's energy transactions result in higher or lower energy costs to American businesses and consumers. The NFP Electric End Users do not seek profit for shareholders or investors. Their public service mission is the singular purpose and reason for their existence, and the interconnected Federal, state and local system of laws and financial regulation within which they operate is designed specifically to support this public service mission.

The markets for power in North America are comprehensively regulated at the Federal, state and local level, with a focus on reliability of service and regulated rates payable by the retail customer. In addition, the electric industry in North America (including the NFP Electric End Users) is subject to extensive environmental regulations and, in many states, renewable energy standards. Unlike other markets for over-the-counter ("OTC") derivatives and/or "swaps" (as newly defined by the Act), these are <u>not</u> unregulated markets. They are comprehensively regulated, and any new regulatory structure must be carefully tailored so as not to conflict or overlap with existing regulatory structures.

Some of the NFP Electric End Users' energy transactions are conducted through, "on," or "in" the "markets" operated by various regional transmission organizations or independent system operators (collectively, "RTOs"). RTOs operate their "markets" in certain defined geographic areas of the United States under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC"). The FERC-regulated markets are established by tariff in many instances, rather than by contract, and analogies between these FERC-created/FERC-regulated "markets," and the bilateral contract markets between independent and arm's length third parties, are inapt. Although in some ways, the markets conducted by the various RTOs are similar in structure, no two RTO markets are exactly alike and their "products" or "transactions" are not fungible between RTOs.

FERC's mandate from Congress under the Federal Power Act is to regulate in the "public interest" -- which is interpreted as the delivery of reliable electric energy to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate the FERC-regulated markets. The markets are intrinsically tied to the reliable physical transmission and ultimate delivery of electric energy in interstate commerce at just and reasonable rates.

All the energy contracts, agreements and transactions in which the NFP Electric End Users are engaged are currently conducted under exemptions or exclusions from the Commodity Exchange Act (the "CEA"), whether conducted in the bilateral OTC contract market (as most are, including RTO transactions) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial characteristics, or by virtue of their involvement in the underlying cash commodity markets relevant to their businesses (as "eligible commercial entities"). Other than a few large industrial companies, retail energy consumers generally do not participate in these wholesale markets directly. The physical and financial commodity transactions occur principal to principal, through agents and energy brokers, with a wide range of counterparties. As distinguished from other markets regulated by the CFTC, a significant percentage of these energy transactions do not involve financial intermediaries.

The transactions contain customized, non-quantitative operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between commercial businesses. Although some legal and administrative terms are standardized through the use of master agreements, the schedules to such master agreements and the individual transaction confirmations are highly negotiated and differ based on the needs and preferences of each pair of contract counterparties. These are commercial transactions, when viewed through the traditional lens of "goods" and "services" used by American businesses. It is only when they are viewed through the financial markets lens (as the Act does) that these transactions are described using the financial market regulatory labels such as "exempt commodities," "swap agreements," "options," "swaps" or "nonfinancial commodities" -- and analogized to "futures contracts" or "positions" created or engaged in by financial entities on a transaction by transaction basis for profit or speculation, and potentially subject to regulation traditionally applicable to such financial market professionals.

The NFP Electric End Users currently have the risk management choice to conduct some of these everyday transactions on CFTC-regulated contract markets, or to clear some of these transactions through CFTC-regulated centralized clearing entities. CFTC-regulated exchanges have only recently begun to list these types of contracts; and central clearing entities have only recently begun to clear energy transactions. Listed and cleared transactions are those delivered at "hubs," in tradable increments and for tradable duration -- "swaps" that are "standardized" and "fungible" in financial market terms, and with sufficient trading liquidity to allow financial markets to function. As the CFTC-regulated financial markets have evolved, some of the larger NFP Electric End Users have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments. But the vast majority of NFP Electric End Users' commercial commodity transactions are still conducted "the old fashioned way": under tariffs within the public power and cooperative systems or by contract with known and reliable suppliers and customers, and not with CFTC-regulated financial intermediaries or on exchanges or with clearing entities.

Due to the Act's wholesale deletion of applicable exemptions in the CEA, and the potentially sweeping nature of the new definitions in the Act, these everyday business transactions of the NFP Electric End Users are at some risk of being suddenly and unexpectedly redefined as "swaps." Although Congress has repeatedly indicated that its intention was NOT to reduce risk management options for end users or impose new costs on end users hedging the risks of traditional commercial enterprises, Congress is relying on the regulators to implement understandable rules consistent with that intent. Congress did not intend for the regulators to read the expansive language of the Act without regard to legislative intent, or to regulate and impose costs on end users as if they were professional financial market participants.[4]

II. COMMENTS

A. *Data record-keeping and reporting requirements for swaps should be articulated by category, class or type of swap. For energy and energy-related swaps to which the NFP Electric End Users are parties, the requirements should be based on (1) a final CFTC rule on the definition of "swap," and the exclusions and exemptions therefrom, (2) a list of existing transactions within such category, class or type that fall within the CFTC's interpretation of the terms "commodity" and "swap," (3) an analysis of the number, percentage and market volume of such swaps likely to be cleared vs. non-cleared, (4) an analysis of the number, percentage and market volume of non-cleared transactions to which neither swap dealers nor major swap participants nor "financial entities" are likely to be parties, (5) an analysis of the quantitative and qualitative data elements necessary to set forth the commercial terms of each such swap, and (5) whether any swap data repository has accepted any or all of such swaps for reporting purposes. Until all these preliminary steps have been taken, the CFTC should not issue for comment any data record-keeping and reporting rules in respect of energy or energy-related swaps. Alternatively, the CFTC should grant an exemption for NFP Electric End Users from any such data record-keeping and reporting requirements.*

The Act's sweeping new definition of "swap," combined with the CEA's broad definition of "commodity," means that transactions in which the NFP Electric End Users engage on a daily basis arguably could be subject to CFTC data reporting and record-keeping requirements. These are commercial transactions in which NFP Electric End Users engage to manage the commodity needs and commercial risks inherent in their public service enterprises. The NFP Electric End Users are new to the CFTC. The NFP Electric End Users are not financial market professionals who choose to transact in "commodities" or "swaps." The NFP Electric End Users do not create new types of commodities or swaps in order to profit from pricing fluctuations. We hedge commercial risk.

The NFP Electric End Users respectfully request the CFTC to defer issuing for comment any data record-keeping or reporting requirements for categories, classes or types of "swaps" to which NFP Electric Energy End Users may be a party until it has issued its final rules on the definition of "swap" and the exclusions and exemptions from such definition. In addition, we

[4] See 156 Cong. Rec. H5248 (the "Dodd-Lincoln letter").

respectfully request that the CFTC defer such rule-makings until the CFTC has gathered and evaluated the information necessary to make such data record-keeping and reporting requirements understandable in the context of an NFP Electric End User's commercial business lexicon. The NFP Electric End Users should not have to evaluate compliance with record-keeping and reporting obligations in respect of non-cleared "swaps" without a final definition of "swap" and an identification of which transactions common in the energy marketplace may be considered "commodities" underlying transactions reportable as "swaps."

We suggest the following procedures be followed **after** the final rules on the definition of "swap" are published. First, the CFTC should publish a list of the physical goods and services which are currently the underlying subject of derivative transactions in the energy markets that the CFTC intends to consider "commodities" for purposes of exercising its regulatory authority. The NFP Electric End Users are asking for regulatory certainty. We shouldn't have to guess if the CFTC considers energy transmission or transportation services, energy capacity or storage transactions, various transactions in fuels for generation from uranium to manure, or emissions allowances or regulatory compliance attributes such as renewable energy credits to be "commodities."

Once the definitions of both "commodity" and "swap" are finalized in the context of the energy industry, the CFTC should then publish a list of the energy and energy-related "swaps" which are currently transacted in the energy markets over which the CFTC intends to exercise its jurisdiction under the CEA. Until those preliminary steps are taken, the NFP Electric End Users respectfully request that the CFTC defer issuing any proposed data record-keeping and reporting rules which would be applicable to energy and energy-related swaps and which could reasonably be expected to place regulatory requirements on NFP Electric End Users.

The NFP Electric End Users and other end users of energy and energy-related swaps cannot be expected to comment on data record-keeping and reporting policies without these basic definitions and lists. If it would assist the CFTC in complying with our request, we are willing to submit an initial list of "energy and energy-related commodities" for consideration and discussion.

Due to the unique nature of the commodities and swaps in which the NFP Electric End Users engage[5], and after discussions with a wide variety of other end users of these commodities and swaps, we anticipate that a much higher number of transactions, and a larger percentage and market volume of such transactions, will be "non-cleared" in the energy and energy-related swaps than in the other classes, categories or types of potential "swaps." In addition, the NFP Electric End Users anticipate their swaps are and will be more likely transacted with counterparties which are <u>not</u> expected to be registered as swap dealers or major swap participants, and are not "financial entities" as that term is defined in the Act. These commercial transactions take place now without the presence of financial intermediaries. Finally, the NFP

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[5] For more information on the unique nature of the NFP Electric End User transactions, see Section I.D above.

Electric End Users anticipate that a much higher number of energy and energy-related transactions (compared to financial swaps, agricultural or metals swaps) contain material non-quantitative conditions, contingencies and risk allocations. These characteristics will make it difficult for swap data repositories to accept standardized information on these swaps.[6]

If it would assist the CFTC in better understanding the unique nature of the swaps to which the NFP Electric End Users are parties, and the unique nature of the markets in which the NFP Electric End Users are required by their commercial enterprises to participate, we are willing to assist in a targeted evaluation and comparative study of such transactions and markets. However, until such a study is completed and evaluated, the NFP Electric End Users do not believe the CFTC has the information necessary to establish record-keeping and reporting requirements for such a class or classes, category or categories, or type or types of swaps. And we do not expect to be able to provide coherent comments on any proposed rules in respect of such record-keeping and reporting requirements. Until such time as such an analysis has been conducted and rules promulgated for comment based on such an analysis, the NFP Electric End Users request a complete exemption from any data record-keeping and reporting requirements the CFTC might promulgate.

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[6] The CFTC acknowledges in its Interim Final Rule on Record-Keeping and Reporting (17 CFR Part 44, 75 Fed. Reg. 63,080) that certain non-cleared swaps will be reported by end users to the CFTC where no swap data repository's system is equipped to accept a particular bespoke swap. The NFP Electric End Users anticipate that there will be a significant number of such swaps to which they will be parties. The NFP Electric End Users caution the CFTC not to underestimate the number or complexity of data elements to be reported in respect of such swaps.

B. *The CFTC rules should not duplicate or overlap with other energy and environmental regulatory record-keeping and reporting obligations to which the NFP Electric End Users are already subject.*[7]

Section 720 of the Act also makes it clear that Congress expects the CFTC to work with FERC to establish procedures to avoid duplicative and overlapping regulation of the FERC-regulated energy industry by agreeing to a memorandum of understanding (an "MOU"). That MOU is to be submitted to Congress within 180 days after the Act is enacted. We call that process to the attention of the CFTC Data Task Forces, and ask the Data Task Forces to honor that Congressional direction in defining record-keeping and reporting requirements for Electric End Users in "swaps" where the underlying "commodity" is electric energy or any other "commodity" (whether a "good" or a "service") related to the FERC-regulated energy industry. We urge the Data Task Forces to defer rule-making on swaps for which FERC-regulated "commodities" constitute the underlying commodity until after the MOU is filed, reviewed and, if necessary, appropriate Congressional Committees have held hearings. It would be a waste of regulatory resources at the CFTC, and an unnecessary burden on those energy end users whose transactions are already reportable to FERC under existing regulations, for the CFTC's Data Task Forces to issue proposed regulations without waiting for the interagency MOU procedures to be implemented to avoid duplicative and overlapping regulations.

In addition to avoiding overlap with FERC requirements, the NFP Electric End Users request that, prior to articulating data record-keeping and reporting requirements for energy and energy-related commodity and "swap" transactions in which NFP Electric End Users engage, the CFTC study the recordkeeping and reporting requirements to which NFP Electric End Users are currently subject by the RTOs in the various geographic regions, the Energy Information Administration (of the United States Department of Energy), the Environmental Protection Agency and, if applicable, state public utility commissions. Each instance of overlapping and duplicative record-keeping and reporting requirements applicable to the NFP Electric End Users increases the cost of energy to the American public. The CFTC should be able to secure nearly

[7] As with all our comments on all rule-makings under the Act, the NFP Electric End Users' focus is on the classes, categories and types of swaps in which their commercial energy enterprises require them to engage. We submit no comments on swaps where the underlying "commodity" is credit, interest rates, equities, agricultural commodities, metals or foreign exchange. If the CFTC articulates its data record-keeping and reporting obligations differently for different categories, classes and types of swaps in recognition of the different market structures in which such swaps are transacted (unregulated markets and comprehensively-regulated markets like energy), the NFP End Users' comments would have no effect on the vast majority of swap transactions subject to the CFTC's new regulatory jurisdiction. The CFTC should focus its limited resources during this time of intense, complex rule-making on issuing regulations which will not be duplicative or overlapping of other regulatory record-keeping and reporting requirements now in effect and on bringing its regulatory focus to bear on markets that most need regulatory price transparency.

all information necessary to regulate these markets from such other regulators (or from CFTC-registered and regulated financial market structure entities, such as designated contract markets, derivatives clearing organizations, swap execution facilities, and swap data repositories, and financial intermediaries, such as swap dealers, major swap participants, futures commission merchants and others). We respectfully request that the CFTC exclude from its record-keeping and reporting requirements at this time any swap which is subject to an ongoing record-keeping and reporting paradigm by another Federal or state regulator, and to which a registered entity (a swap dealer, a major swap participant or a financial entity) is not a party. For those transactions, it is imperative that the CFTC coordinate with other energy regulators in these rule-makings in order to reduce the regulatory burden on commercial end users.

C. *The CFTC Should Interpret the "Real Time" Reporting Requirements in Light of Commercial Realities in Markets for Different Categories, Classes and Types of Swaps.*

Many swaps to which the NFP Electric End Users are parties are not transacted electronically, with all commercial terms confirmed and transactions executed online. This is especially true of swaps which are not cleared and which may include material non-quantitative operating conditions, transmission or transportation contingencies and operating risk allocations. These are customized commercial transactions which may be negotiated over days, weeks and months, on lengthy documents. Such transactions may be subject to approval by regulators, cooperative boards or governmental authorities.

The NFP Electric End User Coalition requests the CFTC to interpret the Congressional phrase "real time reporting" in light of commercial realities in the marketplace for each class, category or type of "swap." As stated in CEA Section 2(a)(13), the purpose of the CFTC's reporting requirements are "to make swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery." CEA Section 2(a)(13)(F) goes on to provide for reporting "in a timely manner as may be prescribed by the Commission" and "as soon as technologically practicable after the time at which the swap transaction has been executed."

In the futures and securities markets, and within the markets for energy and energy-related "swaps" for those transactions between and among swap dealers, major swap participants and other financial entities, "real time" may be viewed differently than in transactions which take place between non-financial entities—end users. Financial entities can be presumed to have back office administrative staff and information technology resources already structured around such financial market transactions and CFTC, SEC or banking market regulatory requirements. To these regular financial market participants, "real time" may mean daily or even intra-day. But energy end users like the NFP Electric End Users have public service commitments, to meet reliability of service obligations and to keep energy costs low and predictable for the consumers they serve. All the NFP Electric End Users' staffing and information technology resources are used primarily to achieve such public service priorities.

D. *<u>The CFTC Should Expressly Exclude "Small Entities" (under SBREFA) From All Data Record-Keeping and Reporting Obligations under the CEA.</u>*

The NFP Electric End Users request an exemption from all record-keeping and reporting requirements for all "small entities" under SBREFA to the extent that such entities anticipate claiming the "end user" exception from clearing. In particular, the NFP Electric End Users request an exemption for all "small entity" members who anticipate claiming the "end user" exception from clearing and who are "eligible commercial entities" and therefore "eligible contract participants" for swaps based on commodities in which they transact with their commercial business. We also respectfully request an evaluation of the need for "real time" reporting in terms of the CFTC's ability to regulate and protect the financial markets vs. the costs to and burdens on the NFP Electric End Users of reporting their swap transactions in "real time." We respectfully request that a complete SBREFA review be conducted, focused on record-keeping and reporting requirements for "swaps" in which the NFP Electric End Users engage as "small entities," with full opportunity for input and public hearing.

E. *<u>If the CFTC decides that Electric End Users will have data record-keeping and reporting obligations for non-cleared swaps, the CFTC should provide for adequate transition periods to allow end users to finance, procure, install and test new information technology systems, to hire, train and manage new administrative staff, and, where necessary, to allow for Electric End Users to request from all applicable state energy regulators and governing bodies the right to recover of all such new regulatory costs in energy rates paid by American consumers and businesses.</u>*

In September 2010, the CFTC declined to grant the NFP Electric End Users' request for an exemption from provisions of the Act for a year after the effective date. In doing so, the CFTC promised adequate transition periods to allow end users time to comply with the CFTC's new rules. Data record-keeping and reporting requirements are a key area in which the NFP Electric End Users respectfully request generous transition periods. Once all the rules are finalized, it will take time for the NFP Electric End Users to develop and implement new record-keeping and CFTC reporting systems, to develop new procedures and to hire and train new staff. In addition, the NFP Electric End Users are not public companies which can draw from either operating reserves or liquidity facilities to implement costly new record-keeping and reporting systems, and to hire and train new staff. The NFP Electric End Users' operating reserves and lines of credit are typically maintained for rate stabilization purposes should operating conditions like adverse weather or sudden increases in operations costs require funding. Allowing additional transition time to implement these changes will reduce the strain on the NFP Electric End Users' reserves and provide additional time to recover some of these regulatory costs through rate increases, if necessary.

III. <u>CONCLUSION</u>

The Coalition strongly encourages the CFTC and the SEC to consider the effect on end users of "swaps" at every step of the regulatory rule-making process. We respectfully request that, as the CFTC drafts its rules, it carefully consider the consequences to those who operate commercial enterprises and are drawn into this new regulatory environment only because of the Act's broad statutory language which could be read to redefine traditional commercial contracts as "swaps." Any new regulatory burdens, direct or indirect costs or requirements will result, dollar for dollar, in higher costs to the NFP Electric End Users' customers and owners -- approximately 87 million American retail consumers of electric energy.

The NFP Electric End Users do not pose a threat or systemic risk to the United States banking or financial system. It was not Congress' intent that the Act should impose new and, in some cases, overlapping and conflicting regulatory burdens on commercial enterprises by treating them like the financial market professionals who participate voluntarily and for profit in CFTC-regulated markets. Regulatory policy-making and rule-making must be tailored to achieve Congressional objectives without creating uncertainty as to who will be regulated, what transactions will be regulated, what records need to be kept and what transactions reported once the effective date for the Act arrives. The rules should be tailored to fit the differing market structures, and to exclude, exempt or treat appropriately, all commercial end users and, in particular, the NFP Electric End Users.

The NFP Electric End Users are relying on the CFTC to draft clear rules, to make clear how current interpretations, no action positions and precedent under the CEA should be read in light of the Act's new and different regulatory structure, to follow coherent rule-making processes in which those who will potentially be affected by the rule-makings can efficiently and effectively participate. And the NFP Electric End Users are relying on the CFTC to conduct all necessary rule-makings and exemption proceedings prior to the effective date of the Act (and with appropriate regulatory transition periods thereafter). We stand ready to help the CFTC understand our industry, our public service enterprises, our transactions and our "markets."

The NFP Electric End Users respectfully request that an analysis be performed (pursuant to rule-making and with an opportunity for public hearing) on the potential impact of such regulations on "small entities" under SBREFA, as noted above, to determine whether less burdensome or alternative forms of regulation can be developed for small entities.

Respectfully yours,

THE "NOT-FOR-PROFIT ELECTRIC END USER COALITION":

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: Russ Wasson
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: Susan N. Kelly
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

LARGE PUBLIC POWER COUNCIL

By: Noreen R
Name: Noreen Roche-Carter
Title: Chair, Tax and Finance Task Force

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

ATTACHMENTS TO DATA RECORDKEEPING AND REPORTING TASK FORCES COMMENT LETTER

NFP Energy End Users Comment Letter on Definitions ANOPR
EEI Comment Letter on Definitions ANOPR

CH2\9226988.2

September 20, 2010

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
Email to secretary@cftc.gov, dfadefinitions@cftc.gov and otcdefinitions@cftc.gov with Definitions in Subject line;

Re: Proposed Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Mr. Stawick:

The trade associations comprising the "Not-For-Profit Energy End User Coalition" (the "Coalition") respectfully submit these comments to the Commodity Futures Trading Commission (the "CFTC") in response to the Advanced Notice of Proposed Rulemaking entitled "Definitions contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act."[1] This rulemaking is part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Given the nature of our members' commercial businesses, our comments focus primarily on the aspects of the definitions that will affect end users of energy and energy-related commodities. [2]

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1 75 Fed. Reg. 51,429 (Aug. 20, 2010).

2 The comments contained in this filing represent the initial comments and recommendations of the organizations comprising the "Coalition," but not necessarily the views of any particular member with respect to any issue.

As the CFTC (along with the Securities and Exchange Commission and the prudential regulators) embarks on the complex and interrelated rule-makings necessary to implement the Act, the Coalition respectfully requests that the regulators keep in mind at each step along the way how these rule-makings will ultimately impact the commercial businesses that are "end users" of commodities and "swaps." These are not financial entities, and they have not previously been regulated by the CFTC. Under current law, if an end user chooses to buy or sell CFTC-regulated futures contracts or options or to utilize a CFTC-regulated clearing entity to manage its commercial risk, this represents one commercial choice among many. In many circumstances, small businesses in particular choose to manage their risks in less expensive ways. On the day after the effective date of the Act, each of these end users will still have a business to run, commercial risks to manage and customers to serve. The Act was intended by Congress to regulate the financial markets more effectively, and to provide regulatory oversight to financial entities. The rule-makings must not leave commercial businesses uncertain as to which of their ongoing activities will now be regulated by the CFTC. Nor should the rule-makings impose on these businesses unnecessary regulatory costs and burdens.

I. THE COALITION MEMBERS[3]

The Coalition is comprised of four trade associations representing the interests of not-for-profit, consumer-owned electric and gas utilities in the United States (collectively, the "NFP Energy End Users"). The primary business of these NFP Energy End Users has been for well over 75 years, and still is today, to provide reliable natural gas and/or electric energy to their retail consumer customers every hour of the day and every season of the year, keeping costs low and predictable, while practicing good environmental stewardship. The NFP Energy End Users are public service entities, owned by and accountable to the American consumers they serve.

A. NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION ("NRECA")

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include

[3] The Coalition is grateful to the following organizations and associated entities who are active in the legislative and regulatory policy arena in support of the NFP Energy End Users, and who have provided considerable assistance and support in developing these comments. The Coalition is authorized to note their involvement to the CFTC, and to indicate their full support of these comments and recommendations: The Transmission Access Policy Study Group (an informal association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other under take and pay "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative owner-members, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members.

The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act (the "SBREFA"). Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). The RFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (SBA). The SBA's small business size regulations state that entities which provide electric services are "small entities" if they dispose of 4 million MWh or less per year. 13 C.F.R. §121.201, n.1.

B. AMERICAN PUBLIC POWER ASSOCIATION ("APPA")

APPA is the national service organization representing the interests of publicly-owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. These systems take various forms, including departments of a municipality; a utility board or a public utility district formed under state or local law; a joint action agency or joint power agency formed under state law to provide wholesale power supply and transmission service to distribution entity members; a state agency, authority or instrumentality; or other type of political subdivision of a state. Like the members of NRECA, the vast majority of APPA's members are considered "small entities" under the RFA.

Public power utilities perform a variety of electric utility functions. Some generate, transmit, and sell power at wholesale and retail, while others purchase power and distribute it to retail customers, and still others perform all or a combination of these functions. All these systems work together pursuant to their common statutory and regulatory mandates. Some are "vertically integrated" electric utilities (engaging in generation, transmission, distribution and retail sales), while others are vertically integrated by contract with other "201(f) entities" (entities that are exempt from full Federal Power Act rate regulation under Section 201(f) of that statute)[4], or by contract with third parties.

Public power utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a public power utility is to provide reliable, safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

C. <u>AMERICAN PUBLIC GAS ASSOCIATION ("APGA")</u>

The APGA is the national association for publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. The purpose of a public gas system is to provide reliable, safe and affordable natural gas service to the community it serves. Public gas systems depend on the physical commodity markets, as well as financial market transactions, to meet the needs of their consumers. Together, these markets play a central role in public gas utilities securing natural gas supplies at reasonable and stable prices. Specifically, many public gas utilities purchase firm gas supplies in the physical delivery market at prevailing market prices, and enter into OTC derivatives customized to meet their specific needs to hedge their customers' exposure to future market price fluctuations and stabilize rates. As with APPA-member systems, the APGA members work together pursuant to their common statutory and regulatory mandates, often without the types of contracts that exist between for-profit entities, but instead under tariff arrangements or all requirements contracts.

D. <u>LARGE PUBLIC POWER COUNCIL ("LPPC")</u>

The Large Public Power Council is an organization representing 24 of the largest locally owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly 90% of the transmission investment owned by non-federal public power entities in the U.S. Our member utilities supply power to some of the fastest growing urban and rural residential markets in the country. Members are located in 11 states and Puerto Rico -- and provide power to some of the largest cities in the country including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando and Austin. Members of the LPPC are also members of APPA.

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[4] For more discussion of 201(f) entities, see the comment in Section IIA3 below.

E. <u>THE COALITION'S MEMBERS ARE UNIQUE, AS ARE THE "MARKETS" IN WHICH THEY TRANSACT, AND THE TRANSACTIONS IN WHICH THEY ENGAGE.</u>

The NFP Energy End Users represented by the Coalition include public power entities, public gas entities and rural electric cooperatives. Some are quite large, but most of these NFP Energy End Users are very small, reflecting the communities they serve, the success of those communities in providing reliable essential services for their citizens at the lowest reasonable rates and, in the case of rural electric cooperatives, the contribution to Americans' quality of life of the Rural Electrification Act of 1936.

Some NFP Energy End Users generate, transmit and sell electric energy to their fellow public power systems and cooperatives at wholesale, while others purchase natural gas and/or electric energy, and distribute it to retail consumers. Still others perform all or a combination of these commercial functions. The Coalition's members are unique among "end users" whose transactions are potentially subject to CFTC regulation as "swaps" (even among those who are "end users" of energy and energy-related commodities and swaps) in that the public power and gas entities have no stockholders and are accountable to elected and/or appointed officials, and ultimately to the consumers of their services. Similarly, the electric cooperatives are directly accountable to their consumer-members and boards. The NFP Energy End Users' public service mission is the singular purpose and reason for their existence, and the interconnected Federal, state and local system of laws and financial regulation within which they operate is designed specifically to support this public service mission.

NFP Energy End Users have a different credit profile than your average "trader" or financial market participant. Due to their consumer-owned and public service nature, most do not have significant assets available to post as margin (due to statutory or government financing restrictions) or significant non-operating accounts, investments or lines of credit available to post "margin" for their long-term infrastructure transactions, especially in the volatile natural gas and power markets. In this way, the NFP Energy End Users are fundamentally different from other entities the CFTC regulates or is charged with regulating under its new jurisdiction.

The markets for natural gas and power in North America are comprehensively regulated at the Federal, state and local level, with a focus on reliability of service and regulated rates payable by the retail customer. In addition, the natural gas and electric industries in North America (including the NFP Energy End Users) are subject to extensive environmental regulations and, in many states, renewable energy standards. Unlike other markets for over-the-counter ("OTC") derivatives and/or "swaps" (as newly defined by the Act), these are <u>not</u> unregulated markets. They are comprehensively regulated, and any new regulatory structure must be carefully tailored so as not to conflict with existing regulatory structures.

A substantial number of the NFP Energy End Users manage the commodity and other commercial risks associated with their business by entering into "contracts, agreements and transactions" in energy and energy-related "exempt commodities," including, without limitation, transactions in electric power, natural gas and, in the case of electric utilities, other fuels for generation. Other commercial risks are managed using options on natural gas, power or other exempt commodities, or "swap agreements." Some of these transactions are conducted through, "on" or "in" the "markets" operated by regional transmission organization or independent system operator (collectively, "RTOs"). These markets operate in certain geographic areas of the United States under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC"). The FERC markets are established by tariff in many instances, rather than by contract, and analogies between this system and the bilateral contract markets between independent and arm's length third parties are inapt.

FERC's mandate from Congress under the Federal Power Act and the Natural Gas Act is to regulate in the "public interest" -- which is interpreted as delivering reliable electric energy and natural gas to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate the FERC-regulated markets. The markets are intrinsically tied to the reliable physical transmission and ultimate delivery of electric energy in interstate commerce at just and reasonable rates.

All these energy contracts, agreements and transactions are currently conducted under exemptions or exclusions from the Commodity Exchange Act (the "CEA"), whether conducted in the bilateral over-the-counter contract market (as most are) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial strength, or by virtue of their involvement in the underlying cash commodity markets relevant to their businesses (as "eligible commercial entities"). Other than a few large industrial companies, retail energy consumers do not participate in these markets directly. The physical and financial commodity transactions occur principal to principal, through agents and energy brokers, with a wide range of counterparties. As distinguished from other markets regulated by the CFTC, many of these energy transactions do not involve financial intermediaries. The transactions contain customized, non-standardized operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between commercial businesses. They are commercial transactions, when viewed through the traditional lens of "goods" and "services" used by American businesses. It is only when they are viewed (as the Act does) through the financial markets lens that they are characterized with the financial market regulatory labels such as "exempt commodities," "swap agreements," "options, "swaps" or "nonfinancial commodities" -- and analogized to "futures contracts" or "positions" created by financial entities for profit or speculation, and potentially subject to regulation traditionally applicable to such financial market professionals.

The NFP Energy End Users currently have the risk management choice to conduct some of these everyday transactions on CFTC-regulated contract markets, or to clear the transactions through CFTC-regulated centralized clearing entities. But NFP Energy End Users make that choice relatively rarely. The exchanges have only recently begun to list a significant number of these types of contracts; and central clearing entities have only recently begun to clear energy transactions, especially those which are not standardized or "fungible" in financial market terms. Compared to markets for other commodities, natural gas, power and related transactions are often highly customized, and contain longer terms as necessary for these infrastructure businesses, as necessary to serve retail customers, and significant operating conditions or contingencies, reflecting the inherent physical and commercial nature of the business. As the CFTC-regulated financial markets have evolved, some of the larger NFP Energy End Users have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments. But the vast majority of NFP Energy End Users' commercial commodity transactions are still conducted "the old fashioned way": under tariffs within the public power and cooperative systems or by contract with known and reliable suppliers and customers, and not with CFTC-regulated financial intermediaries or on exchanges or clearing entities.

Due to the wholesale deletion of applicable exemptions in the CEA, and the potentially sweeping nature of the new definitions, these everyday business transactions of the NFP Energy End Users may suddenly, unexpectedly, be redefined as "swaps." Physical forward commodity transactions, commercial option transactions, and option-like aspects of ordinary course "full requirements" natural gas and electric energy transactions could be captured within the new regulatory paradigm. Although Congress has repeatedly indicated that its intention was NOT to capture commercial transactions or to impose new costs on end users hedging risks of traditional commercial businesses, Congress is relying on the regulators to implement that intent and write clear rules. Congress did not intend for the regulators to read the expansive language of the Act without regard to legislative intent, nor to regulate and impose costs on end users as if they were professional financial market participants.[5]

The NFP Energy End Users are relying on the CFTC to draft clear rules, to make clear how current interpretations, no action positions and precedent under the CEA should be read in light of the Act's new and different regulatory structure, and to conduct all necessary exemption proceedings prior to the effective date of the Act (and with appropriate regulatory transition periods thereafter). We stand ready to help the CFTC understand our businesses, our industry and our "markets." If the CFTC ignores the effect of the Act on end users, NFP Energy End Users will face a wall of regulatory uncertainty on the day the Act is effective. Such a result would be a classic example of the unintended and harmful consequences of sweeping legislation and regulation drafted without careful attention to the potential adverse impacts for industries outside the traditional financial markets that Congress intended to stabilize.

II. COMMENTS

A. DEFINITION OF "SWAP"

The Coalition agrees with the comments and recommendations made regarding the definition of "swap" by the Edison Electric Institute in its comment letter to the CFTC dated September 20, 2010. In addition:

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[5] See 156 Cong. Rec. H5248 (the "Dodd-Lincoln letter")

1. <u>Definition of "nonfinancial commodity"</u>

The Coalition respectfully requests that the CFTC define the term "nonfinancial commodity," which is not otherwise defined in the CEA. Moreover, the Coalition requests that the CFTC identify in its regulations (subject to public notice and industry comment) each of the cash "commodities," "nonfinancial commodities," and "swaps" now being transacted in the natural gas and electric energy industries in North America. The NFP Energy End Users are not financial market professionals. They manage ongoing commercial businesses and provide an essential service to American consumers and businesses. They transact in commercial goods and services every day, and they hedge commercial risks using the identifiable economic tools available to them in the marketplace. NFP Energy End Users do not "create" new transaction types or financially engineer "contracts" or take and trade "positions" to make a profit. They should not have to ask, transaction by transaction, for a CFTC determination as to whether a commonplace commercial transaction falls under the new CFTC jurisdiction. The NFP Energy End Users need regulatory certainty in order to continue conducting their business as usual on the day after the Act's effective date. The NFP Energy End Users should not have to engage in such transactions without being told, in advance, if the CFTC sees such a commercial transaction as a "commodity," or a "swap," or a "financial commodity" (as opposed to a nonfinancial commodity). The Coalition requests that the CFTC grant certainty to end users in the energy industry, by definitively stating in its rule-making which energy and energy-related products and services currently transacted in the marketplace are "commodities," which are "swaps," and which are "nonfinancial commodities."

The Coalition proposes that the definition of "nonfinancial commodities" should include all products and services related to the production, generation, transmission, transportation, storage, delivery or regulation of natural gas or electric energy delivered to North American consumers by commercial businesses in any part of that commodity chain, including all fuels used to produce electric energy, and all services, transactions, allowances, credits, licenses or intangibles defined by an energy or environmental regulator. These types of transactions are used to hedge, mitigate or manage the commercial risks inherent in physical (nonfinancial) delivery of energy commodities, including natural gas and electric energy. "Nonfinancial commodities" should also include all energy and energy-related products and services sold pursuant to "tariffs" approved by Federal, state or local energy regulators, a regulatory process focused on reliability and rate regulated service -- concepts in many ways inconsistent with the concepts that underlie financial market regulation. Finally, "nonfinancial commodities" should also include all contracts, agreements and transactions related to transmission, transportation and storage of energy and energy-related commodities.[6]

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[6] We request that the CFTC clarify this point in the definition of "nonfinancial commodity," which appears in the exclusions to the definition of "swap." The ambiguity actually emanates from the CEA's definition of "commodity," where the word "services" appears. Services agreements in the energy industry, including transmission, transportation and

The NFP Energy End Users deserve clear guidance with respect to each type of energy transaction. Understanding which transactions fall under the new regulatory scheme will be critical to commercial decisions the NFP Energy End Users need to make now and continue to make on the day after the effective date. NFP Energy End Users cannot be expected to stop doing business, develop and submit a request to the CFTC for a rule-making or an exemption on each commercial transaction, and await the CFTC's decision. The energy industry deserves to know in advance, and as soon as possible, which transactions need to be cleared, which need to be transacted on exchanges or swap execution facilities, which need to be recorded for later reporting and in what form, which need to fit within regulatory compliance programs, and which need to be reported, when and to whom. Addressing these issues early in the CFTC regulatory rule-making process will allow NFP Energy End Users to understand the scope of changes that the Act will require to the way in which they conduct their businesses. It will also allow input from the other regulators who have authority over the NFP Energy End Users, their transactions and the energy markets they utilize.

2. Tariff Transactions -- Exemption Process

As part of the definition of "swap," the Coalition requests that the CFTC, in conjunction with FERC, the RTOs, the Texas Public Utilities Commission, the Electric Reliability Council of Texas ("ERCOT") and other government and quasi-government energy tariff regulators, articulate an industry-wide exemption process, filing procedures, timelines and other related matters for the "Tariff Transaction" exemption provided for in Section 722(f) of the Act (CEA section 4(c)(6)(A)(B)). Although this exemption is found in a different section of the Act from the definition of "swap," and it refers to the CEA Section 4(c) exemption process, it is unclear how the exemption process is intended to work for transactions which exist currently under tariffs and, in particular, under the RTO and ERCOT rules. There are hundreds, if not thousands, of such tariff transactions, and all electric utility industry participants, including NFP Energy End Users, doing business in the applicable geographic regions use them every day. It is burdensome and unreasonable to expect individual market participants who utilize RTO products and services to request individual 4(c) transaction exemptions, or even product-by-product exemptions from the CFTC. The CFTC should initiate a process similar to the process outlined in the Act for currently cleared "swaps." Good public policy requires a timely, orderly and comprehensive process for exempting already-regulated transactions from duplicative regulation.

Moreover, the industry-wide exemption process should take place well before the effective date of the Act, and should include input from the regulators who approved the tariffs, as well as industry-wide input and public hearings on any transactions for which the CFTC does NOT intend to grant an exemption. The public interest invoked in Section 722(f) of the Act echoes the "public interest" mission of FERC described in Section IE above -- the public interest in reliable natural gas and power, delivered to the American public at just and reasonable rates. The NFP Energy End Users will continue to need to engage in tariff transactions the day after the

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storage contracts, are commercial transactions which should in almost all circumstances be excluded from the CFTC's jurisdiction under the CEA's forward contract exclusion(s).

Act's effective date in order to deliver energy to their customers. They cannot be left to wonder if these products will be deemed "swaps" by the CFTC on that effective date or retroactively at some later date.[7] After the effective date, there should be a clear and expeditious process whereby such exemptions will be filed by the entity or regulator authorized to approve the tariff, and promptly acted upon by the CFTC, to enable the tariff energy markets to continue to function with a focus on the public interest in delivering reliable and affordable energy delivered to the American consumer.

3. FPA 201(f) Transactions -- Exemption Process

The Coalition requests that the CFTC grant a blanket exemption from all aspects of the Act for all transactions between entities exempted from FERC regulation under Section 201(f) of the Federal Power Act.[8] These transactions are between entities in the public power and cooperative community, with no possibility of or incentive for profit at the counterparty's expense. They facilitate the public power system's, or the electric cooperative system's, public service mission, and have been generally exempt from most aspects of FERC jurisdiction for decades on the express understanding and regulatory determination that they are critical to the delivery of power to the American consumer, and do not represent an opportunity to profit to the detriment of either the counterparty or the ultimate consumer. These transactions are clearly distinguishable from transactions between independent arm's length for-profit parties.

B. DEFINITION OF "SWAP DEALER"

The Coalition agrees with the comments and recommendations made regarding the definition of "swap dealer" by the Edison Electric Institute in its letter to the CFTC dated September 20, 2010.

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[7] To be clear, the NFP Energy End Users believe such transactions should NOT be considered "swaps," as this would introduce burdensome, costly, duplicative and potentially conflicting regulation.

[8] FPA Section 201(f) can be found at 16 U.S.C. § 824, and states as follows:

(f) United States, State, political subdivision of a State, or agency or instrumentality thereof exempt. No provision in this subchapter shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

C. DEFINITION OF "MAJOR SWAP PARTICIPANT"

The Coalition agrees with the comments and recommendations made regarding the definition of "major swap participant" by the Edison Electric Institute in its letter to the CFTC dated September 20, 2010. We agree with EEI's request that the CFTC define the term "commercial risk" for purposes of the definition of "major swap participant" and for consistent use throughout the CEA, as amended by the Act. We recommend the following definition:

> (___) **Commercial Risk**. This term means any risk that a person or governmental entity incurs, or anticipates incurring, in connection with operating a commercial business as distinguished from a financial entity, including, but not limited to: commodity risk; market risk, credit risk; operating risk; transportation and storage risk; liquidity risk; financial statement risk; regulatory risk; and any other risk that can be hedged or mitigated with a swap. Hedging and mitigating commercial risk does not include any activity undertaken to assume the risk of changes in the value of a commodity.

D. DEFINITION OF "ELIGIBLE CONTRACT PARTICIPANT"

1. "Eligible Contract Participants" that are also "Eligible Commercial Entities"

Under the changes to the CEA effected by the Act, it is unlawful for any person who is not an eligible contract participant ("ECP") to enter into a swap, unless the swap is entered into on a designated contract market. The NFP Energy End Users are public power and public gas entities, or electric cooperatives, that operate electric energy or natural gas utility businesses. They currently engage in contracts, agreements and transactions in energy and energy related "exempt commodities," which may or may not be determined to be "swaps" under the Act's sweeping definition. The NFP Energy End Users engage in such transactions in the course of their everyday commercial businesses to fulfill their obligation to deliver energy to retail consumers and to hedge, mitigate or manage commercial risk. It would not be cost-effective to conduct all their hedging transactions on an exchange. But some of these NFP Energy End Users do not meet the financial hurdles established in the definition of ECP due to their status as electric cooperatives or public power or gas entities. See the third paragraph of Section IE above. Accordingly, it is important that the CFTC confirm that such commercial entities qualify as ECPs, so that they can continue to engage in transactions which may be "swaps" under the Act, without transacting on an exchange. The NFP Energy End Users and other commercial entities will also need to be able to confirm the CFTC's interpretation to their counterparties and prospective counterparties.

For electric cooperatives, the relevant portion of the definition of "eligible contract participant" is found in clause (v) of Section 1a(18) of the CEA, which reads as follows:

> (v) _A corporation, partnership, proprietorship, organization, trust or other entity_
>
> (I) That has total assets exceeding $10,000,000;
>
> (II) The obligations of which under an agreement, contract, or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by an entity described in subclause (I), in clause (i), (ii), (iii), (iv), or (vii), or in subparagraph (C); or
>
> _(III) That --_
>
> _(aa) Has a net worth exceeding $1,000,000; and_
>
> _(bb) Enters into an agreement, contract, or transaction in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity's business;_ (_Emphasis added_)

Under this definition, an electric cooperative can qualify as an ECP if it has $1,000,000 net worth and engages in transactions to manage commercial risk. But some of the smallest NFP Energy End Users may not meet the financial test due to their status as a consumer-member owned entity. But such a small electric cooperative would meet the definition of "eligible commercial entity" ("ECE") but for the requirement that an ECE must also be an ECP. See below. Accordingly, we request that the CFTC interpret the definition of ECP so as to include electric cooperatives that satisfy any one of the criteria in clauses (i), (ii) or (iii) of Section 1a(17)(A) of the CEA.

For governmental entities who engage in the delivery of natural gas and/or power, the relevant portion of the definition of "eligible contract participant" is found in clause (vii) of Section 1a(18) of the CEA, which reads as follows:

> (vii) (I) _a governmental entity (including the United States, a State, or a foreign government) or political subdivision of a governmental entity;_ (II) a multinational or supranational government entity; or (III) _an instrumentality, agency, or department of an entity described in subclause (I) or (II);_
>
> except that such term does not include an entity, instrumentality, agency, or department referred to in subclause (I) or (III) of this clause unless (aa) the entity, instrumentality, agency, or department is a person _described in clause (i), (ii), or (iii) of_

> *paragraph (17)(A)*[9]; (bb) the entity, instrumentality, agency, or department owns and invests on a discretionary basis $50,000,000 or more in investments; or (cc) the agreement, contract, or transaction is offered by, and entered into with, an entity that is listed in any of subclauses (I) through (VI) of section 2(c)(2)(B)(ii). *(Emphasis added)*

Under this definition, a public power or gas entity can qualify as an ECP if it qualifies as an ECE under Section 1a(17)(A)(i), (ii) or (iii).[10]

Each of the criteria in Section 1A(17)(A)(i), (ii) and (iii) is independent of the others, and a public power and/or gas entity can qualify as an ECE, and therefore an ECP, if it meets any one of them. We believe that a public power or gas entity that distributes electric energy or natural gas to the public at retail as its commercial business clearly meets the criteria found in Section 1a(17)(A)(i)-(iii) of the CEA in that it "has a demonstrable ability, directly or through separate contractual arrangements, to make or take delivery of the underlying commodity," and/or it "incurs risks, in addition to price risks, related to the commodity."

Finally, in clause (C) of the definition of ECP, the CFTC is given the authority to determine that any other person may be an ECP "in light of the financial or other qualifications of the person."

We respectfully request the CFTC to confirm that a public power or gas entity that meets one or more of the criteria set forth in Section 1a(17)(A)(i)-(iii) automatically qualifies as an ECP, regardless of its size or the value of assets that it owns or invests on a discretionary basis. In addition, we respectfully request that the CFTC determine, as permitted by Section 1a(18(C) of the CEA, that an electric cooperative that enters into a transaction to hedge, mitigate or

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9 See definition of "eligible commercial entity," below.

10 The relevant section defining an "exempt commercial entity" reads as follows:

"The term 'eligible commercial entity' means, with respect to an agreement, contract or transaction in a commodity -- (A) *an eligible contract participant described in clause . . . (v)[electric cooperative] . . . or (vii)[public power and/or gas entity] . . . of paragraph (18)(A) that, in connection with its business --*

(i) *has a demonstrable ability, directly or through separate contractual arrangements, to make or take delivery of the underlying commodity;*

(ii) *incurs risks, in addition to price risk, related to the commodity*; or

(iii) [not relevant to NFP Energy End Users]." *(Emphasis added)* manage commercial risk associated with its business and meets one or more of the criteria set forth in Section 1a(17)(A)(i)-(iii) automatically qualifies as an ECP regardless of its net worth.

2. Related Comments Regarding Treatment of "Special Entities"

Although the CFTC has not, at this time, sought comments on the definition of "Special Entity," due to the interrelationship of this definition with the definition of "eligible contract participant," we submit these comments here and plan also to submit them to the CFTC's Task Force charged with Regulation of Swap Dealers and Major Swap Participants. The NFP Energy End Users must rely on the CFTC's staff to be mindful of the interrelationship of all of the regulations. We understand the complexity of the CFTC staff's challenge under the tight statutory timeframe for rule-makings. But the complexity of the provisions of the Act, and the lack of clarity as to how the various sections were meant to work both together and with the CEA as in effect prior to the Act, creates a challenge for NFP Energy End Users who are struggling to understand whether, how and why this new regulatory scheme will apply to their commercial businesses.

The term "special entity" is defined in the Act to include, among other entities, a State, State agency, city, county, municipality, or other political subdivision of a State. The Act imposes new duties on swap dealers and major swap participants in their dealings with special entities.

The Coalition believes that it is not necessarily an advantage to be treated as a special entity. To the extent that swap dealers or major swap participants face higher costs when dealing with special entities, they may choose not to deal with special entities for certain types of transactions, or they may increase the fees that they (directly or indirectly) charge special entities for engaging in swap transactions. We believe that an entity that is both an ECP and a special entity should be able to "opt out" of the protections afforded by whatever duties the CFTC may establish for swap dealers and major swap participants in their dealings with special entities. This approach is consistent with the traditional CEA use of the ECP definition, which identifies an ECP by financial strength and permits the ECP to act for itself in the exempt markets. It is also consistent with other provisions of the Act in which ECPs are allowed to engage in certain types of transactions that retail customers or smaller entities are not. This proposal would also be consistent with the ability that end users have to opt out of mandatory clearing for their swap transactions.

If the CFTC does not accept our recommendation that all ECPs should be able to opt out of being treated as a special entity, then at the very least an eligible commercial entity should not be treated as a special entity with respect to transactions in the commodities in respect of which the eligible commercial entity operates a commercial business. For example, a public gas or power entity that operates commercial businesses distributing natural gas and/or electric energy to retail consumers would potentially be both an eligible commercial entity (and so an ECP) and a special entity as those terms are defined under the CEA, as amended by the Act. In our view, the very fact that the public power entity is engaged in a commercial business activity involving the distribution of natural gas or electric energy means that it is not appropriate to treat the public power entity as a special entity with respect to swap transactions intrinsically related to its commercial energy activities. Being treated as a special entity would most likely make it more difficult (and certainly more expensive) for the public power or natural gas entity to engage in the types of hedging transactions it needs in order to protect against the risks associated with its commercial activities.

III. CONCLUSION

The Coalition strongly encourages the CFTC and the SEC to consider the effect on end users of "swaps" at every step of the regulatory rulemaking process. We respectfully request that, as the CFTC drafts its rules, it carefully consider the consequences to those who operate commercial businesses and are drawn into this new regulatory environment only because of the broad statutory language which could be read to redefine traditional commercial contracts as "swaps." All of the NFP Energy End Users' natural gas, electric energy and energy-related transactions are intrinsically tied to the physical commodities they deliver to American businesses and consumers -- there is no speculation and, given the NFP Energy End Users' not-for-profit public service business, they have no incentive to speculate. NFP Energy End Users transact only to obtain and deliver energy to retail consumers and to manage commercial risks, so that the ultimate cost of reliable natural gas and electric energy to consumers is as low and predictable as possible, consistent with their environmental stewardship standards. Any new regulatory burdens, direct or indirect costs or requirements will result, dollar for dollar, in higher costs to the NFP Energy End Users' customers and owners -- approximately 87 million (electric) and 5 million (gas) American retail consumers of electric energy and natural gas.

The NFP Energy End Users do not pose a threat to the United States banking or financial system. It was not Congress' intent that the Act should impose regulatory burdens on commercial business by treating them like the financial market professionals who participate voluntarily in CFTC-regulated markets. Regulatory policy-making and rule-making must be tailored to achieve Congressional objectives without creating uncertainty as to who will be regulated and what transactions will be regulated once the effective date for the Act arrives. The rules should be tailored to fit the differing market structures, and to exclude, exempt or treat appropriately, the business entities that engage in commercial transactions which might be determined to fall within the Act's sweeping new definitions.

If the CFTC decides not to clarify whether its regulations under the Act extend to commercial transactions that electric cooperatives and public power and gas systems utilize in their everyday business, the NFP Energy End Users respectfully request that an analysis be performed (pursuant to rule-making and with an opportunity for public hearing) on the potential impact of such regulations on "small entities" under the Regulatory Fairness Act, as noted above, to determine whether less burdensome alternative forms of regulation can be developed for small entities.

Respectfully yours,

THE "NOT-FOR-PROFIT ENERGY END USER COALITION"

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: ______________________
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: ______________________
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

AMERICAN PUBLIC GAS ASSOCIATION

By: ______________________
Dave Schryver
Executive Vice President

LARGE PUBLIC POWER COUNCIL

By: ______________________
Name: ______________________
Its: ______________________

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

David Stawick, Secretary
September 20, 2010
Signature Page

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Finance Task Force

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (File Number S7-12-10 or S7-16-10 (unclear in the Federal Register Notice) – filed by e-mail per Federal Register Notice

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September 20, 2010

VIA E-MAIL: dfadefinitions@cftc.gov

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (August 20, 2010)

Dear Mr. Stawick:

The Edison Electric Institute ("EEI") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") and Securities and Exchange Commission's August 20, 2010, Advance Notice of Proposed Rulemaking (the "Advance Notice") regarding key definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1]

As the agencies begin the process of implementing the Dodd-Frank Act through an unprecedented series of complex and interrelated rulemakings, EEI appreciates the opportunity to provide the CFTC in particular with its views on the impact that certain key definitions, including the definitions of "swap," "swap dealer," and "major swap participant," potentially will have on the business operations of physical energy companies and other commercial end users of commodity swaps. Because EEI's members use, process, produce and market energy commodities, our comments focus primarily on the commodity-related aspects of the key definitions. EEI respectfully requests that the Commission define these key terms in a manner that, consistent with Congress's intent, exempts end users and their hedging transactions from additional regulatory requirements that could materially increase the costs that they and their customers will incur.

I. Description of EEI and its Interest in the Advance Notice

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry.

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[1] Pub. L. No. 111-203 (2010) (to be codified as an amendment to the Commodity Exchange Act in scattered sections of 7 U.S.C. ch. 1 (the "Commodity Exchange Act" ("CEA")) ("Dodd-Frank Act").

EEI also has more than 65 international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members.

Organized in 1933, EEI works closely with all of its members, representing their interests and advocating equitable policies in legislative and regulatory arenas. EEI provides public policy leadership, critical industry data, market opportunities, strategic business intelligence, conferences and forums covering all aspects of the electricity industry, and various products and services to serve the needs of our members and other participants in the electricity industry.

As end users of commodity swaps that are used to hedge commercial risk, EEI's members have a significant interest in how the Commission defines all of the key terms listed in its Advance Notice, but particularly the definitions of "swap," "swap dealer," and "major swap participant." EEI's members are not financial entities. Rather, the typical EEI member is a medium-size electric utility with relatively low leverage and a conservative capital structure.[2] Nevertheless, the way in which the CFTC defines and interprets the key definitions will have a direct and substantial impact on how our members manage their commercial risk. Regulations that make effective risk management options more costly for end users of swaps will make providing consumers with reliable energy more expensive throughout the country.

II. Definition of a "Swap"

A. The Commission Should Interpret the Exclusion from the Definition of a "Swap" and the Forward Contract Exclusion Consistently

The Dodd-Frank Act excludes from the definition of a swap any "sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled."[3] This exclusion parallels the long-standing Commodity Exchange Act ("CEA") exclusion of "any sale of any cash commodity for deferred shipment or delivery" from the definition of "future delivery," commonly known as the forward contract exclusion.[4]

Although there is no definitive list of the elements of a physical commodity forward contract, the Commission and the courts have identified the following important characteristics of a forward contract:

- The contract must be between two commercial parties (*e.g.*, a producer, processor, merchandiser, or commercial user of the commodity) that incur risks related to the underlying physical commodity;

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[2] Many EEI members are subject to substantial state regulatory requirements that impose, among other things, significant leverage limitations and minimum capital requirements.

[3] Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(47)(B)(ii)). The exclusion from the definition of a swap in the Dodd-Frank Act refers to the "sale of a nonfinancial commodity." *Id.* Although "nonfinancial commodity" is not defined in the CEA or the CFTC's regulations, EEI presumes that this term is synonymous with commodities that underlie physically settled transactions (*e.g.*, exempt commodities and agricultural commodities).

[4] CEA § 1a(19) (2010). The CEA grants the Commission exclusive jurisdiction over, among other contracts, "transactions involving contracts of sale of a commodity for future delivery." *Id.* § 2(a)(1)(A). However, the CEA limits the Commission's jurisdiction by defining the term "future delivery" to exclude forward contracts.

- The parties to the contract must have the capacity to make or take physical delivery of the underlying commodity;
- The material economic terms (*e.g.*, price, delivery point, duration, credit support, etc.) of the contract must be individually negotiated; and
- The contract must contain a binding delivery obligation.[5]

The commercial and physical characteristics of forward contracts distinguish them from swaps.[6] Therefore, to provide to provide the same legal certainty for physical energy and other commodity contracts in the new regulatory regime, the Commission should interpret the statutory exclusion from the definition of swap and the forward contract exclusion consistently.

Congress plainly intended the Commission and the courts interpret and apply the statutory exclusion from the definition of swap consistently with long-established precedent regarding the forward contract exclusion in the definition of future delivery. In a letter addressed to Representatives Barney Frank and Collin Peterson, Senators Christopher Dodd and Blanche Lincoln, Chairmen of the Senate banking and agricultural committees and principal drafters of the derivatives title (the "Dodd-Lincoln Letter"), confirmed that Congress intended for these two exclusions be interpreted in the same way:

> Congress encourages the CFTC to clarify through rulemaking that the exclusion from the definition of swap for 'any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled' *is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and the CFTC's established policy and orders on this subject.*[7]

In other words, Congress intended that there be a single legal standard for identifying which forward contracts are excluded from the Commission's jurisdiction, and that the single standard be based upon existing precedent under the forward contract exclusion.

Without legal certainty as to the regulatory treatment of their forward contracts, EEI's members and other end users who rely on the forward contract exclusion likely will face higher transaction costs due to greater uncertainty. These increased transaction costs may include: (i) more volatile or higher commodity prices; and (ii) increased credit costs, in each case caused by changes in market liquidity as end users change the way they transact in the commodity

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[5] *See*, *e.g.*, Exemption for Certain Contracts Involving Energy Products, 58 Fed. Reg. 21,286, 21,294 (Apr. 20, 1993); Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39,188, 39,192 (Sept. 25, 1990); Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options, 50 Fed. Reg. 39,656 (Sept. 30, 1985) (Interpretive Statement of the Office of the General Counsel, CFTC).

[6] For example, a standardized physical transaction, such as a sale of around-the-clock firm (LD) electricity executed in the wholesale power market, is not a swap.

[7] 156 Cong. Reg. H5249 (daily ed. Jun. 30, 2010) (Letter from Sen. Christopher Dodd and Senator Blanche Lincoln to Rep. Barney Frank and Rep. Collin Peterson ("Dodd-Lincoln Letter")) (emphasis added).

markets.[8] A single regulatory approach that uses the same criteria to confirm that a forward contract is excluded from the Commission's jurisdiction over swaps and futures will reduce this uncertainty and the associated costs to end users.

B. The Commission Should Clarify that Forward Contracts will not be Characterized as Swaps Solely Because the Parties Subsequently "Book-Out" Their Delivery Obligations for Commercial Efficiency and Convenience

A "book-out transaction" is a second agreement between two commercial parties to a forward contract that find themselves in a delivery chain or circle at the same delivery point.[9] When commercial parties "book out" a transaction, they agree to settle their delivery obligations (but not their other obligations) by exchanging a net payment (based on price differences).[10] By allowing the parties to a forward contract to financially settle their delivery obligations to one another rather than actually making or taking delivery of the physical commodity, book-outs eliminate the often substantial transaction costs associated with physical settlement. Significantly, no party to a forward contract is required to agree to book-out a transaction.[11] As a result, the parties to a forward contract retain all of the risks and obligations associated with making or taking delivery of a physical commodity until either a book-out is agreed or physical settlement occurs.[12]

Prior to the passage of the Dodd-Frank Act, the CFTC made clear that the forward contract exclusion encompasses booked-out forward transactions.[13] The CFTC recognized that an evolving commercial landscape necessitated more sophisticated forward contracts that "serve the same commercial functions as the forward contracts which originally were the subject of the [forward contract exclusion] notwithstanding the fact that, in specific cases and as separately agreed to between the parties, the transactions may ultimately result in performance through payment of cash as an alternative to actual physical transfer or delivery of the commodity."[14]

In its 1990 Statutory Interpretation, the CFTC explained that in the case of a book-out transaction, if the original contract is entered into between commercial participants in connection with their businesses and imposes specific delivery obligations on the parties, the forward

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8 Wholesale forward contracts for electricity and natural gas are already subject to pervasive regulation by the Federal Energy Regulatory Commission ("FERC") or the Electric Reliability Council of Texas. *See e.g.*, 16 U.S.C. §§ 825f and 825j. By interpreting the forward contract exclusions from the definitions of swap and future delivery consistently, the Commission will promote the efficient and predictable functioning of these physical markets.

9 Exemption for Certain Contracts Involving Energy Products, 58 Fed. Reg. at 21,294; Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,192.

10 Paul Horsnell and Robert Mabro, OIL MARKETS AND PRICES: THE BRENT MARKET AND THE FORMATION OF WORLD OIL PRICES 41 (1993).

11 Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,192.

12 *See id.*

13 *See* Exemption for Certain Contracts Involving Energy Products, 58 Fed. Reg. at 21,294; Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,192.

14 *In re* Bybee, 945 F.2d 309, 314 (9th Cir. 1991).

contract exclusion still applies.[15] The CFTC emphasized the creation of an enforceable delivery obligation, noting that "any party that is in a position in a distribution chain that provides for the opportunity to book-out with another party or parties in the chain is nevertheless entitled to require delivery of the commodity to be made through it, as required under the contracts."[16] Because of this delivery obligation and the fact that subsequent book-out transactions are individually-negotiated, separate agreements, the CFTC has consistently concluded that booked-out forward contracts are excluded from its jurisdiction.[17]

Like the CFTC, the Federal Energy Regulatory Commission ("FERC") treats book-outs as physical transactions. Consistent with the CFTC's precedent, FERC has defined a book-out transaction as "the offsetting of opposing buy-sell transactions" where "[t]he buyer, seller, price, quantity and other agreement details in such agreements *are indistinguishable from those in any other [physical] power sale agreement*."[18] As with all other "sales for resale" of electricity in interstate commerce, FERC requires all sellers of wholesale power to report book-out transactions on their Electronic Quarterly Reports. According to FERC, unlike "purely financial transactions," book-outs (and the transactions that underlie them) are subject to its jurisdiction because they are agreements that "obligate the parties to deliver power at a specified price and, but for the subsequent offsetting power sales, transmission of power would be made."[19] In other words, whether or not they are booked-out, wholesale power forward contracts are sales of a non-financial commodity for deferred shipment or delivery.

Consistent with Commission precedent and commercial practice, Congress specifically intended for book-outs to continue to be treated as forward contracts and, therefore, excluded from the definition of swap. Notably, Representative Collin Peterson, Chairman of the House Committee on Agriculture, explained that with respect to forward contracts and book-outs, Congress intended *for nothing to change*:

> My interpretation of the exclusionary provision from the definition of swap … is that the exclusion would apply to transactions in which the parties' delivery obligations are booked-out…. The fact that the parties may subsequently agree to settle their obligations with a payment based on a price difference through a bookout does not turn a forward contract into a swap. Excluding physical forward contracts, including book-outs, is consistent with the CFTC's longstanding view that physical forward contracts in which the parties later agree to book-out their delivery obligations for commercial

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15 Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,192.

16 *Id.*

17 *See, e.g.*, CFTC Staff Letter Re: Contract Market Resignation, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. ¶ 27,970 (CFTC Dec. 16, 1999); Exemption for Certain Contracts Involving Energy Products; 58 Fed. Reg. at 21,294; Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,192.

18 Revised Pub. Utility Filing Requirements, Order No. 2001, 67 Fed. Reg. 31,043, at 31,062, FERC Stats. & Regs. ¶ 31,127 (2002) (emphasis added).

19 *Id.* at 31,063.

> convenience are excluded from its jurisdiction. *Nothing in this legislation changes that result with respect to commercial forward contracts.*"[20]

Forward contracts are neither futures nor swaps, and, therefore, should remain excluded from the CFTC's jurisdiction. Regulating forward contracts that are subsequently booked-out as swaps would result in significant uncertainty and instability in the physical commodity markets. For example, if forward contracts somehow are transformed into swaps the moment they are booked out, the parties to the swap could potentially (and retroactively) become subject to registration, capital, margin, reporting and other requirements that will be difficult to satisfy, particularly if a considerable amount of time has passed since the original forward contract was executed. Although these regulatory requirements may be appropriate for mitigating risk among financial institutions, they are unnecessary and incompatible with the structure and operations of most commercial enterprises. Congress excluded forward contracts, including those in which the delivery obligations of the parties later are booked-out, from the definition of swap precisely to avoid this result.[21]

C. The Commission Should Clarify that Option Contracts that Settle into Forward Contracts are not Swaps

Commodity option contracts that settle into physically-settled spot contracts or forward contracts are not swaps because, if exercised, they are contracts for the "deferred shipment or delivery" of a commodity that contain binding physical delivery obligations. Like forward contracts, options that settle into spot or forward contracts are used widely by commercial end users to manage price and supply risk. The only material difference between physically-settled options and forward contracts is that, in an option contract, only the option holder has the right (but not the obligation) to require the other party to make or take physical delivery. This difference is not sufficient to justify distinguishing forward contracts and options on forward contracts for purposes of the definition of swap, particularly given the similar ways in which commercial end users use these closely related transactions in practice.

Forward contracts and options that settle into spot or forward contracts provide end users with valuable tools for managing the price risk and other uncertainties associated with their commercial operations. For example, a power marketing company may acquire the capacity of a power plant by purchasing a call option that gives it the right (but not the obligation) to require the writer of the option to deliver energy from the plant at a specified price at any time before the option expires. If the power marketer never exercises its call rights, it has made a payment with no resulting physical delivery of a product, but the option remains a fundamentally physical transaction. At any time before the option expires, the option holder has the absolute right to call for physical delivery of energy. The right to call for physical delivery is consistent with the forward contract exclusion. The Commission should exclude both types of transactions from the definition of swap to ensure that they remain viable risk management tools for end users.

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20 156 Cong. Rec. H5247 (daily ed. Jun. 30, 2010) (statement by Rep. Peterson) (emphasis added).

21 *See id.*

III. End Users Should be Excluded from the Definitions of "Swap Dealer" and "Major Swap Participant"

EEI urges the Commission to ensure that the definitions of swap dealer and major swap participant exclude end users of derivatives. In the text of the Dodd-Frank Act and in numerous statements made by members during the legislative debate, Congress made clear that end users should not be regulated as swap dealers or major swap participants. Notably, the Dodd-Lincoln Letter explained:

> In implementing the Swap Dealer and Major Swap Participant provisions, Congress expects the regulators to maintain through rulemaking that the definition of Major Swap Participant does not capture companies simply because they use swaps to hedge risk in their ordinary course of business. *Congress does not intend to regulate end-users as Major Swap Participants or Swap Dealers just because they use swaps to hedge or manage the commercial risks associated with their business.* For example, the Major Swap Participant and Swap Dealer definitions are not intended to include an electric or gas utility that purchases commodities that are used either as a source of fuel to produce electricity or to supply gas to retail customers and that uses swaps to hedge or manage the commercial risks associated with its business.[22]

End users rely on cost-effective swaps to hedge and manage the commercial risk associated with their business activities. If end users are categorized as swap dealers or major swap participants, they will be subject to extensive new regulatory requirements, including the requirement to clear virtually all of their swap transactions, including swaps that they use to hedge or mitigate commercial risk.[23] The increased costs of clearing and complying with other new regulatory requirements would substantially reduce the ability of most end users to manage their commercial risk efficiently and economically.

Congress excluded end users from the definitions of swap dealer and major swap participant because they do not contribute to systemic risk and because it would be inappropriate to subject end users to the same the regulatory requirements as swap dealers and major swap participants. Consistent with Congress's intent, the Commission should clearly exclude end users from the definitions of swap dealer and major swap participant.

A. The Definition of "Swap Dealer" Should Exclude End Users

The Dodd-Frank Act defines a swap dealer broadly to include any entity that holds itself out as a dealer in swaps, makes a market in swaps, regularly enters into swaps with counterparties in the ordinary course of business for its own account, or is commonly known as a swap dealer.[24] The Commission should propose a definition of swap dealer that unambiguously excludes end users. Unlike a traditional "dealer" that typically is willing to take either side of a

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22 156 Cong. Rec. H5248 (Dodd-Lincoln Letter) (emphasis added).

23 Many end users are pervasively regulated by FERC and subject to credit provisions and business conduct standards set forth in FERC's regulations and each entity's governing tariff.

24 Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(49)).

swap in an effort to profit from the trade itself, most end users only "trade" swaps in order to hedge commercial risks associated with an underlying physical commodity position.[25] The Commission has distinguished between "dealing" and "trading," recognizing that each activity is undertaken by market participants for a different purpose and each has a fundamentally different impact on the operation and integrity of the market itself.[26] The Commission should make this same distinction here and exclude end users that predominantly use swaps to hedge the commercial risk associated with their businesses from the definition of swap dealer.

1. "Holds Itself Out"

The Commission should clarify that an end user (or an affiliate of an end user) that uses swaps to hedge or mitigate its own (or an affiliate's) commercial risk does not "hold itself out" as a swap dealer for any class of swaps unless it *actively and continuously* markets itself as a dealer to the general public. The Commission has addressed the meaning of "holding oneself out" in the context of the definition of "commodity trading advisor," explaining that an entity "holds itself out" if it engages in outward marketing activities, including: promoting itself through mailings, directory listings, and stationery, or otherwise initiating contacts with prospective clients.[27] The Commission similarly should limit the definition of a swap dealer to entities that affirmatively market themselves as dealers.

2. "Makes a Market"

"Market making" activity is generally a hallmark of a "dealer." The Commission should clarify that an end user (or an affiliate of an end user) that uses swaps to hedge or mitigate its own (or an affiliate's) commercial risk does not "make a market" for any class of swaps unless it *actively and continuously* offers to buy and sell swaps.

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25 An energy end user is primarily a "trader" in commodity derivatives, engaging in swaps transactions in order to hedge underlying business risks associated with a physical commodity. In contrast, a "dealer" will take the opposite side of a swap transaction with an end user customer as a service to that customer and as part of its core business model. The dealer will typically "flatten" the position incurred in the transaction with the end user customer via an offsetting swap or futures transaction. Therefore, dealers are usually indifferent as to whether they are long or short in a particular market. Notably, the Commission recognized the unique nature of dealing activities recently in the July 2010 Traders in Financial Futures Report ("TFF Report") (available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tfmexplanatorynotes.pdf). The TFF Report separates large traders into four classifications, one of which is "Dealer/Intermediary." In describing the Dealer/Intermediary, the Commission states in the TFF Report that they "design and sell various financial assets to clients," and that they "tend to have matched books or offset their risks across markets and clients." End users fall outside of this description.

26 For example, the TFF Report distinguishes between "Dealer/Intermediary" activities, such as selling financial products, capturing bid/offer spreads, and otherwise accommodating clients, and all other market activities, which include investing, hedging, managing risk, speculating, and changing the term structure or duration of assets.

27 Interpretive Letter No. 91-9, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,189 (CFTC Dec. 30, 1991). The Division of Trading and Markets has consistently continued to employ this view. *E.g.,* No-Action Letter No. 02-59, Comm. Fut. L. Rep (CCH) ¶ 29,063 at *17 n.22 (CFTC May 17, 2002); Interpretive Letter No. 97-26, Comm. Fut. L. Rep. (CCH) ¶ 27,026 at *2 (CFTC March. 26, 1997); Interpretive Letter No. 96-72, 1996 CFTC Ltr. LEXIS 123 at *2 (CFTC Oct. 15, 1996); No-Action Letter No. 95-38, Comm. Fut. L. Rep. (CCH) ¶ 26,379 at *3 (Dec. 5, 1994).

The fact that an entity both buys and sells commodity swaps consistent with the economics of its commercial business should not be sufficient to treat such an entity as "making a market." For example, owners of electric generating assets in markets that are not overseen by a regional transmission organization often manage price risk associated with future purchases and sales on a portfolio basis. Because some generating assets are more efficient than others, and because a single power plant is more efficient at certain levels of output, such assets can be modelled and risk-managed according to their marginal (*i.e.*, per-unit of electricity) cost of production. Typically, at any given level of expected production (which corresponds to its forecast of customer demand), each unit of additional electricity produced is more expensive than the preceding unit.

Generators can minimize their total costs (and the overall price of electricity paid by their retail customers) by either buying from or selling to the market when doing so is economical. In this example, a generator can reduce its overall operating costs by: (1) buying power from the market (including the market for financially-settled electricity swaps) when the market price is lower than its marginal cost to increase production;[28] and (2) selling power into the market when the market price is higher than its marginal cost to decrease production. As a direct result of its variable marginal costs and demand obligations, a generator is commonly willing to "buy low and sell high" due to changes in its portfolio of positions or to optimize the value of its assets.

In order to protect their retail customers against volatile prices, EEI's members and other power and gas producers must be able to buy and sell swaps based on notional quantities of power, gas and other fuels in order to manage their production costs. Such practical use of derivatives does not constitute "making a market" or "dealing" in swaps, and should not cause energy companies to fall within the definition of swap dealer.[29]

3. "Regularly Enters into Swaps with Counterparties as an Ordinary Course of Business for its Own Account"

The Commission should clarify that an entity "regularly enters into swaps with counterparties as an ordinary course of business for its own account" only if its primary business is "dealing" in swaps, as that term is commonly known in the commodity trade. As the Commission has explained in the context of power marketers in the electric power industry: "[a dealer] *does not in the normal course of business hedge or speculate in electricity markets*… [but rather] routinely engage[s] in both buying and selling, including with other [dealers and] power marketers."[30] End users enter into swaps for precisely the *opposite* purpose. Accordingly, the Commission should define swap dealer to explicitly exclude an end user (or an affiliate of an end user) that primarily uses swaps to hedge or mitigate its own (or an affiliate's) commercial risk.

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28 In this case, the generator would actually buy from the spot market, but receive a fixed price from its swap counterparty over the life of the swap.

29 This is true even in less liquid markets where commercial entities may represent a significant percentage of the overall swap activity. Even though an end user may buy and sell in such a market, it is not "making a market," and therefore, should not automatically be characterized as a swap dealer.

30 CFTC No-Action Letter No. 99-67, Comm. Fut. L. Rep (CCH) ¶ 27, 970 (CFTC Dec. 16, 1999).

If the Commission reads this provision literally and treats *any* entity that regularly enters into swaps as part of its business as a swap dealer, without regard as to whether an entity is in fact "dealing" in swaps, virtually every end user that uses swaps primarily to hedge or mitigate commercial risk will be forced to register as a swap dealer. Such an overbroad interpretation would make other provisions of the Dodd-Frank Act meaningless, especially the end user clearing exception. Congress made clear that it did not intend this result.[31]

For the same reason, an entity that, for operational efficiency or convenience, regularly enters into swaps to hedge or mitigate the commercial risk of an end user affiliate should not be treated as a swap dealer.[32] For example, a centralized hedging affiliate that primarily acts as the counterparty to an affiliated end user's hedge transactions, and then enters into a back-to-back swaps with third-parties (whether through a portfolio of positions or otherwise) should not be regulated as a swap dealer solely due to that activity.

The Commission should clarify that an entity that regularly enters into swaps with counterparties as an ordinary course of business for its own account is only a swap dealer if its business is actually "dealing" in swaps such that it also satisfies one of the other three prongs of the swap dealer definition. End users that use swaps to hedge or mitigate commercial risk, even if they do so as an ordinary course of their business, should not be characterized as swap dealers.

4. "Engages in Activity that Causes the Person to be Commonly Known in the Trade as a Dealer or Market Maker in Swaps"

Under the fourth prong of the swap dealer definition, a person is a swap dealer if it engages in activity that causes it "to be commonly known in the trade" as a dealer or market maker in swaps. The concept of a person or a transaction being "commonly known" in or to the trade appears in several sections of the CEA.[33] Consistent with its prior precedent, the Commission should determine whether a person is "commonly known in the trade" as a swap dealer based upon the understanding of current dealers, market-makers and other participants in, as well as other persons who have substantial and demonstrable experience with or knowledge about, the market for the relevant class or category of swaps.[34] If the "commonly known"

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31 156 Cong. Rec. H5248 (Dodd-Lincoln Letter).

32 Moreover, for the same reason, such an entity should not be construed as "regularly enter[ing] into swaps with counterparties as an ordinary course of business for its own account." Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(49)(A)(iii)).

33 *See* Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(47)) (definition of "swap"); CEA § 1a(36) (definition of "option"); CEA §§ 2(a)(1)(A), 2(a)(1)(C)(ii), and 2(a)(1)(D)(i) (jurisdiction of the Commission); CEA §§ 4c(a)(2), 4c(a)(5), and 4c(b) (prohibited transactions); CEA §§ 9(c) and (d) (violations of the CEA); CEA § 19(a) (leverage contracts).

34 In *In re First National Monetary Corp. and Monex Int'l, Ltd.*, the Commission rejected, on appeal, an administrative law judge's determination that only those witnesses who were currently affiliated with the leverage transaction industry at the time of the adjudication could be considered to be members of that trade. *In re* First National Monetary Corp. and Monex Int'l, Ltd., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,698 at *8 (CFTC Aug. 7, 1985). The Commission determined that, in addition to the testimony of several persons currently affiliated with entities that were members of the leverage industry, the testimony of an economics professor and a professor of law who specialized in the economics of futures trading could be considered in the determination of whether a transaction was "commonly known to the trade" as a leverage transaction under the CEA. *Id.*

standard is properly applied, few, if any, end users should fall within this prong of the swap dealer definition.

5. The Commission Should Propose a De Minimis Exception which Excludes Entities that Engage in Limited Swap Dealing with or on Behalf of their Customers

Assuming that a company otherwise falls within one of the four prongs of the swap dealer definition for one or more categories of swaps, Congress nevertheless provided the Commission with the authority to exempt any entity that engages in "a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers" from the definition of swap dealer.[35] The purpose of the de minimis exception is, among other things, to except from the regulatory requirements that apply to companies whose principal business is swap dealing, those entities whose swap "dealing" activities are sufficiently small that they do not contribute to systemic risk. As Senators Christopher Dodd and Blanche Lincoln explained prior to enactment of the Dodd-Frank Act, "Congress incorporated a de minimis exception to the swap dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation."[36]

Congress charged the Commission with promulgating regulations that identify the "factors" that the Commission will consider in determining whether swap dealing activities are de minimis and, therefore, should be exempted from the definition of swap dealer. EEI is still considering the factors that the Commission should look to in making this determination. At a minimum, those factors should be transparent, objective and measurable, and yet sufficiently flexible so that the Commission can exempt a variety of dealing-type activities which end users and other companies engage in "with or on behalf of their customers" that Congress did not intend to capture in the definition of swap dealer.

In the energy markets, end users sometimes provide services with what some might call dealing attributes to other companies that are their customers for a variety of services. A common example is acting as counterparty to a financial hedge as an "add-on" risk management service provided to a large physical commodity customer or supplier. As long as this type of activity comprises only a small portion of a company's overall business activity, it should not cause a company that is primarily an end user of swaps to hedge commercial risk to be designated as swap dealer. Continuing with this example, to determine whether the de minimis exception applies, the Commission could measure a person's customer-oriented dealing activity against that person's entire portfolio of swap transactions, including swaps used to hedge or mitigate commercial risk. Regardless of the factors that the Commission adopts, the de minimis threshold should be large enough to exclude the swap dealing of end users that is either incidental to providing services to their customers, or a small portion of their business activity.

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35 Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(49)(D)).

36 156 Cong. Rec. H5248 (Dodd-Lincoln Letter).

B. The Definition of "Major Swap Participant" Should Exclude End Users

1. The Definition of "Substantial Position" Must Exclude Transactions that Are Used to Hedge or Mitigate Commercial Risk

The Dodd-Frank Act defines a major swap participant as any person who is not a swap dealer and who maintains a "substantial position" in swaps (excluding positions held for hedging or mitigating commercial risk), whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets, or is a highly leveraged financial entity that holds a substantial position is swaps.[37] The plain language of the definition of major swap participant makes clear that the definition of "substantial position" must exclude transactions that are used to hedge or mitigate commercial risk.

In addition, the Dodd-Frank Act further provides that:

> [T]he Commission shall define by rule or regulation the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of *entities that are systemically important or can significantly impact the financial system of the United States*. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.[38]

In connection with defining "substantial position," the Commission should define the meaning of "positions held for hedging or mitigating commercial risk," and, consequently, define "commercial risk." Section 721(b) of the Dodd-Frank Act provides that the Commission "may adopt a rule to define … the term 'commercial risk;' and … any other term included in an amendment to the Commodity Exchange Act." The term "commercial risk" is an important part of the definition of "major swap participant" and the end user clearing exception. Without a definition of commercial risk, the definition of major swap participant (and other important provisions of the Dodd-Frank Act) will be ambiguous.

The proposed definition of "commercial risk" should accommodate the risk-shifting activities of commercial enterprises and be consistent with related provisions in the CEA, including the end user clearing exception. EEI respectfully suggests that the Commission define commercial risk as follows:

> ***Commercial Risk***. This term means any risk that a person or governmental entity incurs, or anticipates incurring, related to or in connection with a commodity, or any product or byproduct of a commodity, including, but not limited to: market risk; credit risk; operating risk; transportation and storage

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37 Dodd-Frank Act § 721(a)(16) (to be codified at CEA § 1a(33)(A)). EEI does not believe that any of its members are "highly leveraged financial entit[ies] that hold a substantial position is swaps." *Id.*

38 Dodd-Frank Act § 721(a)(16) (to be codified at CEA § 1a(33) (emphasis added).

risk; liquidity risk; financial statement risk; and any other risk that can be hedged or mitigated with a swap.[39]

2. "Commercial Risk" Should Have the Same Meaning Throughout the CEA

The term "commercial risk" appears in several sections of the CEA, as amended by the Dodd-Frank Act.[40] The Commission should propose a single definition of "commercial risk" that will have the same meaning everywhere the same words are used in the statute. As a general rule of statutory interpretation, when Congress uses the same words in a single statute it should be presumed, absent evidence to the contrary, that it intended for those words to be given the same meaning wherever they are used.[41] EEI is not aware of any evidence which suggests that Congress intended the meaning of the term "commercial risk" to vary depending upon where it appears in the CEA.

As practical matter, a single, consistent definition of commercial risk is necessary to implement a commercially practicable and coherent regulatory system. For example, if commercial risk is defined more broadly for the purpose of the end user exception than for the definition of major swap participant, a company could face the following "Catch-22:" it would be permitted to rely on the clearing exception for swaps that hedge or mitigate its commercial risk, except that if such swaps cause the company to fall within the definition of major swap participant, it will be disqualified from relying on the clearing exception. This is an unreasonable result that plainly would be contrary to Congress's intent.

3. Substantial Position Should be Defined Qualitatively, Not Quantitatively

The Commission should define what constitutes a "substantial position" in swaps in terms of the risk and counterparty exposure associated with a portfolio of swap positions.[42] The Dodd-Frank Act explicitly excludes positions in swaps used "for hedging or mitigating commercial risk" from the definition of substantial position for non-financial entities.[43] Congress excluded hedging activity because it determined that transactions which hedge or

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39 Hedging and mitigating commercial risk does not include activity undertaken to assume the risk of changes in the value of a commodity.

40 CEA § 1a(19) (definition of "excluded commodity"); Dodd-Frank Act § 721(a)(16) (to be codified at CEA § 1a(33) (definition of "major swap participant")); *Id.* § 723(a) (to be codified at CEA § 2(h)(7)(A) (general requirements of the end user clearing exception)); *Id.* § 723(a) (to be codified at CEA § 2(h)(7)(D) (treatment of affiliates under the end user clearing exception)).

41 Powerex Corp. v. Reliant Energy Servs., 551 U.S. 224 (2007) ("A standard principle of statutory construction provides that identical words and phrases within the same statute should normally be given the same meaning.").

42 As Representative Collin Peterson stated, the effect of this provision is that, "[f]ew, if any, end users will be major swap participants, as we have excluded 'positions held for hedging or mitigating commercial risk' from being considered as a 'substantial position' under that definition." 156 Cong. Rec. H5248 (daily ed. Jun. 30, 2010) (statement of Rep. Peterson); *see also*, 156 Cong. Rec. S5904 (daily ed. Jul. 15, 2010) (statement of Sen. Lincoln)

43 Dodd-Frank Act § 721(a)(16) (to be codified at CEA § 1a(33)).

mitigate commercial risk are *not* associated with the risk factors that contributed to the recent financial crisis.[44]

The Commission should similarly exclude all other collateralized swaps that do not significantly increase systemic risk. As Senator Blanche Lincoln noted prior to enactment of the Dodd-Frank Act, "[b]ilateral collateralization and proper segregation *substantially reduces* the potential for adverse effects on the stability of the market. Entities that are not excessively leveraged and have taken the necessary steps to segregate and fully collateralize swap positions on a bilateral basis with their counterparties should be viewed differently."[45] Treating all swaps as equal, regardless of the quality of their counterparties and supporting collateral would result in an over-broad definition of major swap participant that might force many companies to comply with additional regulation that does little to enhance the stability or integrity of the financial system.

4. Inter-Affiliate Transactions Should Be Excluded from the Determination of Whether a Person Maintains a Substantial Position in Swaps

Inter-affiliate transactions should be excluded when determining whether a company maintains a substantial position in swaps. Many end users hedge their commercial risk through affiliated entities for operational efficiency or convenience. The end user clearing exception recognizes this common commercial practice by expressly permitting end users to enter into swaps through affiliated non-financial entities while still relying on the clearing exception.

The Commission should clarify that inter-affiliate transactions that are associated with the hedging and management of commercial risk are similarly excluded from the determination of whether a person maintains a substantial position in swaps. If hedging transactions entered into through an affiliate are included when determining whether an end user or its affiliate maintains a substantial position in swaps, end users potentially will be subject to radically different regulatory requirements based solely on how their operations happen to be structured. Congress did not intend for the Dodd-Frank Act (or the Commission) to make such an arbitrary distinction.

5. End Users are not "Systemically Important" and Cannot Significantly Impact the Financial System of the United States

The Dodd-Frank Act also defines a major swap participant as any person whose "outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets."[46] End users are objectively small participants in the swap markets who use swaps to transfer rather than to assume risk. End users *cannot* contribute significantly to systemic risk or have a "serious adverse affect" on the stability of the financial markets. As Representative Peterson stated in the

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44 *See* 156 Cong. Rec. H5245 (daily ed. Jun 30, 2010) (statement of Rep. Peterson) (noting through colloquy that Congress drafted the Dodd-Frank Act with the intent of continuing to allow end user hedging).

45 156 Cong. Rec. S5907 (daily ed. Jul. 15, 2010) (statement of Rep. Lincoln) (emphasis added).

46 Dodd-Frank Act § 721(a)(16) (to be codified at CEA §1a(33)).

Congressional record, Congress did not intend to limit the hedging activities of end users when it enacted the Dodd-Frank Act:

> In crafting the House bill and the conference report, we focused on creating a regulatory approach that permits the so-called end users to continue using derivatives to hedge risks associated with their underlying businesses, whether it is energy exploration, manufacturing, or commercial activities. End users did not cause the financial crisis of 2008. They were actually the victims of it.[47]

The Commission should clarify that end users do not contribute to systemic risk, and should expressly exclude them from the definition of major swap participant under the Dodd-Frank Act.

IV. Conclusion

EEI commends the Commission for its commitment to safeguarding the hedging and trading activities of end users of physical commodities and swaps, and looks forward to working with the Commission throughout the Dodd-Frank Act rulemaking process. As explained herein, we encourage the Commission to define the Dodd-Frank Act's key terms to exclude commercial end users. We welcome the opportunity to discuss these issues further with the Commission and its Staff.

Please contact me at (202) 508-5571, or Aaron Trent, Manager, Financial Analysis, at (202) 508-5526, if you have any questions regarding EEI's comments.

Respectfully submitted,

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SEC File Number S7–16–10

[47] 156 Cong. Rec. H5245 (daily ed. Jun 30, 2010) (statement of Rep. Peterson).