



3333 K Street, NW, Suite 110
Washington, D.C. 20007
Tel: 202-333-3288
Fax: 202-333-3266

February 22, 2011

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

**RE: RIN 3038-AD06 – Notice of Proposed Rulemaking:
Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major
Swap Participant,” “Major Security- Based Swap Participant” and “Eligible
Contract Participant” (75 Fed. Reg. 80173)**

**RIN 3038-AD10 – Notice of Proposed Rulemaking:
End-User Exception to Mandatory Clearing of Swaps (75 Fed. Reg. 80747)**

**RIN 3038-AC98 – Notice of Proposed Rulemaking:
Risk Management Requirements for Derivatives Clearing Organizations (76 Fed.
Reg. 3698)**

Dear Mr. Stawick:

The National Energy Marketers Association (“NEM”)¹ appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“Commission”) notice of proposed rulemakings (“NPR”) regarding three proposed rules – Swap Dealer definition, End User Exception to Mandatory Clearing, and Risk Management Requirements for Derivatives Clearing Organizations. These three rulemakings are commented on jointly because they all touch on the primary concerns of all our members, who are not financial entities and whose primary businesses are not dealing in swaps but rather their primary businesses are to supply physical commodity (electricity and natural gas) to serve retail consumers. Absent the clarifications of the rules as offered herein - the increase in costs to hedge the commercial risks associated with the delivery of these physical commodities to end consumers, the potential loss of liquidity in many of the markets in which we operate and the uncertainty created by an overly broad interpretation of the definition of Swap Dealer could systemically hurt the American consumers by materially harming our members’ ability to bring lower cost energy to them – especially during a time when lower cost energy can help with economic recovery.

¹ NEM is a non-profit trade association representing both leading suppliers and major consumers of natural gas and electricity as well as energy-related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM’s membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, global commodity exchanges and clearing solutions, demand side and load management firms, direct marketing organizations, billing, back office, customer service and related information technology providers. NEM members also include inventors, patent holders, systems integrators, and developers of advanced metering, solar, fuel cell, lighting and power line technologies.

Background on The National Energy Marketers Association

The National Energy Marketers Association's mission is to provide a platform to assist in creating and maintaining sustainable competitive energy markets that serves the interests of consumers. Our primary member constituency is Retail Energy Marketers (and suppliers who serve them), who sell electricity and natural gas to consumers as a competitive alternative to the local utility. Energy marketers as well as their suppliers are not financial entities and are not dealers as contemplated in the legislative history of the Dodd-Frank Legislation. The new energy services and technology industry has emerged as a means of better serving consumers with competitively priced energy and related products and technologies. As such the following legislative history to the act is instructive and it bears on the primary business model of all of our energy suppliers and their customers.

the legislation does not authorize the regulators to impose margin on end users...If regulators raise the cost of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth...Regulators must carefully consider the potential burdens that Swap Dealers and Major Swap Participants may impose on end user counterparties-especially if those requirements will discourage the use of swaps by end users or harm economic growth² (Emphasis added).

Retail Energy Marketers (REMs) primarily buy physical energy and hedges necessary to provide consumers with the physical energy they want at a price (or price structure) they want. For example, REMs often purchase wholesale physical natural gas and electricity on a spot (delivery) month (day) basis and also purchase swaps to lock in prices for any consumers who want a long-term fixed price contract. As providers of physical energy, the activities of REMs are already overseen and regulated by state Public Utility Commissions, Regional RTOs and/or the Federal Energy Regulatory Commission. Capital and credit requirements are already extremely burdensome and often duplicative.

² “See Letter from Sen. Dodd, Chairman, Committee on Banking, Housing, and Urban Affairs and Sen. Lincoln, Chairman, Committee on Agriculture, Nutrition, and Forestry to Rep. Frank, Chairman, Committee on Financial Services, and Rep. Peterson, Chairman, Committee on Agriculture (June 30, 2010).

See also, Floor colloquy between Congressman Frank, Chairman, Committee on Financial Services and Congressman Peterson, Chairman, Committee on Agriculture in response to the letter from Sen. Dodd and Sen. Lincoln. 156 Cong. Rec. H 5248 (daily ed. June 30, 2010) (colloquy between Cong. Frank and Cong. Peterson). Congressman Frank and Congressman Peterson state that the Act does not give regulators the authority to impose margin requirements on end users and that margin requirements imposed on Swap Dealers and Major Swap Participants should be structured in a way to minimize the impact on end users.

NEM has long supported clearing solutions as a means of increasing liquidity of the energy markets ³ However, Retail Energy Marketers and many of the participants that transact in the energy marketplace simply are not the intended Wall Street targets of the Dodd-Frank Act. Retail Energy Marketers were not even remotely the cause of the economic meltdown and do not currently or in the foreseeable future pose a systemic risk to the U.S. economy. Energy swaps are traditionally less than 1% of the notional value of all swaps in the US and no firm, even the collapse of Enron has caused a systemic failure.

After Enron, the energy markets recovered on their own and new markets and clearing mechanisms emerged to facilitate energy transactions in a manner that brings value, capital efficiency and added liquidity. **Dodd-Frank was clearly targeted at financial entities whose primary business is dealing in swaps.** It clearly was not intended to increase the cost and risk of capital, less liquidity and a shortage of customized energy delivery products for suppliers whose primary business is to hedge the commercial risks of the physical delivery of natural gas and electricity and are not financial entities nor dealers as those terms are commonly understood.

The Compliance Schedule Requires a Transitional Safe Harbor

As an initial matter, and notwithstanding our comments set forth herein on the applicability of the Dodd Frank Act rules to retail energy marketers (and their suppliers and customers) , NEM requests that CFTC consider a safe harbor or transitional period for compliance for affected entities. Indeed, the definitions of Swap Dealer and Major Swap Participant that provide the vehicle for the Commission to exercise its new and expanded regulatory oversight authority granted to it under Title VII have not been determined and the key term “swap” has not yet been proposed. As such, entities cannot meaningfully anticipate their potential compliance obligations until the definitions are finally adopted by the Commission. This would indicate that a July 2011 compliance timeframe would be difficult for many stakeholders to meet.

Given the significant changes that the new regulatory framework could impose, an overly aggressive compliance schedule on this industry could force many of our members out of the market for financial products that have served their needs well over the years as they may fear becoming treated as a financial entity subject to the full measure of the Commission’s regulation or not fully understand the implications of their obligations as end-users. Even to the extent that our members are consumers of customized products, entities that offered these types of products in the past may no longer do so leaving key elements of the retail energy markets without low cost hedging options for physical deliveries.

³ See NEM’s Solutions to Improve the Liquidity and Creditworthiness of the U.S. Energy Industry, January 28, 2003, available at:

http://www.energymarketers.com/Documents/Final_Clearing_Solutions_Document.pdf

See also “Clearinghouses work well when they are broadly inclusive of many members, facilitating FCMs who are part of large dealers as well as independent FCMs clearing customer transactions. Swaps clearinghouse membership should be open to parties other than derivatives dealers.”

<http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-57.html>

The Commission must afford all parties sufficient time to structure their organizations, make the requisite investments in IT systems and develop compliance plans that do not disrupt the markets. NEM suggests that once the Commission has adopted its final slate of regulations, it allow for a reasonable phase-in period that gives all market participants a realistic opportunity to comply at a reasonable cost.

If implemented properly, the Dodd Frank Act can meet its overall policy goals of protecting against “systemic risk” to the financial system and enhancing transparency in swap markets without imposing excessive burdens on these markets, or in our case, the energy markets and their participants that provide low-cost, competitive energy supplies to consumers all over the country.

In some respects, transparency that will be provided by a potential increase in clearing and exchanged traded activity will be positive. However, NEM’s general concern is that the current proposals will not only impose excessive burdens on end-users, but it will also eradicate low-cost, flexible options for hedging that our members have been able to obtain as energy suppliers.

To treat entities whose primary business is to obtain physical commodities at the lowest competitive price and to hedge the many commercial risks associated with the delivery of such commodities as financial entities under Dodd Frank will harm the suppliers and the consumers of natural gas and electricity. It will increase both the costs and risks associated with energy and create a significant loss in liquidity and a scarcity of valuable customized products associated with an entire new regime of compliance, clearing and reporting obligations intended for the financial industry.

The Energy Business is Very Cash Intensive With Many Credit and Collateral Requirements Already In Place and Regulated

The energy business is very capital intensive – typically four times that of other businesses.⁴ Thus, mandating incremental cash demands for clearing or real-time reporting systems can substantially raise the costs and risks of their core energy business and thereby raise the costs of energy to consumers as well.

The key point here is that the members of NEM are not financial entities that are primarily in the business of dealing in swaps. Swaps are used solely or primarily to hedge the commercial risks associated with the physical delivery of natural gas or electricity to end-users.

The potential loss of liquidity associated with some suppliers being incorrectly classified as swap dealers could cause the unintended consequences of severely limiting liquidity in both the physical markets as well as the cost and ability to get customized products to either hedge or assist in the physical deliveries of natural gas and electricity. NEM believes it is paramount to hold down the cash intensity of swap transactions so what is not a direct major financial systemic risk (REMs defaulting on swaps) becomes transformed into something that is a major systemic risk – energy reliability.

⁴ <http://www.fortnightly.com/result.cfm?i=/4355.cfm> “Keys to Transmission and Distribution Reliability,” Stephen W. Chapel Jonathan A. Lesser, Public Utilities Fortnightly, April, 2004.

Below we provide specific comments to help address these concerns.

Definition of Swap Dealer⁵

Under the proposed rules a Swap Dealer is considered a financial entity that is subject to among other things, mandatory clearing. **A Swap Dealer is potentially any entity that “is available to accommodate demand for swaps from other parties.”** (Emphasis added.)

NEM’s members are primarily “buyers” of swaps, not “sellers” of swaps for the purpose of hedging sales to retail customers. In contrast to swap dealers, who are generally involved in the “supply” side of the swaps market,⁶ REM members are primarily involved in the “demand” side of swaps. That is, REMs are providing the “demand” for swaps, not “accommodating the demand” from others.⁷ The demand side often involves purchases of swaps, but also involves selling off over-hedged positions that arise in the ordinary course of NEM members’ core business, i.e., unexpected weather changes or customers who wish to change supplies may place an REM in an over-hedged position which in turn requires the REM to sell the excess hedge back into the market. However, this entire transaction model is merely accommodating the demand for the physical commodity not the demand for swaps or the sale/dealing of swaps as a primary business function.

In fact, the concept of dealing under traditional securities regulations covers entities that make markets or and enter into transactions for the benefit of their counterparties or as a service to them, or to collect a fee, or benefit the market by enhancing liquidity.

NEM believes, therefore, that there should be a firm exclusion that makes it clear that unless an entity is a financial entity whose primary business function is that of a swap dealer, such entity should not be deemed to be a swap dealer. The Act and the Commission’s proposed regulations also provide that an entity transacting in a de minimis quantity of swaps or activity that could be associated with swap dealing should be exempt. The Commission proposes a hard cap on the aggregate notional value of their swaps of \$100,000,000 or fewer than 15 [wholesale swap] counterparties or fewer than 20 swaps annually as being de minimis. These standards are not appropriate for energy markets.

The Commission needs to carefully craft the types of firms that will be Swap Dealers. If it pulls in too many and makes the burdens they must pass on excessive, it will negatively impact both suppliers and consumers of energy. The de minimis exception to the

⁵ The comments in this section address proposed further definition of Swap Dealer set forth in CFTC Rule 1.3(ppp), pursuant to Section 1a(49)(A) of the Commodity Exchange Act (“CEA”), as established by Title VII, Subtitle A, Section 712(d)(1) of the Dodd Frank Wall Street Reform and Consumer Protection Act (the “Act”).

⁶ See 75 Fed. Reg. at 80,176 (i.e., Dealers “tend to accommodate demand for swaps,” are “generally available to enter into swaps or security-based swaps to facilitate *other parties’ interest*,” “tend to enter into those instruments on their own standard terms or on terms they arrange in response to *other parties’ interest*,” and “tend to be able to arrange customized terms for swaps or security-based swaps *upon request*.”).

⁷ For instance, a retail energy marketer is required to engage in swaps pursuant to its participation in wholesale electric RTO/ISO markets and wholesale gas ISDA requirements.

definition of a “swap dealer” applies to an entities’ “dealing activity.”⁸ NEM believes that the rules should clearly state that the notional amounts proposed in the de minimis rules relate to “dealing activity,” not demand activity.

Thus, NEM recommends that the Commission simplify the de minimis standard to “The swap positions connected with those activities into which the person *is a seller* over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than \$100 million,” excluding sales to swap dealers. The other two requirements (under 15 counterparties and under 20 swaps) should be eliminated. This provides a straightforward exemption from the definition as a swap dealer since they do not sell more than \$100 million a year in swaps into the marketplace. Because of weather volatility and other factors REMs sometimes will overprocure hedges – and need to sell some back. If the Commission wants to meet the intent of Dodd Frank and ensure that onerous prudential, business conduct, recordkeeping and reporting requirements do not apply to smaller companies with less active trading and wholesale marketing operations that are applicable to Swap Dealers, it should also ensure that the thresholds are realistic and provide certainty to our members, their customers and the marketplace.

End User Exception to Mandatory Clearing

Section 723 of the Act provides for an exception from mandatory clearing for swaps executed by end users intended for bona fide hedging to mitigate commercial risk. This is the case for REMs – whose primary business is to supply physical commodity (electricity and natural gas) to serve their own retail consumers and engage in hedging incidental to that primary business - and they should qualify for the end user exception.

The proposed rule requires a number of actions to be taken by “electing counterparties” to except swaps from mandatory clearing. As many REMs are smaller commercial entities with simpler reporting systems, NEM requests that the Commission provide an option for streamlined, cost-effective compliance under this exception. In particular, NEM proposes that the Commission allow for “electing counterparties” that are not financial entities who sell fewer than \$100 million a year in swaps (excluding sales to swap dealers) to meet their transaction-by-transaction reporting requirements with an annual certification by the Board of Directors or appropriate Board committee that the counterparty:

- elects to claim the End User Exception to mandatory clearing,
- engages in wholesale energy swap transactions primarily for the purpose of bona fide hedging to mitigate commercial risk in the retail sales of physical energy.
- has sold less than \$100 million in swaps during the previous twelve months,
- is willing to allow the Commission or its agent to inspect the Counterparty’s records to confirm that less than \$100 million in swaps were sold.

⁸ 75 Fed. Reg. 80,179.

In addition, NEM proposes that any Electing Counterparties that are not financial entities should not be required to report individual swap transactions to a Swap Data Repository. Since the swap volume of REMs relative to overall energy swaps and all swaps in the US markets is an infinitesimal percentage of the total energy swap volume, there will be no systemic risk nor impact on price discovery to have such a small part of the total energy swap volume not reported (or possibly double reported). It is likely that these swaps will be reported by counterparties that are subject to Commission regulation.

NEM believes that the above refinement and simplification in reporting requirements adequately captures all the reporting requirements necessary from the proposed Section 39.6 to meet the intent of Dodd-Frank. This proposed simplified reporting provides a clear, low cost End User Exception for small Retail Energy Marketers that will still allow the Commission to obtain the information needed to ensure transparency and avoid any potential systemic risk.

Risk Management Requirements for Derivatives Clearing Organizations

The main concern of NEM about the mandatory clearing requirement is the cash requirements in a capital intensive industry. Some of the proposed rules in Risk Management Requirements for Derivatives Clearing Organizations actually make this cash intensity situation worse. These rules will affect a number REMs directly and strongly discourage any voluntary participation in clearing. Just as importantly, it will also affect all REMs indirectly by affecting the suppliers to the REMs. That is any increase in the cash requirements to the suppliers often gets translated into increased cash requirements and/or increased costs to the REMs, which in turn will increase costs to US energy consumers.

The main items of concern to NEM in these proposed rules include:

- *the elimination of letters of credit as an acceptable source of collateral for margin.* NEM believes that letters of credit and other appropriate non-cash collateral should still be used as an acceptable collateral for margin. As hedgers taking transactions to physical delivery, REMs pose less risk to the market than pure financial entities.
- *the requirement that initial margins for OTC trades be set to cover 5 days.* Typically clearinghouses use 2 days for setting such margins. This increase, coupled with the inability to use letters of credit as collateral, increases the cash intensity of clearing. Again we believe that as hedgers going to physical delivery, REMs do not add material risk that warrants an increase in margin.
- *the requirement for daily settlements of funds.* Most REMs use an accrual accounting practice that recognizes revenues and costs after energy delivery to their retail customers. The current clearing solutions that require Daily Cash Settlements will either require a complication in accounting practices or a significant impact on REM cash flows. Any opportunities for encouraging clearing solutions that support such accrual accounting should be supported by the Commission.

In closing, NEM appreciates this opportunity to comment to the Commission. As noted above, NEM historically has supported voluntary clearing. NEM believes its comments are consistent with the intent of Dodd-Frank while improving the clarity and reducing the capital and cost burden for smaller REMs who do not impose a systemic risk on the US economy. Such REMs operate with low cost overheads which allows them to bring lower cost energy to US consumers while creating jobs.

Given the significance and the extent of the proposals for which comments are due on February 22, 2011, NEM or its members may seek to submit additional comments on these proposals after the deadline. NEM will seek leave to file any late comments should additional issues arise.

We would be happy to answer any further questions.

Respectfully submitted,

Craig G. Goodman, Esq.
President
National Energy Marketers Association
3333 K Street, NW, Suite 110
Washington, DC 20007
Telephone: (202) 333-3288
Fax: (202) 333-3266
E-Mail: cgoodman@energymarketers.com