EDISON INTERNATIONAL®

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Electronically Filed

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

RE: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant"; Proposed Rule 75 Fed. Reg. 80,174 (December 21, 2010)
RIN No. 3038-AD06

Dear Mr. Stawick:

Edison International ("EIX") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("CFTC") and Security Exchange Commission's ("SEC," and collectively with the CFTC, the "Commissions") Joint Proposed Rule for the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant" as published on December 21, 2010, in the Federal Register (the "Proposed Rule").[1] In the Proposed Rule, the Commissions request comment on proposed rules and interpretive guidance further defining the above-referenced terms in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

Although EIX believes that the intent of the Proposed Rule is not to capture end users such as EIX and its subsidiary companies in accordance with the statutory mandate of the Dodd-Frank Act and Congressional intent, we recommend that certain clarifications to the regulatory text be implemented to ensure that end users are not unintentionally required to register as a Swap Dealer or Major Swap Participant. EIX offers these comments in the spirit of ensuring that it, along with other similarly situated entities, will be able to minimize the costs of transitioning to compliance with the Dodd-Frank regulatory scheme by reaching the clearest possible understanding of the Commissions' enforcement intentions.

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[1] 75 Fed. Reg. 80,174 (Dec. 21, 2010).
[2] 75 Fed. Reg. 80,175.

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Further to the goal of achieving full compliance with the Dodd-Frank Act, EIX also respectfully requests that the CFTC establish expedited processes by which (1) entities can receive confirmation from the CFTC on whether they will be required to register as a Swap Dealer or Major Swap Participant or (2) entities can request exemptions from this and other Dodd-Frank Act rules.[3] Additionally, EIX requests that the CFTC allow for a transition period beyond July 2011 to comply with the Dodd-Frank Act rules, and that the CFTC create a safe-harbor for companies that make a good faith determination that they are not required to register.

A. Description of EIX's Businesses

As described in greater detail below, EIX, through its subsidiaries, is a generator and distributor of electric power and an investor in infrastructure and energy assets. EIX is the parent company of Southern California Edison ("SCE"), a regulated electric utility, and Edison Mission Group ("EMG"), a competitive power generation business.

1. Southern California Edison ("SCE")

SCE is an electric utility that provides electricity service to nearly 14 million people in central, coastal and southern California, and engages in bona fide hedges solely for the mitigation of commercial risks relating to such service in order to provide a reliable and stable-priced electricity supply for its customers. SCE's business mission is the sale of electricity services to residential, commercial and industrial customers within its service territory. SCE owns and operates electric generation, transmission, and distribution facilities needed to supply power to its customers, and is compensated for such service at rates regulated by the California Public Utilities Commission ("CPUC"). Such rate regulation limits the revenues SCE can collect for its services based on CPUC-established cost recovery mechanisms that, in general, are designed to enable SCE to recover prudently incurred costs of service and to earn an authorized rate of return on capital employed to construct, operate and maintain assets required to provide electricity service.[4]

SCE is authorized by the CPUC to provide electricity service in a franchised service territory located in central, coastal and southern California. SCE serves electricity to its customers from its utility-owned generation resources and from electricity purchased from independent power

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[3] EIX suggests that the CFTC create an expedited process similar to the CFTC's existing exemptive letter and no-action letter regulations. *See* 17 C.F.R. § 140.99 (2010).

[4] Additionally, SCE's wholesale operations (including sales of electricity into the wholesale markets) are subject to regulation by the Federal Energy Regulatory Commission ("FERC"). The FERC has the authority to regulate wholesale rates as well as other matters, including unbundled transmission service pricing, accounting practices, and licensing of hydroelectric projects. *See generally* Federal Power Act, 16 U.S.C. §§ 791, *et seq.*

producers and competitive wholesale electricity markets. SCE's power procurement plans are subject to advance CPUC review and approval under California Assembly Bill 57 ("AB 57"). Among other things, SCE's approved plan calls for SCE to assemble a portfolio of power supply sources (whether generated by SCE-owned plants or purchased from third parties) sufficient to ensure that reliable, least-cost power is delivered to all customers within its service territory.[5] Part of the CPUC's mandate regulates the types of derivative transactions in which SCE can engage. AB 57 was passed after the California electricity crisis of 2000-2001 in an effort to protect California's ratepayers from further financial harm associated with the provision of electric service. Simply put, subjecting SCE to duplicative regulation of its derivative transactions would not provide any meaningful additional protection to SCE ratepayers, but would come at an enormous administrative price tag to those ratepayers.

As a result of electricity deregulation in California, SCE divested a large portion of its generation assets and must rely heavily on power purchase agreements with independent power producers to meet its customers' electricity needs. SCE's power supply portfolio also includes nuclear power generation, renewable energy sources and supply available through the wholesale markets administered by the California Independent System Operator ("CAISO"), a FERC-authorized wholesale power market. In addition to these resources, SCE uses a variety of physical and financial natural gas, electricity and transmission transactions to hedge its customer's price, supply and reliability exposure to risks arising from all components of the electricity supply process.

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[5] AB 57, Cal. Pub. Util. Code § 454.5, enacted in 2002, mandates that Investor Owned Utilities ("IOUs") prepare Long Term Procurement Plans ("LTPPs") for review and approval by the CPUC and ensures that all costs associated with transactions executed by an IOU are in accordance with its CPUC-approved LTPP will be recoverable through rates. The CPUC, to date, has granted SCE approval to engage in certain transaction types, including physical- and financial- settled spot and forward market purchases and sales (including options) of electricity, transmission, natural gas, pipeline capacity, storage, and emissions.

The LTPP provides standards for:

- Procurement products for electric and gas procurement;
- Transactional processes for electric and gas procurement (including "Requests for Offer," transactions on exchanges, transactions through brokers, and bilateral transactions);
- Evaluation and selection of energy resources through a "Requests for Offer" process;
- Contract duration;
- Limits on the volume of electric energy and natural gas that SCE can procure;
- Risk management policies and strategies; and
- Fuel supply procurement strategy.

2. Edison Mission Group ("EMG")

EMG is a holding company which acts through a number of subsidiaries to manage the competitive power generation business of EIX subsidiaries. One of its principal subsidiaries, Edison Mission Energy ("EME"), is an independent power producer engaged in the business of owning, leasing, operating and selling energy and capacity from electric power generation facilities. EME's continuing operations consist of owned or leased interests in 39 power generation facilities, with an aggregate capacity of 10,979 megawatts ("MW"), of which EME's ownership share is 9,852 MW. Because EME produces power in a wholesale market characterized by volatility in both its inputs (primarily fuel) and its output (power), the company conducts price risk management and energy trading activities through its subsidiary, Edison Mission Marketing and Trading ("EMMT").

EMMT executes and administers financial derivatives for hedging activities on behalf of EME subsidiaries, including financial derivatives to hedge the output risk from EME's coal-fired generation plants. EMMT also utilizes heating oil financial derivatives to hedge against the rail transportation costs of coal because EME's rail contracts include cost escalation provisions, with a fuel cost adjustment factor correlated to heating oil prices. In addition, EMMT utilizes financial congestion contracts to hedge against basis risk caused by transmission congestion in PJM Interconnection, LLC ("PJM") (a regional transmission organization), where EME's coal-fired generation output is sold.

To a lesser extent, EMMT also engages in financial derivatives on its own account for direct gain based on EMMT's view of market trends. Specifically, in addition to its hedging activities, EMMT utilizes financial derivatives transactions to profit on price movements in various products related to its underlying competitive power generation business that may not be directly linked to performance of EME's generation facilities. However, the net volumes of these financial derivatives are not large relative to EMG's hedging activities.

B. SCE Is Already Subject to Regulatory Schemes Which Implement Risk-Mitigating Requirements Substantively Similar to the Objectives of the Dodd-Frank Act

As more fully described above, SCE is subject to regulatory oversight by the CPUC. As relevant here, all of SCE's financial derivative transactions are approved by the CPUC or executed in compliance with CPUC-approved procurement plans.[6] Certain procurement-related risk management policies and strategies are also prescribed by a procurement plan.[7] These policies

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[6] *See e.g.*, CPUC D.07-12-1052 (Dec. 21, 2007), *available at* http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/76979.pdf.

[7] *See* Cal. Pub. Util. Code. § 454.5(b)(10).

include hedging strategies, risk assessment reports, credit and collateral requirements, consumer risk tolerance, and measuring portfolio risk exposure.

Specifically, the CPUC, through the Long Term Procurement Plan ("LTPP") process, approves SCE's planned hedging activities, and prohibits SCE from entering into financial derivatives transactions except to mitigate market risk on behalf of its retail customers. The CPUC's regulatory and ratemaking framework does not permit SCE to profit from any hedging activities related to its power procurement, or from volatility in the wholesale price of electric power or fuel used to generate electric power. Thus, the company's business interest is aligned, by state regulation, with the interests of its customers in least-cost delivered power (consistent with satisfaction of system reliability and environmental standards and goals) and a reduction of the risk of adverse impacts from commodity price volatility. To ensure that the interests of California consumers are protected, the CPUC reviews SCE's power procurement plans in advance, and after-the-fact, evaluates whether such purchases were consistent with the procurement objectives it approved.[8] The CPUC recognizes the important role played by financial derivatives in minimizing the impact of an implicitly volatile market and the efficient functioning of commodity markets. It also appreciates that economically appropriate hedging activity can reduce price volatility and enable a utility such as SCE to mitigate the commercial risks associated with commodity markets.[9] However, when it approves the LTPP, the CPUC places specific limits on SCE's participation in commodity derivatives markets.[10] Acting within the limitations of CPUC regulatory oversight, SCE is a counterparty in financial derivatives that

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[8] *See* Cal. Pub. Util. Code. § 454.5(e) (mandating periodic review and modification of an LTPP).

[9] California law mandates that the CPUC approve LTPPs that "moderate the price risk associated with serving . . . retail customers, including the price risk embedded in its long-term supply contracts," by authorizing an IOU to "enter into financial and other electricity-related product" contracts. *See* Cal. Pub. Util. Code § 454.5(b)(2). SCE's procurement plan must include all "electricity-related products," including swaps, that a utility intends to procure, describe the duration, timing and range of quantities of each product to be procured, analyze price risk arising from its particular portfolio of electricity-related products, and describe its "risk management policy, strategy, and practices." *See id.*; CPUC decision D.02-10-062 at 36. SCE must file a "risk report" with the CPUC monthly and the CPUC reviews that report to ensure that SCE complies with its LTPP. *See* CPUC D.04-12-048 at 170 (Dec. 12, 2004) ("The objective of the report is to show that the transactions entered into are in compliance with the upfront standards identified by the Commission."), *available at* http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/43224.pdf.

[10] The CPUC monitors the types of financial contracts and takes action to protect California ratepayers. For example, the CPUC has specifically banned the use of LTCRRs, a product relating to congestion on transmission lines, for speculative purposes, stating that they "should be used for hedging, not for financial speculation." CPUC Res E-4117 at 6-7 & n.11 ("SCE shall use LTCRRs as hedges against congestion costs and not for speculation . . . . SCE should not obtain LTCRRs that are unrelated to SCE's sources of power."), *available at* http://docs.cpuc.ca.gov/WORD_PDF/FINAL_RESOLUTION/74083.PDF.

it uses to hedge specific commercial risk inherent in the business of supplying electricity to its customers.

C. EMG Participates in Financial Derivatives Markets for Hedging and Proprietary Purposes

EMG engages in a variety of financial derivatives transactions for both hedging as well as proprietary purposes. It primarily enters into financial derivatives through EMMT to hedge the output risk of EME's generation assets. Most financial transactions related to EMG's business are reported through ICE, Nodal Exchange or NYMEX. The largest portion of EMG's investment in financial derivatives for profit relates to Financial Transmission Rights ("FTRs") in the organized electricity market operated by PJM and regulated by FERC.[11]

EMMT's utilization of financial derivatives for proprietary purposes is not "dealing" activity as described by the Commissions in the Proposed Rule. EMMT does not serve as the contact point for other traders, offer to create and arrange customized financial swaps for traders, accommodate demand for swaps from other parties for a given product, or otherwise perform the function of making a market in a swap or other financial derivative to profit from a margin on the bid/ask spread. Nor does EMMT maintain a regular clientele of customers for swaps, enter into swaps for another entity's account, or maintain an inventory of swaps held to market to others. EMMT is not, and has never been, a member of any exchange or association of dealers.

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[11] According to FERC staff,

> FTRs are financial instruments that allow their holder to receive, or obligate it to pay, the difference in price between two nodes: a source and a sink. A holder of an FTR with source A and sink B will be paid the difference in price between A and B if A's price falls below B's. Conversely, the holder would be obligated to pay the difference in price if A's price rose above B's. In other words, an FTR is designed to provide payments that substantially match and offset the difference in price between two pricing nodes. As such, FTRs are financial instruments designed to allow power providers to hedge against the possibility of congestion on their supply paths. Because FTRs are financial instruments, non-physical traders may trade FTRs.

Enforcement Staff Report, at p. 14, attached to *PJM Interconnection, L.L.C, v. Accord Energy, LLC et al*., 127 FERC ¶ 61,007 (2009), *order denying reh'g*, 129 FERC ¶ 61,010 (2009).

It appears that a proposed rule on the definition of swap will be issued after the closing date for this Proposed Rule. As such, EIX reserves its rights to comment on whether an FTR is a swap.

D. It Does Not Appear to be the Intent of the Proposed Rule to Require SCE and EMG to Register as Swap Dealers

EIX notes that there is substantial support for the view that the Dodd-Frank Act was not intended to impose Swap Dealer requirements on end-user entities such as the EIX companies. Consistent with that Congressional intent, EIX understands the Proposed Rule to be meant to distinguish Swap Dealers from end users based on their actual function in a swap market and the nature of their regular business. On this basis, as more fully explained below, EIX believes that the intent of the Dodd-Frank Act would be satisfied by a Final Rule that avoids ambiguity in the definition of a Swap Dealer which might lead companies to register as Swap Dealers even though neither the Dodd-Frank Act nor the Commissions' rules are meant to accomplish that result. To reduce potentially costly business uncertainty and to further the goal of prompt, universal compliance with the Dodd-Frank Act requirements, EIX recommends certain clarifications that would support this analysis.

The Dodd-Frank Act defines the term "Swap Dealer" in terms of whether a person engages in certain types of activities involving swaps. Specifically, the Dodd-Frank Act states that "the term 'swap dealer' means any person who—(i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps."[12] As demonstrated below, SCE and EMG *do not* perform any of these functions.

1. SCE and EMG Do Not Hold Themselves Out as Dealers in Swaps

As evidenced by their websites, disclosure documents filed with the Securities and Exchange Commission and other public materials, SCE holds itself out as a public utility and EMG holds itself out as a competitive power generator.[13] Both entities enter into financial derivatives as an ancillary part of their regular business, and neither has held itself out as a "dealer" at any time.

2. SCE and EMG Do Not "Make a Market" in Swaps

A swap dealer "makes a market" by sitting in the center of a market in which it actively promotes and facilitates transactional activity, and is in the regular business of offering to buy

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[12] Section 721 of the Dodd-Frank Act; CEA § 1a(49).

[13] *See* http://www.sce.com/; http://www.edison.com/ourcompany/emg.asp.

and sell swaps.[14] Swap dealers earn profits primarily by executing transactions at different prices within the spread between market bids to buy and offers to sell, not by hedging commercial risk.[15] A swap dealer functions as a "point[] of connection"[16] in the swaps markets, and makes markets in swaps with the aim of making profits in so doing.

SCE's only reason for participation in the financial derivative markets is to hedge commercial risks ancillary to and arising from its "regular" business as a provider of electricity services. It is an end user of products made available by dealers for the purpose of hedging risk, and it uses financial derivatives to offset its customers' price risk associated with volatile energy prices. It does not function as a dealer, meaning that it does not, for example, act as an intermediary bringing together buyers and sellers of commodities. Moreover, as previously noted, the CPUC has not authorized SCE to engage in speculative trading, or to have any line of business in which it conducts or profits from "dealing activities" such as making a market in financial derivatives by entering into financial derivative contracts on either side of the market, *i.e.*, by being a buyer to sellers and a seller to buyers.

Similarly, EMG does not "make markets"; rather, it undertakes transactions for both hedging (risk mitigation) and proprietary (profiting from future market price changes affecting the value of the swap) purposes—all in connection with its primary function as a wholesale power generator. Its transactional activity does not involve serving as an intermediary, or a "point of connection" in the market. Moreover, for the most part it enters into transactions with dealers rather than end users—one of the indictors that the Commissions cite in the preamble to the Proposed Rule that a market participant is or is not acting as a dealer.[17] In addition, EMG's activities are primarily hedging transactions characteristic of end users. Its other transactions are classic examples of a market participant taking a position based on its view of market trends in markets related to its underlying and primary business activity. None of its transactions exhibits the hallmarks of "dealer" activity such as accommodating demand, holding derivatives inventory for, or otherwise soliciting, financial derivatives customers, designing products, or a willingness to make a market by taking both sides of a given risk in transactions with multiple parties.

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[14] While the buy/sell distinction cannot "necessarily" be applied to all swaps, *see* 75 Fed. Reg. 80,176-77, EIX believes that the Swap Dealers behave this way in most, if not all, of the swap transactions to which EIX and its subsidiaries are a counterparty.

[15] *See Staff Report on Commodity Swap Dealers & Index Traders with Commission Recommendations*, CFTC, Sept. 2008, at 39.

[16] 75 Fed. Reg. 80,177.

[17] *Id.*

3. SCE and EMG Do Not Enter into Swaps as a "Regular Business"

Persons who enter into swaps as a part of a "regular business" are those persons whose "function is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties."[18] For both SCE and EMG, financial derivative transactions are ancillary to their primary businesses. Their function is to provide power and electricity products and services to electricity customers, and financial derivatives are primarily used to facilitate this in a cost-effective manner and to reduce risk associated with commodity price volatility. Neither SCE nor EMG accommodates demand from other parties. Rather, they both seek to satisfy their *own demand* for hedging products. Both SCE and EMG enter into financial derivatives transactions as a tool to effectively perform their regular business as providers of reliable and reasonably priced electricity for consumers, in the case of SCE, and utilities and other wholesale purchasers of electricity, in the case of EMG.

4. SCE and EMG Are Not Known in the Trade as a Dealer or Market Maker in Swaps

EIX notes that the preamble to the Proposed Rule indicates that the Commissions will interpret "Swap Dealer" in a functional manner, encompassing how a person holds itself out in the market and how the market perceives the person's activities.[19] The Proposed Rule lists factors that may reasonably indicate that a person is holding itself out as a dealer or is commonly known in the trade as a dealer. These include: contacting potential counterparties to solicit interest in swaps; developing new types of swaps and informing potential counterparties of the availability of such swaps and a willingness to enter into such swaps with the potential counterparties; membership in a swap association in a category reserved for dealers; providing marketing materials (such as a website) that describe the types of swaps that one is willing to enter into with other parties; or generally expressing a willingness to offer or provide a range of financial products that would include swaps.[20] While EIX believes that neither SCE nor EMG should be, or is intended to be, classified as holding themselves out as a dealer or market maker based on this test, EIX believes that some clarification is needed so that the "functional" test does not deter companies from engaging in lawful hedging or trading because a lack of clarity leads them to fear they will be mistakenly classified as Swap Dealers.

Based on the above factors, neither SCE nor EMG holds itself out as a dealer of swaps, and neither is commonly known in the trade as a dealer. SCE markets itself and holds itself out as a regulated electric utility, and only procures financial instruments in the context of reducing the ultimate cost volatility to its customers of delivering energy. EMG is in the business of

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18 *Id.*

19 75 Fed. Reg. 80,176.

20 75 Fed. Reg. 80,178.

producing power for sale in wholesale electricity markets and primarily enters into financial instruments to support that business and manage the risks associated with it. Along the same lines, the Proposed Rule states that non-dealers tend to enter into swaps with Swap Dealers more often than with other non-dealers.[21] SCE and EMG both tend to enter into financial derivatives with entities traditionally known as dealers rather than with entities in the physical electric power business whose primary use of financial derivatives is to hedge their own commercial risk. These entities traditionally known as dealers are not engaged in the primary business of providing electric power; rather, they are in the regular business of providing swaps and other derivative products. Thus, for the most part, it is the counterparties with whom SCE and EMG enter into financial derivatives that function as Swap Dealers as defined in the Proposed Rules.

E. It Does not Appear to be the Intent of the Proposed Rule to Classify SCE and EMG as Major Swap Participants

Neither SCE nor EMG holds a substantial position in financial derivative products after excluding positions held for hedging or mitigating commercial risk, as provided for by the Proposed Rule. As discussed above, all of SCE's financial derivatives, and the majority of EMG's financial derivatives, are used to hedge commercial risk associated with the generation and distribution of power, and to reduce customer exposure to variability in market prices related to their power and gas activities. Additionally, the financial derivatives to which SCE and EMG are parties would not create substantial counterparty exposure or have serious adverse effects on the financial stability of the financial markets, and neither SCE nor EMG fit the definition of a "financial entity" in proposed regulation 1.2(ggg). Moreover, SCE and EMG operate their hedging strategies, including all financial derivatives transactions, in accordance with rules that prohibit coordination, common direction or information exchange between affiliates. As such, the notional value of the derivatives positions taken by SCE and EMG should be evaluated separately and independently of each other for purposes of the proposed regulation.[22] Accordingly, neither SCE nor EMG should be covered by the Major Swap Participant definition.

F. Recommendations

The legislative history is clear that the objective of the Dodd-Frank Act was to regulate dealers and the financial institutions that hold swap positions of sufficient size to pose systemic risk. End users such as electric utilities and wholesale power generators who use financial derivatives to manage the various risks inherent in their regular business—supplying electric power,

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[21] 75 Fed. Reg. 80,178.

[22] EIX requests that the CFTC clarify that an entity that is prohibited by state or federal law from coordinating its financial derivatives activities should calculate whether it should register as a Major Swap Participant without aggregating its positions with the notional value of financial derivatives entered into by its affiliated entities. *See infra* note 28.

profiting from a view of energy pricing trends and/or reducing consumers' exposure to volatile commodity prices—do not fall within either category.[23] This point was underscored in the June 30, 2010 Letter from Chairman Christopher Dodd and Chairman Blanche Lincoln to Chairman Barney Frank and Chairman Colin Peterson (the "Dodd-Lincoln Letter") providing crucial insight regarding the legislative intent of the Dodd-Frank Act. The Dodd-Lincoln Letter states that Congress' intent was to protect end users from burdensome costs and not subject them to the extensive financial requirements imposed on Swap Dealers and Major Swap Participants.[24] The letter also states that imposing the clearing and exchange trading requirements on commercial end users could raise transaction costs where there is a substantial public interest in keeping such costs low to, for example, provide consumers with stable, low prices. In referencing the end-user

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[23] *See, e.g.*, Statement of Sen. Dodd (CT), 105 Cong. Rec. S5904 (daily ed. July 15, 2010) ("It is also the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements."); Statement of Sen. Collins (ME), 105 Cong. Rec. S5907 (daily ed. July 15, 2010) ("I want to make clear that it is not Congress' intention to capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates."); Statement of Rep. Peterson (MN), 185 Cong. Rec. H14705 (daily ed. Dec. 10, 2009) ("Our target for greater regulation and oversight is not the end user but their swap dealer or major swap participant counterparty.").

See also S. Rep. No. 111-176. While noting that the unregulated OTC derivatives market was a major contributor to the financial crisis, the Senate Report on the Dodd-Frank Act pointed out that the top five derivatives dealers in the United States accounted for 96 percent of outstanding over-the-counter contracts made by the leading bank holding companies, and as such, "this market was dominated by the too-big-to-fail financial companies that trade derivatives with financial and non-financial users." *Id.* at 29.

[24] Dodd-Lincoln Letter at 3 ("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*.") (emphasis added).

See also Testimony of CFTC Chairman Gensler before the U.S. House Committee on Agriculture (February 10, 2011) ("Proposed rules on margin requirements should focus only on transactions between financial entities rather than those transactions that involve non-financial end-users"); Letter from Sen. Johanns, et. al., to Treasury Secretary Geithner, Federal Reserve Chairman Bernanke, CFTC Chairman Gensler and SEC Chairman Schapiro dated February 8, 2011 ("Imposing margin requirements on those who engage in the hedging of legitimate business risks would not only blatantly disregard the end-user exemption and Congressional intent, but it could also have the effect of draining scarce working capital from the balance sheets of mainstream American companies . . . and produce higher costs for consumers.").

exception to clearing that Congress created to address this concern, the Dodd-Lincoln Letter explicitly references energy companies which produce and distribute power.

To the extent applicable, EIX adopts and incorporates by reference all clarifications and regulatory text proposed by the Edison Electric Institute and Electric Power Supply Association (together, the "Joint Associations") and supports the recommendations of American Electric Power, EIX, Exelon Corporation, and The Southern Companies (collectively, the "Utility Group") in their comments to the Proposed Rule. Additionally, to further prompt and efficient compliance with the Commissions' regulatory approach, EIX recommends the following.

1. **The CFTC Should Ensure That Electric Utilities and Wholesale Power Generators Can Seek Confirmation They Are Not Required to Register as Swap Dealers or Receive Exemptions from the Related Registration Requirements**

EIX recommends the Commissions adhere to the expectations of Congress by providing clarity to commercial end users who use financial derivatives[25] to hedge risk in their ordinary course of business such as SCE and EMG. These end users are hedging positions in the physical markets for commodities in order to reduce their customers' exposure to variability in market prices of such physical commodities.

Recognizing the uncertainty that end users may feel about the intended scope of the definitions of Swap Dealer and acknowledging that companies may be unnecessarily required to expend significant economic resources as a result of this uncertainty, EIX proposes:

- That the CFTC establish expedited processes by which (1) entities can receive confirmation from the CFTC of whether they will be required to register as a Swap Dealer or (2) entities can request exemptions from this and other Dodd-Frank Act rules;
- That the CFTC establish an expedited process by which entities subject to regulation by the CPUC (which, as described above, regulates hedging activities by limiting the revenues an entity may collect for its services and requiring such entity to share any profits resulting from its hedging activities with its ratepayers) can request an exemption from registration as a Swap Dealer;
- That the CFTC allow a transition period beyond July 2011 to comply with the rules; and
- That the CFTC provide a safe-harbor for companies that make a good faith determination that they are not required to register.

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[25] EIX respectfully requests that the CFTC hold open the comment period on this rule, and the other rules that affect Swap Dealers and Major Swap Participants, until the CFTC proposes a rule defining a "swap."

2. Suggested Revisions to the Regulatory Text to Clarify that End Users Are Not Swap Dealers

As described above, entities such as SCE and EMG who are in the physical electricity business and use financial derivatives for hedging, price discovery, or to hold a position for investment gain, are not dealers and therefore should not be captured under the Swap Dealer definition. Neither SCE nor EMG accommodate others' demand for financial derivatives, serve as the contact point or act in response to the requests of others, or otherwise perform the function of making a market in financial derivatives. Accordingly, EIX recommends that the Commissions clarify the definition of Swap Dealer as follows:

(ppp) Swap Dealer.

(1) In general. The term "*swap dealer*" means any person who:

(i) Holds itself out as a dealer in swaps;

(ii) Makes a market in swaps;

(iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

(iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

(a) The term "Dealer" means a person that makes a market in swaps.

(b) "Makes a market" or "making a market" means regularly quoting bid and offer prices for, and standing ready to enter into, a swap for a person's own account for the purpose of accommodating customer transactions.

provided, however, that in no event shall a person be considered to be a swap dealer to the extent that it enters into transactions for the purpose of transferring risk within a group of affiliated persons.

(2) Exception. The term "*swap dealer*" does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(i) The term "Regular Business" means a usual business activity of a person whose function is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties.

(a) The term "accommodate demand" means enters into swaps to satisfy a business need of other parties.

(b) The term "interest expressed by other parties" means requests by other parties to enter into swaps for the purpose of satisfying their business purposes.

(ii) The following activities do not constitute a Regular Business for purposes of this provision:

(a) Entering into swaps for the purpose of hedging or mitigating commercial risk, as defined in Section 1.3(ttt);

(b) Entering into swaps for the purpose of benefiting from future changes in the price of the underlying commodity;

(c) Entering into swaps on a designated contract market or swap execution facility, unless such swaps are entered into by a party who holds itself out as making a market in the corresponding category of swaps.

3. Suggested Revisions to the Regulatory Text to Clarify that Mitigating Commercial Risk Encompasses all Risks Relating to Operating a Commercial Business

The Proposed Rule states that "[a]s a general matter, the CFTC preliminarily believes that whether a position hedges or mitigates commercial risk should be determined by the facts and circumstances at the time the swap is entered into, and *should take into account the person's overall hedging and risk mitigation strategies*. Although the line between speculation and hedging can at times be difficult to discern, the statute nonetheless requires such determinations. The CFTC expects that a person's *overall hedging and risk management strategies will help inform whether or not a particular position is properly considered to hedge or mitigate commercial risk* (emphasis added)."[26]

While it is clear from the legislative history that Congress intended to include hedging and risk management strategies used by businesses in the electricity and natural gas industry in the scope of activities which hedge or mitigate commercial risk,[27] the definition as currently drafted does not explicitly mention terms relevant to the energy industry such as generation, transmission,

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[26] 75 Fed. Reg. 80,195.

[27] *See, e.g.,* Statement of Sen. Bond (MO), 58 Cong. Rec. S2546 (daily ed.) (April 22, 2010) ("Not all derivative contracts pose systemic risk. As a matter of fact, commercial contracts initiated, for example, *by energy companies, utilities, and the agricultural industry are used to manage risks associated with daily operation*, from cost fluctuations in materials and commodities to foreign currency used in international business. These end users, as they are called, do so in order to plan for future pricing so they can provide the least expensive good or service to their consumers as possible. Costly margin requirements for these end users will be directly passed on to families. This will increase the cost for Americans to turn on their lights and put food on their tables . . . *These end users are not major swap participants and should not be treated as such.*") (emphasis added).

distribution, delivery, transportation and storage. Accordingly, we recommend that the Commissions clarify the intended scope of the definition as follows:

(ttt) *Hedging or mitigating commercial risk.* For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), a swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

(1) Such position:
(i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from:
(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, **delivers, transmits, transports, stores** or merchandises or reasonably anticipates owning, producing, manufacturing, processing, **delivering, transmitting, transporting, storing,** or merchandising in the ordinary course of business of the enterprise;

. . .

(D) The potential change in the value of assets, **liabilities,** services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, **delivering, transmitting, transporting, storing,** merchandising, leasing, or selling in the ordinary course of business of the enterprise.

4. Suggested Revisions to the Regulatory Text to Clarify that Regular Business Does Not Include the Ancillary Function of Mitigating Commercial Risk, Where an Entity Is Barred by Regulation from Profiting from Hedging Activity or When Swaps Are Entered into Among Affiliates Which Are Prohibited from Coordinating Hedging Activities

As described above, the Proposed Rule states that clause (A)(iii) of the statutory definition should be read in combination with the express exception in subparagraph (C) which excludes a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a "regular business." EIX proposes that the Commissions clarify that the term "regular business" does not include the ancillary function of entering into swaps to mitigate commercial risk or where the entity is barred by regulation from profiting from its hedging activity and is required to implement hedging activities for the purpose of mitigating the impact of price volatility on retail customers. Additionally, for entities such as SCE and EMG where affiliate compliance rules prohibit the sharing of information [28] and thereby the

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[28] *See, e.g.*, 16 U.S.C. §§ 824d, 824e; 17 C.F.R. § 35.39 (2010) (FERC Affiliate Restrictions); 17 C.F.R. §§ 358.1-358.1 (2010) (FERC Standards of Conduct); CPUC Decisions D.97-12-088 and D.98-08-035 (CPUC Affiliate Transaction Rules), *available at* ftp://ftp.cpuc.ca.gov/gopher-data/energy_division/affiliate/D9712088.doc and

coordination of hedging activities, EIX proposes that internal, non-market transactions between affiliates should also be excluded from "regular business." Accordingly, EIX recommends that the Commissions clarify the term "regular business" as follows:

(ppp)(2) Exception. The term "swap dealer" does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of **the person's** regular business, **where (i) the entity is proscribed by regulation from profiting from the swaps and is authorized to engage in limited swaps activity for the purpose of mitigating the impact of price volatility on retail customers; (ii) the swaps are entered into among affiliates with affiliate compliance rules prohibiting the coordination of hedging activities;**[29] **or (iii) the role of swaps and other commodity derivatives transactions is an ancillary function that serves to hedge commercial risk arising from (A) fluctuations in the value of an underlying commodity which directly affects the regular business or (B) performance or non-performance of commercial obligations of the regular business. In addition, the term "swap dealer" shall not include one or more affiliated persons whose swaps activities are required by state or federal law or regulation to be implemented without coordination or common direction, including prohibitions on the sharing or exchange of information about hedging or trading of any category of financial derivatives.**

5. Suggested Revisions to the Regulatory Text to Clarify that the De Minimis Exception Is Inherently Tied to the Size of the Overall Swap Market and that an Entity that Is Prohibited from Coordinating Financial Derivatives Activities Should Not Consider Swaps Entered Into by Affiliated Entities When Determining Whether It Qualifies for the De Minimis Exception

As set forth below, EIX supports the Joint Associations' suggested changes regarding the de minimis exception. EIX suggests that the most meaningful measure of the magnitude of "swap dealing" activity is the aggregate effective notional amount of an entity's dealing activity, measured on a gross basis over a discrete period of time.

As noted above, affiliate compliance rules prohibit SCE and EMG from sharing information and coordinating their financial derivatives activities or other commercial hedging strategies.[30] EIX proposes that the CFTC clarify that an entity that is prohibited from coordinating its financial

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ftp://ftp.cpuc.ca.gov/gopher-data/energy_division/affiliate/D9808035.doc.

[29] EIX reserves the right to comment on the implications of affiliate rules in connection with other Dodd-Frank Act rulemakings.

[30] *See supra* Note 28.

derivatives activities should determine whether it qualifies for the de minimis exception without considering financial derivatives entered into by its affiliated entities.[31]

(ppp)(4)*De minimis exception.* **(i)** A person shall not be deemed to be a swap dealer as a result of swap dealing activity involving counterparties, ~~**that meets each of the following conditions :**~~

~~**(i) The swap positions connected with those activities into which the person enters**~~ **for which the associated swaps entered into** over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than ~~**$100 million**~~ **1/1,000th of a percent of the total estimated gross notional size of the U.S. swap market**, and have an aggregate gross notional amount of no more than ~~**$25 million**~~ **1/10,000th** with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act). For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

~~**(ii) The person has not entered into swaps in connection with those activities with more than 15 counterparties, other than swap dealers, over the course of the immediately preceding 12 months. In determining the number of counterparties, all counterparties that are members of a single group of persons under common control shall be considered to be a single counterparty.**~~

~~**(iii) The person has not entered into more than 20 swaps in connection with those activities over the course of the immediately preceding 12 months. For purposes of this paragraph, each transaction entered into under a master agreement for swaps shall constitute a distinct swap, but entering into an amendment of an existing swap in which the counterparty to such swap remains the same and the item underlying such swap remains substantially the same shall not constitute entering into a swap.**~~

(ii) **Swaps entered into among one or more affiliated persons whose swaps activities are required by state or federal law or regulation to be implemented without coordination or common direction, including prohibitions on the sharing or**

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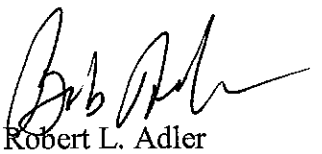
[31] Making this clarification would not run contrary to the Commissions' belief "that the word 'person' in the swap dealer and security-based swap dealer definitions should be interpreted to mean that the designation applies with respect to a particular legal person." 75 Fed. Reg. 80,185.

exchange of information about hedging or trading of any category of financial derivatives, shall not be considered when determining whether a person qualifies for the de minimis exception.

EIX appreciates the opportunity to comment on this Proposed Rule.

Respectfully submitted,



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