February 22, 2011

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

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties
(RIN No. 3038-AD25)

Dear Mr. Stawick:

The American Public Power Association ("APPA") and the Large Public Power Council ("LPPC") submit these comments in response to the Commodity Futures Trading Commission's proposed rule, "Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties," published in the *Federal Register* on December 22, 2010.[1] Specifically, the APPA and LPPC comments concern the rules proposed for swap dealers and major swap participants in their dealings with special entities. As publicly owned entities, most APPA and LPPC members would be "special entities" under section 4s(h)(2)(C) of the Commodity Exchange Act.

APPA is the national service organization representing the interests of not-for-profit, publicly owned electric utilities throughout the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and do business in every state except Hawaii. APPA utility members are load-serving entities, with the primary goal of providing customers in the communities they serve with reliable electric power and energy at the lowest reasonable cost, consistent with good environmental stewardship. This orientation aligns the interests of APPA-member electric utilities with the long-term interests of the residents and businesses in their communities.

Public power systems serve several large communities, but most public power utilities are small. Over 70 percent of APPA's members serve communities with less than 10,000 residents. Collectively, public power systems serve over 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve

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[1] 75 *Fed. Reg.* 80,638 (December 22, 2010).

the public interest. These systems take various forms. Most are municipally-owned, and these utilities may be a department of the municipality or an independent authority established under state or local law. Other forms include political subdivisions of the state, such as public utility districts or public power districts; state-owned utilities, created under state statutes; and joint action agencies ("JAAs"), formed under state law to provide wholesale power supply and transmission service to distribution entity members.

The LPPC 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. LPPC 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 customers while practicing good environmental stewardship.

APPA and LPPC member utilities that enter into swap transactions do so in order to hedge or mitigate the commercial risks inherent in delivering electricity to their customers. Chief among these are fuel price and power price risks. These public power utilities typically have risk management departments and employees experienced in evaluating energy and interest rate derivatives. These employees have the sophistication to manage their utilities' swap portfolios and should not be required to consult with an outside representative. Thus, APPA and LPPC are pleased that the Commission recognized the statute's intent in requiring special entities to have an "independent" representative. As the Commission has clarified in proposed §23.450, the special entity's representative must be "independent" of the swap dealer or major swap participant ("MSP") – not independent of the special entity (public power utility).

APPA and LPPC endorse the comments filed by the American Public Gas Association ("APGA") in this proceeding. The recommendations and clarifications requested by APGA would provide more certainty in respect to the obligations established for swap dealers and their special entity counterparties. At the same time, these recommendations would streamline the compliance process, thereby reducing the regulatory burden on the parties. In addition to the comments made by APGA, LPPC and APPA submit the following additional comments.

Pursuant to the provisions under Dodd-Frank, the Commission has Proposed Rules that would impose significant new requirements on swap dealers that act as advisors to special entities (the "Proposed Rules"). While we understand that Dodd-Frank proposes additional

requirements on swaps with special entities, we are concerned with several provisions of the Proposed Rules related to both commodity and interest rate swaps.

1. Proposed Rule 23.440(a). Swap Advisor Liability

A swap dealer that acts as an "advisor" to a special entity must, among other things, act in the best interest of the special entity. The Proposed Rules state that "advisor" status is triggered by making a "recommendation" about a swap. "Recommendation" is defined broadly to include any communication about a particular swap or trading strategy that is tailored to the needs or characteristics of the counterparty. The proposed rule specifies that a swap dealer would not be acting as an advisor merely by providing to a special entity information that is "general transaction, financial, or market information," or swap terms in response to a request for a competitive bid.[2] Under this definition, a recommendation could include, for example, an investment bank proposing a bond structuring strategy that includes a swap. The potential that these sorts of communications result in swap advisor liability means investment banks would be less willing to present financing ideas involving interest rate swaps to governmental entities.

These swap dealers provide valuable information that could not easily be obtained elsewhere. LPPC and APPA are concerned that this rule will eliminate or minimize communications between swap dealers and LPPC and APPA's members, thereby depriving the members' ratepayers of potential cost savings. Dodd-Frank does not mandate this "recommendation" standard. Further, given that special entities are required to have an independent swap advisor in connection with any swap transaction, we believe that this requirement is unnecessary. Therefore, we suggest that this requirement be eliminated provided that the party making a recommendation notifies the special entity that it is not acting as an advisor and that the special entity should consult its swap advisor regarding the potential transaction.

2. Proposed Rule 23.440(b)-(c). Reliable Reasonable Representations

Under proposed Rule 23.440(b), a swap dealer acting as an advisor to a special entity will be required to make reasonable efforts to obtain a wide range of information to determine that a recommended transaction or trading strategy is in the best interests of the special entity. The proposed rule would allow a swap dealer to rely on a special entity's representations with respect to the required information if there is a reasonable basis to believe the representations are reliable in the context of a particular transaction. The special entity's representations must also be sufficiently detailed to allow the swap dealer to reasonably conclude that the special entity is capable of independently evaluating the risks of the recommended transaction, exercising independent judgment, and absorbing potential losses associated with the transaction.

We believe that greater clarity with respect to what constitutes "a reasonable basis to believe that the representations are reliable" would benefit the relationship between swap dealers or MSPs and special entities. This could be accomplished by providing that the representations made on behalf of a special entity by a designated employee of the special entity will be conclusive unless the swap dealer has actual knowledge that such representations are untrue.

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[2] Proposed Rule 23.440(a).

Independent Representative Requirement

1. Proposed Rule 23.450(b):

Proposed Rule 23.450(b) requires swap dealers that offer or enter into swaps with special entities to "have a reasonable basis to believe that the Special Entity has a representative that" meets a variety of qualifications. The Proposed Rules do not appear to define "offer." As a result of this potentially broad definition of "offer," swap dealers may be reluctant to make proposals that involve interest rate swaps to special entities. We suggest that the rules be modified to clarify when an "offer" occurs.

A swap dealer counterparty with a special entity is responsible for determining that the special entity has an "independent" representative. The independent representative must have the knowledge to evaluate the transaction, must be independent of the swap dealer, has a duty to act in the best interests of the specialty entity, must make appropriate disclosures to the special entity, and must evaluate the pricing and appropriateness of the swap. Although it is the special entity's obligation to have an independent advisor, the swap dealer must have a "reasonable basis" to believe that these requirements are met by the independent advisor. A swap dealer may rely on written representations of the special entity to satisfy this reasonable basis requirement.

The Proposed Rules provide that this reasonable basis rule is met if the swap dealer has a reasonable basis to believe that the special entity's representations are reliable and are sufficiently detailed for the swap dealer to evaluate the representative's: (1) relationship with the special entity, (2) capability to make hedging decisions, (3) use of consultants, (4) level of experience with the financial markets and the particular swap, (5) ability to understand the swap's economic features and how market developments would affect the swap. An additional consideration in making this evaluation is the complexity of the swap.

Although there are a number of specific concerns with respect to these rules, two overriding concerns arise. First, there is concern that the approach taken in the Proposed Rules is so complex and burdensome that swap counterparties will be hesitant to engage in swaps with special entities and thereby reduce market liquidity. Second, although we appreciate that the swap dealer is permitted to rely on representations made by the special entity for these purposes, given the number and complexity of the determinations that must be made, we are concerned that swap dealers will feel compelled to overreach on their requests for representations, leading to significant negotiations, delays and costs. Swap counterparties may have an even more difficult time satisfying these requirements in the context of governmental employees serving as independent advisors. As a result, the representations required should be modified to better fit with special entities that have independent representatives that are their employees. We believe that the Proposed Rules should be modified to permit greater reliance on representations made by the special entity and without imposing new obligations on the counterparty to diligence those representations.

The Proposed rules require that the "independent representative" meet the definition of "independent." The Proposed Rules provide that to qualify as independent the representative must not have: (i) been associated with the swap dealer within the past year, (ii) a "principal" relationship with the swap dealer, or (iii) a "material business relationship" with the swap dealer.

A "material business relationship" includes any relationship during the past year that could affect the independent judgment or decision making of the representative.

The "material business relationship" standard is both broad and somewhat vague and could make it difficult for special entities to find qualified swap advisors. Further, it is up to the swap dealer to determine that this standard is satisfied, and dealers may be reluctant to take on the potential liability related to this determination. We believe greater clarity is needed on this aspect of the rules.

The Proposed Rules also provide that if the independent advisor received any compensation from the swap dealer during the prior year, that compensation must be disclosed to the special entity, and the special entity must then agree in writing that such compensation does not constitute a material business relationship between the dealer and the representative. We are concerned that instances of swap dealer compensation of advisors may be relatively common and that governmental entities may be reluctant to waive the related issue in writing, making it difficult to find a qualified swap advisor. We note that frequently swap advisors to governmental entities are paid by swap counterparties at the closing of the transaction, with the governmental entity reimbursing the counterparty over the life of the transaction through payments on the swap. This could complicate the analysis and add to the associated burdens. We suggest that the rule be modified to require only that the special entity be provided disclosure of any and all compensation related to the specific transaction.

Taken as a whole, we are concerned that the regulatory regime contemplated by the Proposed Rules will operate to make swap dealers reluctant to engage in swaps with special entities and, where they do, will drive up the costs of these transactions.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

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LARGE PUBLIC POWER COUNCIL

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Noreen Roche-Carter, Chair, LPPC Tax and Finance Task Force

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