WRIGHT & TALISMAN PC

1200 G Street, N.W.
Suite 600
Washington, D.C. 20005-3802
202.393.1200
Fax 202.393.1240
www.wrightlaw.com

February 22, 2011

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

Re: WSPP Inc. Comments on End-User Exception to Mandatory Clearing of Swaps Proposed Rule (RIN No. 3038-AD10)

Dear Mr. Stawick:

WSPP Inc. ("WSPP") respectfully submits the following comments regarding the Commodity Futures Trading Commission's ("CFTC" or "Commission") End-user Exception to Mandatory Clearing of Swaps proposed rule ("Proposed Rule").[1] As described further below, WSPP is a non-profit organization of some three hundred bulk electric energy market participants.

The Commission proposes a new section 39.6 of its regulations, 17 C.F.R. § 39.6, to set forth requirements regarding the elective end-user exception to mandatory clearing of swaps available to entities meeting certain conditions. The proposed regulation is to implement the end-user exception set forth in section 2(h)(7) of the Commodity Exchange Act,[2] as amended by Section 723 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3]

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1 *End-User Exception to Mandatory Clearing of Swaps*, 17 C.F.R. Part 39, Proposed Rule, 75 Fed. Reg. 80747 (Dec. 23, 2010).

2 7 U.S.C. § 2(h)(7).

3 *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

The Commission should ensure that its final regulations give full breadth to the letter and spirit of the end-user exception contained in the Dodd-Frank Act. While much in the Proposed Rule implements the end-user clearing exception consistent with the Congressional intent, as described below, clarifications and revisions to the language in proposed section 39.6 are required to more clearly give full breadth to the end-user exception and fully support end-users' ability to avail themselves of that exception. Some of the proposed revisions would better incorporate Congressional intent into proposed section 39.6. Other revisions would more explicitly incorporate the Commission's own intent as expressed in the Proposed Rule.

I. Description Of WSPP And Its Interest In The End-User Exception

WSPP is a non-profit organization of some three hundred bulk electric energy market participants, about one hundred and fifty of which are active in the organization. Its diverse membership includes participants from all sectors of that market: load serving entities such as investor owned utilities, public utility districts, municipal electric companies and electric cooperatives; independent power producers (generation owners); public power agencies chartered under Federal law (such as the Bonneville Power Administration and the Western Area Power Administration); and trading organizations including financial entities and aggregators.

Many WSPP members who purchase and sell power or purchase fuel supply for their generation have hedging programs to manage their price, creditworthiness, and other risks. Many if not all of these members are entitled to the benefits of the end-user clearing exception. Several other members are financial entities offering, among other things, hedging instruments.

WSPP's principal functions are to administer the WSPP Agreement, foster competitive electricity markets, serve as a neutral forum for discussion of market issues, and educate and train members about the WSPP Agreement, energy trading and related matters. Many, but not all, of WSPP's members are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC").

The WSPP Agreement is a multilateral, enabling agreement for bilateral bulk electric energy and capacity transactions. The Agreement is filed with and approved by the FERC under the Federal Power Act, 16 U.S.C. §§ 792 et seq. It is used nationally, but most extensively in the West. The pre-set terms and conditions contained in the FERC-filed WSPP Agreement eliminate the need for members to enter into separate bilateral agreements with each of their counterparties to establish trading relationships. Instead, the WSPP Agreement provides an immediate contractual basis for members to enter into bilateral energy transactions with each other by agreeing to transaction-specific price, quantity, delivery point, and schedule terms, and documenting these terms in a simple, bilateral confirmation. WSPP itself is not a party to any transaction and provides

no clearing, brokerage, or market administration function. WSPP energy transactions are forward contracts within the meaning of the Commodity Exchange Act.

II. The Commission's Final Rule Should Provide Clear And Concise Regulations Implementing The End-User Exception Consistent With Congressional Intent

Consistent with the plain language of section 723 of the Dodd-Frank Act, the Commission should ensure that its final rule provides clear and concise regulations implementing the end-user exception from mandatory clearing requirements of swaps for firms and entities that use swaps to hedge commercial risk. The final regulations should broadly facilitate end-users' application of the exception, ensuring that clearing requirements do not intrude upon or cause any diminution of end-user hedging activities associated with legitimate commercial risk. The Commission also should ensure that other rulemakings arising out of the Dodd-Frank Act do not interfere with the ability of end-users to avail themselves of the end-user clearing exception.

Section 723 of the Dodd-Frank Act amends section 2 of the Commodity Exchange Act ("CEA") to include a requirement for swaps to be cleared through a derivatives clearing organization.[4] The amendment includes an exception: the clearing requirement does not apply if one of the parties to the swap is an end-user. More specifically, the clearing requirement does not apply to a swap if one of the counterparties, "(1) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared swaps."[5] Entities exempt under the definition have the option to either clear or not to clear swaps used to hedge or mitigate commercial risk.[6]

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[4] In the Proposed Rule, the Commission stated that the Dodd-Frank Act amended the CEA "to require that: (1) Swaps be cleared through a derivatives clearing organization ("DCO") if they are of a type that the Commission determines must be cleared, unless an exception from mandatory clearing applies; (2) swaps be reported to a registered swap data repository ("SDR") or the Commission; and (3) if a swap is subject to a clearing requirement, it be executed on a registered trading platform, *i.e.*, a swap execution facility or a designated contract market ("DCM"), unless no facility or market is available for execution of such swap." Proposed Rule, 75 Fed. Reg. at 80748.

[5] 7 U.S.C. § 2(h)(7)(A), as amended by Section 723(a)(3) of the Dodd-Frank Act.

[6] 7 U.S.C. § 2(h)(7)(B), as amended by Section 723(a)(3) of the Dodd-Frank Act.

The final rule should ensure that the exception be given full breadth consistent with Congressional intent.[7] The Congress recognized that "[e]nd users who hedge their risks may find it challenging to use a standard derivative contract[] to exactly match up their risks with counterparties willing to purchase their specific exposures."[8] Moreover, it was recognized that "[s]tandardized derivative contracts may not be suitable for every transaction."[9] In short, the end-user clearing exception was intended to prevent the increased costs associated with clearing and exchange trading requirements "where there is a substantial public interest in keeping such costs low."[10]

The Commission explains that the Proposed Rule provides "a user-friendly, check-the-box approach to the Dodd-Frank Act's notification requirement."[11] These proposed check boxes would require for each swap an indication of (i) "each method used to mitigate the credit risk associated with non-cleared swaps," (ii) "whether [a] finance affiliate or a SEC Filer is involved," and (iii) "whether the swap was being used to hedge or mitigate commercial risk, as defined by proposed § 39.6(c)."[12] As discussed in greater detail in Section III of these comments below, while a check-box approach is helpful, the requirement of repetitive transaction-by-transaction notifications fails to maximize efficiency, minimize burdens and costs, and ensure consistency with the express language of new Section 2(h)(7)(A) of the CEA. The Commission should adopt an annual reporting requirement. Further, the regulatory text requires clarification to harmonize the actual rule with the Commission's intentions stated in the Proposed Rule description.

To preserve the full breadth of the end-user exception, the Commission should assure needed clarity in the definitions of certain terms not addressed in this particular rulemaking. The definitions of "Swap Dealer" and "Major Swap Participant" bear

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7 "[A] consistent Congressional directive throughout all drafts of this legislation, and in Congressional debate, has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing." 156 Cong. Rec. H5248 (daily ed. June 30, 2010) (letter from Sen. Christopher Dodd and Sen Blanch Lincoln to Rep. Barney Frank and Rep. Colin Peterson, at 2 ("Dodd-Lincoln Letter")).

8 *Id.*

9 *Id.*

10 *Id.*

11 Proposed Rule, 75 Fed. Reg. at 80755.

12 *Id.*

considerably on the breadth and effectiveness of the end-user exception and should not hinder its availability to end-users.[13] Although these definitions are subject to a separate rulemaking proceeding,[14] the Commission should assure that the results of another Dodd-Frank Act rulemaking do not defeat the statutory purposes to be implemented in the instant proceeding. More specifically, the Commission should consider whether ambiguities in these definitions would make them applicable to end-users, thereby preventing those end-users from being able to avail themselves of the end-user exception. The Congress did "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."[15] It recognized that these definitions "should not inadvertently pull in entities that are appropriately managing their risk" and that it expected "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."[16] In particular, the Congress noted that "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."[17] These considerations are relevant to ensuring that actual end-users are able to use and elect the end-user exception and are not inadvertently excluded as end-users because they are inadvertently or inappropriately captured within the definitions of Swap Dealer or Major Swap Participant.

End-users in the bulk electric industry customarily hedge against material risks including sale, purchase, and fuel prices, and credit risk. Efficient hedging requires flexibility to transact in both physical and financially-settled products, including over the counter swaps. As the Congress recognized, hedging by these entities does not create systemic risk.[18] Giving full effect to Congressional intent will support market liquidity

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13 *See* Proposed Rule, 75 Fed. Reg. at 80748, n.7.

14 *Id.* (citing *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 75 Fed. Reg. 80174 (Dec. 21, 2010)).

15 Dodd-Lincoln Letter at 3 (156 Cong. Rec. H5248).

16 *Id.*

17 *Id.*

18 156 Cong. Rec. H5244-45 (daily ed. June 30, 2010) (statement of Mr. Peters in Conference Report of H.R. 4173, the Dodd-Frank Act) (End-users that 'use derivatives to hedge legitimate business risks, do not pose systemic risk and (continued . . .)

and efficiency in the energy sector while preventing unnecessary transaction costs, all in the public interest. Given the direct, dollar-for-dollar impact of utility costs upon electric power ratepayers, that public interest is both measurable and substantial. The final rule should give full breadth to the Congressional intent and implement the robust end-user clearing exception ensuring that end-users continue to have cost-effective access to these critical risk management tools.

III. The Commission's Proposed Check-The-Box Approach For The Notification Requirements For End-users Electing To Use The End-User Exception Requires Further Clarification

Proposed section 39.6(b)(5) is intended to address the requirement that an end-user "notify the Commission of 'how it generally meets its financial obligations associated with non-cleared swaps.'"[19] The Commission proposes that each time an end-user avails itself of the end-user clearing exception, it must provide additional information to an SDR or the Commission. Specifically, on a transaction-by-transaction basis, at least ten additional items of information are required, including information to address how entities meet their financial obligations and the prevention of abuse of the end-user clearing exception. Two additional items are required if the counterparty electing to use the end-user clearing exception is an issuer of securities under Exchange Act Section 12 or required to file periodic reports with the Securities Exchange Commission under Exchange Act Section 15(d) ("SEC Filer"), including "whether the appropriate governing body of that counterparty has reviewed and approved the decision not to clear the swap."[20]

As the Commission explains, the proposed regulation "would require non-financial entities to notify the Commission each time the end-user clearing exception is elected by delivering specified information to a registered SDR or, if no registered SDR is available, the Commission in the manner required by the proposed part 49 rules for swaps data recordkeeping and reporting."[21] The Commission further explains that "[t]he notification will occur only once at the beginning of the swap life cycle" and that "[i]f one of the counterparties to the swap transaction is a swap dealer or a major swap

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(. . . continued)
because they solely use these contracts as a way to provide consumers with lower cost goods, they are exempted from clearing and margin requirements.").

19 Proposed Rule, 75 Fed. Reg. at 80749.

20 *Id.*; proposed section 39.6(b)(6) (Proposed Rule, 75 Fed. Reg. at 80757).

21 Proposed Rule, 75 Fed. Reg. at 80756.

participant, notification would be provided through that counterparty."[22] A "non-financial counterparty would provide notice only in the event its counterparty is not a swap dealer or a major swap participant."[23]

The Proposed Rule fails to implement the end-user exception fully in two respects. First, it appears to limit the ability of all end-users to elect to use the exception. Under the statutory language, the exception is available for a swap if one of the counterparties meets three criteria. Subsections 2(h)(7)(A)(i) and (ii) provide that the exception is available if one counterparty is not a financial entity and "is using swaps to hedge or mitigate commercial risk." The exception is not solely focused on entities that may be physical consumers of a commodity or on individual swaps that are tied to an entity's actual hedge or risk management. Instead the exception focuses on the nature of the entity and generally how it hedges or mitigates its commercial risk. The Proposed Rule, however, does not implement this intent and permits the exception only on a swap-by-swap basis and appears to exclude some end-users from being able to fully avail themselves of the exception.

Second, the proposal requires reporting in excess of the statutory intent. The Dodd-Frank Act requires that an end-user notify the Commission of how it "*generally* meets its financial obligations associated with entering into non-cleared swaps."[24] The Commission should adhere to the plain words of the statute and, in particular, give life to the word *"generally."* While a simple, check-the-box approach for the required notification process would be appropriate on an annual basis, the transaction-by-transaction approach of the Proposed Rule approach would be burdensome and administratively costly, and diminish overall the efficacy of the exception. The general and unimposing nature of the statutory language evinces an intent that the notification be simple and unburdensome. Stated differently, the statutory requirement of notification of how an entity *generally* meets its financial obligations is a statement of intent that reporting not be transaction-by-transaction; indeed, contrary to accepted canons of statutory construction, a transaction-by-transaction requirement deprives the word "generally" of meaning.

Additionally, to ensure that the final regulatory text clearly reflects the Commission's intentions as described in the Proposed Rule, WSPP suggests several clarifications to proposed section 39.6(b). First, proposed section 39.6(b) states that "one of the counterparties to the swap (the 'reporting counterparty') shall provide or cause to

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22 *Id.*

23 *Id.*

24 7 U.S.C. § 2(h)(7)(A)(iii), as amended by Section 723(a)(3) of the Dodd-Frank Act (emphasis added).

be provided" the required information, but does not specifically reflect or indicate the identity of the "reporting counterparty." In the Proposed Rule, the Commission indicates that the reporting counterparty is "defined in the swap data recordkeeping and reporting rules"[25] and that if one of the counterparties is a major swap participant or swap dealer, that entity would be the "reporting counterparty" for purposes of section 39.6.[26] Proposed section 39.6 does not clearly implement this intention. The section appears to define "reporting counterparty" for purposes of the section only, and does not indicate that it is intended to be the same entity defined as the "reporting counterparty" for other portions of the regulations. A cross reference to the intended definition of "reporting counterparty" or inclusion of a specific definition for purposes of the proposed section 39.6 reporting notifications would provide sufficient clarification to reflect the Commission's intention expressed in the Proposed Rule. Such clarification would avoid confusion regarding who is the "reporting counterparty" with respect to these notification requirements.

Second, proposed subpart (a) requires that if both counterparties are electing counterparties, the required information needs to be provided for both entities. When read in conjunction with proposed subpart (b) it is implied that the "reporting counterparty" would provide the information for both entities at the same time. If that is not the intent, the regulatory language should be clarified. The regulatory language also should provide a process for determining which end-user in such circumstances would be the reporting counterparty.

Third, proposed section 39.6(b) should include a cross reference to the rules for the form and manner required for delivery of the information specified to be provided. Proposed subpart (b) references that the information is to be provided "in the form and manner required for delivery of information specified under the Commission's rules" but does not indicate what those rules are or where the rules may be found. The Proposed Rule discusses that the reporting is to be in the form and manner generally required for delivery of information specified under proposed swap data recordkeeping and reporting rules, which is the subject of a separate rulemaking, and also references part 49 of the Commission rules and regulations.[27] Including cross references to the intended "Commission's rules" would provide additional clarity to the regulatory text, provide important information to end-users, and more clearly reflect the intentions of the Commission. Additionally, proposed section 39.6(b) also does not clearly reflect that the notification is intended to be a check-the-box process as discussed in the Proposed

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25 Proposed Rule, 75 Fed. Reg. at 80749.

26 *Id.* at 80756.

27 *Id.* at 80748, 80751, and 80756.

Rule.[28] Proposed section 39.6(b) should be clarified to reflect the intent that the form of reporting the required information is intended to be a check-the-box type process.

Many entities that would be eligible to elect to use the end-user exception, such as many WSPP members, are small entities that do not have internal counsel. These entities, as well as others, would benefit from clear, straightforward regulations providing all relevant information for them to comply with the requirements of the end-user exception. With the suggested clarifications, entities would be able to assess their election of the end-user exception without engaging many additional resources.

Finally, regarding the additional information requirements for SEC Filers, the Commission should clarify that the language of proposed section 39.6(b)(6)(ii) requiring indication of "[w]hether an appropriate committee of the board of directors (or equivalent) has reviewed and approved the decision not to clear the swap" is not intended to require such a committee provide its review and approval on a transaction-by-transaction basis. The Commission should clarify that the contemplated review and approval may be more general, such as for a category or type of swaps. Section 2(j) of the Commodity Exchange Act setting forth the requirement indicates that the requirement is that a committee of the issuer's board or governing body has reviewed its decision to enter into swaps that are subject to exemptions. The proposed regulation, however, appears to potentially require board approval on a transaction-by-transaction basis. Such a requirement, however, would be inconsistent with the statute and would be unduly burdensome to, and impractical for, SEC Filers electing to use the end-user exception. The Commission should clarify that the review and approval required is not required on a transaction-by-transaction basis but rather, consistent with the statutory language, on a more general basis, such as a decision to elect to use the end-user exception for certain types of swaps or in general.

Additionally, the Commission should consider whether additional provisions are necessary to address the protection of counterparties to swaps elected not to be cleared pursuant to the end-user exception. For example, if there is a potential for such a swap unexpectedly to be required to be cleared, would there be protections for the counterparties from other requirements or penalties related to cleared swaps or the unexpected change in status of the swap. Similarly, another issue that could be addressed is that if a reporting counterparty reasonably believes that the information provided to it or that it is reporting is accurate that the swap would not be subject to the clearing requirement.

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[28] *See Id.* at 80755.

IV. The Commission Should Broadly Define "Hedging Or Mitigating Commercial Risk"

In the Proposed Rule, the Commission explains that "[t]o qualify to use the end-user clearing exception with respect to a particular swap, CEA Section 2(h)(7)(A)(ii) requires that a non-financial entity must be using the swap to hedge or mitigate commercial risk."[29] The Commission further explains that under proposed section 39.6(c), the use of a swap will be deemed to be used for hedging and mitigating commercial risk if the swap fulfills any of three conditions: (i) it "[i]s economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risk arise from" six enumerated categories, including potential changes in value of assets, liabilities, services and other related items in the ordinary course of business; (ii) "[q]ualifies as bona fide hedging for purposes of an exemption from position limits under the" Commodity Exchange Act, or (iii) "[q]ualifies for hedging treatment under Financial Accounting Standards Board Accounting Codification Topic 815, Derivatives and Hedging."[30]

The definition set forth in the proposed regulation is sufficiently broad to provide end-users the appropriate ability to avail themselves of the end-user clearing exception. However, the Commission should revise the proposed regulation to clearly reflect the Commission's intention that the use of "commercial" does not exclude non-profit and governmental entities from using the end-user exception. This clarification is particularly important in view of the significant number of governmental entities that participate in the bulk energy market and related hedging activities.

The Commission should include language in the proposed regulatory text to clarify that non-profit and governmental entities, as well as for-profit companies, are permitted to avail themselves of the end-user exception and that their activities may be considered "commercial" notwithstanding their not-for-profit status. The Commission explained in the Proposed Rule that whether an activity is commercial should be determined by the underlying activity to which the swap relates and should not be determined solely by an entity's organizational status – e.g. whether it is a for-profit company, non-profit organization, or a governmental entity.[31] The regulatory text should explicitly and clearly reflect this intent.

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[29] Proposed Rule, 75 Fed. Reg. at 80752.

[30] Proposed section 39.6(c)(1) (Proposed Rule, 75 Fed. Reg. at 80757); *see also* Proposed Rule, 75 Fed. Reg. at 80752-53.

[31] Proposed Rule, 75 Fed. Reg. at 80753.

Additionally, in response to one of the Commission's specific questions, the Commission should *not* limit swaps qualifying as hedging or risk mitigating "to swaps where the underlying hedged item is a non-financial commodity."[32] Including such a limitation on swaps qualifying as hedging or risk mitigating could hamper end-users' ability to elect to use the end-user exception for many swaps that hedge legitimate commercial risk. For example, utilities selling physical electricity to retail customers may need in their daily business certain financial products, such as financial electricity contracts or financial fuel contracts, including natural gas or coal futures and should be able to hedge those contracts and use the end-user exception for such hedges.

V. Conclusion

WSPP urges the Commission to adopt a final rule consistent with the suggestions above.

Respectfully submitted,

WRIGHT & TALISMAN, P.C.
By:

/s/Arnold B. Podgorsky

Arnold B. Podgorsky
Deborah C. Brentani
Attorneys for WSPP Inc.

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32 *Id*.