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David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 25081

Re: Comments in Response to Commission NOPRs Addressing Key Definitions Referenced in Dodd-Frank and the "End User Exemption"

Dear Mr. Stawick,

The Pacific Gas and Electric Company ("PG&E") is pleased to respond to the request for comments by the U.S. Commodity Futures Trading Commission (the "Commission") regarding: (i) a Notice of Proposed Rulemaking ("NOPR") which addresses key definitions referenced in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[1]; and (ii) a NOPR which addresses the so-called "end user exemption" to the mandatory clearing of swaps required by Dodd-Frank.[2] The comment period for both NOPRs closes on February 22, 2011. Given the volume of comments we expect these NOPRs to generate and in consideration of the limited time the Commission has to implement the proposed rules, we have made every effort to keep this letter as brief as possible. If the Commission has any questions about or wishes to discuss our comments, please contact us for additional information at your earliest convenience.

In summary, for the reasons discussed herein, PG&E respectfully suggests the following:

- The broad purposes and intent of Dodd-Frank are not served by applying the new regulatory paradigm to the hedging transactions of PG&E and other regulated public utilities;

- PG&E's hedging transactions are regulated by the CPUC and the FERC and therefore should be exempt from Commission regulation;

[1] 75 Fed. Reg. 80174 (Dec. 21, 2010).
[2] 75 Fed. Reg. 80747 (Dec. 23, 2010).

- Even if the Commission determines that PG&E is not broadly exempt from Dodd-Frank, PG&E is an end user and should be covered by the "end user exemption"; and

- GHG allowances issued under California law should not be treated as "swaps" under Dodd-Frank.

PG&E is a public utility operating in northern and central California and is wholly owned by PG&E Corporation, a holding company whose primary purpose is to invest in energy-based businesses. PG&E generates revenues mainly through the sale and delivery of electricity and natural gas to our ratepayers. PG&E is primarily regulated by the California Public Utilities Commission (the "CPUC") and the Federal Energy Regulatory Commission (the "FERC"). The CPUC regulates utilities in the state of California, including electric power, telecommunications, natural gas and water companies. PG&E's accounts for electric and gas operations are maintained in accordance with the Uniform System of Accounts prescribed by the FERC.[3]

I. The Broad Purposes and Intent of Dodd-Frank Are Not Served by Applying the New Regulatory Paradigm to Hedging Transactions of PG&E and Other Utilities.

A. *Prior Regulatory Paradigm*.

Prior to the enactment of Dodd-Frank, energy commodity derivatives were broadly exempt from regulation by the Commission under the Commodity Exchange Act ("CEA").[4] For PG&E, the regulatory paradigm for our hedging programs prior to Dodd-Frank consisted of the review and oversight of such programs by our state and federal prudential regulators, the CPUC and the FERC. There is no indication of any kind that the use of swaps to hedge or mitigate commercial risks by PG&E and other utilities was in any way related to the types of systemic risk that caused the financial crisis.[5]

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[3] 18 C.F.R., Part 101 (electric), and 18 C.F.R., Part 201 (natural gas).
[4] *See* Commission's Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989); Exemption for Certain Contracts Involving Energy Products (58 Fed. Reg. 21286 (April 20, 1993); Exemption for Bilateral Transactions, 17 C.F.R. Part 35.
[5] *See* The Financial Crisis Inquiry Commission Report, January 2011 (the "FCIC Report"). The FCIC Report concludes that the financial crisis was caused by (i) the failure of Fannie Mae and Freddie Mac to understand the risks of the subprime mortgage market and the loosening of their credit underwriting standards, (ii) failure of regulatory oversight, (iii) inadequate corporate governance and executive compensation practices, (iv) inadequate capital at banks, (v) failure of credit rating agencies to conduct adequate due diligence regarding certain asset pools, (vi) failure of banks to account for risks in the housing market, (vii) misuse of over the counter derivatives related to housing, and (viii) fraud, among other causes.

B. *Purposes of Dodd-Frank.*

As indicated in both of the NOPRs referenced above, the 111th United States Congress enacted Dodd-Frank explicitly to: (i) reduce systemic risk, (ii) increase transparency, and (iii) promote market integrity.[6] In a letter from two of Dodd-Frank's primary drafters, Senators Blanche Lincoln and Christopher Dodd (the "Lincoln-Dodd Letter"), written shortly after the enactment of Dodd-Frank, the Senators wrote in pertinent part:

> 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 risk 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*.[7]

In closing, the Senators wrote:

> Regulators must carefully follow Congressional intent in implementing this bill. While Congress may not have the expertise to set specific standards, we have laid out our criteria and guidelines for implementing reform. It is imperative that these standards are not punitive to the end users, that we encourage the management of commercial risk, and that we build a strong but responsive framework for regulating the derivatives market.[8]

We respectfully submit, as described in greater detail below, that neither the broad purposes of Congress in enacting Dodd-Frank nor the specific intent of the Senators, as described above, would be served by requiring PG&E and other utilities to comply with the new regulatory paradigm enacted as part of Dodd-Frank in addition to the current state and federal regulation and supervision by the CPUC and the FERC. Indeed, there are public interest considerations supporting the Commission's exercise of its broad exemptive powers in favor of PG&E and similarly situated regulated public utilities.

II. PG&E's Hedging Transactions Are Regulated by the CPUC and the FERC and Therefore Should be Exempt from Commission Regulation.

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[6] 75 Fed Reg. 80174 and 75 Fed. Reg. 80747 ("The Dodd-Frank Act was enacted to reduce risk, increase transparency, and promote market integrity within the financial system . . .").
[7] 156 Cong. Rec. H5248 (daily ed. Jun. 30, 2010) (addressed to Representatives Barney Frank and Collin Peterson) (emphasis added).
[8] *Id.* at H5249.

Where swap transactions are required or approved (or both) by our prudential regulators, PG&E should be generally exempt from Commission oversight and should not have to rely on the "end user exemption" or exceptions to the definitions of "swap," "swap dealer," and "major swap participant." Furthermore, PG&E should be permitted to satisfy any reporting requirements under Dodd-Frank[9] by submitting copies of the reports that we prepare and submit to the CPUC and the FERC[10], provided that those reports are subject to the same level of confidentiality as required by the CPUC and the FERC.

A. *Regulation by the CPUC is Broad and Analogous to that of a Prudential Regulator.*

The California energy market is a highly regulated environment. PG&E is regulated by the CPUC with respect to our long term procurement plans and natural gas hedging programs, which are used to manage price volatility for our retail (core gas and bundled electric) customers, and exposures to fuel costs for our electricity generation assets. Under the Long Term Procurement Plan regulations, the CPUC requires PG&E to submit 10-year procurement plans

[9] *See* Dodd-Frank §§ 727 and 729 as well as the NOPRs published by the Commission at 75 Fed. Reg. 78892 (Dec. 17, 2010) and 75 Fed Reg. 76573 (Dec. 8, 2010).

[10] As a Major Electric Utility, PG&E is subject to a wide array of regular FERC reporting requirements. These include: FERC Form 1 – Annual Report of Major Electric Utility (comprehensive financial and operating report for previous calendar year), 18 C.F.R. § 141.1; 18 C.F.R. § 260.1; FERC Form 3-Q – Quarterly Report of Electric Utilities, Licensees and Natural Gas Companies (quarterly supplement to Form 1), 18 C.F.R. §§ 260.300; FERC Form 516 - Electronic Quarterly Report (summarizing power sales, and contractual terms and conditions of agreements for jurisdictional services), 18 C.F.R. § 35.10b; 18 C.F.R. § 260.401; FERC Form 566 – Twenty Largest Purchasers (annual report of identities and business addresses of twenty largest purchasers of electric energy), 18 C.F.R. § 46.3; FERC Form 714 – Annual Electric Balancing Authority Area and Planning Area Report (reporting balancing authority data including generation, system peaks, and inter-balancing authority area transfers) 18 C.F.R. § 141.51; FERC Form 715 – Annual Transmission Planning and Evaluation Report (report on transmission planning, constraints and available transmission capacity), 18 C.F.R. § 141.300. As a Hinshaw pipeline providing interstate natural gas transportation services under a limited jurisdiction blanket certificate, PG&E has additional reporting requirements, including; FERC Form 549 – Intrastate Pipeline Annual Transportation Report (summarizing transportation transactions) 18 C.F.R. 284.126(b); and FERC Form 549D – Quarterly Transportation & Storage Report for Intrastate Natural Gas and Hinshaw Pipelines, (contractual information regarding shipping and storage, effective April 1, 2011), 18 C.F.R. 284.126. PG&E must also file FERC Form 552 – Annual Report of Natural Gas Transactions (data on purchases and sales of natural gas), 18 C.F.R. § 260.401.

every two years.[11] These Long Term Procurement Plans forecast the resource needs in PG&E's service territory and propose plans to satisfy those needs.

The CPUC has jurisdiction to set the rates, terms and conditions for PG&E's electricity and natural gas retail distribution and generation and storage activities in California. The CPUC also has authority over PG&E's issuance of securities, dispositions of assets, energy purchases on behalf of PG&E's retail customers, rate of return, depreciation, and siting of natural gas transportation and electricity transmission systems.

Most importantly, the CPUC reviews and approves all ratemaking for retail sales, including all costs associated with electricity and natural gas procurement – including the costs and benefits associated with PG&E's hedging transactions. In practice, the CPUC is a prudential regulator[12] of PG&E, and the Commission should consult and coordinate with the CPUC to assure "regulatory consistency and comparability" to the extent that PG&E's hedging activities are already regulated by the CPUC.[13] The costs and burdens of compliance with duplicative or inconsistent regulation by the Commission would be passed through to PG&E's ratepayers and would therefore be adverse to the public interest.

Pursuant to an order or authorization by the CPUC, PG&E may be asked or required to help municipalities or irrigation districts create or implement a procurement plan for electricity and natural gas. Since these activities are requested or ordered by the CPUC and, in all cases, regulated by the CPUC, and are in the public interest, they should not trigger application to PG&E of the "swap dealer" or "major swap participant" rules of Dodd-Frank. For example, the CPUC may from time to time direct or order PG&E to enter into transactions that might be construed as "swaps" under Dodd-Frank in order to mitigate risk on behalf of our customers. In other cases, as part of our obligation to serve our customer loads, we may be directed to perform hedging on behalf of third parties (*e.g.*, PG&E performs certain transactions at CPUC direction for municipalities as their agent and in connection with municipal power supply contracts that provide power for PG&E). PG&E may also assist municipalities in making decisions about hedging transactions based on a CPUC order which also should not fall within Commission

[11] Cal. Pub. Util. Code § 454.5 (2010) and Rulemaking 10-05-006.
[12] We refer to the CPUC and the FERC here each as a "prudential regulator." Dodd-Frank does not literally define the CPUC or the FERC as such. Both agencies are, however, clearly regulators with oversight power and authority over issues that are essentially the same as issues overseen by those agencies that are labeled as prudential regulators with respect to financial institutions in Dodd-Frank § 712.
[13] *See* Dodd-Frank §§ 712 and 722. Under Dodd-Frank § 712, the Commission is directed to consult and coordinate with the Securities and Exchange Commission (the "SEC"), in recognition of overlapping or concurrent jurisdiction of the two agencies. Similarly, we submit that the Commission should undertake the same process with respect to the CPUC and the FERC, to effectuate the purposes of Dodd-Frank § 722.

oversight. In these and analogous cases where the utility is directed by the CPUC to engage in certain transactions that are derivatives or similar to derivatives in order to protect our customers, those activities should be exempt from Commission regulation.

B. *Regulation by the FERC is Broad and Analogous to that of a Prudential Regulator.*

PG&E is regulated by the FERC with respect to the rates we charge our wholesale customers. Specifically, the FERC regulates the prices, terms and other conditions of transactions involving transmission, energy, and capacity in interstate commerce relating to both electricity and natural gas, including interconnections with other electric systems and generation facilities. The FERC regulates the tariffs and conditions of service of the regional transmission organizations within which PG&E's electricity transactions occur, including the California Independent System Operator (the "CAISO"). That oversight extends to market design and the terms and conditions of various market products and includes extensive reporting, market monitoring, and transparency requirements for both CAISO and the CAISO's market participants, including PG&E. Because hedging activity could have a direct impact on the rates subject to FERC review and oversight, FERC can ensure full transparency and prudency of any such activity under its enforcement of the "just and reasonable" pricing standard. Finally, the FERC has jurisdiction over the licensing of substantially all of PG&E's hydroelectric generation facilities. The FERC is thus a prudential regulator of PG&E and the Commission should consult and coordinate with the FERC to assure "regulatory consistency and comparability" to the extent that PG&E's hedging activities are already regulated by the FERC.[14] The costs and burdens of compliance with duplicative or inconsistent regulation by the Commission would be passed through to PG&E's ratepayers and would therefore be adverse to the public interest.

C. *Dodd-Frank Reporting Requirements Should be Satisfied Without Requiring Real-time Reporting by PG&E.*

To the extent that PG&E's hedging transactions constitute "swaps," they will be reported by PG&E's counterparties. As described above, PG&E is required by the CPUC to submit periodic reports to the CPUC about our hedging transactions.[15] These reports are also disclosed in accordance with GAAP and the FERC's accounting system rules. If necessary, PG&E is willing to provide the Commission (or any swap data repository designated by the Commission) with copies of these reports and disclosures in order to satisfy Dodd-Frank's reporting mandate.[16] Such reports should be treated with the same level of confidentiality as required by the CPUC

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[14] *See* note 12 above.

[15] *See* Quarterly Procurement Transaction Report filed with CPUC Advice Letter 3798-E, dated January 31, 2011 and the Annual Core Procurement Incentive Mechanism Application 96-08-043, dated March 5, 2010.

[16] *See* Dodd-Frank § 727.

and the FERC. The costs of compliance with any additional reporting requirements (such as real-time reporting requirements proposed by the Commission[17]) would be passed through to PG&E's ratepayers and would therefore be adverse to the public interest.

III. PG&E's Hedging Transactions Are Covered Under the "End-User Exemption."

A. *Description of Transactions*.

PG&E faces market risks related to electric and natural gas commodity prices. PG&E uses derivatives to manage those risks and to reduce commodity price volatility for the benefit of our ratepayers. PG&E uses non-derivative contracts in order to manage our ratepayers' exposure to commodity-related price risks, such as fixed-price physical forward contracts. In addition, PG&E uses derivative instruments to manage those risks, including: (i) fixed-for-floating swaps, (ii) option contracts and (iii) futures contracts. PG&E uses derivative instruments only for non-trading purposes (*i.e.,* risk mitigation) and not for speculative purposes. PG&E's use of any or all of these instruments is subject to stringent regulatory requirements.

1. *Electricity Procurement*.

PG&E obtains electricity from a range of resources (*e.g.,* PG&E-owned electricity generation facilities). Due to the fluctuation in output of hydroelectric and other renewable power facilities, changes in ratepayers' electricity demands, economic growth and decline, weather, community choice aggregation, closure of generation facilities, and changes in market prices, the amount of electricity PG&E needs to meet our demand is in flux. Thus, PG&E also enters into third-party power purchase agreements ("Purchase Agreements") to ensure sufficient electricity to meet demand. Some of these Purchase Agreements include market-based pricing terms. In order to reduce cash flow volatility associated with fluctuating electricity commodity prices and the exposure of PG&E's customers to these price fluctuations, PG&E enters into financial swaps to effectively fix the price of future purchases under those Purchase Agreements.

PG&E has completed, and the CPUC has approved, a Long Term Procurement Plan for 2007-2016. PG&E's financial swaps related to electricity procurement are transacted in accordance with this plan. PG&E recovers the costs incurred under the Purchase Agreements and related financial swaps, as well as other electricity procurement costs, through retail electricity rates that are adjusted when the forecasted aggregate collections exceed (either over or under) 5% of PG&E's revenues. All of these costs are subject to review and approval by the CPUC and are ultimately passed through to our ratepayers.[18]

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[17] *See* 75 Fed. Reg. 76574 (Dec. 8, 2010).
[18] CPUC Decision 07-12-052.

In addition, PG&E's electric procurement portfolio is exposed to natural gas price risk through PG&E's natural gas-fired generating facilities, tolling agreements, and natural gas-indexed electricity procurement contracts. In order to reduce the future cash flow volatility associated with fluctuating natural gas commodity prices, PG&E uses: (i) futures contracts, (ii) fixed-for-floating swaps and (iii) options. These risk management strategies are periodically reviewed by the CPUC. Currently, the CPUC has ordered PG&E to continue operating under a previously approved natural gas hedging plan.[19]

2. *Congestion Revenue Rights ("CRRs").*

The CAISO controlled electricity transmission grid used by PG&E to transmit power is subject to certain transmission constraints, which subject PG&E to financial risks associated with the cost of transmission congestion. As a result, the CAISO created CRRs to allow market participants, such as PG&E, to hedge the financial risks of CAISO imposed congestion charges. The CAISO releases CRRs through an annual and monthly process, each of which includes: (i) an allocations phase, during which PG&E is allocated CRRs at no cost based on customer demand or "load," and (ii) an auction phase, during which CRRs are priced at market and available to all market participants.[20] PG&E acquires CRRs through both allocation and auction, the costs of which are filed with the CPUC in the same manner as our electric procurement costs, as described above. The CRR product is subject to the CAISO tariff and approved by the FERC[21], and PG&E's costs with respect to CRRs are subject to the review and approval of the CPUC.

3. *Natural Gas Procurement.*

PG&E enters into physical natural gas commodity contracts to fulfill the needs of our core commercial and residential customers. Fluctuations in the average daily or monthly temperature cause natural gas demand to vary daily and seasonally. Consequently, varying volumes of natural gas may be purchased or sold in the monthly or daily spot market to balance supply and demand. PG&E manages our winter exposure to natural gas commodity prices pursuant to our CPUC-approved core gas portfolio hedging program. Under this plan, PG&E has entered into financial instruments, such as swaps, options, and futures contracts, in order to reduce the risks related to natural gas commodity prices. For example, PG&E's Winter Core Gas Hedging Program allows PG&E to recover costs for hedging 90% of the volume needed to service our core gas customers assuming average winter conditions for the three month period of December

[19] CPUC Decision 06-08-027.

[20] California Independent System Operator Corporation Fifth Replacement FERC Electric Tariff (Feb. 2, 2011) § 36, available at http://www.caiso.com/pubinfo/tariffs/index.html.

[21] *Id.*

through February. PG&E files annual reports with the CPUC to ensure compliance with the CPUC-approved hedging program.

B. *PG&E's Hedging Transactions Should not be Captured by the Definition of "Swap."*

Dodd-Frank broadly defines "swap,"[22] but specifically lists the following exclusions from the definition:

- Commodity futures (and similar transactions);
- Commodity forwards (sales of nonfinancial commodities for deferred shipment intended to be physically settled);
- Transactions already subject to regulation under the Securities Act of 1933 and the Securities Exchange Act of 1934 and notes, bonds and debt, as defined by the Securities Act of 1933;
- Foreign exchange swaps entered into on a national securities exchange (unless the Treasury Secretary determines otherwise);
- Agreements with the Federal Reserve, US Government, or any federal agency as counterparty.[23]

Like swaps that are already subject to regulation under the Securities Act of 1933 and the Securities Exchange Act of 1934, PG&E's hedging transactions should be excluded from regulation under the CEA. These transactions are reviewed and approved by the CPUC and/or the FERC, which act as prudential regulators with respect to PG&E.

Furthermore, the Commission should clarify in its rulemaking that transactions such as CRRs are not "swaps" subject to the jurisdiction of the Commission. Treatment of these transactions as "swaps" under Dodd-Frank does not comport with the objectives of Dodd-Frank, and these transactions are better regulated exclusively by the CPUC and the FERC, agencies that

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[22] "Any agreement, contract, or transaction that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred." Dodd-Frank § 721, amending CEA § 1a(47).

[23] *Id.*

have extensive experience and expertise in reviewing and approving CRRs and other risk mitigation products that are offered by the CAISO.

C. *PG&E's Hedging Transactions Should not Cause PG&E to be Captured by the Definitions of "Swap Dealer" and "Major Swap Participant."*

In the event that PG&E's hedging activities are treated as "swaps" under Dodd-Frank, such hedging activity should not cause PG&E to be characterized as a "swap dealer" or "major swap participant."[24]

With regard to the definition of "swap dealer," PG&E does not: (i) hold itself out as a swap dealer, (ii) make a market or create demand for swaps, (iii) regularly enter into swaps with counterparties as an ordinary course of business for its own account, or (iv) engage in activity causing it to be known as a dealer or market maker in swaps when executing the hedging transactions described above.

Under Dodd-Frank, "an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers" is exempt from designation as a "swap dealer."[25] Although PG&E's hedging transactions do not satisfy the elements of a "swap dealer" described above, and therefore PG&E should not have to rely on the Dodd-Frank *de minimis* exception, we respectfully suggest that the *de minimis* exception: (i) should refer to the size of an entity's swap dealing activity as compared to its primary business or to the risks that such activity poses to the financial system rather than on the notional amount and number of an entity's swaps, or (ii) should be simplified by considering only the aggregate notional amount (measured on a gross basis) over a 12-month period and not considering the number of swaps or number of swap counterparties, which are not good proxies for judging whether an entity poses systemic risk.

As to the first point, we do not think that the number of swaps entered into by an entity in a 12- month period is a meaningful measure for determining whether that entity is a swap dealer. The focus, rather, should be on the aggregate notional amount of those swaps, and preferably would compare that aggregate notional amount with the total amount of the entity's business. Such a comparison would be helpful in determining whether the entity in question is creating a market for swaps, driving demand and/or straining the financial system in such a way that leads to systemic risk. As for the second point, we submit that the aggregate notional amount must not

[24] Dodd-Frank § 721, amending CEA § 1a(49) ("swap dealer") and CEA § 1(a)(33) ("major swap participant").

[25] Dodd-Frank § 721, amending CEA § 1a(49)(D). As stated in the Dodd-Frank letter, "Congress incorporated a *de minimis* exception to the Swap Dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation." 156 Cong. Rec. H5248 (daily ed. Jun. 30, 2010).

be set so low such that it would cover many entities that pose no systemic risk to the financial system; accordingly, we respectfully suggest an aggregate notional amount of $500 million during the preceding 12-month period (and $150 million for swaps with "special entities").

Under Dodd-Frank, a "major swap participant" is a person who is not a swap dealer and (i) maintains a "substantial position" in swaps; (ii) whose outstanding swaps create "substantial counterparty exposure;" or (iii) is a financial entity that is highly leveraged. PG&E does not maintain a substantial position in swaps or create substantial counterparty exposure, because all of our swaps qualify as *bona fide* hedges, which are not included when measuring the substantial position test. PG&E's hedging transactions qualify as *bona fide* hedges because they: (i) represent a substitute for transactions made or to be made in a physical marketing channel; (ii) are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; (iii) arise from the potential change in the value of assets, liabilities or services of a person, or (iv) reduce risks attendant to a position resulting from a swap that is a *bona fide* hedge.[26]

As contemplated by the Lincoln-Dodd Letter, the Commission should clarify by rulemaking that engaging in the sort of transactions described above does not subject PG&E or other regulated public utilities to treatment as a "swap dealer" or "major swap participant."[27]

D. *PG&E's Hedging Transactions Qualify for the "End User Exemption."*

Under Dodd-Frank, it is unlawful for any person to engage in a swap unless the person submits such swap for clearing. The statute carves out any swap where one of the counterparties to the swap: (i) is not a "financial entity;" (ii) is using swaps to "hedge or mitigate commercial risk;" and (iii) notifies the Commission about how it generally meets its financial obligations associated with entering into non-cleared swaps.[28] This is the so-called "end user exemption."

PG&E enters into the transactions described in Section III(A) above for the purpose of hedging or mitigating commercial risk. The CPUC regularly reviews and approves these transactions as appropriate to the reduction of risks in the conduct and management of PG&E's commercial enterprise. More specifically, the CPUC reviews and approves these transactions as a necessary risk management activity that ultimately benefits PG&E's ratepayers. Equally important, the transactions described above are not used for speculation, investment or trading.

IV. *Conclusion.*

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[26] *See* Dodd-Frank § 737(c), amending CEA § 4a(c).
[27] *See* note 7 above.
[28] Dodd-Frank § 723, amending § 2(h)(7) of the CEA.

PG&E's hedging activities: (i) do not create a market in swaps or drive demand for swaps; (ii) do not implicate the purposes of Dodd-Frank; (iii) are mandated, reviewed and approved by the CPUC; and (iv) are subject to FERC regulation. These kinds of derivative transactions should not be regulated by the Commission under Dodd-Frank. Clarity and certainty regarding the applicability of the definition of "swap," "swap dealer," and "major swap participant" as well as certainty as to PG&E's status as an "end user" will save PG&E significant and unnecessary compliance expense, which would ultimately be passed through to our ratepayers. Accordingly, exempting PG&E's hedging transactions is in the public interest.

V. Other Comments

Carbon Market Study.[29]

In 2006, California enacted Assembly Bill 32 ("AB 32"), which requires that the state reduce its greenhouse gas emissions to 1990 levels by 2020.[30] As part of AB 32, and similar to the Regional Greenhouse Gas Initiative or "RGGI" in the Northeastern United States, the California Air Resources Board ("CARB") will establish a cap-and-trade program with reporting, monitoring, and other requirements similar to the RGGI system. An overall limit on greenhouse gas emissions from capped sectors will be set by the program, and facilities subject to the cap will be able to trade permits ("GHG allowances") to emit greenhouse gasses. Investor-owned facilities such as PG&E are required to auction the allowances that are allocated to it for the cap-and-trade program.[31] For the reasons cited in the *Report on the Oversight of Existing and Prospective Carbon Markets,*[32] these greenhouse gas allowances should be considered emissions permits. For the same reasons, the related market on which they will be traded will be overseen by CARB and/or other California state agencies and, as a primary market[33] therefore does not require oversight by the Commission. We respectfully request that the Commission clarify by rulemaking that these GHG allowances issued pursuant to AB 32 are not "swaps" as defined by Dodd-Frank.

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[29] See Dodd-Frank § 750.
[30] Cal. Health & Saf. Code § 38562. *See* http://www.arb.ca.gov/cc/inventory/1990level/1990level.htm.
[31] Cap-and-Trade Proposed Regulation Order § 95892(c). *See* www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf.
[32] Interagency Working Group for the Study on Oversight of Carbon Markets, *Report on the Oversight of Existing and Prospective Carbon Markets* (Jan. 18, 2011). *See* www.cftc.gov/ucm/groups/public/@swaps/.../dfstudy_carbon_011811.pdf.
[33] *See id.* at p. 51.

We thank the Commission for the opportunity to comment on the NOPRs described above. If the Commission would like any further information or elaboration on the information presented in this letter, please contact me at your earliest convenience. We very much appreciate your time and effort on these matters.

Very Truly Yours,

Steven L. Kline