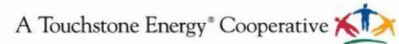
**National Rural Electric Cooperative Association**




April 11, 2011

***Electronically Filed***

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

**RE: Comments of Edison Electric Institute, and National Rural Electric Cooperative Association, 17 CFR Part 23, Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants**
**76 Fed Reg. 6708 (February 8, 2011)**
**RIN No. 3038-AC96**

Dear Mr. Stawick:

The Edison Electric Institute ("EEI") and the National Rural Electric Cooperative Association ("NRECA") (hereafter "Joint Associations") respectfully submit these limited comments in response to the Commodity Futures Trading Commission's ("Commission's" or "CFTC's") Notice of Proposed Rulemaking on the Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants ("NOPR") published February 8, 2011 in the *Federal Register*. In the NOPR, the Commission invites public comment on proposed rules setting forth parameters for the inclusion of liquidation termination parameters in swap trading relationship documentation for swap dealers and major swap participants.[1]

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[1] NOPR at 6708.

## I. Description of Joint Associations and Interest in Proceeding

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI also has more than 65 international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members. EEI's members are not financial entities and do not pose the systemic risk that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[2] sought to address. Rather, the typical EEI member is a medium-sized electric utility with relatively low leverage and a conservative capital structure.

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members. The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act ("SBREFA").[3] Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. The RFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (the "SBA"). The SBA's small business size regulations state that entities which provide electric services are "small entities" if their total electric output for the preceding fiscal year did not exceed 4 million megawatt hours.[4] NRECA is grateful to ACES Power Marketing which has provided considerable assistance and support in developing these comments.

Joint Associations' members are largely end users,[5] as contemplated by the Dodd-Frank Act, of energy and energy-related commodity swaps, and they engage in such swaps to hedge commercial risk. As such, Joint Associations' members are likely to enter into uncleared, bilateral transactions for which they generally use an International Swaps and Derivatives Association ("ISDA") Master Agreement, including appropriate credit support and other annexes. Any provisions negotiated by the parties are included in these agreements, including

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[2] Pub. L. No. 111-203 (2010).
[3] 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996).
[4] 13 C.F.R. §121.201, n.1
[5] CEA § 2(h)(7). Although the term "end user" is not defined in the CEA, the "end user clearing exception" is available to non-financial entities that use swaps to hedge or mitigate commercial risk, and that notify the Commission as to how they generally meet their financial obligations associated with entering into non-cleared swaps.

protections in the event one party files for bankruptcy or enters receivership under the laws and prudential regulations, if any, applicable to such party.

## II. Comments

In the NOPR, the Commission proposes to require that "swap dealers and major swap participants include in the documentation with each of their counterparties a provision that confirms both parties' understanding of how the new orderly liquidation authority under Title II of the Dodd-Frank Act ("Title II") and the Federal Deposit Insurance Act ("FDIA") may affect their portfolios of uncleared, over-the-counter, bilateral swaps."[6] In addition, the Commission proposes to require counterparties to agree contractually to the process set forth in Title II -- which includes a one day stay on the termination, liquidation or netting of swaps with a covered financial company as defined in Title II.[7] While Joint Associations recognize that these provisions are contained in Title II, as further explained below, Joint Associations oppose the Commission's proposal to require inclusion of these provisions in swap dealer or major swap participant contracts with end users.

First, Joint Associations agree with the Commission's acknowledgment in its proposed rule that it "is not granted explicit authority under Title II."[8] Nor does the Commission identify any provision under Title VII that requires the Commission to enact the proposed rule. While recognizing that it does not have jurisdiction, the Commission attempts to justify the proposed rule by indicating that Title II recognizes the need for US financial authorities to work together. Clearly, if the Federal Deposit Insurance Corporation ("FDIC") is appointed as the receiver of a swap dealer or major swap participant for which the Commission is the primary regulator, then the FDIC must consult with the Commission.[9] However, the consultative process will take place regardless of whether the Commission has in place this proposed rule and regardless of whether the proposed provisions are included in the swap dealer or major swap participant's swap documentation. A statutory provision intended to encourage cooperation among federal agencies does not provide Congressional authority for the Commission to unilaterally establish new jurisdiction for itself. Rather, Congress was explicit throughout the Dodd-Frank Act when it intended for new jurisdictional authorities to be granted to federal agencies.

One of the concerns with having two agencies assert jurisdiction at the same time is the possibility of differing and conflicting requirements. This is illustrated by the fact that the NOPR states that the proposed language "very closely tracks the statutory language of section 210(c)(10)(B) of the Dodd Frank Act."[10] The NOPR does not state that the language is identical

[6] NOPR at 6709.
[7] Id. at 6711.
[8] *Id*. at 6711.
[9] *Id*.
[10] *Id.*

to that in the statute which could lead to conflicting language with the statute as well as with any rule eventually promulgated by the FDIC. Commissioner O'Malia raised this issue in his dissent when he stated that "…neither the proposal regarding an explicit consent to transfer, nor the discussion regarding affiliates and cross default agreements is a reflection of language already included in Title II or FDIA."[11] Accordingly, given the absence of statutory support for this proposed rule, Joint Associations request that the Commission refrain from pursuing a rulemaking in this area and allow the FDIC to take the lead as contemplated by the statute.

Second, as indicated by Commissioner O' Malia in his dissent, the "proposal would require Dealers and MSPs to include a provision in their swap documentation which will prevent their counterparties from exercising certain private, contractual rights in the event that a swap becomes subject to the processes of either Title II or FDIA."[12] The Commission only proposes to include this provision in uncleared, bilateral contracts, which are more likely to be with end users who may avail themselves of the end user exception to mandatory clearing.[13] The effect of the proposed rule is not just on the swap dealers or major swap participants, but also on their counterparties. For the reasons that follow, Joint Associations suggest that end users would be particularly harmed by the implementation of this proposed rule. Essentially, the provision requires the counterparties to a potential "covered financial company" (a "potential CFC"), including energy swap end users, to defer exercise of closeout rights and, perhaps, to lose the benefit of negotiated contractual setoff rights in the event that their swap dealer or major swap participant counterparty is determined by the FDIC to be subject to either Title II or FDIA receivership. Thus, energy swap end users would be asked to unilaterally waive valuable contractual rights. Joint Associations are concerned that the Commission's proposed rule would require end users to defer or lose the benefit of certain valuable contractual rights that are consistent with the bankruptcy laws, and that the proposed rule does not evaluate the significant costs or consequences to end users of such impact.

Another impact of the proposed rule would be to disadvantage end users in master agreement negotiations and administration with their potential CFC counterparties. The ISDA master agreements executed by energy end users and their counterparties typically govern both financial swaps and physical transactions. The Commission's proposal will increase energy swap end users' credit risk exposure in respect to swaps executed under such an ISDA (as unsecured creditors to these potential CFCs) if the energy swap end users are required to (a) delay close out or giving effect , to any setoff rights or (b) be subject to a forced transfer in which all swaps between it and a potential CFC are transferred by the FDIC to another, unknown entity thereby leaving behind all physical transactions. In the event of a stay on an end user's ability to terminate, close-out and net its transactions with a potential CFC, the end user is

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[11] 76 *Federal Register* 6727 (February 8, 2011) ("Commissioner O' Malia's Dissent")
[12] *Id*.
[13] NOPR at 6709 footnote 6.

exposed additional market movement. The amount owed to it by a defaulting covered financial company could simply increase during the period of the stay. Similarly, an end user is faced with the loss of negotiated netting benefits, if its swaps are transferred without its consent to another entity. Prudent credit risk management practices, in this circumstance, would dictate that an end user needs to collect margin or collateral from the potential CFC for swaps and physical transactions separately to avoid such a scenario. In other words, the only way for an end user to adequately protect itself is to require separate collateralization or margin be posted for swap transactions and physical commodity transactions with potential CFC counterparties. However, requiring separate collateralization and netting of swaps and physical commodity transactions will eliminate one of the primary benefits of using master agreements to cost-effectively hedge commercial risks using swaps.

In addition, the proposed rule would require amendments to all master agreements that potential CFC counterparties have in place, including with energy swap end users. If the energy swap end users are required by regulation to contractually agree to defer or lose the benefit of valuable rights, and as a consequence must separately collateralize swaps and physical commodity transactions to effectively protect themselves against the credit risk caused by this regulatory requirement, it will be at significant cost to the energy swap end users' ability to hedge commercial risks using swaps. Thus, it will be the end users that bear the unintended consequences of this proposed rule. Due to this possibility of unintended consequences and costs for energy swap end users, Joint Associations would like to explore these issues carefully with the Commission prior to having the Commission require inclusion of such provisions in all swap dealer and major swap participant contracts if the Commission decides to proceed with this rulemaking.

The Joint Associations support Commissioner O'Malia's dissent and request that the Commission not proceed with this rulemaking. Please contact us if you have any questions regarding these comments.

Respectfully submitted,

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