

June 3, 2011

**Via Online Submission**

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

Re: **COMMENTS OF EDISON ELECTRIC INSTITUTE**– Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act; Global Comment

Dear Mr. Stawick:

On May 4, 2011, the Commodity Futures Trading Commission ("CFTC" or "the Commission") issued a notice in the Federal Register<sup>1</sup> reopening and extending the comment periods of certain proposed rules issued to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").<sup>2</sup> The Commission stated that because the rulemaking process for Dodd-Frank implementation was "substantially complete," it was "reopening or extending the comment period of many of its proposed rulemakings in order to provide the public with an additional opportunity to comment on the proposed new regulatory framework for swaps, either in part or as a whole."<sup>3</sup> The Commission specifically indicated that it was hoping to receive "additional quantitative or qualitative information relating to the costs and benefits of the proposed rules."<sup>4</sup>

In accordance with the Notice, the Edison Electric Institute ("EEI") provides these comments on various Notices of Proposed Rulemakings ("NOPRs") affecting its members' interests and proposed by the Commission pursuant to Dodd-Frank. Although these comments will discuss specific NOPRs, they are focused on the process EEI believes the Commission ought to follow to ensure that its final rules constitute a consistent, comprehensive, and clear set of regulations that are appropriately directed at the harm that Dodd-Frank is intended to prevent.

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve ninety-five percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately seventy percent of the U.S. electric power

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<sup>1</sup> Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011) ("Notice").

<sup>2</sup> Public Law No. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> Notice at 25275.

<sup>4</sup> *Id.*

industry. EEI also has more than sixty-five international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members.

EEI has participated in the Commission's Dodd-Frank rulemaking process since August 2010 through individual company and group meetings with members of Commission staff, as well as through comments. EEI understands and appreciates the enormity of the effort that the Commission has undertaken to understand the many and diverse requirements of Dodd-Frank and to propose the multiple rules required to create the entirely new regulatory regime needed to implement those requirements. At this juncture, therefore, it makes sense to step back and consider whether there are any overarching principles the Commission could follow to help it ensure that the final ensemble appropriately implements the statute.

As end-users that principally use swaps to hedge commercial risk, EEI's members have approached their evaluation of the proposed rules from two perspectives:<sup>5</sup> (1) a cost perspective, with a focus on the costs and the potential burden of implementation that the proposed rules would entail; and (2) a compliance perspective, with a focus on the degree of complexity and technical sophistication that new processes they develop to enable them to comply will require. EEI has concerns with some of the Commission's rule proposals when evaluating them from both perspectives and offers these comments to assist the Commission as it develops its final rules.

Given the magnitude and scope of what must be done to implement Dodd-Frank, EEI offers the following "Governing Principles": (1) postpone the issuance of any regulatory requirements that are not specifically required by Dodd-Frank until core requirements are implemented and both regulators and industry gain more experience; (2) provide as much specificity and clarity as possible in the regulations that are issued; (3) limit the direct and indirect costs of the rules, including compliance costs as much as reasonably possible; (4) develop and require a post-final rules implementation process, relying where possible on industry standard-setting organizations, designed to yield straightforward and user-friendly tools and accompanying software that enable compliance standardization; and (5) do not sacrifice any of the foregoing to meet a deadline not required by the statute.

EEI believes that if the Commission follows these Governing Principles, its ability to bring about a smooth and orderly implementation of Dodd-Frank will be greatly enhanced. The central concept of the Governing Principles is to seek out the core components of the required regulatory scheme and create a set of final rules that gets the job done in a manner that is clear, fair, cost-effective, and implementable. As end-users, EEI's members expect to be among the class of entities that will ultimately pay the costs of implementing Dodd-Frank.

1. Postpone Enacting Any Rules or Imposing Any Regulatory Requirements That Are Not Specifically Required to Put Dodd-Frank's Core Requirements Into Effect

Some of the most burdensome features of the proposed rules are not required by Dodd-Frank. When the scope and magnitude of these required elements is weighed against their supposed benefits, the only conclusion is that the Commission should eliminate them from its

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<sup>5</sup> Of course, the EEI and its members have submitted comments to many of the individual proposed rules.

final rules. Any consideration of these requirements should be deferred until the core Dodd-Frank requirements are implemented. They should not be taken up until both regulators and industry gain more experience and can discern whether these measures are necessary for the overall Dodd-Frank regulatory regime. Set forth below are examples of such proposed requirements:

- Position Limits:<sup>6</sup> As observed by many commenters, position limits are not required by Dodd-Frank, and the Commission does not have sufficient information to make the finding required by Commodity Exchange Act ("CEA") to impose position limits.<sup>7</sup> The position limits rule as proposed is likely the most directly burdensome, confusing, and costly rule that would potentially affect end-users.<sup>8</sup> Given the significant burden they would impose and the lack of any basis that such limits are appropriate at this time, the Commission should decline to impose position limits.<sup>9</sup>
- Real-Time Reporting for End-Users:<sup>10</sup> When viewed through the prism of a cost/benefit analysis, there is no meaningful basis upon which to require end-users to report transactions in real-time. The number of transactions for which end-users would be required to report under the proposed rules is expected to be low, but the cost and burden of developing and implementing the systems and processes needed to comply would be substantial; it is likely that very few, if any, end-users are capable of meeting the proposed requirements without the implementation of significant upgrades to their computer systems and processes. In addition, as proposed by the Commission, such reporting could inadvertently reveal the identity and confidential trading positions of end-users due to location-specific aspects of hedging trades.<sup>11</sup> For these reasons, this requirement should therefore be eliminated.<sup>12</sup>
- Daily Reporting and Valuation Reporting for End-Users:<sup>13</sup> There is no regulatory purpose served by requiring end-users to submit data regarding their swaps on a daily basis.

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<sup>6</sup> Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011).

<sup>7</sup> See Dodd-Frank § 737(a)(4) (as codified at 7 U.S.C. § 6a(a)(2)(A)) ("[T]he Commission shall . . . establish limits on the amount of positions, *as appropriate* . . .") (emphasis added); Comments of EEI/EPISA – Position Limits For Derivatives at p 2 (March 28, 2011).

<sup>8</sup> See Comments of EEI/EPISA – Position Limits For Derivatives at p 6 (March 28, 2011).

<sup>9</sup> *Id.* at 5 ("Absent a finding that explains why particular position limits are 'necessary' to diminish, eliminate, or prevent excessive speculation, the Joint Associations believe that the Commission lacks the statutory authority to set, and therefore should not set, position limits."); Comments of the Utility Group – Position Limits For Derivatives at p 3 (March 28, 2011) ("Dodd-Frank does not require the issuance of a position limits rule.").

<sup>10</sup> Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76140 (Dec. 7, 2010).

<sup>11</sup> Comments of EEI/EPISA (Coalition of Energy End-Users) – Real-Time Public Reporting of Swap Transaction Data at p 3 (Feb. 7, 2011) at p 3, n8 ("Because of a bespoke swap's inherently unique terms, counterparty identities or positions are highly likely to be identifiable if such nonstandardized swap terms are publicly reported.").

<sup>12</sup> *Id.* at p 3 ("End-user to end-user swap transactions should not be subject to real-time reporting.").

<sup>13</sup> See Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76574 (Dec. 8, 2010).

There is also no regulatory benefit from requiring the provision of valuation data by end-users at all.<sup>14</sup> Neither is required by Dodd-Frank, and neither, if in place before the financial crisis, would have had any impact on the events that unfolded in the financial markets at that time.

- Reporting of Transactions That Are Not Swaps: The proposed rules include reporting requirements for data concerning physically settling transactions that are not swaps.<sup>15</sup> The Commission should remove any non-jurisdictional transaction types from its proposed datasets.<sup>16</sup> Moreover, this proposed rule will require end-users to implement costly new processes and system changes to be in compliance.

## 2. Provide as Much Specificity and Clarity as Possible in the Regulations That Are Issued

The final rules will together constitute a comprehensive regulatory scheme that will be in place for years. It is critical that the regulations be specific and clear. The regulatory preamble to a regulation is a useful interpretive tool, but the Commission should not expect market participants to determine whether their interpretations of overly general or vague regulations, which regulations will actually govern their behavior, are correct. Regulatory preambles, like legislative history, are not regulations and do not control.<sup>17</sup>

An example of proposed regulatory text that is vague and hard to interpret is the Commission's proposed definition of a Swap Dealer.<sup>18</sup> Unlike the clear and detailed language defining a Major Swap Participant, the language proposed for Swap Dealer is long on noting "tendencies" that Swap Dealers have, but short on actual, detailed requirements. It should be

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<sup>14</sup> See Comments of EEI/EPISA (Coalition of Energy End-Users) – Recordkeeping and Reporting of Swap Transaction Data at p 7 (February 7, 2011) ("An end-user's opinion of forward market value will add nothing to the understanding of the forward market values in liquid transparent markets.").

<sup>15</sup> See *id.* at p 4 (noting that certain primary economic terms proposed to be reported under Recordkeeping and Reporting NOPR relate to physically delivered products, which should be eliminated from the proposed set of reportable data).

<sup>16</sup> *Id.* ("As each of these items ['Settlement Method' (cash or physical) and 'Delivery Type' (for physical delivery)] relates to physically delivered products, the Commission should eliminate them from the data that any party with a reporting obligation must report.").

<sup>17</sup> *Nat'l Wildlife Fed'n v. EPA*, 286 F.3d 554, 570 (D.C. Cir. 2002) ("It is the language of the regulatory text, and not the preamble, that controls.").

<sup>18</sup> 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); Comments of EEI/EPISA – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" at p 5 (February 22, 2011) ("[T]he Joint Associations believe that the Commission can provide greater certainty for market participants and more effectively advance the Dodd-Frank Act's goal of promoting financial stability by modifying the final regulatory text to define with more detail the activities that constitute dealing, and therefore, which entities will be required to register as swap dealers.").

replaced with clear and specific language, such as the language proposed by EEI in its Comments to the relevant NOPR.<sup>19</sup>

3. Limit the Direct and Indirect Costs of the Rules, Including Compliance Costs, as Much as Possible

There are many examples of burdensome and costly requirements that are not necessary to accomplish Dodd-Frank's regulatory mission. Some examples of possible improvements in current proposals are as follows:

- End-User Exception Notice: Dodd-Frank requires that end-users "notify" the Commission of the manner in which they generally meet their financial obligations associated with non-cleared swaps.<sup>20</sup> Rather than permit an end-user to provide such a notification once in a comprehensive and detailed manner subject to an update for any changes, the Commission has proposed that the notification be made every time an end-user elects not to clear a swap.<sup>21</sup> This is simply not necessary. Nothing in a notice for one swap would differ from information provided in a detailed, one-time notification regarding how an end-user manages its financial obligations for all swaps.<sup>22</sup> Moreover, this proposed rule will require end-users to implement costly new processes to be in compliance.
- Swap Dealer/Major Swap Participant Documentation Requirements:
  - Eligibility Documentation: As proposed by the Commission, an end-user that elects to opt out of clearing must not only inform its Swap Dealer/Major Swap Participant counterparty of its decision to opt out, but also it must furnish documentation that the Swap Dealer/Major Swap Participant counterparty can use to determine that the end-user is acting in accordance with the statute.<sup>23</sup> This proposal is not only burdensome and potentially fatal to many transactions where time is of the essence, but also requires the sharing of confidential and proprietary information that may not be subject to sufficient confidentiality protections.<sup>24</sup> The

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<sup>19</sup> *Id.* at pp 6-8, 11, 18.

<sup>20</sup> Dodd Frank § 723(a)(3) (as codified at 7 U.S.C. § 2(h)(7)(A)(iii)).

<sup>21</sup> *See* End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747 at 80748 (Dec. 23, 2010).

<sup>22</sup> *See* Comments of EEI/EPSC - End-User Exception to Mandatory Clearing of Swaps at p 5 (February 22, 2011) ("[T]he Joint Associations believe that the Commission . . . should establish a Financial Obligation Notice that allows end-users to provide this general information once, and to update it as necessary.").

<sup>23</sup> Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715, 6726 (Feb. 8, 2011) (proposed § 23.505(a))

<sup>24</sup> *See* Comments of EEI, National Rural Electric Cooperative Association, American Public Power Association, and Large Public Power Council – Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants at pp 9-10 (April 11, 2011) ("Joint Electricity Associations Documentation NOPR Comments") ("[The end-user opt out documentation requirement]

Commission should eliminate this burdensome proposal and require no more than a representation of compliance from the end-user for counterparty reliance.

- Swap Valuation: The Commission has also proposed that every swap include an objective valuation formula that is susceptible to third party valuation replication.<sup>25</sup> As parties to such swaps, EEI members do not believe that this burdensome requirement is workable or advisable.<sup>26</sup> Similar to the "documentation" requirement addressed above, such a requirement would hinder the efficient execution of trades and potentially prove fatal due to timing issues in a dynamic and constantly moving market.<sup>27</sup> Further, and more importantly, this requirement will prove extremely difficult if not impossible to implement given the dynamic market conditions in electricity markets. It is also completely unnecessary; the burdens are not justified by a compelling regulatory purpose.<sup>28</sup> Accordingly, this requirement should be eliminated.
- Business Conduct Standards for Swap Dealer/Major Swap Participants: The Commission has proposed pervasive business conduct standards for Swap Dealers/Major Swap Participants.<sup>29</sup> These requirements effectively change the nature of the current relationship that end-users have with their counterparties to one that resembles the relationship between a securities trader and a broker/dealer.<sup>30</sup> End-users may not be Swap Dealers or Major Swap Participants, but they are also not unsophisticated entities. The result of this unnecessary rule will therefore be increased costs to end-users without any countervailing regulatory benefit. In fact, the requirement will create more risk for the financial systems because of its potential chilling effect on hedging transactional activity.<sup>31</sup> The Commission should scale back this rule to ensure that normal business conduct between sophisticated counterparties can continue without undue burden and cost.<sup>32</sup>

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creates the burdensome need to provide some sort of undefined documentation to the counterparty that will delay commerce and could even prevent a swap from being executed as the market moves.").

<sup>25</sup> 76 Fed. Reg. 6715 at 6726 (proposed § 23.504(b)(4)).

<sup>26</sup> See Joint Electricity Associations Documentation NOPR Comments at p 5.

<sup>27</sup> *Id.* at 6 ("The requirement that the parties also negotiate a formulaic valuation of the swap in question simply adds to the negotiation and documentation effort needed[, which] is unwarranted and potentially disruptive.").

<sup>28</sup> *Id.*

<sup>29</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 Fed. Reg. 80638 (December 22, 2010).

<sup>30</sup> See Comments of Exelon Corporation - Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties at p 2 (February 22, 2011).

<sup>31</sup> *Id.* at p 3 ("If the NOPR's regulations are implemented as proposed, . . . canned and scripted statements will be the core of communication with SD/MSP counterparties since unsupervised communication could trigger the need for further disclosure or risk a violation and litigation.").

<sup>32</sup> *Id.* at p 4.

4. Develop and Require a Post-Final Rules Implementation Process, Relying Where Possible on Industry Standard-Setting Organizations

Much of Dodd-Frank requires both an industry-wide, commonly-agreed set of processes and protocols, and significant information technology components for implementation. EEI is confident that these items can be sorted out in due course. It would be burdensome and wasteful for end-users to be compelled to comply with Dodd-Frank (for example, the proposed reporting rules) until these necessary prerequisite matters are resolved.<sup>33</sup> Accordingly, the Commission should announce a clear process that incorporates a path to standardization and defer non-Swap Dealer/Major Swap Participant compliance until such standardization is accomplished.

5. Do Not Sacrifice Clarity, Consistency, and Cost Effectiveness to Meet an Implementation Deadline Not Required by the Statute

Now that the Commission's body of proposed rules is substantially complete, the enormous scope and breadth of the rules and the Commission's efforts to implement them are truly evident. The regulations proposed by the Commission are highly diverse and require a complex series of new processes and systems to implement a regulatory regime which is also entirely new. And, unlike regulation of the securities industry, for example, which evolved over many years, the Commission and industry is faced with the difficult task of implementing these complex requirements over a very brief period of time. EEI urges the Commission to not rush to issue a body of regulations that do not achieve the clarity, consistency and cost effectiveness that are the hallmarks of good industry regulation. In simple terms, the Commission should "measure twice and cut once."

The Commission has sufficient flexibility in Dodd-Frank to phase the issuance of rules as well as their implementation dates to produce an orderly implementation process. Although the earliest effective date for many of Dodd-Frank's rules was 360 days from its enactment, in most cases the rules can be made effective over a period that is at least 60 days from the date of each final rule's issuance. This allows the Commission to build its final rules in a common-sense manner: to start with basic definitions of "swap," "swap dealer," and "major swap participant"; to next build strong institutions such as swap execution facilities, derivative clearing organizations, and swap data repositories who provide the institutional support for new swaps markets; to then implement the mandatory clearing, exchange-trading, reporting, recordkeeping, and other rules controlling those new markets; and then, finally, to implement the obligations of swap dealers and major swap participants in a phased manner that is synchronized to the development of the new markets and the institutions that support them.

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<sup>33</sup> For example, there are several elements of the proposed reporting fields that could be better aligned with the terminology and conventions of the electricity marketplace by including an electricity-specific set of reporting tools or a key to use to correctly report electricity trades in existing Commission-identified categories. Once the Commission provides clarity on reporting terminology, it will need to provide a user-friendly reporting convention to facilitate the massive data transfer from multiple sources that will be required to accomplish the reporting contemplated in the NOPRs. It is EEI's experience that an open and collaborative process conducted by an industry standard-setting organization is the best method to accomplish this result.

## **Conclusion**

EI believes that if the Commission adheres to the Governing Principles proposed herein and makes the specific changes proposed above, as well as other similar changes based upon the suggested principles, its implementation of Dodd-Frank will be more likely to create a workable regulatory scheme that best serves the intended regulatory purpose.

Respectfully submitted,

/s/ Richard F. McMahon, Jr.

Richard F. McMahon, Jr.  
Vice President  
Edison Electric Institute  
701 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004  
Phone: (202) 508-5571  
Email: [rmcmahon@eei.org](mailto:rmcmahon@eei.org)