dcenergy

June 3, 2011 *Via Electronic Submission*

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

Re: *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant",* RIN No. 3038-AD06

Dear Mr. Stawick:

On May 4, 2011, the Commodity Futures Trading Commission ("Commission") published in the Federal Register a reopening and extension of the comment periods for the rulemaking proceedings implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act. DC Energy, LLC ("DC Energy")[1] appreciates the opportunity to provide supplemental comments, particularly now that DC Energy and others can consider the various rulemakings in context with each other. As highlighted by these comments, the proposed rulemaking defining "Swap Dealer" is significantly linked with the proposed rulemakings establishing the various requirements for swap dealers, including but not limited to the proposed rulemaking establishing an initial $20 million tangible net equity capital requirement for swap dealers, along with additional capital requirements to address market risk and OTC derivates credit risk, and the proposed rulemaking establishing margin requirements for swap dealers. DC Energy is concerned that the proposed

[1] DC Energy and a number of its affiliates operate under Federal Energy Regulatory Commission-approved market-based rate electricity tariffs and are active in the electricity and related RTO/ISO financial markets as well as in the over-the-counter electricity and natural gas markets. DC Energy and its affiliates engage in the purchase and sale of financial transmission rights, purely financial energy-related transactions (*i.e.*, virtual energy transactions) and certain cross-control area energy transactions.

definition of swap dealer in conjunction with the proposed capital and margin requirements for swap dealers may have an unintentional negative impact on the energy industry, particularly on energy aggregators and power marketers that are not financial entities, end-users or commercial hedgers, but that also do not resemble or act like a dealer.

The Commission Should Adopt a Definition of Swap Dealer that Clearly Exempts Non-Financial, Non-Major Swap Participants that are Not Commercial Hedgers, End-Users, or Dealers But are Entities Entering into Swaps to Benefit from Future Market Price Changes

An overly broad definition of "swap dealer," coupled with a very narrow de minimis exemption, is likely to include a number of energy entities that do not create systematic risk for the markets, but could result in these relatively small market participants being disproportionately impacted by the Commission's proposed margin and capital requirements for swap dealers. DC Energy is filing these comments in order to provide the Commission with a few illustrative examples of energy entities that may be unintentionally included in the swap dealer definition as currently proposed by the Commission. These comments highlight some of the non-financial, non-major energy swap participants that are neither end-users nor physical energy participants, but instead are energy swap participants that would be Major Swap Participants if they were larger and had a "substantial position" as defined by the Commission in its proposed definition for Major Swap Participant.[2] These types of entities should not be included in the definition of swap dealer or, alternatively, should be included in any de minimis exemption.

[2] Rulemaking RIN Number 3235-AK65, 17 CFR Part 1 Securities and Exchange Commission 17 CFR Part 240 Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant".

1. Aggregators that Serve Retail Energy Consumers, Retail Energy Suppliers, and/or Demand Side Customers

In the energy industry, in particular in regions where there is retail electricity and/or natural gas competition, aggregators have begun to participate in the retail energy markets. Some aggregators help retail energy customers (such as individual consumers, organizations and/or businesses) form a buying group for competitive energy services, which allows the group to buy retail electricity and/or natural gas in bulk from a competitive energy supplier. In addition to energy aggregators that work directly with retail energy consumers, there also are aggregators that provide aggregation services to retail energy suppliers. In particular, the aggregators help the retail energy suppliers meet their obligations to wholesale energy providers, wholesale energy transmission providers, and/or utilities.

In addition to aggregators that provide retail supply-related services to retail energy suppliers and/or retail energy consumers, there also are commercial entities that provide energy demand side aggregation services to energy end-users. As the Commission is aware, demand side energy services have grown in response to rising energy costs, the development of Smart Grid, and the Administration's and various States' push towards renewable energy sources. These aggregators allow small end-user loads to participate in the larger energy markets and to be compensated for such participation. A demand side aggregator generally acts as an intermediary between an ISO/RTO or utility and end-users that provide demand response. For example, an end-use customer may participate in a curtailment and/or time-of-use pricing program in order to reduce total system demand during peak periods, with the aggregator interfacing between the end-user and/or the end-user's Smart Grid meters and the ISO/RTO.

As the retail energy and demand side aggregator models continue to develop and mature, aggregators may want to offer ancillary services to their customers, such as offering financial/price protection options for the demand side or supply price risks. In order to provide such services, an aggregator would likely bundle the positions of all of its aggregation customers and then enter into swaps with various counterparties in order to effectively hedge its aggregation customers' price risks. Although the aggregator is effectively providing a hedging service to its aggregations customers, the aggregator is not hedging its own commercial risk but hedging the bundled risk of its customers. In addition, the aggregator will probably not be able to tie each of its swaps to a particular end-user or a particular hedgeable risk as the aggregator will be entering into certain swaps based on its understanding of energy market fundamentals and the bundled risk of all of its customers.

Given the emerging nature of the energy aggregator business, a $20 million initial capital requirement coupled with ongoing capital and margin requirements could cripple these businesses before they can develop into self-sustaining enterprises. If the aggregator is classified as a swap dealer and subject to significant capital and margining costs as a result of offering such ancillary services to its aggregation customers, then the aggregator is likely to only act as an agent in the swap market for its aggregation customers. As a result, any economies of scale would be significantly diminished and each individual aggregation customer position would likely be too small to be attractive to other potential swap counterparties and/or the transaction costs for such swaps would be too expensive. In addition, to the extent such aggregators become successful and are providing financial/price protections for a number of customers at significant levels (*i.e.*, the aggregator has a "substantial position"), the Commission's proposed Major Swap Participant requirements should address any concerns with potential systematic risks.

2. Non-Financial Power Marketers Making Proprietary Trades

Similar to the above energy aggregators, there also are other energy entities, such as non-financial proprietary energy traders and power marketers, which assist in creating liquidity in the energy market while not imposing a systematic risk on the markets. To the extent such swap participants are large enough and have a "substantial position" to create a potential systematic risk, they should be fully covered by the Commission's proposed requirements for Major Swap Participants. DC Energy is not suggesting that the Commission's definition of swap dealer should not include any power marketers. To the contrary, there may be certain power marketers that do act as points of connection for other entities to access the swap market and are willing, ready, and able to take any number of positions on either side as long as they believe that they can enter into a similar number of swaps with opposite positions. However, the Commission's definition of swap dealer should not include by default all non-financial proprietary energy traders or power marketers that are not hedging commercial risk, but instead are entering into swaps based on market fundamentals.

In the electricity markets, proprietary traders are likely to be licensed by the Federal Energy Regulatory Commission as power marketers with market-based rate tariffs. These power marketers are likely to participate in the wholesale power markets by making physical sales and/or purchases as well as by participating in the various RTO/ISO financial markets. Based on their knowledge and views of the underlying electricity commodity markets, power marketers also are likely to enter into power swaps, with many of the swaps being cleared. Given the number of potential counterparties, as well as the short-term nature of some swap transactions, even a relatively small power marketer is likely to enter into more than twenty swaps over a one-year period and also is likely to

enter into swaps with more than fifteen counterparties over a one-year period.

Generally, as part of its larger power trading, marketing and sales business, a power marketer's decision to enter into a swap with a counterparty (which usually is a power generator, end-user, wholesale supplier or utility) is based on the power marketer's view of the underlying power market and future price expectations. Unlike a dealer, the power marketer is not entering into a "buy" swap in order to profit by entering into a "sell" swap. Power marketers may approach a counterparty or may be approached by a counterparty regarding a specific swap. However, in neither case is the power marketer accommodating demand for swaps or entering into the swap in response to interest by the counterparty, instead the power marketer enters into a swap for its own business reasons. At no time is the power marketer holding itself out as a point of connection for other entities to access the swap market, but instead has relationships and experience in the relevant power market and is entering into swaps based on its market fundamentals.

For example, a power marketer may have a primary business function of maintaining proprietary fundamental models of power prices in a specific region. This power marketer will then use its models to guide proprietary trading decisions in power contracts, including fixed-block power swap contracts. There are hundreds of locations with cleared swap power contracts, each of which has very distinct risk and volatility regimes with most of the liquidity and volatility in the last two months of tenor. A power marketer may focus on only a handful of these and may take positions in those locations for the last two months of trading. A single, monthly cleared swap contract in power typically has a notional value of $1MM and initial margin of $80,000. Therefore, a power marketer with $1MM of margin capital can realistically be expected hold a dozen open contracts and trade this a dozen times a year for a total annual notional traded volume in excess of

$100MM. Since contracts for power locations away from the "major hub" will not be liquid, this power marketer may have to rely on transactions with end-users such as customers or physical suppliers to achieve its intended trades. As a result, the power marketer could realistically trade with a number of distinct counterparties despite a small geographic focus. For power locations away from "major hubs", the market is fairly illiquid, which means that the transaction volumes are so low that there is no profit model for a dealer. A dealer's risks to operate in such illiquid markets are high because the dealer may not be able to find a counterparty for the other side of a position that it has taken.

As long as the power marketer is not (1) holding itself out as a dealer and (2) does not have bid-asks around the "market" and is not standing willing, ready and able to take any number of positions on either side as long as it believes it can enter into a similar number of swaps with opposite positions (*i.e.,* acting as a market maker), but instead is entering into swaps based on its view of market dynamics and expected price changes, the power marketer should not be treated like a swap dealer subject to a $20 million initial capital requirement, additional credit and market risk capital requirements, and margin requirements. To the contrary, this type of swap participant is much more like a physical energy supplier taking a material commercial position in the commodity in order to further a commercial interest than it is like a swap dealer that is profiting from the bid-ask spread by offering bid-asks around the "market". Both the power marketer and the physical energy market participant decide to enter into a swap in order to benefit from that entity's views of the underlying energy market and future commodity price changes. Neither type of energy market participant is acting as an intermediary or dealer that is indifferent to which side of a position it takes with any particular counterparty, but instead each is a taking a business-based position in one direction based on its view of the underlying

commodity market. In both scenarios, the entity may change its position in response to underlying commodity market changes, but not to take advantage of both sides of a position. For these reasons, the proprietary energy trader entering into swaps based on market fundamentals should be deemed to be a non-dealer, non-major swap participant or should qualify for a de minimis exemption, unless it has a "substantial position" and qualifies as a Major Swap Participant.

Respectfully submitted,

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