

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D. C. 20426

July 22, 2011

OFFICE OF THE GENERAL COUNSEL

*VIA ELECTRONIC SUBMISSION*

David Stawick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

**Re: Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (File No. S7-16-11)**

Comments of the Staff of the Federal Energy Regulatory Commission

Dear Mr. Stawick:

On April 29, 2011, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) issued a joint notice of proposed rulemaking (NOPR)<sup>1</sup> pursuant to various provisions of the Commodity Exchange Act (CEA)<sup>2</sup> and the Securities Exchange Act of 1934,<sup>3</sup> as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),<sup>4</sup> in which they propose to adopt rules implementing the provisions of Dodd-Frank that would define the term “swap” and certain other terms. Staff of the Federal Energy Regulatory Commission (FERC) submits these comments on the proposals as they relate to transactions involving electricity and natural gas that are subject to FERC’s jurisdiction.

FERC regulates the transmission and sale for resale of electricity in interstate commerce pursuant to the Federal Power Act (FPA),<sup>5</sup> as well as the

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<sup>1</sup> 76 Fed. Reg. 29,818 (May 23, 2011).

<sup>2</sup> 7 U.S.C. §§ 1 et seq. (2006).

<sup>3</sup> 15 U.S.C. §§ 78a et seq. (2006).

<sup>4</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> 16 U.S.C. §§ 824 et seq. (2006).

transportation and sale for resale of natural gas in interstate commerce pursuant to the Natural Gas Act.<sup>6</sup> Generally, FERC has a statutory mandate to ensure that all rates charged for these sales or services are just, reasonable, and not unduly discriminatory or preferential. This responsibility extends to contracts or other arrangements and practices that significantly affect those sales and services. In this regard, section 722(e) of Dodd-Frank declares that nothing in Dodd-Frank “shall limit or affect any statutory authority of the Federal Energy Regulatory Commission . . . with respect to an agreement, contract, or transaction that is entered into pursuant to a tariff or rate schedule approved by the Federal Energy Regulatory Commission . . . and is (I) not executed, traded, or cleared on a registered entity or trading facility; or (II) executed, traded, or cleared on a registered entity or trading facility owned or operated by a regional transmission organization or independent system operator.”<sup>7</sup>

We have previously submitted comments on other proposed Dodd-Frank implementing rules in which we raised concerns that the CFTC’s regulation of swaps could, depending on how broadly the term “swap” is construed, lead to inconsistent regulation of participants and transactions in the wholesale electricity and natural gas markets subject to FERC jurisdiction, and in particular the organized markets.<sup>8</sup> As we noted in our prior comments, we are concerned that transactions such as financial transmission rights (FTRs), forward capacity sales, and day-ahead market transactions conducted in the organized markets that FERC regulates, i.e., regional transmission organizations (RTOs) and independent system operators (ISOs), could be subject to regulation as “swaps,” depending on how that term is defined. Based on these concerns, we have stated that the CFTC should interpret and apply the CEA, as amended by Dodd-Frank, to ensure that CFTC jurisdiction and FERC jurisdiction do not overlap (except as determined by Congress in anti-manipulation contexts).

Dodd-Frank excludes from the definition of “swap” “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as

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<sup>6</sup> 15 US.C. §§ 771 et. seq. (2006).

<sup>7</sup> Dodd-Frank § 722(e) (adding new § 2(a)(1)(I)(i) to the CEA).

<sup>8</sup> We addressed these concerns in a letter dated February 22, 2011 submitted in response to the CFTC’s request for comments on various proposed swap-related definitions. That letter can be found among other comments submitted in comment file RIN 3235-AK65.

the transaction is intended to be physically settled.”<sup>9</sup> In the NOPR, the CFTC provides guidance on the applicability of the exclusion from the definition of the term “swap” under CEA section 1a(47)(B)(ii) with respect to nonfinancial commodities (which would include electricity and natural gas). Specifically, the CFTC states that forward contracts with respect to nonfinancial commodities are “commercial merchandising transactions,” the primary purpose of which is to transfer ownership of the commodity and not to transfer solely its price risk.<sup>10</sup> The CFTC also states that the forward contract exclusion in Dodd-Frank<sup>11</sup> should be read consistently with established, historical understanding that a forward contract is a commercial merchandising transaction.<sup>12</sup> The CFTC also provides guidance, based on established precedent, that a forward contract in a nonfinancial commodity does not lose its character as such if the parties enter into a subsequent, separately-negotiated agreement to settle or cancel their respective obligations,<sup>13</sup> and that a forward contract that contains an embedded option would be considered an excluded nonfinancial forward contract (and not a swap) if certain conditions are met, including that the option feature does not render delivery optional.<sup>14</sup>

In general, FERC staff supports a broad interpretation of the swap definition forward contract exclusion, using concepts from the CFTC’s precedent on the CEA’s forward contract exclusion from the term “future delivery.” FERC staff supports codification in regulatory text of such an interpretation of the swap definition forward contract exclusion.

Further, it would be appropriate to include in the regulatory text a listing of the kinds of contracts and transactions that are excluded from the definition of “swap” as commercial merchandising agreements (without, however, making any determination whether, in the absence of any such express exclusion, such

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<sup>9</sup> Dodd-Frank § 721(a)(21) (adding new CEA § 1a(47)(B)(ii)).

<sup>10</sup> NOPR at 29,828.

<sup>11</sup> CEA section 1a(47)(B)(ii).

<sup>12</sup> NOPR at 29,828.

<sup>13</sup> NOPR at 29,829.

<sup>14</sup> NOPR at 29,830.

agreements would fall within the definition of a swap). This type of list would help provide regulatory certainty in the energy industries. However, a detailed listing of all such excluded commercial merchandising agreements commonly used in the electric and natural gas industries is not feasible. Thus, if the CFTC chooses to adopt a list of excluded commercial merchandising agreements involving electricity and natural gas, it should be made clear that the list is not intended to be exhaustive and comprehensive.

Finally, citing section 722(f) of Dodd-Frank, which amended CEA section 4(c), the CFTC indicates that it intends to consider the status of transactions in FERC-regulated RTOs and ISOs, including FTRs, under the standards and procedures specified in section 722 rather than through this joint rulemaking.<sup>15</sup> Of course, if and when any such section 4(c) public interest exemption applications are filed, FERC staff may have further comment. We point out, however, that transactions that are executed or traded on RTOs/ISOs should be excluded from the definition of “swap,” whether because they are deemed commercial merchandising transactions or because defining these transactions as swaps is inconsistent with the text, goals, and purpose of Dodd-Frank. As we have stated in prior comments, Dodd-Frank terms should be interpreted as not applying to any contract or instrument traded in an RTO/ISO market pursuant to a FERC-accepted or approved rate schedule or tariff.

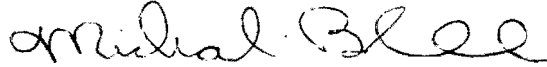
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<sup>15</sup> NOPR at 29,839.

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FERC staff thanks the CFTC and the SEC for soliciting comments on the  
NOPR.

Sincerely,

A handwritten signature in black ink that reads "Michael Bardee". The signature is written in a cursive style with a large initial "M" and a long, sweeping underline.

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