

July 22, 2011

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

RE: Product Definitions, File No. S7-16-11

Dear. Mr. Stawick:

In its proposed rules for further definitions of “Swap”, “Security-Based Swap”, “Security-Based Swap Agreement”, “Mixed Swaps”, and “Security-Based Swap Agreement Recordkeeping”¹, the Commodity Futures Trading Commission (“CFTC” or “Commission”) explicitly acknowledges that it intends to continue to use its historical interpretation of the “forward contract exclusion”² from the definition of “swap” under the Dodd-Frank Act. For the reasons set forth below, we, the Renewable Energy Markets Association (REMA), believe that environmental commodities, such as Renewable Energy Certificates (RECs), are physically settled, and therefore satisfy the Commission’s longstanding precedent for a forward contract exclusion from the definition of “swap”.

Because the Commission seeks comments on the proposed definition of the term “swap”, specifically on whether the forward contract exclusion should apply to environmental commodities, REMA is pleased to provide the following comments to the Commission. REMA represents the collective interests of both for-profit companies and nonprofit organizations that sell or promote renewable energy products, including renewable technology, renewable electricity, and RECs to individuals, companies and institutions throughout North America.

¹ 76 FR 29818

² 76 FR 29826

Renewable Energy Markets are Robust and Expanding

Companies involved in the generation, marketing, and sale of RECs are spread evenly across the nation and serve all areas of the renewable energy market. According to the U.S. Department of Energy's Green Power Network, there are currently 133 marketers actively selling to small and large customers, and 20 environmental brokers that facilitate REC transactions between buyers and sellers nationwide.³ These providers sell renewable electricity that is differentiated from standard electricity. There are also thousands of solar photovoltaic (PV) providers in the U.S. who sell PV systems directly to end-use customers, including large commercial and government customers.

There is a robust and expanding U.S. market for renewable energy and other environmental commodities due in part to state compliance requirements, corporate sustainability efforts, and consumer demand for green power, to name a few. In 2009, U.S. consumers made voluntary purchases of renewable energy totaling in excess of 30 million megawatt hours (MWh), a 17% increase over 2008 levels. Further, voluntary purchases of renewable energy have grown at an average annual rate of 41% since 2005.⁴ Renewable energy has made impressive progress in the U.S.; however, the presence of additional regulatory measures would deter its ability for future success.

RECs are "Physically Settled"

As other commenters have previously noted, RECs, allowances and other environmental commodities are either "commodities" or "nonfinancial commodities," as proposed by the Commission. Furthermore, the spot or forward delivery of these products are "physically settled" and, therefore, when they are purchased and sold through contractual agreements, they fall within the exclusion from the definition of "swap" in Sections 1a(47)(B)(i) and (ii) of the Commodities Exchange Act as amended by Section 721(a)(21) of the Dodd-Frank Act.⁵ While at first blush it might appear to one that RECs and other environmental commodities lack the corporeal elements to be "physically settled" as all that is seen transferred is a paper certificate, further examination of this market shows why this is not actually the case.

³ U.S. Department of Energy, Energy Efficiency and Renewable Energy Office, Green Power Network, <http://apps3.eere.energy.gov/greenpower/markets/certificates.shtml?page=2>, 22 June, 2010, compiled 15 Nov. 2010.

⁴ L. Bird, J. Sumner, Green Power Marketing in the United States: A Status Report (2009 Data), Golden, CO: National Renewable Energy Laboratory, pg. v, Sep. 2010, 2 Nov. 2010, http://www.renewablemarketers.org/pdf/resources/NREL_2009_VRE.pdf.

⁵ Environmental Markets Association comments to File No. S7-12-10 filed September 20, 2010.

A REC represents the right to the environmental attributes associated with one megawatt-hour of electricity generated by an eligible renewable resource. In effect, the REC is an intangible contract right or interest in that specific quantity of energy; thus, it is quite analogous to a warehouse receipt that represents title to a physical commodity. Furthermore, RECs are actually settled and transferred with a title using electronic tracking systems or paper contracts. These systems of record allow RECs to be delivered from the renewable generator to the purchaser and eventually to the end user, who can claim to own the environmental attributes. The physical transfer of the title is a necessary component of the sale of a REC, since the REC itself serves no other purpose than to allow transfer of the environmental benefit ownership claim.⁶ Quite simply stated, if actual delivery did not occur, the market would not function. As a result, RECs strongly parallel other “traditional” commodities (i.e., corn, wheat or oil) whose market transfer requires physical settlement.

That is why the transfer of a REC is similar to the delivery of a bushel of wheat and different from a pure financial swap where only price risk is transferred. As the Commission itself notes, forward contracts with respect to nonfinancial commodities, such as environmental commodities, are simply commercial merchandizing transactions of which the purpose is to transfer ownership of the commodity (i.e., in the case of a REC in the [environmental attributes associated with] electricity generated via a renewable source) *and not to transfer a price risk.* (emphasis added).⁷

Further evidence that the industry has long recognized the physical nature of a REC can be found in commonly used REC agreement such as the Edison Electric Institute’s “EEI Master Power Purchase and Sale Agreement.” Contained within that document is a REC annex that essentially treats RECs as physical commodities. Specifically, the annex notes that in order [for renewably generated power] to qualify as a REC, it must be traded as a physical commodity that must be physically settled, (through a registry); and it may be bundled or unbundled with the underlying power MWH.⁸

⁶ See, e.g., Green-e National Energy Standard, available at http://www.greene.org/getcert_re_stan.shtml. See also Jeremy Weinstein, Contract Techniques for Renewable Resource Power Purchase Agreement Off-Takers, Chapter 20 in Kramer & Fursaro, eds., ENERGY AND ENVIRONMENTAL PROJECT FINANCE LAW AND TAXATION: NEW INVESTMENT TECHNIQUES, Oxford University Press, 2010.

⁷ 76 FR 29828

⁸ Edison Electric Institute, “EEI Master Power Purchase and Sale Agreement,” see, <http://www.eei.org/ourissues/ElectricityGeneration/Documents/EEI%20RECs%20Annex%20v1%200.doc>

The term “physical settlement” has not previously been defined by the Commission. REMA recommends that the Commission adopt a straightforward definition for physically settled, which is in line with previous Commission consideration on the issue. REMA recommends that “physical settlement” be defined as such, “Physical Settlement is the settling of contractual obligation through transfer of title to the commodity underlying the transaction, from one party to another.” This definition would be easy to administer and allow market participants certainty regarding their transactions. If there is a transfer of title, and the rights inherent in the ownership of title, between the seller and buyer, the transaction has been physically settled. If the parties choose to instead make a cash payment or offset their obligations, then a physical settlement has not occurred.

The spot and forward delivery of RECs typically occurs through (1) the transfer of the REC over a tracking system from seller’s account to buyer’s; (2) seller’s permanent retirement of the REC in seller’s tracking system account in buyer’s name, and seller transferring an attestation to buyer which memorializes the retirement and rights conferred on buyer pursuant to the retirement; or (3) if neither seller nor buyer have a tracking system account, seller will issue a paper attestation conferring title to the REC to buyer.⁹ In scenarios 1 and 2, title is transferred to buyer via the tracking system. In settlement scenario 3, title is transferred to buyer via the delivery of the attestation. In all scenarios, exclusive title to the REC, and all of the rights which are inherent in title to the REC, are transferred from the seller to the buyer.

The transfer of RECs constitutes physical settlement under previous Commission determinations, as well as straightforward definitions, therefore, when RECs are purchased and sold through forward agreements, they fall within the exclusion from the definition of “swap” in Sections 1a(47)(B)(i) and (ii) of the Commodities Exchange Act as amended by Section 721(a)(21) of the Dodd-Frank Act.¹⁰ The defining characteristic of physical settlement is the transfer of title, and when RECs are transferred, title is transferred from the seller to the buyer.

⁹ Sometimes parties do not open or maintain tracking system accounts because there are fees associated with opening and maintaining an account, and additional fees for transferring and retiring RECs. In order to avoid these fees, a party can gain title to the REC, and all of the associated rights and benefits in the REC through the paper transfer of title.

¹⁰ Environmental Markets Association comments to File No. S7-12-10, filed September 20, 2010.

Preventing Any Possible Misuse of the Forward Contract Exclusion

The Commission also seeks comment on whether the application of the forward contract exclusion to environmental commodities would permit transactions that should be subject to new regulatory regime for swaps to fall outside the Dodd-Frank Act. As outlined above, REMA firmly believes that environmental commodities, and RECs in particular, fully satisfy the criteria established by precedent of the Commission to qualify for the forward contract exclusion, and that this exclusion has served a valuable historical purpose.

Renewable Energy Markets Would Be Harmed if RECs Were Considered Swaps

It must be clearly articulated that inclusion of a REC within the definition of a 'swap' would generate substantial barriers to the renewable energy markets, its participants, and renewable energy project development overall. RECs provide wind farms, solar facilities and other renewable energy project owners with revenues outside of those from the sale of electricity alone. However, new regulatory burdens could impede the growth of the renewable energy market through new financial regulatory requirements originally designed to curb risky financial transactions. For instance, these requirements could include mandatory clearing of REC trades over a floor subject to a to-be-determined liquid collateral posting, and burdensome new reporting and oversight requirements for participating swap dealers. Together, these new obligations would raise transaction costs for everyone, from developers to marketers to end users, thereby making it more difficult and expensive to support renewable energy and creating barriers to the industry's growth.

Increased costs from unnecessary regulatory requirements could also have the very real impact of reducing green power participation from both commercial and residential customers. Renewable energy project developers would most likely respond to a drop in customer demand by slowing the pace of new installations. Reducing the reach and effectiveness of voluntary renewable energy purchases through regulatory requirements, especially at a time of declining government support for renewable energy, could damage the progress that has been made towards a clean energy economy.

Concluding Remarks

REMA encourages the CFTC to take its recommendations on the placement of RECs in the forward contracts exemption under serious consideration. The U.S. government has been a strong proponent for the use of RECs in promoting renewable energy deployment. The White House Council on

Environmental Quality (CEQ) has issued guidance to federal agencies outlining the role of RECs as a product that may be used to reduce greenhouse gas emissions.¹¹ Further, the U.S. Department of Energy has led federal agencies in the purchase and use of RECs, not only as the third largest purchaser of green power products from various generation sources and suppliers,¹² but also by recognizing utility and non-utility suppliers of renewable energy—suppliers that sell RECs—as leaders in their fields.¹³ Today’s rulemaking is an opportunity for the CFTC to continue the federal government’s renewable energy leadership and partnership through the recognition of RECs as “physically settled.”

Again, REMA appreciates this opportunity to submit its comments to the CFTC and hopes that the agency will carefully consider the impact that financial regulations will have on the growth and health of renewable energy markets. For either questions or clarifications regarding REMA’s formal comments, please contact Josh Lieberman, REMA General Manager, at 202-457-0868, x322 or jlieberman@ttcorp.com.

Sincerely,



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¹¹ U.S. Council on Environmental Quality, *Federal Greenhouse Gas Accounting and Reporting Guidance*, 6 Oct. 2010, pg. 23-25, http://www.whitehouse.gov/sites/default/files/microsites/ceq/GHG%20Guidance%20Document_0.pdf

¹² U.S. Environmental Protection Agency, *Green Power Partnership: Top 10 Federal Purchasers*, 5 Oct. 2010, <http://www.epa.gov/greenpower/toplists/top10federal.htm>.

¹³ U.S. Environmental Protection Agency, *2010 Green Power Leadership Awards*, 24 Oct., 2010. <http://epa.gov/greenpower/awards/winners.htm>