DEFINITION OF "SWAP"

July 22, 2011

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

Re: Comments on Joint Proposed Rules and Proposed Interpretations on Further Definition of "Swap," "Security-Based Swap," "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (17 CFR Part 1) RIN No. 3038-AD46

Dear Mr. Stawick:

The Electric Trade Associations[1] respectfully submit these comments to the Commodity Futures Trading Commission (the "Commission") on the joint proposed rules and proposed interpretations issued by the Commission and the Securities and Exchange Commission (the "SEC") captioned **Further Definition of "Swap," "Security-Based Swap," "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping**[2] (the "Swap Definition NOPR") pursuant to the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

[1] The National Rural Electric Cooperative Association ("NRECA"), the American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the Edison Electric Institute ("EEI") and the Electric Power Supply Association ("EPSA"). See Attachment A for a description of the members of each Electric Trade Association. The comments contained in this filing represent the comments and recommendations of the Electric Trade Associations, but not necessarily the views of any particular member of any one or more of the Electric Trade Associations on any issue. The Electric Trade Associations are authorized to note the involvement of the following organizations and associated entities to the Commission, and to indicate their full support of these comments and recommendations: the Transmission Access Policy Study Group (an association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing, and The Energy Authority.

[2] 76 Fed. Reg. 29,818 (May 23, 2011).

This rulemaking represents the single most important proceeding to the electric industry and its customers arising from the Commission's implementation of the Dodd-Frank Act. Consumers throughout the United States are facing higher electricity prices, less infrastructure investment (including in green technologies), and more unhedged energy market price risk, due to the Commission's failure (for more than a year after the Dodd-Frank Act was enacted, and for more than 10 months after being directly asked by the electric industry) to answer a simple question: "Does the Commission contend that the broad array of nonfinancial commodity transactions used by the electric industry to meet Americans' need for 24/7 electric power are "swaps" under the Dodd-Frank Act?" Based on clear Congressional intent, the answer must be "no." But the Commission is respectfully requested to give the electric industry the certainty it needs, to issue proposed rules for comment, and to respond to the electric industry's requests promptly, directly and completely.

The Dodd-Frank Act defines "swap" in a new, broad and heretofore uninterpreted manner. The word no longer has the meaning it had under the CEA and the Commission's regulations prior to the Dodd-Frank Act.[3] Nor does it have the common meaning used by energy finance and credit professionals prior to the Dodd-Frank Act.[4] As the Commission acknowledges in the Preamble to the Swap Definition NOPR, the words in the new statutory definition "could be read" to encompass many types of common commercial transactions, and yet "nothing in the Dodd-Frank Act or the legislative history suggests that such transactions should be regulated as swaps."[5] It seems clear to the Electric Trade Associations from the commentary in the Preamble that the Commissions assume that a "swap" is a transaction that by

---

[3] As the Commission acknowledges in footnote 13 to the Preamble of its "Commodity Options and Agricultural Swaps" NOPR, 76 Fed. Reg. 6095 at 6096: "Prior to the Dodd-Frank Act, the Commission had defined "swap" as follows: A swap is a privately negotiated exchange of one asset or cash flow for another asset or cash flow. In a commodity swap [including an agricultural swap], at least one of the assets or cash flows is related to the price of one or more commodities." (See 72 Fed. Reg. 66,099, note 7, Nov. 27, 2007).

[4] Among energy finance and credit professionals, the term "swap" is commonly understood to mean a derivative agreement, contract or transaction that *by its terms calls for financial settlement*, with the financial settlement based on a change in value of an underlying commodity, asset, event or occurrence. In further defining this critical statutory term, the Proposed Rules merely reference the statute, in Proposed Rule 1.3(xxx), then reiterate as "swaps" a list of transaction types that include the defined term itself (*e.g.* "cross-currency swaps"), and then add an incomplete list of certain industries' agreements, contracts and transactions that are not "swaps." The Proposed Rules provide regulatory text for the insurance industry and the foreign exchange industry to comment on. The Proposed Rules do not provide regulatory certainty for the electric industry, and instead put the burden of proposing rules on the industry.

[5] 76 Fed. Reg. at 29,821. In fact, the words in the statutory definition have been read as ambiguously broad by numerous commenters over the past 10 months. *See*, for example, Gagoomal, Prashina and Young, Mark D., "Dodd-Frank's Product Quandaries: What's In, What's Out, What's What?" Futures and Derivatives Law Report, February 2011, for an analogy to the iconic Abbott and Costello "Who's On First?" dialogue that articulates the confusion felt by many commercial entities that are not professional participants in the financial markets industry.

its terms calls for financial settlement. A direct clarification of that fact in the rules of the two Commissions would provide regulatory clarity.

The Electric Trade Associations first filed comments asking the Commission to further define "swap" in response to the Commission's inaugural rulemaking under the Dodd-Frank Act, the "Definitions ANOPR" in September 2010.[6] In those comment letters, we asked the Commission (1) to clarify the "nonfinancial commodity forward contract" exclusion from the defined term "swap" in a manner consistent with Commission precedent, (2) to define the statutory term "nonfinancial commodity,"[7] (3) for regulatory clarification of exemptions under the Commodity Exchange Act (the "CEA"), including confirmation that exemptions in the Commission's pre-Dodd-Frank Act rules and interpretations, such as the trade option exemption, would be available to exclude a transaction from the definition of "swap,"[8] and (4) to initiate proceedings, as it has the authority to do under Section 4(c) of the CEA, for the "public interest waivers" that Congress instructed it to grant under new Section 4(c)(6) of the CEA.[9] We agree in general with the approach the Commission describes in the Preamble to the Swap Definition NOPR in terms of how the Commission should draft its rules. By this letter, the Electric Trade Associations respectfully renew each of their requests – for the Commission to implement this approach and draft such rules, consistent with these and prior comments.

The Electric Trade Associations comment on behalf of their members, which are producers, generators, processors, refiners, merchandisers or commercial end users of nonfinancial energy commodities, including electric energy and natural gas – commercial (or "nonfinancial") entities which are given the statutory right under the Dodd-Frank Act, as "end

---

[6] 75 Fed. Reg. 51,429 (Aug. 20, 2010).

[7] See the comment letter dated September 20, 2010 by EEI and EPSA, at p. 2, and the comment letter dated September 20, 2010 by the "NFP Energy End User Coalition," at p. 7-8.

[8] See the comment letter dated September 20, 2010 by EEI and EPSA, at p. 6. "The Commission should clarify that option contracts that settle into [nonfinancial commodity] forward contracts are not swaps." See also the comment letter dated September 20, 2010 by the "NFP Energy End User Coalition," at p. 7. "Physical forward commodity transactions, commercial option transactions, and option-like aspects of ordinary course "full requirements" natural gas and electric energy transactions could be captured within the new regulatory paradigm. Although Congress has repeatedly indicated that its intention was NOT to capture commercial transactions or impose new costs on end users hedging risks of traditional commercial businesses, Congress is relying on the regulators to implement that intent and ***write clear rules***… The NFP Energy End Users are relying on the CFTC to ***draft clear rules***, to make clear how current interpretations, no action positions and precedent under the CEA should be read in light of the Act's new and different regulatory structure, and to conduct all necessary exemption proceedings prior to the effective date of the Act."

[9] See the comment letter dated September 20, 2010 by the "NFP Energy End User Coalition," at p. 9-10. New Section 4(c)(6) provides that the Commission "shall" exempt the specified categories of transactions from the requirements of the CEA if it determines the exemption to be consistent with the public interest and the purposes of the CEA. See Section VIII for further discussion of this request.

users"[10] of "swaps," to except such transactions from mandatory clearing and from many of the Dodd-Frank Act's other requirements.[11]

The Electric Trade Associations and their members have a direct and significant interest in the definition of "swap," and in clear rules distinguishing between a "swap" and a "nonfinancial commodity forward contract" and between a "swap" and a "commercial merchandising arrangement" involving a "nonfinancial commodity," and in clear rules excluding

---

[10] This term is not defined in the Dodd-Frank Act. Congress also refers to these entities as "commercial end users," but that term is not defined in the Dodd-Frank Act either. The Electric Trade Associations respectfully request the Commission to define the term "end user" (which is the term that seems to appear most often in its Proposed Rules to date), and to agree with the Securities and Exchange Commission and prudential regulators on the definition. The term is used inconsistently in the Commission's proposed rules to date, and is defined inconsistently in the other regulators' proposed rules. See the Prudential Regulators proposed rules, 76 Fed. Reg. 27,564 (May 11, 2011), which defines "financial end user." In legislative history, Congress used the term "commercial end user" or, in shorthand "end user," to mean an entity that has the right to elect the "end user exception" provided in new CEA Section 2(h)(7). That Section provides that the "end user exception" cannot be elected by a "financial entity" as therein defined. For nonfinancial entities reviewing the proposed rules implementing the Dodd-Frank Act, this and other inconsistent use of the same defined terms to have different meanings in the regulations creates confusion: as to who is, and who is not, entitled to the statutory rights and benefits provided to an "end user." Members of the Electric Trade Associations are all nonfinancial entities, and anticipate utilizing the end-user exception in respect of all or a significant number of the "swaps" to which they are parties.

[11] Our comments on the Swap Definitions NOPR will be narrowly-focused. The Energy Trade Associations are not commenting on any provisions of the Preamble or the Proposed Rules that deal with "security-based swaps," "mixed swaps" or "security-based swap agreements." Nor are we commenting on the Proposed Rules that provide further definition and clarity with respect to foreign exchange transactions and insurance industry agreements, contracts or transactions. We are not commenting on interest rate, currency, credit or equity asset classes of "swaps," *i.e.*, those asset classes of "swaps" where the Commission's jurisdiction might be shared with or potentially overlapping with the jurisdiction of the SEC. Again, although some of our members may utilize such commodity "swaps" to manage their financial affairs or treasury operations, those asset classes are not integral to the principal operations of our members' nonfinancial commodity-based enterprises. We are focused exclusively on transactions which might fall within the Commission's "Other Commodity" asset class of "swaps." And even within that "Other Commodity" asset class, we are not commenting on "swaps" that are based on agricultural commodities, metals, crude oil, gasoline or refined petroleum products other than fuel oil (which is a fuel for electric generation). All of these asset classes and product types of commodities and commodity "swaps" are transacted in different market structures than the over-the-counter ("OTC") markets for nonfinancial energy commodities and commodity derivatives which are integral and intrinsically related to the operations of our members' nonfinancial commodity-based enterprises – generating, transmitting and delivering electric energy to the American public. For a more detailed description of the United States electric industry, the entities, the commercial agreements, contracts, transactions and arrangements (some involving "nonfinancial commodities"), the derivatives, including options and swaps, utilized in such industry, and other regulators with jurisdiction over the entities and transactions in the industry, see Attachment A.

certain categories of common electric industry transactions from the definition of "swap." The Electric Trade Associations and their members also have a direct and significant interest in the new Section 4(c)(6) public interest waiver provisions for electric industry transactions that were added to the CEA by the Dodd-Frank Act.

If the regulatory lines are not clear and the parties cannot be certain if a transaction is, or is not, a "swap" at the time the transaction is executed, the parties cannot determine how such transaction should be priced, documented, or managed for credit support/credit risk purposes. The parties cannot determine the appropriate tax or accounting treatment for the transaction, whether or to whom to report the transaction, or how to comply with other potentially applicable new regulatory requirements. The cloud of regulatory uncertainty will continue its drag on legitimate commercial activity in the electric industry.

I. Summary of Comments of the Electric Trade Associations.

The Electric Trade Associations respectively request that the Commission:

- Follow the approach described in the Preamble's "interpretive guidance," and
    - Codify in its rules the distinction between a "swap" and a "nonfinancial commodity forward transaction."
    - Clarify in its rules that "intended to be physically settled" in new CEA Section 1a(47)(B)(ii) means the transaction includes a binding obligation to deliver and receive the nonfinancial commodity, and that such intent is determined at the time the transaction is executed.
- Define in its rules the statutory term "nonfinancial commodity."
- Provide in its rules that an option which, if exercised, by its terms becomes a nonfinancial commodity forward transaction, is excluded or exempted from the definition of "swap."
- Provide in its rules that an embedded option or optionality in a nonfinancial commodity forward transaction will <u>not</u> result in such transaction being a "swap," unless the transaction provides that delivery and receipt of such nonfinancial commodity is optional (to either the seller or the purchaser of the option), and instead permits financial settlement.
- Provide in its rules that commercial merchandising arrangements involving nonfinancial commodities are excluded from the definition of "swap," so long as the arrangement serves a commercial purpose and does not merely transfer commodity price risk.

- Provide in its rules an exclusion from the definition of "swap" and from all requirements of the CEA, for certain categories of agreements, contracts and transactions common in the electric industry (including ISO and RTO transactions and services), or initiate an industry-wide CEA Section 4(c)(6) public interest waiver proceeding.

- Conduct the cost-benefit analysis required by law with respect to the proposed rules implementing the Commission's new Dodd-Frank Act jurisdiction over "swaps", and the burdens imposed by such rules on "small entities," at such time as an integrated and complete mosaic of proposed rules are available for review and analysis, including the definitions which give meaning to the proposed rules, and provide the legally required economic basis for the Commission's cost-benefit analysis.

II. Background of the Electric Trade Associations' Active Involvement in the Commission's Dodd-Frank Act Rulemakings.

Since September 2010, the Electric Trade Associations and individual members have been active participants in the Commission's rulemaking process.[12] We have met with the Commission and various members of the Commission's staff on numerous occasions. When invited by the Commission, the Energy Trade Associations and our members have participated in the Commission roundtables. The Electric Trade Associations have awaited the Swap Definition NOPR, expecting the Commission to propose rules clarifying that the vast majority of their members' agreements, contracts and transactions involving nonfinancial commodities are not "swaps" at all.

In each comment letter, we renewed our request for the Commission to explain the scope of its jurisdiction over energy and energy-related agreements, contracts, transactions and arrangements involving nonfinancial energy commodities by further defining "swap."[13] We have described the types of transactions in which our members engage, and provided citations to treatises and websites for further information about electric industry transactions. We provided profiles of some of our members and examples of our commercial hedging activities.[14] We

---

[12] Individually and collectively, the Electric Trade Associations have filed 45 comment letters. Their members, individually and in other industry coalitions and groups, have filed dozens more. For a list of the comment letters filed by the Electric Trade Associations, with links to the Commission's website, please call any of the signatories to this letter.

[13] See, for example, footnote 4 of nearly every comment letter filed by NRECA, APPA and LPPC as the Not-for-Profit Electric End User Coalition.

[14] See the profiles of NRECA, APPA and LPPC members attached to the NFP Electric End User Coalition's "Pre-NOPR comment letter" to the Capital and Margin Task Force, at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission5_121410-0017.pdf and the EEI/EPSA comment letter on the Entities Definition NOPR (75 Fed. Reg. 80,174, Dec. 23, 2010, at http://comments.ctfc.gov/PublicComments/ViewComment.aspx?id=279188SearchText=

recommended in our comment letter on the "30 Day Reopener" NOPR,[15] that the Commission convene a workshop in conjunction with the Federal Energy Regulatory Commission ("FERC"), focused on the electric industry transactions.[16]

Today (prior to Dodd-Frank Act), some of our members ***choose*** to engage in agreements, contracts or transactions (also referred to as "products" and "instruments") that are regulated by the Commission. Nonfinancial entities understand where the regulatory lines are drawn under the pre-Dodd-Frank Act CEA. If an electric generator or an electric utility wants to execute a transaction on a market regulated by the Commission, there are exchanges and exempt commercial markets that list such standardized products, and Commission-regulated financial intermediaries and market professionals that stand ready and willing to accommodate these nonfinancial electric companies as "customers." However, if the nonfinancial entity doesn't want to pay the price to access the presumed regulatory "safety" of the Commission-regulated world, or the standardized Commission-regulated products offered on Commission-regulated entities do not match the commercial risks in the nonfinancial entity's business, the nonfinancial entity can conduct its commercial operations outside the Commission-regulated financial markets. The nonfinancial entity can transact in "exempt commodities" or "swaps"[17] or "swap agreements" with entities that are, or are believed to be, "eligible contract participants" or "eligible commercial entities." Or, the nonfinancial entity can simply enter into commercial merchandising arrangements involving nonfinancial energy commodities.

The Dodd-Frank Act has blurred these regulatory lines with its new definition of "swap." A nonfinancial entity in the normal course of its commercial business cannot identify the new regulatory lines, and therefore could ***inadvertently*** cross either the line between a "swap" and a "nonfinancial commodity forward contract," or the line between a "swap" and a "commercial merchandising arrangement" involving a "nonfinancial commodity." The consequences of stepping over one of such lines are serious – *e.g.* the agreement, contract, transaction or arrangement could be unenforceable, void or voidable as against its counterparty as an "unlawful" swap; or the counterparties could violate the tax laws or the accounting rules on the correct treatment of the transaction. The counterparties could be in violation of the many new

[15] 76 Fed. Reg. 25,274 (May 4, 2011).

[16] It seems unreasonable for the Commission to expect the Electric Trade Associations' members, with public service obligations to fulfill, to provide the Commission with a detailed written analysis of each and every type of commercial agreement, contract, transaction or arrangement involving "nonfinancial commodities" that is now or ever could be used in the evolving electric industry in response to Question 35.

[17] See footnote 3 for the pre-Dodd-Frank Act definition of the term.

regulatory requirements applicable to entities that execute "swaps." Congress recognized this and instructed the Commission to provide regulatory certainty in its rules.[18]

As we have previously pointed out in our comment letters, the Electric Trade Associations' members are not part of "the trade" or the professional financial markets industry. They are part of the electric industry -- generating or producing, transporting or transmitting, and/or using and delivering electric energy to American consumers and businesses. The members buy and sell goods and services under commercial relationships and arrangements governed by state contract law or energy regulatory tariffs. These commercial agreements, contracts, transactions and arrangements, in many cases, involve "nonfinancial [energy] commodities." The members all "hedge" commercial risks of one sort or another -- risks that arise in the ordinary course of their operations, and that are either retained or hedged in some way (in each case, a commercial risk management decision). Commercial risk management decisions are made by each entity's authorized managers, in accordance with each entity's unique business model and risk tolerances. From time to time, members may engage in some type of economic derivative based on nonfinancial energy commodities to accomplish those commercial risk management objectives. But the principal industry in which each and every one of the Energy Trade Associations' member participates is the United States electric industry.

The Dodd-Frank Act was enacted to reduce risk, increase transparency and promote market integrity within ***the financial system***, including by (i) providing comprehensive regulation of ***financial entities***, (ii) imposing clearing and trade execution requirements, subject to exceptions, on ***standardized derivative products,*** and (iv) enhancing authority of the Commission with respect to, among others, ***financial entities*** subject to the Commission's oversight.[19] We fully support these policy objectives, and urge the Commission to focus its regulatory efforts on financial entities and standardized derivative products. However, in order to comply with Congressional intent, the Commission must write rules that tell commercial enterprises (nonfinancial entities) which of their ongoing commercial agreements, contracts, transactions and arrangements will now be regulated by the Commission as "swaps." Only then can potentially affected entities continue their ongoing operations and understand how to comply with applicable law and with the Commission's new rules.

[18] [T]he Commission is encouraged "to clarify *through rulemaking* that the [nonfinancial commodity forward contract] exclusion from the definition of swap…," says the letter authored by Senators Lincoln and Dodd and introduced into the Congressional Record at 156 Cong. Rec. H5248-49 (June 30, 2010) (the "Lincoln-Dodd Letter").

[19] See the Preamble to each of the Commission's rulemakings.

III. The Commission Should Codify the Approach Described in the Interpretive Guidance in the Preamble in its Rules.

The Electric Trade Associations strongly agree with the Commission that it needs to clarify the distinction between a swap and a "nonfinancial commodity forward contract."[20] The Electric Trade Associations also agree with the Commission's approach described in the Preamble of using concepts from its precedent distinguishing commodity "forward contracts" from "contracts of sale of a commodity for future delivery" (or "commodity futures contracts") as the basis for distinguishing "nonfinancial commodity forward contracts" from "swaps" for purposes of new CEA Section 1a(47)(B)(ii). This approach is consistent with Congressional intent and with the Commission's statements over past 10 months.[21] However, the Commission precedent makes a distinction between two different statutory terms *(i.e.*, commodity futures contracts and commodity forward contracts), not between "swaps" and "nonfinancial commodity forward contracts," and the Commission's approach to this new statutory interpretation needs to be codified in its rules.

The nonfinancial commodity forward contract exclusion to the newly-defined term "swap" is a *similar* line, ***but not the same line,*** that distinguishes a commodity "forward contract," from a "contract of sale of a commodity" "for future delivery."[22] Congress recognized this and asked the Commission to use its prior analysis of those two statutory terms "in its rulemaking" in distinguishing between the new statutory terms. The Electric Trade Associations respectfully request that the Commission propose for comment rules to further define "swap," and rules to clarify the "nonfinancial commodity forward exclusion" from such defined term.[23]

---

[20] 76 Fed. Reg. at 29827, footnote 60.

[21] *Id.* Chairman Gensler indicated his support of this approach in his testimony before the House Agriculture Committee on March 31, 2011. See http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-76.html: "I believe it would be appropriate to interpret that [nonfinancial commodity forward contract] exclusion in a manner that is consistent with the Commission's previous history of the forward exclusion from futures regulation, including the Commission's treatment of bookouts."

[22] See footnote 57 at 76 Fed. Reg. 29,827 and accompanying text.

[23] The interpretive guidance in the Preamble does not fairly apprise interested persons of the nature of the Commission's rulemaking, nor does it provide notice of "the terms or substance of the proposed rule or a description of the subjects and issues involved," as required by the Administrative Procedures Act. For more on this topic, see the request for a logical sequencing of the regulatory process and a clearly-articulated request for rehearing process recommended in the comment letter dated March 11, 2011 by NextEra Energy Resources, in the Commodity Options and Agricultural Swap docket (76 Fed. Reg. 6095, Feb 3, 2011). See also the letter sent on July 14, 2011 by Representatives Lucas and Conaway to Chairman Gensler on the need to establish a Commission process for reproposing rules for comment, when the public comments received to date on the initial proposed rules raise substantial concerns or recommend alternative and less burdensome/more tailored regulatory solutions. The Representatives

A. The Commission should codify the distinction between a "swap" and a "nonfinancial commodity forward contract" in its rules.

The Electric Trade Associations appreciate the Commission's effort to maintain a consistent approach in treating forward contracts in energy commodities as non-jurisdictional. We are concerned, however, that the different pieces of that precedent are not melded together in a coherent way that provides the degree of protection that Congress intended under Section 1a(47)(B)(ii). For example, the Preamble describes various factors considered by the Commission in the 1993 Brent Interpretation in making the distinction between a commodity forward and a commodity futures contract. In other sections, the Preamble notes factors taken into account in analyzing the energy contracts that were exempted from Commission jurisdiction in the Energy Exemption, such as the fact that an energy contract "imposes binding obligations to make and take delivery with no right of cash settlement without consent." But then the Commission proposes to withdraw the Energy Exemption while expanding the Brent Interpretation to cover other nonfinancial commodities than oil.[24] In still other places, the Preamble discusses factors which were deemed relevant to the exemption analysis in the Swap Policy Statement, such as the "line of business" factor. But then, at the same time, the Preamble notes that the Dodd-Frank Act supersedes the Swap Policy Statement.[25]

The Preamble is not clear as to which factors the Commission would view as determinative in analyzing the distinction between the two *new* statutory terms incorporated into the CEA by the Dodd-Frank Act (a "swap" vs. a "nonfinancial commodity forward contract"). Moreover, the Commission appears tentative in its thinking, observing in numerous places in the Preamble that, although the Commission "believes" certain principles underlying the Brent Interpretation or the Energy Exemption or the Swap Exemption should apply in drawing the statutory distinction at issue, the Commission has not yet made up its mind as to whether or which of those principles should govern its analysis of the new statutory terms.[26]

In fact, in contrast to the Preamble's statement that the Commission believes it should rely on the Brent Interpretation for all nonfinancial commodity forwards,[27] the Preamble nonetheless goes on to state the Commission's belief that intent should be evaluated using a multi-factor approach. The Preamble also continues to consider (or reconsider, as if not relying on the Brent Interpretation) whether separate events subsequent to execution of the contract, such

---

expressed their concern, which echoes the electric industry's concern, that the Commission address in each rulemaking whether issuing a final rule meets the "logical outgrowth" standard in the Administrative Procedures Act.

[24] 76 Fed. Reg. at 29,829.

[25] 76 Fed. Reg. at 29,829, footnote 74.

[26] See questions 22-29.

[27] See 76 Fed. Reg. at 29,829.

as the frequency or regularity of amendments or "bookouts," might call into question the parties' intent to physically settle the nonfinancial commodity forward transaction.

Simply put, the Electric Trade Associations agree that a consistent approach with Commission precedent is appropriate, but the language of the Preamble does *not* provide notice to the electric industry or other potentially affected nonfinancial entities as to how to determine whether a nonfinancial commodity agreement, contract or transaction is a "swap" or a "nonfinancial commodity forward contract." Consequently, the Electric Trade Associations request that the Commission further define the statutory term "swap" and clarify new Section 1a(47)(B)(ii), by defining relevant terms in the Dodd-Frank Act, reconciling the wording used in the various provisions in the CEA as amended by the Dodd-Frank Act, and setting forth in the Commission's rules the factors that are determinative in drawing the distinction between a "swap" and a "nonfinancial commodity forward contract."[28]

B. The Commission should provide in its rules that the statutory phrase "intended to be physically settled" means that the agreement, contract or transaction which constitutes "the sale" contains a binding obligation to deliver and receive the nonfinancial commodity.

It is a basic principle of contract law that the legally-binding terms of the contract are the best evidence of the parties' "meeting of the minds" at the time the contract is executed. No facts outside the four corners of the contract are considered in establishing the parties' agreement

[28] We respectfully disagree with the Commission's conclusion in the Preamble that "extensive further definition of the terms by rule is not necessary." In fact, Congress expressly directed the Commission "to clarify *through rulemaking* that the [nonfinancial commodity forward contract] exclusion from the definition of swap is intended to be consistent with the forward contract exclusion that is currently in the [CEA]…" 156 Cong. Rec. H5248-49 (June 30, 2010) introducing into the record the so called "Lincoln-Dodd letter." Attachments B, C and D include proposed rules that would provide certainty that many commonly used commercial agreements, contracts, transactions and arrangements would not be deemed to be swaps. The basis for this determination would be the application of the criteria identified in this letter including the criteria traditionally used by the Commission for identifying forward contracts. One clarifying point, however, concerns the application of one of the traditional factors -- whether the principal economic terms of the agreement, contract or transaction have been individually negotiated. Since the time this factor was identified, many states have implemented policies to effectuate various environmental goals and/or to allow customer choice of electric suppliers through regulatorily-mandated procurements. These programs may require parties to obtain renewable credits or electricity under a standardized form of agreement that is reviewed and approved by a state utility commission after a stakeholder process in which potential market participants have significant input. These agreements, nonetheless, should be deemed to still come within the scope an "individually negotiated" contract for the purpose of this analysis because the primary economic terms of each agreement (*i.e.*, the price, quantity, and delivery location(s)) are all subject to negotiation.

unless the contract is ambiguous.[29] Unlike the futures market or other regulated financial markets where "products" are created to be traded between anonymous market participants, and regulated market professionals (the "sell side") sell the traded products to non-market professionals (the "buy side") (or trade among themselves), subject to oversight by financial market regulators, bilateral derivatives transactions are commercial contracts, negotiated and executed by pairs of "contract counterparties," governed by contract law principles and enforceable in the courts.

During the term of a contract, one contract party does not look to a regulator to enforce its rights. The contract party looks at the terms of the contract, which are enforceable under state contract law in the courts. Consequently, it is the terms of the contract, not the regulatory framework, that should decide the parties' "intent" to deliver and receive the nonfinancial commodity at the time of the contract. There is no reason for the Commission to conduct a regulatory "primary purpose" test separate from the contract, or to weigh factors outside the four corners of the contract, to determine the parties' intent. In fact, doing so undermines the most basic principles of contract law.[30]

The Commission should not consider or analyze events or circumstances which occur before or after the transaction is executed in determining the contract parties' binding contract obligations. A review of the parties' contract obligations at the time an agreement, contract or transaction constituting the "sale" referenced in Section 1a(47)(B)(ii) is executed should end the regulatory analysis, just as it ends the contract law analysis. In response to Questions 26 and 28, the Commission should not consider the *frequency* or the *regularity* of actual delivery/receipt of the nonfinancial commodity as compared with the incidence of separate, subsequent amendments or "bookout" agreements related to the nonfinancial commodity forward. If an amendment to the contract, or a separate agreement from the contract (a "bookout"), is made between the two parties *after* the forward contract is executed but *before* delivery/receipt occurs, such separate and subsequent event is not part of the original agreement or transaction. In the electric industry, if there is a change in the electric company's commercial operations (a generation unit that has an unexpected outage, a surge in electric customer demand due to weather, or a change in other circumstances or events) before delivery/receipt, there may be a subsequent transaction netting or financial settlement. But the later event or circumstance does not somehow relate back in time to change the character of the forward contract at the time when it was executed.[31] The

---

[29] Uniform Commercial Code Article 2 at 201(1). Course of dealing may only be considered to add a consistent additional term to a contract, not to contradict an existing contract term. See also Williston on Contracts.

[30] The Electric Trade Association's answer to the Commission's question 28 is that no primary purpose test is necessary or appropriate if the agreement, contract or transaction that is the "sale" referenced in Section 1a (47)(B)(ii) contains a binding obligation to deliver and receive.

[31] The Preamble is unclear in several ways on this topic. It sometime refers to a bookout as "one type of forward contract," whereas the Brent Interpretation analyzes a separate, subsequent "bookout" as distinct from the forward contract. The Commission should be clear in its rules on this point. The Preamble does

regulatory analysis should not go beyond the contract law analysis. The Electric Trade Associations propose the rule clarifying Section 1a(47)(B)(ii) set forth in Attachment C.

IV. The Commission Should Define "Nonfinancial Commodity" in its Rules for Purposes of Legal Certainty -- that a Forward Contract for Delivery/Receipt of such a "Nonfinancial Commodity" is Excluded from the Definition of "Swap."

Defining the term "nonfinancial commodity" is essential to understanding the line between the two new statutory concepts -- "swap" and "nonfinancial commodity forward transaction." Not all commodities can form the basis for a forward contract which is excluded from the definition of "swap." Only forward contracts in "nonfinancial commodities" fit the exclusion. The Electric Trade Associations propose the definition of "nonfinancial commodity" set forth in Attachment B.[32]

In defining a "nonfinancial commodity," the Commission is also requested to reconcile in its rules how that term interrelates with the three existing statutory subdivisions of the term "commodity" in the CEA: "excluded commodity," "exempt commodity," and "agricultural commodity." Prior to the Dodd-Frank Act, a "commodity"[33] was commonly understood to fall within one of those three defined categories.[34] Although those defined terms were available to Congress when the Dodd-Frank Act was drafted, the drafters chose to use a new term: "nonfinancial commodity," and chose to draw a different distinction in Section 1a(47)(B)(ii) to

---

not state whether the Commission would consider the frequency or regularity of "bookouts" between one particular set of contract counterparties, between any or all sets of contract counterparties in a particular market, between any or all sets of contract counterparties in any or all markets for one or more such "nonfinancial commodity," or between any or all sets of counterparties in any or all markets for all "nonfinancial commodities" in general. And yet, Questions 26 and 28 ask questions about such concepts. In response to Question 29, as we have discussed with the Commission's staff, in the electric industry, the "bookout" or transaction netting of "daisy chains" of electric power forward transactions serves an important commercial purpose in the electric industry, in that bookouts conserve limited (or "constrained") electric transmission capacity required for the delivery of the nonfinancial commodity electric energy.

[32] See the comment letters noted in footnote 7, as well as the Environmental Markets Association comment letter filed in the Definitions ANOPR docket, requesting a definition of the term (available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26166&SearchText=ema) In questions 23 and 24, the Commission asks if the "statutory interpretation" provided in the Preamble is sufficient to allow commercial transactions in the electric industry to continue without disruption if the Commission withdraws the Energy Exemption and the Swap Policy Statement. The Electric Trade Association's answer is "no." We respectfully request that the Commission propose rules defining and clarifying this critical new statutory term.

[33] CEA 1a(4) as amended by the Dodd-Frank Act to be Section 1a(9).

[34] The tripartite categorization was so commonly understood that when Congress defined the term "exempt commodity," the definition is simply a commodity that is not an excluded commodity or an agricultural commodity. CEA Section 1a(14), as amended by the Dodd-Frank Act to be Section 1a(20).

describe the type of forward contract that is not a "swap."[35] It is, therefore, up to the Commission to define the term "nonfinancial commodity" in its rules and make clear the statutory exclusion.

The Electric Trade Associations recommend that the Commission define the term "nonfinancial commodity" by using the concepts found in the statutorily-defined term "excluded commodity".[36] Historically, the term "excluded commodity" was used to distinguish those "commodities" that are financial in nature, *i.e.*,. those commodities created and defined by financial market participants and upon which standardized derivative products could be created, defined or compiled by the financial markets or financial market participants for purposes of trading on a designated contract market, such as indexes, rates, events or occurrences. These financial commodities were initially distinguished from the agricultural commodities over which the Commission had jurisdiction, and then later distinguished from energy, metals and other "exempt commodities."[37]

---

[35] Presumably the simple antonym of a "nonfinancial commodity" is a "financial commodity," but "financial commodity" is not among the three categories in the pre-Dodd-Frank Act CEA either. Congress did not use the term "physical commodity," although the defined term "physical" appears in Regulation 1.3(ll), as used in the trade option exemption. The new term "nonfinancial commodity" should not be interpreted as synonymous with "physical commodity," therefore potentially requiring a "corporeal existence" or a "physical" nature for the "commodity." The statutory definition of the noun "commodity" in the CEA incorporates intangible, non-physical concepts of "services" and "rights."

[36] The Electric Trade Associations respectfully suggest that the defined terms "excluded commodity" and "exempt commodity" may not be intuitively-named for use in the Commission's post-Dodd-Frank Act CEA regulations, as those two definitions might apply to "commodity swaps." Concurrently with giving the Commission its new jurisdiction over "swaps," the Dodd-Frank Act deleted the "exclusions" and "exemptions" from CEA Section 2 that created those two adjective-distinguished categories of commodities. Instead, as discussed herein, the important statutory distinction for purposes of new CEA Section 1a(47) is between a "nonfinancial commodity" and a "financial commodity." In response to Question 32, the Electric Trade Associations recommend the Commission define a nonfinancial commodity to include all "environmental commodities" such emissions allowances, carbon offsets/credits and renewable energy certificates. These nonfinancial commodities are subject to the jurisdiction of other regulators, with differing regulatory missions from that of the Commission, and are transacted to accomplish commercial and public policy goals separate and distinct from their existence as commodity-based trading "products." Although these transactions "lack a physical existence other than on paper," so do other nonfinancial commodities such as electric energy, generation capacity, transmission (which is a service), and motion picture box office receipts. We also concur with Environmental Markets Association comment letter in this docket and note our objection to the CFTC's proposed redefinition of the term "physical" in the "Adaptation NOPR" (76 Fed. Reg. 33066 at 33068).

[37] CEA Section 1(a)(14), as amended by the Dodd-Frank Act to be Section 1(a)(20).

In contrast, "nonfinancial commodities" like crops, energy and metals that have a finite supply[38] are not created with the financial markets in mind. They exist in the commercial world. Nonfinancial commodities like emissions allowances and renewable energy credits are not created with the financial markets in mind. They serve public policy purposes distinct from financial market trading or commodity price discovery purposes. Whether or not such a "nonfinancial commodity" is, now or in the future, the subject of a futures contract or a standardized "swap," nonfinancial entities will still buy and sell such nonfinancial commodities in order to accomplish operational, regulatory, public policy or other commercial purposes.

The Electric Trade Associations respectfully recommend that the Commission define a "nonfinancial commodity" as set forth in Attachment B. As noted above, we have taken the concepts from the CEA-defined term "excluded commodity," in an effort to adopt the approach that Congress has used in evolving the Commission's jurisdiction over time, while applying the approach to clarifying the new statutory provisions. This definition is consistent with Congressional intent in giving the Commission its new jurisdiction over all standardized derivatives, which would include substantially all those swaps derived on "financial commodities," which are by their nature created, defined, fungible and tradable on financial markets as "products" of unlimited supply. But the definition is also consistent with Congressional intent to allow nonfinancial entities to continue to engage in commercial merchandising arrangements and forward contracts involving "nonfinancial commodities" – which are *not* "swaps" – to accomplish operational, regulatory, public policy and other commercial purposes governed by state law contract principles.

V. The Commission Should Interpret the Nonfinancial Commodity Forward Contract Exclusion to Apply to Options which, if Exercised, Become Nonfinancial Commodity Forward Contracts.[39]

The Electric Trade Associations acknowledge that new CEA Section 1a(47)(A)(i) includes a commodity option, just as Section 1a(47)(A)(iii) includes a commodity swap, in the defined term "swap." Moreover, we recognize that *some subparts of Section 1a(47)(B)* mention options that are currently subject to the CEA and/or SEC rules, and expressly exclude those instruments from *also* falling within the newly defined term "swap."[40] In contrast, subpart (ii) of

[38]These include regulatory attributes and regulatorily-defined transactions for which a market-based or commodity-like exchange market is established.

[39] Alternatively, as the Electric Trade Associations requested in the "Commodity Option and Agricultural Swap" docket, 76 Fed. Reg. 6095 (Feb. 3, 2011), the Commission should clarify in the rules that options which, if exercised, become forward transactions for nonfinancial commodities, will have the benefit of a "trade option" exemption, and be exempt from the definition of "swap."

[40] Section 1a(47)(B)(i) references options on commodity futures, which are traded and regulated under the CEA (pre-Act); Section 1a(47)(B)(iii) and (iv) exclude options on securities and certain options on foreign currency, respectively. These statutory references to options subject to other financial regulators' jurisdiction are, similarly, distinguishable from the categorical exclusion provided in 1a(47)(B)(ii). Such

new CEA Section 1a(47)(B) does not include the word "option." However, unlike the other subparts of 1a(47)(B), new CEA Section 1a(47)(B)(ii) is not merely the acknowledgement of a previously drawn regulatory line. It is, rather, a new, important, statutory and categorical exclusion of commercial merchandising transactions involving nonfinancial commodities from the newly-defined term "swap." The Electric Trade Associations recommend that the Commission interpret this new categorical, statutory exclusion broadly to encompass nonfinancial commodity options which, if exercised, become non-financial commodity forward contracts.[41]

CEA Section 1a(47)(B)(ii) excludes "a sale of a nonfinancial commodity…for deferred shipment or delivery" from the definition of "swap" in Section 1a(47)(A). Nothing in the Dodd-Frank Act precludes the Commission from interpreting Section 1a(47)(B)(ii) to cover "nonfinancial commodity ***optional*** sales," subject to such other conditions as the Commission may impose in its rules (see Attachment C for recommended rules). Nonfinancial commodity options are commercial merchandising transactions. Once exercised, without further action by the parties, the option "becomes" a nonfinancial commodity forward contract with a binding obligation to deliver and receive. Nonfinancial commodity options meet all the other criteria set forth in the recommended rules in Attachment C for nonfinancial commodity forward contracts. The only distinguishing feature is that one party holds an option, inseparable from the underlying nonfinancial commodity forward contract, to exercise the option in accordance with the option's terms (which may or may not include payment of an exercise price or a fixed, agreed forward price for the nonfinancial commodity).

In particular, nonfinancial commodity options in the electric industry -- such as those listed in Attachment C's Proposed Rule 1.3(xxx)(__) for exclusion of nonfinancial commodity forward transactions -- are typically highly customized commercial transactions. The options are unique to regional or local electricity markets. The operational contingencies are negotiated, locational details are negotiated, the ways in which the parties define rights and benefits are negotiated – all with the particular geographic region in mind. Such options are used by nonfinancial electric companies located in such geographic regions for operational purposes and to meet the demands of the electric customers in the service territory reliably and efficiently, *i.e.*,

---

references do not require the conclusion that Section 1a(47)(B)(ii) – which is a categorical exclusion of transactions that were not previously regulated by the Commission -- must not be intended to encompass nonfinancial commodity options.

[41] This section is a response to Question 36 on nonfinancial commodity options. In response to the Commission's docket captioned "Commodity Options and Agricultural Swaps," 76 Fed. Reg. 6095, Feb. 3, 2011, the Electric Trade Associations objected to the deletion of the trade option exemption for nonfinancial commodities, cross referencing to this docket and recommending that, in either that docket or this docket, the Commission propose rules providing a trade option exemption rule for nonfinancial commodity options. See the EEI/EPSA comment letter at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35406&SearchText=, and the NFP Electric End User Coalition (NRECA, APPA, LPPC) comment letter at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35397&SearchText=.

to hedge or mitigate commercial risks inherent in the electric company's commercial operations due to seasonal and geographically-unique weather and load patterns and fluctuations, taking into account the fact that electric energy cannot be stored or transmitted over long distances without dissipating.

The smallest of the Electric Trade Association's members (that may not meet the financial hurdles in the definition of "eligible contract participant") need such nonfinancial commodity trade options to manage their public service operations.[42] In each geographic region, the electric companies may use shorthand trader-like terms to refer to such options. Counterparties may use more elaborate definitions of such terms in transactions, or put in place definitions in master agreements or "umbrella" terms and conditions, to flesh out the contractual legal relationship between each set of contract counterparties. Nonetheless, the terms of these regional nonfinancial commodity options are customized to the regional operational needs of non-financial entities. The transactions are ***not*** identical, when compared to another region's nonfinancial commodity options, even when the same generic nonfinancial commodity label is used.[43] These are "nonfinancial commodity trade options," that are not transferable separate from the nonfinancial commodity forward contract, and are not traded or tradable on registered entities.

---

[42] See the comment letter filed by the NFP Electric End User Coalition in the Commodity Options NOPR docket, 76 Fed. Reg. 6095 (Feb. 3, 2011) at page 14-19.

[43] The Electric Trade Associations also support the Commission's "substance over form" approach in footnote 60 and on page 29,830 of the Preamble. The use of shorthand references to transactions is commonplace in dynamically-changing commercial operations, like the electric companies who must make commercial risk management decisions under time constraints about transactions involving nonfinancial commodities like electric energy, where prices are volatile. This use of shorthand terms should not be dispositive of the legal characterization of such commercial transactions, notwithstanding new CEA Section 1a(47)(A)(iv). Nor should the type of master agreement or general terms and conditions used in a transaction affect whether the transaction is a "swap," a nonfinancial commodity forward transaction or a commercial merchandising arrangement. Just as the Electric Trade Associations agree with the Commission's decision not to be governed by colloquial labels used "in the trade" in determining what is and is not a "swap," as provided in Proposed Rule 1.3 (xxx)(6)(iv), we request the Commission to use an analytically rigorous evaluation for identifying economically equivalent or "fungible" non-financial commodity options, and distinguishing those nonfinancial commodity options that are merely labeled with similar terms for ease of commercial conversation among operations staff in the same geographic electric industry region. A capacity option in New England does not necessarily have the same primary economic terms as a capacity option in Texas.

VI. The Commission should Provide in its Rules that An Embedded Option or Embedded Optionality Will Not Result in a Nonfinancial Commodity Forward Transaction Being a "Swap unless the Embedded Option or Optionality Makes Delivery and Receipt of the Nonfinancial Commodity Optional (to Either the Purchaser or Seller of the Option) and Allows Financial Settlement, and the Forward Transaction Permits Transfer and Trading of the Option Separate from the Underlying Forward Transaction.

Unlike commodity futures or exchange-traded commodity options, commercial contracts ("commercial merchandising arrangements") involving the purchase and sale of "nonfinancial commodities" include an almost infinite variety of customized economic terms binding on the two contract counterparties. Many of these contract terms may contain economically important "embedded" options or optionality that are exercisable by one party or the other sometime during the term of the contract.

For example, there may be options affecting (1) the quality (grade) or quantity (volume) of the goods or services to be delivered, (2) the price or payment terms, (3) the time of delivery and receipt, (4) the method of delivery and receipt, or (5) the place of delivery and receipt. In contracts for "unit contingent" electricity, or renewable energy (such as electricity produced by wind or solar generation units), delivery of the nonfinancial commodity may be "intermittent," or the seller may be allowed "not to deliver" during certain periods of the contract if the designated energy resource is not online. If, during some period, a minimum quantity of the nonfinancial commodity is not delivered (a "capacity factor" is not reached), there may be a financial "availability guaranty" payment, or other financial consequences. [44]

Another example would involve "full requirements" contracts used by investor-owned electric utilities to meet "supplier of last resort" obligations in states that allow "open access" for retail electric customers to choose suppliers of electricity other than the local electric utility. In these cases, the utility nonetheless has a statutory obligation to provide electric service to the electric customers in its service territory ("load") that do not choose an alternative electric supplier, and the utility typically will enter into full requirements contracts to meet this

[44] Question 35 requests comments on a list of particular types of contracts and arrangements used by business entities, many of which are employed in the electric industry. Certain of these types of contracts and arrangements are discussed in this letter such as in this paragraph and the proceeding paragraph as well as elsewhere. In general, however, Electric Trade Associations believe that a separate review of each and every type of contract or arrangement used in the electric and gas industry is not necessary. The primary attributes of most of these types of contracts and arrangements are well understood and can be readily categorized based on the criteria requested by the Electric Trade Associations. In addition, many of these contracts are subject to FERC, ERCOT, state, local or other tariffs. *See* Attachment A, Section II (a). In Attachment D, we propose rules that create safe harbor status for certain types of contracts and arrangements.

obligation.[45] Although delivery and receipt of electric energy is not optional under these contracts, the total volume of electricity delivered will vary depending on a variety of factors, including the extent to which electric customer usage (or "load" levels) fluctuate due to weather and economic conditions. These attributes of the contracts, however, do not change their underlying purpose of effecting physical delivery of electricity.[46] In this respect they are indistinguishable from a forward contract that by its terms requires delivery of a nonfinancial commodity, and thus should be deemed to fall squarely within the nonfinancial commodity forward contract exclusion.

It is not at all clear in the Preamble whether the Commission could determine, based on a facts and circumstances test conducted at some regulatory review date after the transaction is executed, that one or more of these option-like or optionality provisions "target" or "operates on" the delivery term – and therefore determine that the commercial transaction is (or retroactively was) a "swap." See the Preamble at 29,830. In some, but not all, of such cases where delivery and receipt does not occur, there may be financial consequences for the seller or buyer. In such a case, the delivery requirement could be considered "targetted," "operated on" or "affected," but the contract should still meet the requirements of the nonfinancial commodity forward contract exclusion from the definition of "swap."

Only a provision in the agreement, contract or transaction that makes delivery and receipt of the nonfinancial commodity completely optional to one party, and allows financial settlement instead without additional cost payable to or consent by the other party, changes the fundamental underlying character of the forward contract.[47] Only contract provisions permitting the option to be transferred and tradable separately from the forward transaction should change the agreement, contract or transaction from a nonfinancial commodity forward transaction to a "swap."[48] In

---

[45] These full requirements contracts are known as provider of last resort (POLR) contracts, supplier of last resort contracts, or standard offer service (SOS) contracts. Such "load following" or variable quantity full requirements contracts are also used in numerous other contexts in the electric industry.

[46] *See* In the Matter of Cargill, Inc. CFTC Docket No. 99-16, 2000 CFTC LEXIS 260; Comm. Fut. L. Rep. (CCH) P28,425 (Nov. 22, 2000) ("[a contract] satisfies the Commission's test for the forward contract exclusion, even though it includes a price conditional delivery requirement.").

[47] In response to Questions 33 and 34, a retroactive application of a "facts and circumstances" test does ***not*** provide the legal certainty required by nonfinancial entities engaging in commercial contracts in the normal course of business. Nonfinancial entities must know, *at the time a transaction is entered into*, whether it is or is not a "swap" and therefore subject to the requirements of the CEA as amended by the Dodd-Frank Act. Although the analysis in the 1985 Interpretation and in the Commission's *Wright* decision, cited in the Preamble at 29,830, may be helpful in understanding how the Commission would draw the line between commercial merchandising contracts and a "swap," it is not a substitute for the line actually being drawn in the Commission's rules. The Electric Trade Associations respectfully request that the Commission propose the rules set forth in Attachment C.

[48] Note that, in some cases, either a nonfinancial commodity forward contract, or a commercial merchandising arrangement involving a nonfinancial commodity, may provide that the consequence or

Attachments C and D, the Electric Trade Associations propose rules that create safe harbor status for certain types of commercial contracts and arrangements which may contain option-like provisions embedded in nonfinancial commodity forward transactions.

VII. Agreements, Contracts and Transactions Involving "Nonfinancial Commodities" May be Either "Swaps" or "Nonfinancial Commodity Forwards," ***or*** They May Simply be Bilateral Commercial Merchandising Arrangements Involving Nonfinancial Commodities.

In Section IIB3 of the Preamble, the Commission recognizes the need to provide certainty so that "commercial and non-profit entities [can] continue to operate their businesses and operations without significant disruption and ensure that the swap and security-based swap definitions are not read to include commercial and non-profit operations that have not historically been considered to involve swaps or security-based swaps."[49] The Electric Trade Associations are supportive of the Commission's "approach" to this rulemaking with regard to such commercial agreements, contracts and transactions. But we urge the Commission to provide regulatory certainty by implementing its approach and incorporating its analysis into rules.[50]

The interpretive guidance in section IIB3 of the Preamble for all "commercial agreements, contracts and transactions" explains the characteristics that the Commission should

---

remedy for failure to deliver or receive is the payment of a market-rate replacement price, a payment on a performance guaranty, or "cover damages" to compensate the other counterparty for the failure of a party to fulfill its contract obligation to deliver or receive a nonfinancial commodity (or to deliver less than the guarantied quantity). Such a commercial contract damages or remedy provision is NOT a financial settlement "option" analogous to a financial settlement option in a trading instrument. Given the nature of a commercial agreement, contract, transaction or arrangement involving a nonfinancial commodity, one party or the other may be unable, excused or prevented for commercial reasons from performing its contractual obligations to deliver or receive, and therefore may be liable to the other party for a monetary payment, calculated in accordance with the contract. In its Order No. 890 defining electric energy that may qualify as a network resource, FERC acknowledge that, "[w]hile any party to any contract can choose to fail to perform, that does not convey a contractual right to fail to perform. The [Edison Electric Institute Master Agreement for Purchase and Sale of Power (the "EEI Contract")] clearly obligates the supplier to provide power, except in cases of force majeure." The EEI Contract is the master agreement frequently used to document transactions for deferred delivery and receipt of nonfinancial electric energy, and the terms of the ISDA North American Power Annex contain substantially identical master agreement provisions allowing parties to an ISDA master agreement to buy and sell electric energy for deferred delivery and receipt under the ISDA master agreement, allowing the parties the benefit of netting and cross collateralization of both financial derivatives and nonfinancial forward transactions.

[49] See 76 Fed. Reg. at 29,833.

[50] Question 39 asks whether the interpretive guidance proposed in the Preamble is necessary. The Electric Trade Associations response is that while yes, such guidance is necessary, it is not sufficient to give nonfinancial entities certainty.

incorporate in rules, that distinguish such customary commercial arrangements from "swaps" (as outlined in the Preamble at 29,833). Commercial merchandising arrangements:

- Do not contain payment obligations, whether or not contingent, that are severable from the agreement, contract or transaction;

- Are not traded on an organized market or over-the-counter; "so that such arrangements would not involve risk-shifting arrangements with financial entities, as would be the case for swaps…"[51]

- Are entered into by commercial or not-for-profit entities as principals (or by their agents) to serve an independent, commercial, business or not-for-profit purpose, other than for speculative, hedging or investment purposes."[52]

The discussion of these concepts in Section IIB3 of the Preamble is instructive, as it acknowledges the broad range of commercial transactions that "could be read" to fall within the scope of the defined term "swap" in the Dodd-Frank Act. And yet, except for the Proposed Rules that provide clarity for the insurance industry and the foreign exchange industry, the

[51] Commercial transactions are not standardized enough to be "traded" on a registered entity like a designated contract market or a swap execution facility. Note that, in using the term "organized market" in this section of the Preamble, the Commission likely intended to use the defined term "registered entity." The Preamble does not mean "organized [geographic wholesale electric] market" as that term is used in the FERC-regulated RTO context, where FERC and the electric industry draws a distinction between geographic regions in which an RTO operates to maintain the reliable electric grid and uses market mechanisms referred to as an "organized market" to ensure just and reasonable rates, as compared with a geographic region without an RTO, which is sometimes described as a geographic region "outside the organized [RTO] markets." Electric industry transactions, as commercial merchandising arrangements, typically shift commercial interests like title and ownership, or commercial risks, burdens, costs and benefits in nonfinancial commodity-based operations from one nonfinancial entity to the other, but such transactions are not standardized such that they are traded or tradeable or are used to shift financial risks, separate from commercial risks, to financial entities.

[52] The third bullet's use of the word "hedging" seems to mean "hedging financial (or price) risk," rather than hedging commercial risks, since the word is included in the clause which distinguishes independent commercial purposes of the commercial transaction from "speculative, hedging or investment" purposes associated with standardized financial "swaps." From the perspective of a nonfinancial entity, all commercial merchandising transactions are "risk-shifting" of commercial obligations and risks, and "hedge" the enterprise's commercial risks. The nonfinancial "buyer" of a good or a service is willing to pay the "seller" to bear the burden of producing that good or service as part of their commercial relationship. We have clarified what we understand to be the Preamble's meaning of this distinction in the proposed rule that appears in Attachment D. See also 76 Fed. Reg. at 29,828. Consistent with the Brent Interpretation's characterization of a commodity forward transaction as a commercial merchandising arrangement, the primary purpose of the commercial transaction is to transfer title or the benefit of a "good, article, service, right or interest" from the seller to the purchaser, not to "trade" or "deal in" a "product," a "contract" or an "instrument" to shift price risk.

Commission inexplicably stops short of providing the clarity requested by nonfinancial entities in its rules. Nor does the Commission explain why for some industries, it chose to propose rules, while for other industries, it chose to provide "interpretive guidance" and ask further questions.

VIII. The Electric Trade Associations Respectfully Request the Commission to Provide in its Rules an Exclusion from the Defined Term "Swap" For Certain Categories of Commercial Transactions involving Nonfinancial Commodities Commonly Used in the Ordinary Course of Operations in the Electric Industry, *or* to Initiate the Section 4(c)(6) "Public Interest Waiver" Proceeding Contemplated by Congress in Section 722 of the Dodd-Frank Act.

Congress recognized that additional regulation by the Commission of energy transactions that were already subject to state and Federal energy regulators' jurisdiction could interfere with the energy regulators' ability to ensure the delivery of reliable and affordable electric energy to American electric consumers and businesses. See Section 722(e) of the Dodd-Frank Act, in which Congress amended Section 2(a)(1) of the CEA -- the fundamental jurisdiction section of the CEA -- to clarify subsection (A) and to add subsection (I), confirming the jurisdiction of FERC and State energy regulatory authorities over tariffed transactions. In recognition of this Congressional intent, the Commissions should propose rules that exclude such transactions from the defined term "swap," in the same manner that the Commissions proposed rules for the insurance industry. The Electric Trade Associations respectfully propose the rules set forth in Attachment D.

In the alternative, the Commission should enter into the memorandum of understanding (the "FERC/CFTC MOU") that Congress called for in Section 720 of the Dodd-Frank Act, making clear that the transactions and services subject to FERC's jurisdiction are not "swaps." Congress instructed the Commission and FERC to promptly enter into the FERC/CFTC MOU, to avoid lingering regulatory uncertainty about electric industry transactions as the Commission began implementing its new jurisdiction with respect to "swaps." Congress directed the Commission to work with FERC to (1) "ensure effective and efficient regulation," (2) to "resolve conflicts concerning overlapping jurisdiction" and (3) to "avoid to the extent possible conflicting or duplicative regulation.[53] The FERC/CFTC MOU was to have been filed with the appropriate Committees of Congress on or before January 17, 2011.

Due to the delay in agreeing on the terms of the FERC/CFTC MOU, the electric industry is still waiting for clarity on how the two agencies will draw the jurisdictional lines, and how the Commission's new jurisdiction over "swaps" will affect the electric industry's mission to deliver electric energy to American consumers -- more than a year after the Dodd-Frank Act was

[53] See Section 720 of the Dodd-Frank Act. President Obama's Executive Order 13,563, issued July 11, 2011, confirms the President's commitment to regulatory coordination and restraint to avoid unnecessary, duplicative and burdensome regulatory burdens on American businesses. The Executive Order calls on independent Federal agencies, including the Commission and FERC, to carefully balance the need for regulation against the costs imposed on business.

enacted and more than 6 months after the due date for the FERC/CFTC MOU. The transactions involved in the electric energy, natural gas and related nonfinancial commodities are complex, well-regulated by FERC and state energy regulators, and instrinsically related to the operational challenges of providing reliable, affordable electric service. The geographically unique electric industry operates differently than financial commodity markets, and differently than other nonfinancial commodity markets. The Electric Trade Associations respectfully request that the Commission and FERC work together to avoid duplicative and overlapping jurisdiction, and deliver the FERC/CFTC MOU as Congress intended.

In addition to requiring the FERC/CFTC MOU, Congress provided specific direction to the Commission in respect of certain categories of transactions in the United States electric industry. Section 722(f) of the Dodd-Frank Act provides for certain "public interest waivers" and directs that the Commission ***shall exempt*** such categories of transactions from its new jurisdiction over "swaps," and in fact from ***all the requirements of the CEA***, if the Commission determines such an exemption is "consistent with the public interest and the purposes of [the CEA]."[54]

In the Preamble, the Swap Definition NOPR notes the "public interest waiver" provisions in Section 722 of the Dodd-Frank Act.[55] However, rather than initiating a Section 4(c)(6) public interest waiver process, which the Commission has the authority to do under Section 4(c)(1) and which the NFP Energy Coalition specifically requested in its September 2010 comment letter,[56] and rather than proposing rules to exclude these categories of transactions from the definition of "swap" as it did for the insurance industry and the foreign exchange industry, the Commission seems to set the electric industry aside. The Preamble simply remarks that "persons with concerns about whether FERC-regulated ***products*** may be considered ***swaps (or futures)*** should request ***an exemption*** pursuant to section 722 of Dodd-Frank."[57]

The Electric Trade Associations respectfully submit that, contrary to the Preamble, nothing in the Dodd-Frank Act or the Congressional Record indicates that Congress intended the

---

[54] See new CEA Section 4(c)(6). The provisions of new CEA Section 4(c)(6) are directive (*i.e.*, "the Commission shall exempt"), rather than permissive (*i.e.*, "the Commission may exempt") as are the other provisions in Section 4(c).

[55] See Preamble at page 29,839. The Preamble neglects to mention the FERC jurisdiction provisions of Section 722, or the Section 720(a)(1) FERC/CFTC MOU process and the missed deadline.

[56] See footnote 7.

[57] This statement is particularly troublesome because, notwithstanding their active participation in the Commission's Dodd-Frank Act rulemakings, it leaves the electric industry without guidance or relief while the effective dates of other Commission rulemakings containing compliance obligations in respect of "swaps" loom. Section 720 and 722(f) of the Dodd-Frank Act make it clear that Congress intended the Commission to address these categories of transactions about which the entire electric industry "has concerns."

Commission to "limit its rulemaking in the electric industry" to granting exemptions when and if "persons with concerns" present an exemption request under Section 4(c).[58] Congress itself was concerned, as demonstrated by Sections 720 and 722 of the Dodd-Frank Act, and the deadline of January 17, 2011 for the FERC/CFTC MOU. The electric industry is concerned, as has been evidenced by our dozens of comment letters. FERC is concerned, as demonstrated by the comment letter it filed in this docket and others it has filed in the Commission's earlier Dodd-Frank Act rulemaking proceedings.

If the Commission decides not to provide legal certainty for the electric industry by proposing rules excluding electric industry transactions from the definition of "swap," as it did for the insurance industry and the foreign exchange industry, then the Commission should immediately initiate a broad, open and inclusive Section 4(c)(6) public interest waiver exemption process for the electric industry, in cooperation with FERC and the other energy and environmental regulators. Such a process should focus on unique electric industry nonfinancial commodity agreements, contracts, transactions and commercial arrangements intrinsically related to the delivery of electric energy in the United States, and provide clear categorical public interest waivers of all CEA requirements for such transactions.

The Section 4(c) exemption process that the Commission has historically conducted in determining under Sections 4(c)(1) and 4(c)(2) whether to exempt transactions from the requirements of Section 4(a),[59] is not well-suited for an industry-wide "public interest waiver" exemption of all tariffed transactions and "between FPA 201(f)" transactions from all CEA requirements. The Commission seems to presume incorrectly in the Preamble that the analysis of whether such an exemption would be "consistent with the public interest and the purposes of the CEA" (based on which the Commission is directed to waive all CEA requirements for an industry-wide category of agreements, contracts or transactions) would be conducted in an identical way that the Commission conducts an exemption analysis requested for an individual agreement, contract or transaction (also called a "product" or an "instrument" by the Commission) from regulation under Section 4(a) as a "contract of sale of a commodity for future delivery." There is no indication that Congress intended such a result. In fact, given the broad categories of commercial electric industry transactions that "could be read" to fall within the definition of "swap" and are described in Section 4(c)(6), the statute requires the Commission to conduct the "consistent with the public interest" analysis in a fundamentally different way."[60]

---

[58] See the Preamble at 29,839.

[59] Section 4(a) provides that "[u]nless exempted by the Commission pursuant to subsection (c)…, it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of,…any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery [a "futures contract"], unless such transaction is executed on a [registered entity]."

[60] We understand that the Commission has discussed with some or all of the FERC-regulated RTOs and with ERCOT an exemption process for a narrow category of tariffed transactions -- tariffed transactions executed on an RTO platform. These would be a subset of transactions referenced in new CEA Section

As discussed in Section V and in Attachment A, tariffed transactions are not all executed electronically, nor are they all executed on RTO/ISO platforms. Many tariffed transactions are executed "end-user-to-end-user," without financial entities involved. Under certain FERC, ERCOT and state tariffs, a public utility sells a tariffed service, the terms of which are set forth in the tariff, to entities that take the tariffed service at regulated rates. Under other tariffs, the

---

4(c)(6)(A). The Electric Trade Associations respectfully submit that this exemption process should be conducted with input from all parties who will be affected by the result – including the Electric Trade Associations and their members – and with FERC. FERC already has complete authority over RTO/ISO markets under the Federal Power Act, and FERC's charge under that statute is to ensure that RTO/ISOs produce just and reasonable rates for electric transmission and electric service. FERC created RTO/ISOs and RTO/ISO transactions with that regulatory mission in mind. Further, unlike Commission-regulated exchanges which have self-regulatory authority, FERC is the direct regulator of RTO/ISOs, and takes an active role in closely overseeing every aspect of their operations. RTO/ISO transactions and service are precisely the FERC-regulated subject matter that Congress expected would remain subject to FERC's sole jurisdiction.

When a market professional or an exchange asks the Commission to exempt an agreement, contract or transaction from the provisions of 4(a), and from all or a portion of the Commission's jurisdiction by submitting a Section 4(c) application, that "product" has yet to be offered or transacted, and the applicant is the only interested party. The analysis as to whether such a product, or its exemption, is "consistent with the public interest and the purposes of the CEA" can look at the product's fixed written terms, the manner in which the applicant indicates the product will trade, and how or whether that product will be regulated and monitored. FERC-regulated and -tariffed and ERCOT-tariffed RTO transactions are important to the Electric Trade Associations and all their members within the geographic RTO region are affected by the Commission's exemption process with respect to RTO transactions. As is FERC, the primary regulator of the RTOs and the RTO transactions. RTO transactions are not futures, so conducting an exemption process comparable to a Section 4(c)(1 and 4(c)(2) process for exemption from the Commission's jurisdiction over futures is not appropriate. Although FERC-tariffed RTO transactions are, perhaps, the most standardized tariffed transactions, the transactions are not static "products" or "instruments." Rather, RTO transactions are standardized (by an individual RTO, not across RTOs) under FERC tariffs and are transacted on electronic platforms pursuant to rules that are also created by FERC tariff to achieve FERC's regulatory mission. FERC-tariffed RTO transactions remain subject ongoing FERC jurisdiction and the terms of the transactions are subject to potential change in order that FERC can achieve its regulatory mission -- to ensure that the RTOs efficiently allocate the rights to limited electric transmission grid access to maintain reliable transmission of electricity on the grid, and ensuring that electric rates for transmission and power supply services are just and reasonable. FERC's jurisdictional mandates under the Federal Power Act take precedence over the "market mechanisms" by which FERC allows the RTOs to function under tariffs and under its continuing jurisdiction. The Commission should grant a public service exemption from all CEA requirements for existing and new FERC-tariffed and ERCOT-tariffed transactions, for tariffs amending existing tariffed transactions to avoid interference with FERC's regulatory mission. These FERC-created and monitored market mechanisms, regulatory transactions and entities are consistent with the public interest in maintaining fair, liquid and efficient trading markets for futures contracts and standardized swaps, because these transactions are not futures contracts, nor are they standardized trading products, instruments or "swaps." Thus, granting such an exemption (or excluding the transactions from the definition of "swap") would be consistent with the purposes of the CEA.

purchaser and seller of the nonfinancial commodity negotiate highly-customized bilateral contract provisions and implement reciprocal, ongoing and customized credit risk management analyses. Some of these arrangements may be undocumented, in that the electric utilities are members of an affiliated service group or an infrastructure project development entity or arrangement that share a common public service commitment to the electric consumers in their service territory.

The credit support, collateral, credit risk or other risk mitigation aspects of these tariffed and "between FPA 201(f)" transactions are measured and monitored by finance professionals and executives experienced in risk management for the geographic region of the electric industry in which the nonfinancial entities participate. Such risk and credit risk management processes and procedures are informed by similar processes in the financial markets. But electric industry commercial risk management must also take into account the constantly changing local weather patterns, projected generation asset performance and availability, and projected electric customer load usage. And, each nonfinancial entity must take into account its operational obligations, risk tolerances and the ways in which it is regulated by different Federal, state and local energy and environmental regulators and reliability coordinators. No two regulators oversee these processes in quite the same way, nor do all the regulators monitor on a transaction-by-transaction basis; as the Commission might expect of a self-regulatory organization such as an exchange.

The "consistent with the public interest" analysis conducted in connection with the 4(c)(6) waiver process cannot parallel the analysis the Commission conducts in deciding whether to exempt individual "products" or "instruments" from its jurisdiction over "contracts of sale of a commodity for future delivery." Many tariffed transaction terms are left for the public utility to determine and offer for sale, subject to regulatory review, or to the counterparties to negotiate and monitor.

If the Commission declines to initiate Section 4(c)(6) public interest waiver proceedings for all tariffed transactions and "between FPA 201(f)" transactions, the Electric Trade Associations respectfully request that the Commission articulate how it will evaluate whether it is, or is not, "consistent with the public interest" for the Commission to waive the requirements of the CEA for such transactions. The Electric Trade Associations respectfully request an open and transparent Section 4(c)(6) public interest exemption process, with appropriate opportunity for comment by all members of the electric industry that will be affected by the Commission's determination.

The electric industry should not be expected to seek Section 4(c)(6) exemptions on a commercial transaction-by-commercial transaction basis. It is simply not practical for electric companies to submit every commercial arrangement involving nonfinancial commodities entered into throughout the country on a daily basis to the Commission for an exemption to be sure the arrangement is not a "swap." Nor would it be a good use of the Commission's limited resources to entertain such transaction-by-transaction exemption requests.

The Electric Trade Associations respectfully request the Commission to finalize the CFTC-FERC MOU process, propose rules to expressly exclude these transactions from the

definition of "swap," or initiate and conduct an open, industry-wide public interest waiver analysis and 4(c)(6) exemption process. The electric industry should not be left in the dark as the time continues to pass, rules being finalized and compliance deadlines looming, with no regulatory clarity on the basic jurisdictional question asked on page 2.[61]

IX. The Commission is Respectfully Requested to Consider the Overall Impact of its Rules Promulgated Under the Dodd-Frank Act on Small Entities such as NRECA and APPA's Members.

The Commission's cost-benefit analysis assumes that, since the Proposed Rules and the statutory interpretations in the Swap Definition NOPR relate only to definitions, and not to operable regulatory provisions, the Proposed Rules and statutory interpretations have no independent costs, and instead only facilitate the benefits that Congress intended by the Dodd-Frank Act. We respectfully disagree. As the Electric Trade Associations have said consistently in prior comment letters, the cost-benefit analysis required by law must be conducted in respect of the Commission's initial rulemakings under the Dodd-Frank Act taken as a whole. And the overall scope of the Commission's new jurisdiction under the Dodd-Frank Act over "swaps," and the burdens that the Commission's rules place on nonfinancial entities, including small entities, that execute such "swaps" can ***only*** be determined once the rules and interpretations in this Swap Definition NOPR are finalized.[62]

The Commission cannot assume the overarching regulatory benefit of its Proposed Rules, while pleading its inability to estimate the regulatory costs of those same Proposed Rules that it will be imposing on nonfinancial entities, for markets about which the Commission

---

[61] See the request for such an industry-wide, Commission-initiated public interest waiver exemption process in the NFP Energy End User Coalition's comment letter dated September 20, 2010 referenced in footnote 7. Another such electric industry request is also noted in footnote 153 in the Preamble. See also the Electric Trade Associations' request for an electric industry workshop in our comment letter in the 30 Day Reopening of Comment Periods docket.

[62] The vast majority of NRECA's 900 members meet the definition of "small entity" under the Small Business Regulatory Enforcement Fairness Act. 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996 by the Small Business Regulatory Enforcement Fairness Act) ("SBREFA"). 13 C.F.R. §121.201, n.1. Only four distribution cooperatives and approximately twenty-eight generation and transmission entities do not meet the definition. The Regulatory Flexibility Act 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 an entity which provides electric services is a "small entity" if its total electric output for the preceding fiscal year did not exceed four million megawatt hours. Most of APPA's members also meet the definition of "small entity" under the Small Business Regulatory Enforcement Fairness Act. The Electric Trade Associations refer the Commission to the comment letter filed by NRECA, APPA and LPPC as the "Not-for-Profit Electric Coalition" in the Commodity Option NOPR (76 Fed. Reg. 6095, Feb. 3, 2011) for comments on certain other fundamental flaws in the Commission's cost-benefit analysis, including the unsupported assertion that there are no "eligible contract participants" that are "small entities" for RFA purposes.

acknowledges it has insufficient information. Each of the complex and interrelated regulations currently being proposed by the Commission has both an individual, and a cumulative, affect on such small entities. As hundreds of small entities, NRECA and APPA's members seek to continue their use of nonfinancial commodity "swaps" only to hedge the commercial risks of their not-for-profit public service activities. Their members are all "end user only" and "bona fide hedger only" entities. NRECA and APPA, for and on behalf of their members, reserve the right to assess the full impact of the initial rulemakings being promulgated by the Commission under the Dodd-Frank Act, and to require a SBREFA analysis be conducted with respect to those regulations as a whole. In each of its ongoing rulemakings, the Commission acknowledges that it has no experience under the new requirements of the Dodd-Frank Act in regulating the swaps markets or in regulating nonfinancial entity market participants.

Each Proposed Rule addresses a different piece of the Commission's overall rulemaking challenge under the Dodd-Frank Act. The Commission's cost-benefit analysis in each NOPR includes assumptions about the number of non-cleared "swaps," the number of "swap dealers" and major swap participants," the number of "financial entities," the number of annual transactions, the number of end-user-to-end-user transactions, the number of calculations, valuations and disclosures, and what information the Commission needs about the non-cleared swaps markets or each non-cleared swap transaction or each market participant. The Electric Trade Associations reserve the right to dispute all these assumptions, and request that the Commission fulfill its statutory requirements under SBREFA to provide economic data showing that the aggregate costs and cumulative regulatory burdens imposed on such small entities by the initial rulemakings to implement the Dodd-Frank Act are necessary, and that there are no alternative ways to achieve the regulatory goals that would reduce the burdens imposed by the Commission's rulemakings under the Dodd-Frank Act on such small entities.

The Commission cannot assume the overarching regulatory benefit of its Proposed Rules, while ignoring the regulatory costs of those same Proposed Rules. Nor can the Commission ignore the heavy regulatory burden and cost it will be imposing on nonfinancial entities. We urge the Commission not to ignore or underestimate these significant burdens on American business.[63]

X. Conclusion.

The Electric Trade Associations' members need clear rules to help them distinguish a "swap" from a nonfinancial commodity forward transaction and a "swap" from a commercial merchandising arrangement involving nonfinancial commodities, at the time the transaction is executed. We have adopted the Commission's approach, and proposed rules to define the new statutory terms, and to clarify the new statutory terms as they apply (and as they should not apply) to our electric industry transactions. We renew our requests for regulatory certainty, and

[63] See the letter sent on July 14, 2011 by Representatives Lucas and Conaway to Chairman Gensler requesting a response to certain questions by July 29, 2011 on the cost-benefit analysis being conducted under the Dodd-Frank rulemakings.

express again our concern about the delay in the Commission's response to the electric industry's most basic jurisdictional question: "Does the Commission contend that the broad array of nonfinancial commodity transactions used by the electric industry to meet Americans' need for 24/7 electric power are "swaps" under the Dodd-Frank Act?" Please contact any of the Electric Trade Associations' undersigned representatives for more information or assistance.

DEFINITION OF "SWAP"

Respectfully yours,

ELECTRIC POWER SUPPLY ASSOCIATION

Daniel S.M. Dolan
Vice President, Policy Research & Communications

EDISON ELECTRIC INSTITUTE

Richard F. McMahon, Jr.
Vice President

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Russell Wasson
Director, Tax Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

LARGE PUBLIC POWER COUNCIL

Noreen Roche-Carter
Chair, Tax and Finance Task Force

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Daniel Berkovitz

ATTACHMENT A

I. Description of the Electric Trade Associations.

NRECA is the national service organization for more than nine hundred rural electric utilities and public power districts that provide electric energy to approximately forty-two million consumers in forty-seven states or thirteen percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately eleven percent of all electric energy sold in the United States. Because an electric cooperative's electric service customers are also members of the cooperative, the cooperative operates on a not-for-profit basis and all the costs of the cooperative are directly borne by its consumer-members.

APPA is the national service organization representing the interests of government-owned electric utilities in the United States. More than two thousand public power systems provide over fifteen percent of all kilowatt-hour sales to ultimate electric customers. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Some government-owned electric utilities generate, transmit, and sell power at wholesale and retail, while others purchase power and distribute it to retail customers, and still others perform all or a combination of these functions. Government-owned utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a government-owned electric utility is to provide reliable and safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

LPPC is an organization representing twenty-four of the largest government owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly ninety percent of the transmission investment owned by non-Federal government-owned electric utilities in the United States. LPPC member utilities supply power on a not-for-profit basis to some of the fastest growing urban and rural residential markets in the country. Members are located in eleven states and Puerto Rico, and provide power to some of the largest cities in the country, including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando, and Austin.

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate electric 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.

EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced

electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers.

II. Commercial Electric Industry Agreements.

Agreements, contracts and transactions (as well as commercial merchandising arrangements) involving nonfinancial commodities like electric energy and related commodities, and the standardized and customized derivatives related thereto, are often executed without Commission-regulated financial intermediaries or trading facilities involved, in geographic regional "markets" throughout the United States. Such agreements, contracts, transactions and arrangements contain highly customized commercial terms. Reciprocal counterparty credit risk analysis and management is an integral and ongoing part of this bilateral contract market structure.

a. Well-Regulated.

The market for the purchase and sale of electric energy in interstate commerce in the United States is well-regulated at the Federal, state and local level, with a focus on reliability of service and affordable regulated rates payable by the retail energy customer. In addition, the electric industry in North America is subject to extensive Federal environmental regulations and, in many regions and states, further environmental regulation and renewable energy standards. Unlike other "markets" for nonfinancial commodities and related OTC commodity derivatives and/or commodity "swaps" (as newly defined by the Dodd-Frank Act), these are <u>not</u> unregulated markets. Any new regulatory structure must be carefully tailored so as not to conflict with existing regulatory structures and unnecessarily burden market participants with existing regulatory public service obligations.

Some of the electric industry transactions are conducted through, "on," or "in" the "organized [wholesale electric] markets" operated by various regional transmission organizations or independent system operators (collectively, "RTOs"). Each RTO operates in a separate and defined geographic area of the United States, and all RTOs operate under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC") or, in the case of the Electric Reliability Council of Texas ("ERCOT"), by the Public Utility Commission of Texas ("PUCT").[1] In the FERC-regulated geographic markets, the parties' rights and obligations are established by tariff in many instances, rather than by contract, and analogies between these FERC-created/FERC-regulated "markets," and the bilateral contract transactions between independent and arm's length third parties and governed by and enforced under state contract laws, are inapt. Although, in some ways, the markets conducted by the various RTOs are similar in structure, no two RTO market are exactly alike and their "products, "contracts" or

[1] Throughout the rest of this attachment, when references are made to FERC-regulated markets and transactions, it should be noted that, within the state of Texas, ERCOT (which is regulated by the PUCT, rather than by FERC) maintains the tariffed or "organized [wholesale electric] markets" and manages the transmission grid. Transactions are completed in and pursuant to the terms of the ERCOT tariffs.

"instruments" are ***not*** fungible between RTOs. Each RTO also has in place credit risk mitigation policies and procedures to protect market participants from the credit risk of other market participants, and to protect the RTO markets from disruption due to a market participant default. These RTO credit risk mitigation policies are established and maintained in accordance with the regulatory principles established by FERC.[2]

For "public utilities," as that term is defined in the Federal Power Act, the sale of wholesale electric energy and electricity transmission in interstate commerce are also subject to extensive FERC regulation, through approval of cost-based tariffs and market-based rate authorizations, as well as regulations governing utility-affiliate transactions and utility governance, among others. Electricity sales to customers that consume electricity in homes or businesses are subject to similar scrutiny by state public utility commissions. In some cases, moreover, contracts may be subject to both state and federal oversight as is the case with contracts by utilities to obtain electric supply to meet "provider of last resort" obligations in states that allow retail open access. In these cases, the contracts typically are initially approved by the state commission and then become subject to FERC jurisdiction after execution.

In addition, FERC has in place extensive regulatory requirements for recordkeeping and reporting of wholesale electric energy and electricity transmission transactions and for financing transactions involving public utilities. FERC has recently proposed a rule that would expand its transaction reporting requirements to encompass additional entities.[3] States also have counterpart recordkeeping and reporting requirements applicable to electric energy sales by utilities under their jurisdiction to consumers and businesses.

FERC's mandate from Congress under the Federal Power Act is to regulate in the "public interest" -- which is interpreted as the delivery of reliable electric energy to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate, the FERC-regulated markets. The RTO markets are intrinsically tied to the physical transmission capacity, reliability, and ultimate delivery of electric energy in interstate commerce at just and reasonable rates. The same tests apply to FERC regulation of public utility rates for electric energy sales outside the RTO context.

Most of the nonfinancial electric energy and related commodity and commodity derivatives agreements, contracts, transactions and arrangements in which the Electric Trade

---

[2] Such policies were recently updated by FERC in its Final Rule on Credit Reforms in Organized Wholesale Electric Markets, 18 CFR Part 35, Docket No. RM10-13-000, Order No. 741 (issued October 21, 2010). 111 FERC Stats. & Regs., Regs. Preambles 31,317(2010), order on reh'g, Order No. 741-A, 111FERC Stats. & Regs., Regs. Preambles 31,320, reh'g denied, Order No. 741-B, 135 FERC 61,242 (2011) (PJM Docket No. ER11-3972-000).

[3] 76 Fed. Reg. 24188, "Electricity Market Transparency Provisions of Section 220 of the Federal Power Act," April 29, 2011. A web link is: http://www.gpo.gov/fdsys/pkg/FR-2011-04-29/pdf/2011-10113.pdf.

Associations' members are engaged are conducted under exemptions or exclusions from the Commodity Exchange Act (the "CEA"), whether conducted as bilateral OTC transaction (as most are, including RTO transactions) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial characteristics, or by virtue of their use of underlying nonfinancial commodities relevant to their businesses (as "eligible commercial entities"). The nonfinancial commodity transactions occur principal to principal, some through agents and/or energy brokers, and often with a wide variety of counterparties.

b. End-User-to-End-User Transactions -- Highly Customized.

The Electric Trade Associations' members engage in a substantial number of non-cleared, "end-user-to-end-user" nonfinancial energy commodity agreements, contracts, transactions and arrangements ("Energy Commodity Transactions").[4] Counterparties for these Energy Commodity Transactions may be traditional commercial (nonfinancial energy commodity) counterparties, rather than financial entities (whether financial intermediaries or financial institutions) from whom the electric companies secure financing or buy financial commodity derivatives.

In the markets for Energy Commodity Transactions, an end user may be a buyer one day and a seller the next, as its seasonal commercial needs for one or more energy commodities fluctuate. And, the end user may be a buyer of one type of energy commodity or derivative, and a seller of another type of energy commodity or derivative. In the markets for Energy Commodity Transactions, a single energy company may buy natural gas swaps and sell electric energy swaps for the same month, or it may buy natural gas swaps for one month and sell natural gas swaps for the next month.

Most electric companies' commercial risks are system-specific, geography-specific, and seasonal. Commercial risk management decisions are made based on ever-changing long-term and short-term regional weather forecasts, generation or transmission availability and/or load projections, evolving environmental regulatory constraints, and the affect of constantly changing market dynamics on the most cost effective way to hedge projected electric load requirements, from among a variety of available fuels and sources, including the wholesale power market. It is not uncommon for load-serving energy companies to hedge multiple commodity risks, such as an electric utility hedging the commercial risks of its input (natural gas as fuel) and the risks of its

[4] We use the term "end-user-to-end-user swaps," but we also intend to include in this definition swaps that are executed by two nonfinancial entities, whether or not one or both of the nonfinancial entities elects the end-user exception. There will be an even higher percentage of these end-user-to-end-user swaps if the Commission does not clarify the nonfinancial commodity forward contract exclusion to the definition of "swap" to exclude nonfinancial energy commodity option transactions in which the Electric Trade Associations' members engage every day. In particular, nonfinancial commodity options are often executed between large and small nonfinancial energy companies hedging offsetting commercial risks in a particular geographic region.

output (electric generation/deliverable electric energy). Consequently, cross-commodity hedging is commonplace. There is no "sell-side/buy-side" dichotomy in the non-cleared Energy Commodity Swap market, and there are often no financial intermediaries -- many nonfinancial entities play multiple commercial end user roles.[5]

The transactions contain customized, non-quantitative operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between pairs of commercial enterprises. Although legal and administrative terms may be standardized through the use of master agreements, the negotiated schedules to such master agreements and individual transaction confirmations are highly negotiated and differ based on the needs and preferences of each pair of counterparties. Nonetheless, in each transaction, the primary economic terms are negotiated between the counterparties. These are commercial merchandising arrangements or transactions, when viewed through the traditional lens of "goods" and "services" used by American businesses. It is only when these transactions are viewed through the financial markets lens that these transactions are described using the financial market regulatory labels such as "products," "instruments," "exempt commodities," "swap agreements," "swaps" or "nonfinancial commodities" -- and analogized to "futures contracts" or "positions" created and traded by financial entities interacting with "buy-side customers" on a transaction-by-transaction basis for profit ("dealing") or speculation ("trading"). These commercial agreements, contracts, transactions and arrangements should not be subject to a regulatory regime that is traditionally applicable to financial market instruments.[6]

c. Counterparty Credit Risk Management -- Extensive, Continuous and Relationship-Based.

Credit support arrangements in the bilateral world of non-cleared Energy Commodity Transactions are grounded in broad-based, continuing and reciprocal commercial credit risk analysis and credit risk management between each set of counterparties, backstopped by credit support and collateralization principles. This credit risk analysis and management is ***not*** performed because a regulator requires it or specifies its parameters. Each of the Electric Trade Associations' members' senior management and Board of Directors recognizes the credit risks in the commercial markets and implements credit risk management policies appropriate for the size of the entity, the types of counterparties with which it deals, and the entity's unique risks and risk tolerances. This type of credit risk management is not analogous to the transaction-by-transaction margining (without regard to counterparty identity) that takes place in today's Commission-regulated futures and options markets, and that is required by clearing entities of their members or required by Commission regulation of the clearing entities and exchanges.

[5] Please let us know if the Electric Trade Associations can provide the Commission with further information on this important and unique aspect of "the markets" for Energy Commodity Transactions.

[6] 76 Fed. Reg. at 29,833.

Today, the Electric Trade Associations' members have the commercial risk management choice to conduct some Energy Commodity Swap transactions on Commission-regulated contract markets, or to clear some of these transactions through Commission-regulated centralized clearing entities. Listed and cleared transactions are typically those delivered at "hubs," in tradable increments and for tradable durations -- transactions or "products" that are "standardized" and "fungible" in financial market terms, and with sufficient contract trading liquidity to allow for financial commodity and commodity derivatives market structures to function. As the Commission-regulated financial markets have evolved, some of the larger electric companies have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments in addition to customized OTC transactions. The vast majority of smaller electric companies' Energy Commodity Transactions are still conducted "the old fashioned way": under tariffs or in transactions with known and reliable commodity suppliers and customers, and not with Commission-regulated financial intermediaries, on exchanges or with clearing entities. Most of the smaller members of the Electric Trade Associations, especially the members of the NRECA and APPA that are SBREFA "small entities," do not either post collateral to their counterparties or require that their counterparties post collateral to them. [7] Similarly, larger companies dealing with known and reliable commodity suppliers will take account of the creditworthiness of the counterparty and, frequently, will negotiate margining requirements to the extent that they are determined to be needed in the over-the-counter contracts.[7]

Due to the Dodd-Frank Act's wholesale deletion of applicable exemptions in the CEA, the potentially sweeping nature of the Dodd-Frank Act's new definition of "swap," the lack of

---

[7] For examples of the diversity of credit support arrangements and collateral (or "margin") relationships which NRECA, APPA and LPPC members have in place with their Energy Commodity Swap counterparties, as well as the diversity of assets, load (customers served within the utility's geographic service territory), energy hedging and risk management policies, and swap usage within these Electric Trade Associations' membership, see the profiles attached to the pre-NOPR comment letter filed by the "Not-for-Profit Energy End User Coalition" to the Capital and Margin Task Force, dated December 14, 2010, or the comment letter filed in respect of the Entity Definitions NOPR (75 Fed. Reg. 80,174, Dec. 21, 2010) by EEI and EPSA. Web links to these comment letters can be found in footnote 14. None of these profiles purport to be "typical" of large, medium or small entities that are members of the Electric Trade Associations (measured by number of customers).

[7] For examples of the diversity of credit support arrangements and collateral (or "margin") relationships which NRECA, APPA and LPPC members have in place with their Energy Commodity Swap counterparties, as well as the diversity of assets, load (customers served within the utility's geographic service territory), energy hedging and risk management policies, and swap usage within these Electric Trade Associations' membership, see the profiles attached to the pre-NOPR comment letter filed by the "Not-for-Profit Energy End User Coalition" to the Capital and Margin Task Force, dated December 14, 2010, or the comment letter filed in respect of the Entity Definitions NOPR (75 Fed. Reg. 80,174, Dec. 21, 2010) by EEI and EPSA. Web links to these comment letters can be found in footnote 12. None of these profiles purport to be "typical" of large, medium or small entities that are members of the Electric Trade Associations (measured by number of customers).

clarity of the nonfinancial commodity forward contract exclusion, and the commercial merchandising analysis that appears in the Preamble but not in the rule, many of these everyday commercial agreements, contracts, transactions (including nonfinancial commodity trade options) and arrangements are subject to continuing legal uncertainty – in 20/20 hindsight a binding contract could be recharacterized by the Commission or a counterparty as a "swap."[8]

[8] The Commission should not, in its rulemaking under the Dodd-Frank Act, be distracted by those commentators who intone or invoke the names "AIG" or "Enron," without analysis. In fact, neither AIG nor Enron would be a nonfinancial entity or entitled to the end-user exception under the CEA as amended by the Act, and so neither would be able to except its swaps from clearing or be exempt from margin requirements. AIG, whose substantial positions in non-cleared credit default swaps allegedly endangered the financial system, would be registered and regulated as a "major swap participant" or a "swap dealer." Enron, with its notorious "one-to-many" electronic interface, offering to buy or sell swaps on underlyings from energy to broadband, is the poster child for the Act's definition of "swap dealer," and would be registered and regulated as such. Nonfinancial entities hedging commercial risk with Energy Commodity Transactions, and other types of non-cleared swaps, simply do not represent the types of systemic risk that the mere mention of those entities' names implies.

ATTACHMENT B

Definition of "Nonfinancial Commodity." –

Section 1.3(xxx)(__) *Nonfinancial commodity*. For purposes of Section 1a(47)(B)(ii) of [the CEA], the term *nonfinancial commodity* means any good, article, service, right and interest in which contracts for future delivery are presently or in the future dealt in [a "commodity," as defined in Section 1a(4) of the CEA], that is:

(i) not an interest rate, exchange rate, currency, security, security index, credit risk or measure, debt or equity instrument, index or measure of inflation, or other macroeconomic index or measure (each of these, for purposes of this definition, a "financial commodity");

(ii) not any other rate, differential, index, or measure of economic or commercial risk, return, or value, that is –

(I) based in substantial part on the value of a narrow group of financial commodities; or

(II) based solely on 1 or more financial commodities;

(iii) not an economic or commercial index based on prices, rates, values, or levels that are within the control of any party to the relevant contract, agreement or transaction; and

(iv) not an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value or level of a financial commodity) that is –

(I) beyond the control of the parties to the relevant contract, agreement or transaction; and

(II) associated with a financial, commercial or economic consequence.

For the avoidance of doubt, nonfinancial commodities in the United States electric industry include, but are not limited to: electric energy, transmission and distribution services for electric energy, natural gas, generation capacity, reserves, electric storage, ancillary services, transportation and storage services for natural gas, cross-commodity concepts (nonfinancial commodities only) based on heat rates or "tolling," demand response (or "negawatts"), energy imbalances, pipeline or other natural gas "cashouts," delivery location or time (basis) in-kind exchanges based on nonfinancial commodities, curtailment rights for all or a portion of a supply resource or a supply system, transmission or transportation rights, storage, capacity or pipeline capacity release (including reservations), environmental rights, allowances or attributes, including emissions reductions, allowances and credits and carbon offsets and credits, clean energy and energy efficiency credits, and renewable energy credits or similar regulatory attributes or compliance determinations.

ATTACHMENT C

Further Clarification of CEA Section 1a(47)(B)(ii) –

Section 1.3(xxx)(__)*(i) Exclusion of nonfinancial commodity forward contracts*. The term *swap* excludes an agreement, contract or transaction (or an option that, if exercised, becomes such an agreement, contract or transaction) that provides for deferred shipment or delivery of a nonfinancial commodity; provided that (I) the agreement, contract or transaction contains a binding obligation to deliver and receive such nonfinancial commodity, (II) the agreement, contract or transaction is entered into by parties acting as principals (or through agents) that have the capacity or ability, directly or through separate *bona fide* contractual arrangements, to make or take delivery of such nonfinancial commodity, (III) the principal economic terms of the agreement, contract or transaction are individually negotiated (or are established by regulators other than the Commission with jurisdiction over either the parties or the transaction), (IV) if an option, such option does not eliminate or allow one party to unilaterally avoid its obligation to deliver or receive the nonfinancial commodity and, instead, to settle financially, and the option is not severable, traded or tradable separately from the agreement, contract or transaction, and (V) the agreement, contract or transaction (or option) is not executed, traded or cleared on a registered entity.

(iii) The terms of the contract, agreement or transaction shall govern the interpretation of the phrase "intended to be physically settled" in Section 1a(47)(B)(ii) of the [CEA], and no discussions, negotiations, amendment, arrangements or agreements between the parties, or other events or circumstances, which take place before or after the contract, agreement or transaction is executed shall be considered in determining the applicability of the exclusion set forth in Section 1a(47)(B(ii). For the avoidance of doubt, a separate agreement or amendment, or an event or circumstance, that takes place after the initial agreement, contract or transaction is executed but before delivery and receipt of the nonfinancial commodity occurs, that allows such initial agreement, contract or transaction to be cancelled, netted or offset against another agreement, contract or transaction between the parties, exchanged, or otherwise settled without the initial agreement, contract or transaction being physically settled (sometimes referred to as a "bookout"), shall not affect the interpretation of the initial agreement, contract or transaction under Section 1a(47)(B)(ii).

For the avoidance of doubt, agreements, contracts and transactions involving nonfinancial commodities in the United States electric industry that are encompassed within the Section 1a(47)(B)(ii) exclusion from the definition of "swap" include, but are not limited to: standard offer or provider of last resort contracts, network services agreements, tariffed sales of electric energy or natural gas, electric energy transmission and distribution of transactions, generation capacity and reserve sharing agreements, energy storage agreements, ancillary services agreements, nonfinancial commodity take or pay transactions and swing options (with minimum or maximum take options), cross-commodity (non-financial commodities only) transactions based on heat rates or "tolling" arrangements, demand response programs, energy imbalance transactions, pipeline or other natural gas "cashouts," delivery location or time (basis) in-kind

exchange transactions based on nonfinancial commodities, full requirements contracts or arrangements with demand or supply variability, including options to adjust quantities over time or load following or load shaping provisions, fluctuating, intermittent or interruptible energy supply contracts, off-take agreements (with or without curtailment rights),transmission or transportation rights, storage, capacity or capacity release transactions (including reservations), contracts for sale of environmental rights, allowances or attributes, including emissions allowances and credits and carbon offsets and credits, clean energy and energy efficiency credits, and renewable energy credits or similar regulatory attributes or compliance determinations, in any case that contain provisions for deferred shipment or delivery; provided however that the agreement, contract or transaction (or option) is not executed, traded or cleared on a registered entity.

ATTACHMENT D

Further Exclusion from "Swap" –

Section 1.3(xxx)(__) *Exclusion of certain commercial electric energy, natural gas, and related nonfinancial commodity transactions.* The term *swap* does ***not*** include:

(I) an agreement, contract, transaction (or an option which , if exercised, becomes such an agreement, contract or transaction) or commercial merchandising arrangement involving the sale of one or more nonfinancial commodities that is entered into pursuant to a tariff, regulation, certificate, protocol, authorization or rate schedule establishing rates, charges, terms or conditions, or approved, promulgated, accepted or permitted to take effect by the Federal Energy Regulatory Commission or the Electric Reliability Council of Texas;

(II) an agreement, contract or transaction (or an option which, if exercised, becomes such an agreement, contract or transaction) or commercial merchandising arrangement involving the sale of one or more nonfinancial commodities that is entered into pursuant to a tariff, regulation, certificate, protocol, authorization or rate schedule establishing rates, charges, terms or conditions for, or protocols governing, the sale of electric energy or natural gas approved, promulgated, accepted or permitted to take effect by the regulatory authority of any State, municipality or other governmental entity having the jurisdiction to regulate rates, charges, terms or conditions for the sale of electric energy or natural gas within such State, municipality or other governmental entity's jurisdiction; or

(III) an agreement, contract or transaction (or an option which, if exercised, becomes such an agreement, contract or transaction) or commercial merchandising arrangement involving the sale of one or more nonfinancial commodities that is entered into between counterparties that, in the normal course of business, are producers, generators, processors, refiners, merchandisers or commercial end users of a nonfinancial commodity that is intrinsically related to the production, generation, processing, transportation, storage, transmission or delivery of electricity or natural gas in interstate commerce in the United States, including any agreement, contract or transaction that is the subject of a tariff, regulation, certificate, protocol, authorization or rate schedule approved, accepted or permitted to take effect by the Federal Energy Regulatory Commission or the Electric Reliability Council of Texas, or any State, municipality or other governmental authority; provided that, (i) at the time the agreement, contract or transaction (or option) is entered into, such counterparties are acting as principals (or through agents) and have the capacity or ability, directly or through separate *bona fide* contractual arrangements, to make or take delivery of such nonfinancial commodity in connection with a line of business, (ii) the principal economic terms of the agreement, contract, transaction or arrangement serve an independent commercial purpose, other than for speculative, trading or investment purposes, (iii) to the extent an agreement, contract, transaction or arrangement includes characteristics otherwise indicative of an option, such option does not eliminate or allow one party to unilaterally avoid its obligation to deliver or receive the nonfinancial commodity and, instead, settle financially, and the option is not severable, traded or tradable separately from the

obligation to deliver and receive such nonfinancial commodity, and the agreement, contract or transaction (or option) or arrangement is not executed, traded or cleared on a registered entity, or

(IV) an agreement, contract or transaction (or an option which, if exercised, becomes such an agreement, contract or transaction) or a commercial merchandising arrangement involving nonfinancial commodities that is entered into between entities described in Section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).

For the avoidance of doubt, commercial agreements, contracts, transactions and arrangements involving nonfinancial commodities in the United States electric industry, that are excluded from the definition of "swap" as commercial merchandising agreements include, but are not limited to: standard offer or provider of last resort contracts, network services agreements, energy storage, tariffed sales of electric energy or natural gas, electric energy transmission and distribution transactions, generation capacity and reserve sharing agreements, nonfinancial commodity take or pay transactions and swing options (with minimum or maximum take options), cross-commodity transactions (non-financial commodities only) based on heat rates or "tolling arrangements," demand response (or "negawatt") programs, energy imbalance agreements, pipeline or other natural gas cashouts, delivery location or time (basis) in-kind exchange transactions based on nonfinancial commodities, full requirements contracts or arrangements with demand or supply variability, including options to adjust quantities over time or load following or load shaping provisions, fluctuating, intermittent or interruptible energy supply contracts, off-take agreements (with or without curtailment rights) or energy management or services agreements for all or a portion of a supply resource or a supply system, transmission or transportation rights, storage, capacity or capacity release transactions (including reservations), environmental rights, allowances or attributes, including emissions reductions and credits and carbon offsets and credits, clean energy and energy efficiency credits, and renewable energy credits or similar regulatory attributes or compliance determinations, in any case that contains provisions for deferred delivery; provided however that the agreement, contract or transaction (or option) or arrangement is not executed, traded or cleared on a registered entity.

US_ACTIVE-106758456.4