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

October 12, 2012

Re: RIN number 3038–AD46 – Comments on Forward Contracts with Embedded Volumetric Optionality & Usage Contracts

Dear Mr. Stawick:

I. Introduction

A. Summary

Entergy Corporation respectfully submits these comments in response to the interpretation of the Commodity Futures Trading Commission (the "Commission") regarding forwards with embedded volumetric optionality and usage contracts. This comment letter briefly discusses the arguments and proposals made in the Edison Electric Institute and the Electric Power Supply Association (collectively, "EEI/EPSA") comment letter,[1] and Entergy's concurrence with EEI/EPSA's comments. Entergy also provides several examples of common transactions that Entergy enters into that could be implicated by the Commission's rules. Lastly, a brief discussion of the compliance efforts that would be required is provided.

Entergy appreciates the opportunity to provide these comments and respectfully requests the Commission's consideration of such comments.

B. Background

Entergy Corporation is a public utility holding company that owns both traditional franchised utilities in the southern United States and non-utility wholesale power plants

[1] EEI and EPSA Comments on Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (RIN 3235-AK65) (Oct. 12, 2012) ("EEI/EPSA Letter").

in the northern, midwest and southern United States. The corporate parent has six traditional franchised utility subsidiaries located in four southern states (the "Entergy Operating Companies").[2] The Entergy Operating Companies are vertically integrated electric utilities that provide retail electric power service in Arkansas, Louisiana, Mississippi, and Texas. The Entergy Operating Companies combined own over 15,800 miles of transmission lines and provide transmission service to an area of almost 114,000 square miles. The Entergy Operating Companies provide electric service to retail customers subject to state and local regulation and transmit and sell power at wholesale, subject to regulation by the Federal Energy Regulatory Commission ("FERC"). The non-utility wholesale business does not sell power at retail and does not have captive customers. Each of the non-utility wholesale subsidiaries in the northern United States is an exempt wholesale generator ("EWG"), and sells wholesale capacity, energy and ancillary services under market-based and cost-based wholesale power sales tariffs approved by and on file with FERC. Each of the remaining non-utility wholesale subsidiaries is an EWG and sells power at market-based rates or pursuant to a FERC-approved cost-based tariff. The non-utility retail power marketer supplies retail electricity to certain customers in the northeast United States. The utility and non-utility companies (collectively referred to as "Entergy") have regularly participated in the public discussion of the rules and regulations created to implement the Dodd-Frank Act, most commonly as a part of an industry association or working group.

II. Comments

A. Entergy supports and concurs with the arguments and recommendations discussed in the EEI/EPSA Letter.

i. Contracts with embedded optionality that meet the three-factor test satisfy the forward contract exclusion and therefore, are not swaps.

Entergy agrees with EEI/EPSA's arguments that applying the three-factor test for forward contracts with embedded optionality "preserves the Commission's goal in assuring that contracts" intending physical delivery are excluded from the swap definition.[3] Such delivery is contemplated by the parties when the contract was entered into.[4] Requiring forward contracts with embedded optionality to meet specifications beyond the three-factor test will increase costs to energy market participants without reducing systemic risk or otherwise protecting the U.S. financial markets.

ii. The seventh factor of the seven-factor test for contracts with embedded volumetric optionality should be eliminated.

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[2] The Entergy Operating Companies include Entergy Arkansas, Inc.; Entergy Gulf States Louisiana, L.L.C.; Entergy Louisiana, LLC; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; and Entergy Texas, Inc.

[3] EEI/EPSA Letter at 4.

[4] EEI/EPSA Letter at 4.

If the Commission insists on holding contracts with embedded volumetric optionality to a standard other than the three-factor test, it should ensure the standard it adopts provides clear guidelines to market participants. The Commission's proposal – which would require evaluation of seven aspects of physical delivery contracts – fails this test.

Entergy is particularly concerned that the seventh factor ("Part Seven"), which requires that "the exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors, or regulatory requirements, that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity," will prove to be unworkable.[5] EEI/EPSA argues that Part Seven articulates "a new test that is not required by the statutory language."[6] Moreover, economic decisions that lead to the exercise of a physical option would fail Part Seven despite the fact that they are intended for physical delivery. In addition, it is difficult, if not impossible, to determine when entering into an agreement exactly why the option will be exercised—whether it is due to factors beyond a party's control or another reason.[7] Given the various regulatory requirements that attach to a swap upon execution, it is imperative that any standard adopted by the Commission provide market participants a way to distinguish forward contracts and swaps at the time of execution. Accordingly, EEI/EPSA suggests that the Commission eliminate Part Seven. Entergy agrees with this recommendation.

To illustrate the issues with Part Seven of the seven-factor test, Entergy provides three examples of contracts commonly entered into by Entergy and across the industry: natural gas supply agreements, power purchase agreements and partial requirements agreements.

a) Natural Gas Supply Agreements

Power suppliers must consider a number of factors in order to meet their obligations to customers. These factors include, but are not limited to, changes in weather, generating unit availability, changes in load and fuel supply. To illustrate one of these points, Entergy provides an example and arguments similar to those provided in the ConocoPhillips comment letter.[8] To address uncertainty regarding the exact amount of gas required in a given day, a natural gas purchaser executes a base load supply agreement for 50,000 dekatherms of natural gas per day priced at the first-of-month index, which also allows the purchaser, on any day, the flexibility to take an additional 10,000 dekatherms at the first-of-month index price or to put back to the natural gas supplier 10,000 dekatherms. Assume further that the purchaser also has natural gas storage from which supply can be drawn. As commonly occurs, a spike of cold weather increases the purchaser's demand for natural gas. This type of weather event is an

[5] Swap Definition Final Rule at 48,238.
[6] EEI/EPSA Letter at 6.
[7] EEI/EPSA Letter at 6.
[8] Public Comments on the Commission's Interpretation Regarding Forwards with Embedded Volumetric Options at 3-5 (Aug. 23, 2012) ("ConocoPhillips comment letter").

example of a factor "outside the control of the parties" that "influenc[es] the demand for [. . .] the nonfinancial commodity." The purchaser can meet the increased demand in three ways:

- i. using the contractual volumetric flexibility;
- ii. purchasing natural gas in the daily market; or
- iii. drawing natural gas from storage.

Although the purchaser's need for additional gas results from an event outside of the purchaser's control that creates additional demand, the method of satisfying such additional demand will be a business decision by the purchaser. Put differently, the purchaser would only use the volumetric flexibility in the base load supply agreement if doing so makes more sense commercially than other options. Part Seven of the Commission's proposed test for evaluating the status of contracts with volumetric flexibility appears to ignore this business reality and therefore creates significant regulatory uncertainty about whether base load supply agreements that contain volumetric flexibility will be forward contracts or swaps. The Commission should eliminate Part Seven of its volumetric optionality test because it would be punitive and inappropriate for a company using good reasoned and prudent business judgment to fail Part Seven merely because the decision to use volumetric flexibility in a contract involves consideration of a company's commercial objectives.

b) Power Purchase Agreements

Part Seven also raises concern about whether power purchase agreements will be considered swaps or forward contracts. Power suppliers use power purchase agreements to support their portfolio to meet daily load uncertainty. Under a common type of power purchase agreement, a buyer contracts to purchase power from a seller with flexibility in the amount of power the buyer can purchase. For example, assume a power purchase agreement provides that the buyer must schedule 250 MW of power in a given hour but has the flexibility to schedule up to an additional 100 MW in such hour.[9] As in the gas supply example above, the buyer of power will consider a number of factors in determining whether or not to schedule the variable amount of power in a given hour, which could include, among others, customer demand, unavailability of other sources of power, reliability, and price. Most importantly, the buyer's assessment of the relative importance and weighting of the factors generally varies from transaction to transaction and is, accordingly, difficult to quantify.

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[9] Some power purchase agreements provide the buyer the flexibility to purchase up to a certain quantity of power without being required to purchase a minimum amount, though the buyer fully expects to schedule and take delivery of power at different times throughout the term of the agreement. While such a power purchase agreement may not fit within the framework for evaluating forward contracts with embedded volumetric optionality, such an agreement is a common commercial contract for delivery of a nonfinancial commodity entered into by a buyer to add to its mix of power supply to meet its customers' demand and, as such, should have the benefit of the same regulatory certainty afforded to forward contracts that satisfy the forward contract exclusion safe-harbor.

c) Partial Requirements Agreements

The third example involves partial requirements agreements. Under a partial requirements agreement,[10] a load-serving entity (*i.e.*, a retail electric provider or other entity that delivers power to consumers) may not run or may not be able to run part of its own generation resources for operational, maintenance or other reasons. To avoid service disruptions, the load-serving entity enters into a contract to partially balance its load requirement using power supplied by a power supplier. Unlike the case of a power purchase agreement, the load-serving entity does not schedule the power it requires from the power supplier. Instead, its load is balanced in real-time, and the power supplier determines the amount of power actually supplied to balance such load after the fact.

The Commission's proposed interpretation of forward contracts with embedded volumetric optionality does not provide clarity as to how a partial requirements agreement would be treated under Part Seven. While it could be theoretically possible for the load-serving entity to balance its load without taking delivery of any power from the power supplier during the term of the agreement, the load-serving entity fully intends and expects to take delivery of power from the power supplier at different times throughout the term, even if the agreement contains no minimum take obligation. Similarly, the power supplier intends and expects to make delivery of power at different times throughout the term. In addition, while the load-serving entity does not schedule or affirmatively call on the power available under the partial requirements agreement, it is unclear how the Commission would view decisions by the load-serving entity not to run its own generation resources and whether such decisions would be subject to Part Seven. If subject to Part Seven, such decisions would present the same issues addressed above.

iii. The Commission's interpretation for usage contracts should be withdrawn.

Entergy joins EEI/EPSA in urging the Commission to reconsider its proposed test for determining whether tolling agreements, natural gas transportation and storage agreements, and possibly firm transmission agreements should be considered swaps or forward contracts because it creates regulatory uncertainty.[11] The following language is particularly problematic:

> However, in the alternative, if the right to use the specified facility is only obtained via the payment of a demand charge or reservation fee, and the exercise of the right (or use of the specified facility or part thereof) entails the

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[10] Under a common partial requirements agreement, a power supplier contracts to sell capacity and energy to a load-serving entity to meet any deficiencies such load-serving entity has in meeting its load with its own generation in exchange for capacity and energy payments. Note that the terms contained in these agreements are not standardized and often contain a number of unique features negotiated by the parties (*e.g.*, the power supplier may have the ability to purchase power from the load-serving entity if the load-serving entity's generation resources have excess capacity).

[11] EEI/EPSA Letter at 7.

> further payment of actual storage fees, usage fees, rents, or other analogous service charges not included in the demand charge or reservation fee, such agreement, contract or transaction is a commodity option subject to the swap definition.[12]

This paragraph unnecessarily calls into question whether tolling agreements[13] will be regulated as "swaps" under the rules. Tolling agreements are common commercial arrangements entered into by power suppliers for the physical delivery of a nonfinancial commodity and not with the intent of transferring commodity price risk. As such, these arrangements should not be regulated as "swaps" under the rules. The Commission's interpretation does not provide clear guidance on how these agreements will be treated under the rules, which will result in unnecessary regulatory uncertainty for these common commercial arrangements.

Usage contracts of this nature are the energy industry norm and a vital means to create new infrastructure and maintain existing infrastructure. Without fixed or demand charges, it is probably less likely that owners or developers of assets would be able to finance those projects. At the same time, if a user of the asset were required to commit to a fixed charge for variable costs, instead of paying a usage fee, there would be substantially less incentive to enter into a commitment that would foster and enhance the development of essential assets.

In addition, EEI/EPSA explains that "[FERC] and the state regulatory commissions already provide appropriate regulatory oversight"[14] of these transactions, and therefore regulatory duplication should be avoided. Entergy agrees that these agreements should fall under the forward contract exclusion, rather than based on the "However" clause cited above.

III. Implications of Compliance with the Rules

If the Commission does not provide clear guidance that contracts for the physical delivery of a nonfinancial commodity are forward contracts, industry will need to devote more resources to compliance and administrative costs.[15] For example, in addition to costs associated with increased recordkeeping and reporting requirements, contractual terms that are implicated by the rules must be factored into contract negotiations. Other

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[12] 77 Fed. Reg. at 48242 (Aug. 13, 2012) ("However clause").

[13] A tolling agreement is an agreement whereby the owner of an electric generation facility agrees to convert fuel provided by its counterparty into electricity and deliver the electricity to the counterparty. As payment for these fuel conversion services, the counterparty generally will pay both a capacity payment and a variable energy payment, although some tolling agreements only require the payment of a variable energy payment.

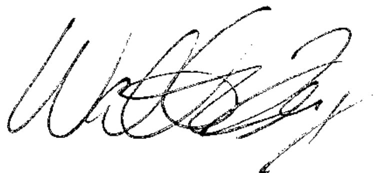
[14] EEI/EPSA Letter at 8.

[15] To lessen such compliance and administrative costs, we request that the Commission provide clear guidance so that each party to a transaction can readily reach the same conclusion as to whether such transaction will be subject to regulation as a swap under the rules, regardless of whether a party is the buyer or seller and regardless of whether the parties are in the same or different industries.

business process changes will include items such as additional training, new reporting systems, internal audits of business processes, and management certification to ensure compliance. These costs, which could be millions of dollars for the electric power industry, will be passed on to customers, including retail rate payers, through increased electricity rates. The contracts discussed above, by their very nature, are designed to provide a power supplier with a portfolio of resources to meet customer loads reliably and at the lowest reasonable costs. The additional compliance costs cited here will clearly offset savings that would otherwise benefit customers.

We hope you understand the effects of the rules on our companies and consider the suggested revisions. We appreciate the opportunity to provide comments on these issues. Please let us know if you would like to discuss any portion of our comments further.

Respectfully submitted,



cc: The Hon. Gary Gensler, Chairman
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner