PRODUCT DEFINITIONS RELEASE

October 12, 2012

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

Re: Comments on Joint Final Rule and 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; Further Comments on Interim Final Rule on Commodity Options (17 CFR Parts 3.32, and 33), RIN 3038-AD62; and Request for Reconsideration of Statutory Construction of Section 721(a)(21) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[1]

Dear Ms. Yochum:

The NFP Electric Associations[2] respectfully submit these comments on the joint final rule and interpretations issued by the Commodity Futures Trading Commission (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**[3] (the "Product Definitions Release").[4] The

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1 Public Law 111-203, 124 Stat. 1376 (2010).

2 The National Rural Electric Cooperative Association ("NRECA"), the American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), and the Transmission Access Policy Study Group ("TAPS") (collectively, the "NFP Electric Associations."). See Attachment A for a description of the members of each NFP Electric Association. The comments contained in this filing represent the comments and recommendations of the NFP Electric Associations, but not necessarily the views of any particular member of any one or more of the NFP Electric Associations on any issue. The NFP Electric 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: ACES Power Marketing and The Energy Authority.

3 77 Fed. Reg. 48,208 (August 13, 2012).

4 The NFP Electric Associations' comments are related ***only*** to those aspects of the Product Definitions Release that interpret the definition of "swap," and the exclusions therefrom in respect of nonfinancial commodities, not securities. The NFP Electric Associations' comments do not relate to provisions of the

NFP Electric Associations also provide further comments on the Interim Final Rule 32.3 on **Commodity Options** (the "Trade Options IFR" as part of the "Commodity Options Release").[5] Finally, the NFP Electric Associations respectfully request rehearing or reconsideration of the Commission's statutory construction of Section 721(a)(21) of the Dodd-Frank Act with respect to a nonfinancial commodity option transaction, where the parties intend the transaction to settle physically.[6] Each of these inter-related rulemakings is being conducted to implement and interpret Section 721(a)(21) of the Dodd-Frank Act.

This inter-related pair of ongoing Commission rulemakings represents the most important proceeding arising from the Commission's implementation of the Dodd-Frank Act for the electric industry and its customers.[7] The NFP Electric Associations continue to work with the Commission as it further defines the term "swap," construes the intent of Congress in enacting the Dodd-Frank Act, and continues to grapple with the energy industry's simple question: "What is a 'swap,' and what is excluded?" The NFP Electric Associations also continue to respectfully request that the Commission give clear, useable, regulatory guidance to enable the NFP Electric

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Product Definitions Release that apply to "security-based swaps," "security-based swap agreements," "mixed swaps," or "security-based swap agreement recordkeeping." Hence, the NFP Electric Associations' comments are addressed to the Commission, although we have provided a copy to the SEC for convenience and information.

5 77 Fed. Reg. 25,320 (April 27, 2012). See the comment letter dated June 26, 2012 filed by the Edison Electric Institute ("EEI"), the Electric Power Supply Association ("EPSA"), NRECA and APPA in the Commodity Options docket, at p. 4.

6 This statutory construction issue was initially identified when the Commission issued its Notice of Proposed Rulemaking on Commodity Options and Agricultural Swaps, 76 Fed. Reg. 6095 (February 3, 2011) (the "Commodity Options NOPR"). However, the Commission did not finalize its analysis of the statutory construction issue until the Product Definitions Release. See Section XB herein for a discussion of the procedural history.

7 The Commission recognizes the inter-related nature of the two rulemakings. In footnote 6 to the Commodity Options Release, the Commission limits its rulemaking in that docket, and its use of the term 'commodity options' therein "to apply solely to commodity options ***not*** excluded from the swap definition set forth in CEA section 1a(47)(A)." The Commission indicated that '[t]he final rule and interpretations that result from the Product Definitions NPRM will address the determination of whether a commodity option…is subject to the swap definition in the first instance." *See* 77 Fed. Reg. 25,320 at 25,321. See also footnote 374 of the Product Definitions Release that notes that the Commission has issued a no-action letter in respect of the Trade Options IFR until December 31, 2012 in order to allow the Commission to consider the two rulemakings together. The electric industry has requested the Commission to issue comprehensive relief from all relevant effective and compliance dates applicable to nonfinancial energy commodity transactions and "swaps," in light of the significant regulatory uncertainty created by the Product Definitions Release and other continuing and incomplete rulemaking proceedings to implement the Dodd-Frank Act, and the disruption that will likely affect the energy industry and nonfinancial energy commodity markets. However, the Commission has not yet responded to this electric industry request. See footnote 12.

Associations' members to confidently determine whether and which everyday nonfinancial commodity transactions and which customary operations-related transactions are ***not*** "swaps."[8]

The statutory line between "swap" and "not-a-swap" is what the Commission and the SEC are called upon by Congress to further define. The line was initially drawn by Congress in Section 721(a)(21) of the Dodd-Frank Act, and then the SEC and the Commission are directed in Section 712(d) to further define the term "swap" and other terms listed in Section 712(d). Section 712(d)(1) then directs the agencies to jointly "adopt such *other* rules regarding such definitions" as the agencies shall determine are necessary and appropriate. It is clear from the plain language of the Dodd-Frank Act that Congress intended the joint agency efforts to further define the term "swap" in CEA 1a(47) to take the form of rules, which would then be further interpreted by the agencies jointly adopting "other rules." It also seems clear that, in further defining the term "swap," Congress intended the agencies to look at the whole of the definition of "swap" (including the exclusions in CEA 1a(47)(B)), rather than merely adopting rules, and other rules, to interpret the defined term "swap" in CEA 1a(47)(A).

Despite Congressional intent, the portion of the Product Definitions Release dealing with nonfinancial commodities and energy industry transactions, implementing and interpreting CEA 1a(47)(A) and the applicable exclusion in CEA 1a(47)(B)(ii), speaks for the Commission alone. Indeed, the interpretations beginning with Section II.B.2(a) of the Product Definition Release explicitly speak only on behalf of the Commission. In Section II.B.2(a)(i) of the Product Definitions Release, the Commission declines the statute's express direction to write rules further defining "swap." The Commission sets aside the words of the statute, and quotes instead from legislative history to rationalize its unilateral regulatory interpretation approach.[9] The

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[8] In September 2010, the NFP Electric Associations asked expressly for regulatory certainty for everyday business transactions, physical forward commodity transactions, commercial option transactions and option-like aspects of ordinary course "full requirements" natural gas and electric energy transactions, and for a definition of the statutory term "nonfinancial commodity," among others. 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. The NFP Electric Associations appreciate the Commission's interpretation in the Product Definition Release that full requirements contracts, and certain other common energy industry contracts, are not "swaps." We also appreciate the Commission's interpretation of the term "nonfinancial commodity" to include intangible commodities under certain conditions. In the comment letter the NFP Electric Associations (along with EEI and EPSA) filed on the Product Definitions NOPR in July 2011, we asked the direct 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?" As we respond to the Commission's latest questions in the Product Definitions Release about everyday transactions in our industry, the question remains the same: "Where is the line between "swap" and "not-a-swap" for the electric industry?"

[9] The Commission also declines to write rules because it has not, in the past, written rules to codify its interpretations of the exclusion from the Commission's CEA 2(a)(1) jurisdiction for "any sale of any cash commodity for deferred shipment or delivery," the so-called "forward contract exclusion." Although the Commission is writing reams of rules to implement the Dodd-Frank Act, the NFP Electric Associations reluctantly accept the Commission's decision that, in this case, it will not write rules as Section 712(d) of the Dodd-Frank Act directs, but will only provide regulatory interpretations, because it has provided regulatory interpretations on similar topics in the past.

Commission also reasons that clear rules would "provide a roadmap to evasion."[10] As a result of the Commission's decisions in the Product Definitions Release, the NFP Electric Associations and other commercial businesses are left without a regulatory roadmap to compliance.

In these comments, the NFP Electric Associations respectfully request that the Commission focus on the plain language of the Dodd-Frank Act's Section 721(a)(21), including the statutory definition of "swap" in CEA 1a(47)(A) and the statutory exclusion from the defined term "swap" in CEA 1a(47)(B)(ii). In the Product Definitions Release, the Commission skips this step and instead evolves its own historical interpretations of a "forward contract exclusion" from the Commission's jurisdiction over futures contracts. Congress expressed in legislative history its intent that the Commission interpret the "swap/not-a-swap" line ***consistent with*** the way in which the Commission had traditionally drawn the "futures/forward" distinction.[11] Congress did not ask the Commission to simply put aside the Dodd-Frank Act and evolve and modify its prior interpretations about what is and is not a "forward contract," or what is and is not an "option." The question at hand remains: "what is a 'swap,' and what is not a 'swap'?"[12]

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[10] See footnote 370 at 77 Fed. Reg. 48,241 (August 13, 2012).

[11] See page 3 of the Dodd-Lincoln Letter, read into the congressional record at 156 Cong. Rec. H5248–49 (June 30, 2010) stating in pertinent part that "a consistent Congressional directive throughout all drafts of this legislation, and in Congressional debate, has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing."

The Dodd-Lincoln Letter also states at page 3:

In implementing the derivatives title, Congress encourages the CFTC to clarify through rulemaking that the exclusion from the definition of swap for "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled" is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and the CFTC's established policy and orders on this subject, including situations where commercial parties agree to "book-out" their physical delivery obligations under a forward contract.

[12] EEI, EPSA and the NFP Electric Associations have requested the Commission to defer all applicable effective dates and compliance dates for its Dodd-Frank Act implementation rulemakings to allow the continued development and completion of the Commission's rulemaking process on these important matters. See the *Request for an Extension of the Effective and Compliance Dates for Dodd-Frank Regulations Affecting Non-SD/MSP Energy Market Participants, or, in the Alternative, for No-Action Relief*, filed September 24, 2012, and the *Letter in Support of Request for Comprehensive Relief*, filed September 27, 2012. The Trade Options IFR and the interpretations included in the Product Definitions Release were not logical outgrowths of prior rules proposed by the Commission to implement and interpret Section 721(a)(21) of the Dodd-Frank Act. See footnote 22. The Commission acknowledged as much when it sought further public input on a number of aspects of the rulemakings with direct applicability to the energy industry. If the Commission allows the untested, incomplete and inconsistent rules to become effective, or requires compliance by energy market participants with new regulatory obligations, the NFP Electric Associations and other groups in the energy industry have put the Commission on notice of likely serious disruptions in the ability of commercial energy companies, including the NFP Electric Associations' members, to purchase and sell energy commodities and to hedge or mitigate the commercial risks of their ongoing electric operations. The NFP Electric Associations also wish to point out that the Commission has not yet acted on the March 11, 2011 request of NextEra Energy Resources recommending,

I. Summary of Comments of the NFP Electric Associations.

The NFP Electric Associations respectfully request that:

- The Commission clarify how the third step in the regulatory "safe harbor" for forward transactions "with embedded option(s)" implements or interprets the statutory exclusion in CEA 1a(47)(B)(ii). If the Commission decides not to clarify this third step, the Commission should confirm that demand-response programs, as described in this comment letter, are not "swaps."

- The Commission evaluate forward contracts "with embedded volumetric optionality" under a three-element test that mirrors the Commission's three-step test for forward contracts "with embedded option(s)" and, alternatively, that the Commission clarify the fourth, fifth and sixth elements of its regulatory "safe harbor" and withdraw the seventh element.

- The Commission withdraw the regulatory interpretation regarding "certain physical commercial agreements, contracts or transactions for the supply and consumption of energy."

- The Commission clarify certain aspects of its regulatory "safe harbor" providing that customary operations-related transactions and arrangements with certain characteristics and factors are not "swaps."

- The Commission withdraw the new regulatory requirement that parties to a nonfinancial commodity transaction document oral "bookouts."

- The Commission clarify which entities are entitled to the benefits of the regulatory "safe harbor" interpretations for customary operations-related transactions and nonfinancial commodity forward contracts.

- The Commission confirm that the statutory interpretation of the term "nonfinancial commodity" is applicable to identify the types of commodities eligible for the Commission's "trade option exemption" in Interim Final Rule 32.3(f).

- The Commission reconsider its statutory construction of section 721(a)(21) of the Dodd-Frank Act with respect to nonfinancial commodity option transactions.

- The Commission consider the overall impact of its rules implementing and interpreting the Dodd-Frank Act, particularly section 721(a)(21), on "small entities."

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inter alia, that the Commission extend and re-open comment periods on core substantive rules after the final definitional rules are issued, and adopt a sequenced order for implementing its final rules required under the Dodd-Frank Act.

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

Since September 2010, the NFP Electric Associations have been active participants in the Commission's rulemaking process. In each comment letter, we renewed our request for the Commission to further define "swap" and explain the scope of its jurisdiction over agreements, contracts, transactions and arrangements involving nonfinancial energy commodities.[13]

The Dodd-Frank Act blurred regulatory lines for the electric industry with its new definition of "swap," and the statutory exclusion from "swap" for "any sale of a nonfinancial commodity…for deferred shipment or delivery, so long as the transaction is intended to be physically settled."[14] During the more than two years of Dodd-Frank Act implementation rulemakings, the Commission has blurred the lines even more. The Commission did not sequence its rulemakings to define or further define the most important Dodd-Frank Act noun (*i.e.*, "swap") first. Nor did it issue rules and implementing regulations with clear principles that can be applied by market participants to achieve regulatory certainty about what the Commission believes is the scope of its jurisdiction. Instead, the Commission waited more than two years to publish new regulatory interpretations about nonfinancial commodity transactions and is still soliciting comments on its new regulatory interpretations. In the Commodity Options Release and the Product Definitions Release, the Commission is evolving its historical jurisdiction and interpretations, still trying to define more precisely a "forward contract" or to distinguish between a forward contract and an option. The NFP Electric Associations respectfully request that the Commission directly address the task Congress assigned to it, namely, to further define the term "swap" and the exclusions therefrom introduced into the CEA by Section 721(a)(21) of the Dodd-Frank Act.

The members of the NFP Electric Associations are end users of nonfinancial energy commodities, including electric energy and natural gas, and end users of nonfinancial energy commodity "swaps" to hedge or mitigate commercial risks arising from electric operations.[15]

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[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* Section 721(a)(21) of the Dodd-Frank Act.

[15] Our comments on the Product Definitions Release will be narrowly-focused. As noted in footnote 4 above, the Energy Trade Associations are <u>not</u> commenting on any provisions of the Product Definitions Release that deal with "security-based swaps," "mixed swaps" or "security-based swap agreements." Nor are we commenting on the provisions of Product Definitions Release (or the rules provided therein) 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 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." Even within that "Other Commodity" asset class, we are not

The NFP Electric Associations' members also regularly execute agreements, contracts and transactions that are "not-swaps" – nonfinancial commodity transactions excluded from the defined term "swap" by CEA 1a(47)(B)(ii), as well as commercial operations-related transactions and arrangements that the Commission interprets as "commercial agreements, contracts and transactions entered into as part of…operations" and ***not*** intended by Congress to be regulated as "swaps" (see Section II.B.3 of the Product Definitions Release).

The NFP Electric Associations and their members have a direct and significant interest in the definition of "swap," and in clear rules distinguishing between "swaps" and the categories of common electric industry transactions that are "not-swaps." If the regulatory lines are not clear, the parties cannot accurately know whether a transaction is, or is not, a "swap" at the time the transaction is executed. As a result, the parties cannot determine how such transactions should be priced, documented, or managed for credit support/credit risk purposes. The parties also 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.

III. The NFP Electric Associations Support the Commission's Interpretation With Respect to the Circumstances Under Which a Nonfinancial Commodity Transaction "With Embedded Option(s)" Is Not a "Swap." However, The NFP Electric Associations Respectfully Request That the Commission Clarify Its Interpretation With Respect to One Type of Transaction Common in the Electric Industry.

The NFP Electric Associations support the Commission's interpretation in Section II.B.2.(B)(ii) of the Product Definitions Release with respect to the circumstances under which a nonfinancial commodity transaction "with embedded option(s)" is entitled to a regulatory safe harbor, but request clarification of the regulatory interpretation in one respect. The NFP Electric Associations understand the Commission to be interpreting the statutory exclusion in CEA 1a(47)(B)(ii) consistent with the Commission's historical interpretation of the forward contract exclusion in *Wright*[16] and elsewhere in Commission precedent.

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commenting on "swaps" that are based on metals, or crude oil, gasoline or refined petroleum or agricultural commodities, other than those used as 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' enterprises – generating, transmitting and delivering electric energy to the American public.

[16] *In re Wright*, CFTC Docket No. 97-02 (CFTC Oct. 25, 2010).

The statutory exclusion from the definition of "swap" in CEA 1a(47)(B)(ii) requires that the parties to a nonfinancial commodity transaction "intend the transaction to be physically settled." The Commission's regulatory interpretation describes a three-step analysis for such transactions if such transactions contain embedded options affecting the pricing of the contract. Specifically, in order to fit within the regulatory "safe harbor,"[17] the Commission requires, as its first step, that any price adjustment provision (which might otherwise be viewed as an embedded option by the Commission) cannot undermine the "overall nature" of the contract as a forward contract. In the second step, the Commission notes that any embedded option cannot "target the delivery term," or "operate on" the delivery term, as distinguished from "operating on" the price term of the nonfinancial commodity forward contract. The second step in the interpretation also requires that "the predominant feature of the contract is actual delivery."

The NFP Electric Associations understand these two steps in the Commission's "safe harbor" as applying the Commission's precedents to interpret the "intent to physically settle" requirement in CEA 1a(47)(B)(ii) – that any price adjustment provision (or any other provision in the contract) must not undermine the parties' intent to physically settle their obligations.

The NFP Electric Associations are less certain about how the third step in the regulatory "safe harbor," which requires that the embedded pricing adjustment mechanism (characterized as an embedded option by the Commission) cannot be "severed and marketed separately," implements or interprets the statutory exclusion in CEA 1a(47)(B)(ii).[18] If the embedded option is actually severed and marketed separately, that separately-marketed contract would need to be analyzed to determine whether it is a "swap" or "not-a-swap." But it is unclear why the existence of an embedded option in a transaction, and the question of whether it can potentially be severed and marketed separately, should have any bearing on whether the transaction fits within the statutory exclusion in CEA 1a(47)(B)(ii). Although the third step in the analysis may be important in distinguishing a forward contract from a futures contract (or a distinguishing a forward contract from an options contract which, too, may be subject to the Commission's

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17 The NFP Electric Associations understand that transactions that fit within any of the regulatory safe harbors are nonetheless subject to the Commission's facts and circumstances analysis and its anti-evasion authority.

18 The NFP Electric Associations understand that the third step comes from the Commission's traditional forward contract analysis in ***Wright***. However, the Commission's third step seems to ***add*** an additional regulatory requirement to the statutory exclusion in CEA 1a(47)(B)(ii) that Congress did not include in 721(a)(21) of the Dodd-Frank Act, nor did the Commission cite any Congressional intent to impose this additional condition on parties to a nonfinancial commodity transaction. Adding such a requirement to the statutory exclusion, thereby burdening those entities that would otherwise be entitled to rely on the statutory exclusion as contemplated by Congress, is not interpreting a statute, but legislating. For example, in its reversal of a U.S. Court of Claims decision, the U.S. Supreme Court stated that an administrative agency should not enlarge the scope of an unambiguous statue. *Iselin v. United States*, 270 U.S. 245 (1926). There, where Congress subjected specific categories of ticket sales to taxation but failed to cover another category, either by specific or by general language, the Court refused to extend the coverage as requested by the Commissioner of Internal Revenue. To do so, given the "particularization and detail" with which Congress had set out the categories, would amount to "enlargement" of the statute rather than "construction" of it. *Id.* at 250.

jurisdiction), the NFP Electric Associations question whether the third step is either necessary or appropriate in an interpretation of the Dodd-Frank Act's new distinction between a "swap" and a "not-a-swap."[19]

The NFP Electric Associations respectfully submit that there may be contracts in the electric industry that fall within the statutory exclusion in CEA 1a(47)(B)(ii), but that the NFP Electric Associations' members are uncertain meet the "third step" in the Commission's regulatory "safe harbor" interpretation. The NFP Electric Associations respectfully request that the Commission provide an interpretation that the following type of common transaction in the electric industry is not a "swap," despite what might be viewed as an embedded option that can be severed and marketed separately.[20] In certain retail electric market demand-response programs, the electric utility has the right (the contractual choice) to interrupt or curtail service to the customer. Alternatively or additionally, the utility has the right to call on the customer to produce power from a "behind the meter" generation unit owned or controlled by the customer for delivery into the grid. In some programs, the customer has the right to determine a price point at which its services will be curtailed or its generation will be utilized. Either the utility or the customer may be able to sever the right to curtail service, or sever the right to call on the unit, or the right/obligation may automatically trigger at a particular agreed market price point. Either party may also be able to sever the right to payment of the pricing mechanism that is triggered by such contractual choice, within certain parameters established by either tariff or contract.

Such transactions, and other demand response programs with similar embedded contract choices and potentially severable pricing or payment mechanisms, exist throughout the electric industry to facilitate delivery of the nonfinancial commodity at regulated rates. None of these contract choices or severable pricing or payment mechanisms changes the underlying intent of the parties -- to physically settle their nonfinancial commodity contract obligations. The NFP

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[19] Moreover, it is unclear what the regulatory ramifications would be of failing the third step in the Commission's regulatory "safe harbor" for a nonfinancial commodity transaction "with embedded option(s)." If the contract fits within the statutory exclusion in CEA 1a(47)(B)(ii) and, but for failing to meet the third step in the Commission's interpretation, would have clearly been "not-a-swap." Moreover, if the embedded option is, itself, a nonfinancial commodity transaction that the parties intend to physically settle (see Section X) and, therefore is a transaction that is itself excluded under CEA 1a(47)(B)(ii), this additional step become unnecessary.

[20] This type of transaction clearly meets the statutory exclusion in CEA 1a(4)(B)(ii) and the first two steps of the three-step test for forward contracts with embedded options. The parties intend physical settlement or actual delivery of the nonfinancial commodity – electric power. The overall nature of the transaction is a forward contract (step 1 of the test is met). The option does not target the delivery term; delivery is not optional and there is no alternative settlement contemplated or that would fulfill the parties' intent/requirements (step 2 of the test is met). The predominant feature of the transaction is actual delivery. For purposes of the Commission's basic regulatory safe harbor for forward contracts, both parties are typically "commercial market participants," assuming that end users fall within that definition. See Section VIII.

Electric Associations respectfully request that the Commission confirm that such demand-response programs do not constitute "swaps."[21]

IV. The NFP Electric Associations Respectfully Request That The Commission Withdraw All But the First Three Elements of The Interpretation Related To Nonfinancial Commodity Contracts "With Embedded Volumetric Optionality" or, in the Alternative, Clarify the Fourth, Fifth and Sixth Elements and Withdraw the Seventh Element.

The NFP Electric Associations respectfully request the Commission to withdraw all but the first three elements of the interpretation related to nonfinancial commodity transactions "with embedded volumetric optionality" in the second part of Section II.B.2.(b)(ii) of the Product Definitions Release, beginning on page 48238. The Commission's interpretation is not a logical outgrowth of prior proposed rules or prior proposed interpretations of Dodd-Frank Act 721(a)(21).[22] The Commission acknowledges as much by asking questions about the interpretation in the Product Definitions Release.[23]

The confusion in the energy industry about this additional interpretation is based in part on the fact that the Commission fails to define what it means by the critical phrase "with embedded volumetric optionality,"[24] or to explain how its understanding of that phrase differs from the

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21 Another way to analyze this type of transaction may be as a "customary operations-related transaction," as such transactions are directly related to the utility's regulated business of providing reliable, rate-regulated electric service to its customers. The NFP Electric Associations request a determination that such types of transactions are "not-swaps," under whichever regulatory safe harbor the Commission chooses to make such a determination.

22 An agency's proposed rule and its final rule may differ only insofar as the latter is a "logical outgrowth" of the former. *See Shell Oil Co. v. EPA*, 950 F.2d 741, 750-51 (D.C. Cir. 1991). See also See 5 USC § 553.

23 The NFP Electric Associations support the Commissions continuation of its rulemaking process with respect to these transactions and have requested that the Commission delay effective and compliance dates relevant to these transactions until the Commission's reasoned decision-making process is completed. See footnote 12 above.

24 In the energy industry, the meaning of such a phrase varies in colloquial conversations among power, fuel, transmission, transportation or other operations or procurement personnel. More often than not, such phrase means that the volume delivered is or may be variable during the term of the transaction. "Optionality" can mean that there is, or is not, an obligation on the "holder" of the "optionality" to exercise the optionality, or to explain or articulate a reason for such exercise (or non-exercise). The "optionality" may not even be exercised or exercisable by either party to the contract, and may result from an externality outside the control of one or both of the parties. Contract "optionality" is a common phrase, but it can be used to describe any one of many choices, or decision points, or events occurring in an ongoing commercial contractual relationship.

Throughout the course of performance of a commercial contract, parties often have contract choices to make. Some choices or decisions entitle the party to a price adjustment or to certain additional contract rights or greater or lesser volumes of goods or services. Some choices may adjust the risks/rights/benefits/costs of performance as between the parties in a pre-negotiated way – Party A can

phrase "with embedded option(s)" analyzed under the interpretation described in Section III above. Nor does the Commission explain how the phrase "with embedded volumetric optionality" relates to the Commission's implementation and interpretation of Section 721(a)(21) of the Dodd-Frank Act – the statute being implemented and interpreted. Nor does the Commission explain why any such "embedded volumetric optionality" would preclude a nonfinancial commodity transaction, where the parties intend to physically settle, from the statutory exclusion from the term "swap" in CEA 1a(47)(B)(ii).

The NFP Electric Associations understand the first three elements of the seven-element test to mirror the three steps of the "forward transactions with embedded option(s)" test described in Section III above, but to relate to embedded option(s) or "optionality(ies)" affecting terms of the transaction other than pricing (which is the focus of the three-step test). Based on that understanding, and our understanding of the three-step test for contracts with embedded option(s) in light of the Commission's precedent, we recommend that the Commission limit its interpretation of "forward transactions with embedded volumetric optionality" to be consistent with the three-step test for "forward transactions with embedded option(s)." The Commission confirms this understanding by stating that "the predominant feature of a forward contract is a binding, albeit deferred, delivery obligation."[25] This is consistent with the Commission's pre-Dodd-Frank Act precedent, and is a workable interpretation of new CEA 1a(47) – the "swap/not-a-swap" distinction.

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choose X, and pay $Y to Party B for that choice or additional right. Some choices enable a party to cancel or extinguish its own or the other party's delivery or receipt obligation or other rights (a "reduction to zero," or in the electric industry, a "curtailment" or "interruption"). Some of the contract choices may be considered economically important "optionalities," *i.e.*, decisions or choices exercisable or determinable by one party or the other, sometime during the term of the contract, that will have economic ramifications for one or both parties.

Some of these "optionalities" affect the quality (grade) of the commodity. Other choices, events or decisions may vary quantity (volume) of the goods or services to be delivered. Still other contract choices affect the price or payment terms, or other contract provisions as to the method or the place of delivery/receipt of either the goods/services or payment therefor. For example, 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 source is not on-line or available. In certain demand response programs administered under state or Federal energy regulatory jurisdiction, the energy user or the energy provider may be able to decide to forgo (for the user) or curtail (for the energy provider) delivery of energy at certain times. In other cases, the energy user, if it has its own generation source, is entitled to use its own generation and be credited with a payment by the entity that would otherwise be required to provide it electricity. Some of these choices or decisions arise upon the occurrence of certain events or, in some instances, for any reason or no reason. The primary intent of the parties in executing such a transaction is nonetheless, and remains, delivery/receipt of the nonfinancial ***commodity*** (referred to in Section 721(a)(21) of the Dodd-Frank Act as "physical settlement").

[25] 77 Fed. Reg. 48,238 (August 13, 2012).

The fourth and fifth elements of the seven-element test – that "the seller…intends…to deliver if the optionality is exercised" and that "the buyer… intends…to receive…if it exercises the embedded volumetric optionality" embody two concepts neither of which adds clarity to the Commission's interpretation of CEA 1a(47). First, these two elements seem again to restate, in different words, the statutory requirement of CEA 1a(47)(B)(ii) that these parties "intend physical settlement." However, the Commission has already interpreted that statutory requirement in the first two steps in the "forward transactions with embedded option(s)" interpretation described in Section III above (and in the first two elements of this seven-element test). This concept in the fourth and fifth elements is redundant.

Second, the fourth and fifth elements seem to require that the seller of the nonfinancial commodity will always be the writer, and not the holder, of the "volumetric optionality," and the buyer of the nonfinancial commodity will always be the holder of the "volumetric optionality." The Commission's assumption that the roles of commodity seller/optionality writer and commodity buyer/optionality holder are always aligned unnecessarily restricts, and inappropriately simplifies, the ways in which commercial entities enter into nonfinancial commodity transactions. For example, if a generation owner sells a "percentage of unit output" to a buyer, it may be the generation owner that is viewed as "holding" the "embedded volumetric optionality"– its obligation to deliver physical power is quantified, and therefore may be limited, by reference to the designated unit producing power. The generation owner's intent is the same, whether or not the volumetric optionality is "exercised" (or "nonexercised" depending on what the Commission means by that term) – to deliver or settle the transaction physically. Similarly, the purchaser's intent is to receive power, regardless of whether the generation owner exercises (or non-exercises) an optionality. The purchaser, in fact, "holds" no optionality to exercise. These two elements of the interpretation are confusing and should be clarified or withdrawn.[26]

The sixth element – that both parties are "commercial parties," with a reference in footnote 336 back to the Commission's explanation in Section II.B.2(a)(i)(B) of the Product Definitions Release of its "safe harbor" requiring that any forward contract be between "commercial market participants" -- is either confusing or superfluous. It is either a reiteration of the requirement in the Commission's regulatory "safe harbor" interpreting CEA 1a(47)(B)(ii) that the parties to a nonfinancial commodity transaction must be "commercial market participants," or it is an additional requirement that adds unnecessary confusion to the interpretation, by using a different term – "commercial parties." The sixth element should be clarified or withdrawn.

The seventh element of the regulatory "safe harbor" is particularly ambiguous and confusing. It cannot be monitored, controlled or affected by either the seller (not necessarily the

[26] See the comment letter dated August 23, 2012 by Conoco-Philips, filed in this docket, for additional examples of the confusing nature of the fourth and fifth elements. See pages 4-5. The NFP Electric Associations concur with the analysis in the Conoco-Phillips letter, and support the recommendation, that the Commission should at the very least clarify the fourth and fifth elements and withdraw the seventh element.

offeror or writer of an embedded option or "optionality") or the buyer (not necessarily the offeree or holder of the embedded option or "optionality") of the nonfinancial commodity. Both of the parties intend, and have executed a binding forward contract providing for, physical settlement. The focus of CEA 1a(47)(B)(ii) is on the parties at the time they agree to buy and sell the nonfinancial commodity, and on their intent at such time. Even if you assume perfect alignment of the seller/writer and purchaser/holder roles by eliminating the confusion in the fourth and fifth elements, the Commission has not articulated in the seventh element a clear standard whereby the commodity seller/writer of the embedded option or "optionality" can control the conduct of the commodity buyer/holder, after the contract is executed and upon "exercise/non-exercise" of the "optionality," with knowledge of the regulatory consequences.

The seventh element occurs as an event or circumstance (the exercise or non-exercise) that takes place well after the transaction is executed, and over which only one contract party, if either, has any control. The seventh element contains ambiguous language that cannot be quantified or measured, and would require the parties, and allow the regulators, to infer intentions from either action or inaction. The decision in the seventh element would presumably be made by the holder of an "optionality," which is presumed to have a decision to make -- to "exercise or to not exercise" that optionality -- based on factors that either are or are not "primarily" or "predominately" outside its control or the control of the seller of the optionality.[27]

The NFP Electric Associations respectfully request that the Commission withdraw the seventh element of this regulatory interpretation.

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[27] *Id. at 4.* In a commercial context, it is entirely unclear how the act (or non-act) of one party to a binding contract could retroactively change the character of such contract *ab initio* from a nonfinancial commodity contract entitled to the statutory exclusion in CEA 1a(47)(B)(ii), and what would be the regulatory ramifications to each of the two parties. *See* also *In the Matter of Cargill, Inc.*, CFTC Docket 99-16 (November 22, 2000), in which the Commission affirmed an administrative law judge's decision that analyzed a contract with extensive and complex commercial pricing and other variability or option-like terms. The administrative law judge issued a lengthy opinion reciting the number of areas in the contract where the Commission staff alleged there were embedded options and multiple provisions "of the character of an option." The administrative law judge examined the contract in light of the Brent Interpretation and other Commission precedent, and found that the contract satisfied the Commission's test for the forward contract exclusion, even though it included a price conditional delivery requirement and numerous other "option-like" provisions.

If the Commission declines to withdraw all but the first three elements of this interpretation or at least to withdraw the seventh element, the NFP Electric Associations respectfully request the Commission to provide guidance in terms of the regulatory ramifications for each party to the transaction, should such transaction fail to meet one or more of the "last" four elements of the Commission's "safe harbor" interpretation, or merely to fail to meet the seventh element, but nonetheless fit squarely within both the statutory exclusion in CEA 1a(47)(B)(ii) and the Commission's regulatory "safe harbor" for nonfinancial commodity transactions "with embedded option(s)."

V. The NFP Electric Associations Respectfully Request The Commission To Withdraw The Interpretation Regarding "Certain Physical Commercial Agreements, Contracts Or Transactions For The Supply And Consumption Of Energy."

The NFP Electric Associations respectfully request the Commission to withdraw the interpretation regarding "certain physical commercial agreements, contracts or transactions for the supply and consumption of energy" in Section II.B.2.(b)(iii) of the Product Definitions Release. The Commission offers an interpretation that does not implement or interpret Dodd-Frank Act Section 721(a)(21), and does not interpret or clarify either CEA 1a(47)(A) or the statutory exclusion in CEA 1a(47)(B)(ii).

This interpretation is not a logical outgrowth of any proposed rule or interpretation in the Commission's rulemakings implementing the Dodd-Frank Act.[28] The Commission acknowledges as much by asking questions about the transactions identified in this interpretation. The interpretation causes unnecessary regulatory uncertainty for agreements commonly found in the energy industry and used to facilitate the delivery of nonfinancial energy commodities such as natural gas and electric energy: tolling agreements, nonfinancial commodity transportation or electric transmission services agreements and peaking supply agreements, including those that reference specific facilities.

The interpretation discusses certain characteristics of these operations-related transactions that facilitate the delivery of a nonfinancial energy commodity via the electric grid or a pipeline system, certain operations-related storage transactions in respect of nonfinancial commodities and certain other customary operations-related transactions or nonfinancial commodity transactions. The interpretation does not explain the characteristics that would squarely place such a contract within this regulatory safe harbor, and does not explain why the safe harbor adds anything to the other regulatory safe harbors that the Commission provides elsewhere in the Product Definitions Release. Moreover, the language of the interpretation is directly contrary in many respects, or adds additional but difficult to understand requirements, to "safe harbors" provided elsewhere in the Product Definitions Release. The focus on specific facilities (clearly an operational feature) indirectly calls into question whether or why a transaction that was related to either more than one facility, or not tied to a specific facility, would result in a transaction being a "swap," or would still be within the "safe harbor" as "not-a-swap."

Moreover, the regulatory interpretation analyzes whether these physical commercial agreements are options, but does not provide a useable interpretation or safe harbor as to whether the agreements are "swaps." The lack of context and the ambiguous reasoning for providing such an interpretation about options in a regulatory proceeding where the question at hand is "what is a swap/not-a-swap?" causes confusion about whether certain transaction elements and pricing terms discussed in the "interpretation" have a bearing on whether a particular agreement, contract or transaction is a "swap" under CEA 1a(47).

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[28] See footnote 22 above.

In particular, the "however" paragraph which appears in this interpretation on page 48,242, immediately prior to the "Comments" portion, calls into question certain pricing adjustment mechanisms that appear regularly in electric industry contracts. Such pricing mechanisms are in fact required in some cases by Federal and state energy regulatory agencies for electric transmission or natural gas transportation tariffs, which allocate limited or constrained transmission or transportation resources and facilitate the delivery of these nonfinancial energy commodities. Such pricing adjustment mechanisms are integral parts of customary commercial agreements executed in connection with electric (and natural gas) operations, and cannot be viewed or interpreted by the Commission as evidencing a "swap" or a commodity option where the parties intend physical delivery of the nonfinancial commodity or intend to deliver and receive an operational service, such as transportation or transmission or storage, to facilitate the delivery of the nonfinancial commodity.

The legislative record of the Dodd-Frank Act does not support a finding that Congress intended such operations-related agreements to be considered "swaps." The interpretation does not provide guidance that is useful in structuring such operations-related agreements that are commonplace in the energy industry.[29] Accordingly, the Commission should withdraw this interpretation and allow these transactions to be analyzed under the statutory exclusion in 1a(47)(B)(ii) and the Commission's other regulatory interpretations provided elsewhere in the Product Definitions Release.

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[29] In Question 6 and 7, the Commission asks whether the Interpretation is sufficiently clear. The NFP Electric Associations' response is "no," and the interpretation should be withdrawn. The interpretation causes more, not less, regulatory uncertainty. The NFP Electric Associations and other participants in the energy industry have provided to the Commission staff summaries, explanations and examples of the wide variety of contracts, agreements and transactions labeled "capacity contracts," "transmission (or transportation) [of nonfinancial energy commodities] services agreements," "peaking supply contracts," and/or "tolling agreements." All these agreements are either executed by parties that intend physical settlement of a nonfinancial commodity or the agreements are customary operations-related agreements commonly used in electric and natural gas operations to facilitate delivery of the nonfinancial commodity or to achieve other operational objectives. These are not standardized agreements, nor are they "traded" in any venue of which the NFP Electric Associations are aware, as investments or "products." None of these agreements allows one of the parties to "cash-settle," "financially-settle" or deliver a contract rather than the nonfinancial commodity itself as substituted performance. The primary purpose of each of these agreements, contracts and transactions, and the intent of the parties at execution, is to transfer ownership of the nonfinancial energy commodity or to facilitate operations or the transfer of the nonfinancial commodity. None of these agreements are intended by the parties "solely to transfer commodity price risk" from one investor or trader, or dealer or speculator, to another. These agreements are not "swaps," and the Commission is, again, requested to provide such regulatory clarity by withdrawing this interpretation.

If the Commission declines to withdraw this interpretation, the NFP Electric Associations respectfully request the Commission to provide guidance in terms of the regulatory ramifications for each party to the transaction, should such contract fail to meet the Commission's "safe harbor" interpretation because it fails to meet one of the elements set forth in the interpretation, or contains a pricing mechanism described in the "however" paragraph, but nonetheless fits squarely within either the Commission's "safe harbor" for customary operations-related transactions or the Commission's "safe harbor" for nonfinancial commodity forward transactions.

VI. The NFP Electric Associations Appreciate and Support the Commission's Interpretation That Customary Operations-Related Transactions and Arrangements Are Not "Swaps," But Request Certain Minor Clarifications to Provide Regulatory Certainty.

In Section II.B.3. of the Product Definitions Release, the Commission provides an interpretation that certain customary commercial agreements, contracts or transactions that businesses and other entities, *whether or not for profit*, *enter into as part of their operations*, are not "swaps." This is a critically important interpretation for commercial end users, and the NFP Electric Associations commend the Commission for providing such regulatory clarity. The Commission lists certain types of such customary operations-related transactions – "not-swaps." And then the Commission identifies certain characteristics and factors that it views as common to such customary operations-related transactions. The Commission explains that other customary operation-related transactions with such characteristics and factors are also eligible for the Commission's "safe harbor" interpretation that such transactions are "not-swaps."

In the course of describing these common characteristics and factors, the NFP Electric Associations believe the Commission's interpretation would benefit from clarification, so that it is more easily understood by commercial entities. For example, the Commission should delete or clarify the meaning of the "distinguishing characteristic" that a customary operations-related transaction is 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...."[30] The Commission should make it clear that parties to a customary operations-related arrangement do not have any due diligence obligation to verify that such a characteristic is, in fact, the case. Commercial entities have no ability to canvas all "organized markets" or all "over-the-counter" trading venues. Moreover, using the term "organized markets," without a definition, in the interpretation is ambiguous to the electricity industry – where RTOs/ISOs are called "organized markets," and yet are the operational delivery mechanisms through which the NFP Electric Associations' members routinely deliver and receive (and are required by FERC to deliver and receive) nonfinancial energy commodities. The RTOs/ISOs also provide the operational mechanisms through which the members participate in customary operations-related transactions to ensure the reliability of the regional electric grid (some transactions with the RTOs as contract counterparties and others with other electric entities as contract counterparties).

The Commission should also clarify its statement that presumes that such customary operations-related transactions are ***not*** used for "hedging" purposes.[31] In the context of this interpretation, the Commission seems to be using the term "hedging" in a financial markets sense, but the interpretation will cause confusion when read by commercial entities such as the members of the NFP Electric Associations. Customary operations-related transactions *are* entered into by commercial entities in the ordinary course of operations "to *hedge* or mitigate

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30 See 77 Fed. Reg. 48,208 at 48,247-48,248 (August 13, 2012).

31 See 77 Fed. Reg. 48,208 at 48,249.

commercial risks," as such phrase appears in CEA 2(h)(7) and as interpreted by the Commission in rule 39.6(c). For example, electric companies "hedge" the need for natural gas or coal inventory and/or the need (for business purposes) to fix the price of inventory (business inputs) or goods, services or office space anticipated to be needed in the future, by entering into customary operations-related transactions, such as those listed in the Commission's interpretation. Electric companies also use customary operations-related transactions to acquire goods and services for future use at a fixed, rather than an escalating or fluctuating, price. Hedging commercial risks by acquiring and fixing the price of business inputs, and then engaging in sales contracts and fixing the price to be obtained for business outputs, is the very definition of "customary operations" in a commercial business context.

The Commission should also delete from the interpretation the reference to "financial entities" where the interpretation implies that commercial entities only execute transactions with such financial entities to hedge commodity price risk.[32] The provision introduces unnecessary ambiguity into the "safe harbor." Alternatively, the Commission should clarify that it will not interpret the involvement of a party that is a "financial entity" or a "non-commercial market participant" to imply that the commercial arrangement hedges or allocates only commodity price risks, to imply that hedging commodity price risk is not part of commercial risk hedging, and to imply therefore that a commercial arrangement with a "financial entity" is not eligible for the "safe harbor." Customary electric industry operations-related transactions, as is the case with most all commercial merchandising arrangements, typically shift commercial interests like title and ownership, or commercial risks (including the availability and price of business inputs, i.e., inventory, supplies, services, or business outputs, *i.e.*, services delivered or goods produced), burdens, costs and benefits, from one contract party to the other. The presence of a "financial entity" (a term not defined in the Product Definitions Release) does not change the character of a customary commercial or operations-related arrangement. Electric companies sell electricity to banks as customers and enter into customary operations-related transactions, like leases, with financial entities as well.[33]

VII. The NFP Electric Associations Respectfully Request That The Commission Withdraw The Interpretation That Requires Parties To A Nonfinancial Commodity Transaction To Document An Oral "Bookout."

In Section II.B.2.(a)(i)(D) of the Product Definitions Release,[34] the Commission introduces a new regulatory requirement for commercial market participants to ***document*** oral "bookouts" for nonfinancial commodity transactions in order to maintain the benefit of the Commission's regulatory "safe harbor" interpreting CEA 1a(47)(B)(ii). This new regulatory requirement provides no benefit to either party to the nonfinancial commodity transaction. It is

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[32] See 77 Fed. Reg. 48,208 at 48,248-48,249.

[33] If the Commission's concern is that such a financial entity might be acting in a financial intermediary capacity, the interpretation should be revised to make that portion of the interpretation clear.

[34] *See* 77 Fed. Reg. 48,230.

not a requirement of the Dodd-Frank Act statutory exclusion from the definition of "swap." The requirement is not consistent with the Commission's prior interpretations of the "forward contract exclusion" from the Commission's jurisdiction over contracts for "future delivery."[35] Therefore, the NFP Electric Associations respectfully request the Commission to delete or withdraw this new regulatory requirement.

This interpretation is not a logical outgrowth of any proposed rule or interpretation in the Commission's rulemakings implementing the Dodd-Frank Act.[36] The Commission concedes in the Product Definitions Release that it is proposing the new documentation burden "in order to prevent abuse of the safe harbor" interpreting CEA 1a(47)(B)(ii). In doing so, the Commission is punishing all those who are operating commercial businesses within the statutory exclusion provided in CEA 1a(47)(B)(ii) for nonfinancial commodity transactions or within other exclusions, exemptions and public interest waivers,[37] and that have historically operated their commercial businesses consistently with the Commission's interpretation of the forward contract exclusion in the Brent Interpretation.[38] This is a burdensome new regulatory requirement that is imposed on every commercial market participant to "prove you're not a bad actor abusing a safe harbor."

The Commission has announced an opportunity for public comment on the proposed new regulatory requirement.[39] In order to comply with the Paperwork Reduction Act ("PRA"), the

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35 To the knowledge and belief of the NFP Electric Associations, there is no such documentation currently required to maintain the regulatory "safe harbor" provided for a forward commodity transaction in the Brent Oil interpretation. The NFP Electric Associations understand the new requirement to be applicable to all market participants to all nonfinancial commodity forward transactions – oral bookouts must be documented in order to maintain the forward contract exclusion from the Commission's jurisdiction over futures contract ***and*** the regulatory "safe harbor" interpreting the exclusion in CEA 1a(47)(B)(ii).

36 See footnote 22.

37 If, in a delivery chain for 5 electric energy transactions, there are two transactions for delivery of "spot" month nonfinancial commodities and 3 transactions where the parties have in place a longer term forward transaction, it is unclear if schedulers on the telephone "booked out" all 5 transactions -- would all 5 "oral bookouts" need to be confirmed? What if the schedulers do not know which of the megawatts deliverable on a particular day are "spot" transactions or nonfinancial commodity forward transactions (both of which are ***clearly*** not "swaps" under CEA 1a(47)). This is just one of the operational anomalies and complexities caused by this new regulatory documentation requirement.

38 The new Product Definitions Release imposes this new documentation requirement on all those whose nonfinancial commodity forward contracts are "booked out" orally. Whether a commercial market participant in the Brent Oil markets, or an electric utility operating the grid to deliver electric energy to its customers, whether the electric utility is in an RTO/ISO region and engaged with the RTO/ISO in oral generation and transmission decisions/directions, or operating outside an RTO/ISO region and interacting with other transmission owners and electric industry market participants, all commercial entities will be subject to this new regulatory requirement for documenting oral bookouts of their nonfinancial commodity transactions.

39 *See* 77 Fed. Reg. 49428 (August 16, 2012). The NFP Electric Associations intend to file this comment letter in the Agency Information Collection docket. Public comments are due by October 15, 2012, three

Commission is required to describe the specific regulatory purpose for such a new information collection requirement, and to evaluate whether the information will have practical regulatory use or utility, and finally to explain why the regulatory requirement is necessary and the least burdensome way of fulfilling the identified regulatory purpose. The NFP Electric Associations respectfully submit that the Commission has not fulfilled this predicate requirement of the PRA. Instead, in its OMB Notice, the Commission asks the public whether the proposed collection of information is necessary and whether the information will have a practical use. The NFP Electric Associations hereby respond with an emphatic "No."

The Commission states in the OMB Notice, without providing citation or support, that "it believes that, as part of customary and usual business practices, most respondents already create and store bookout agreements in either a written or electronic format." Such belief is unfounded and is contrary to discussions that representatives of the electric industry have had with Commission staff. The delivery of electric power, a nonfinancial commodity that cannot be stored and that must be delivered over an electric transmission grid that must be kept "balanced" within a narrow physical frequency at all times, is a highly specialized engineering operations activity, conducted by month, by day, by hour, by second to enable power to flow from generation source to "sink." Oral bookouts, between electric power schedulers with a focus on reliability and efficiency and who have dealt with each other by telephone for decades, are in keeping with prudent electric utility operations protocols.

The Commission may have technically complied with the OMB requirement that it provide estimates for purposes of evaluating the costs of the new documentation requirement. However, the Commission provides estimates without cited sources and without basis in facts to explain or support its estimates. For example, the Commission estimates that 30,000 "potential respondents" will need to comply with the new requirement. But the Commission does not say whether that number includes all participants in all markets for all nonfinancial commodities, and if so, how the estimate was derived or calculated. The Commission also estimates, without citation, that only one or two oral "bookouts" occur annually in the United States, per respondent. The Commission asks for comments on the accuracy of the estimates and the methodology and assumptions used. The NFP Electric Associations are unable to comment as the Commission has not explained either its methodology or its assumptions. Based on the collective experience of the NFP Electric Associations' members, who are actively involved in nonfinancial energy transactions, and in operationally delivering/receiving electric energy every minute of every day of every year, the "one or two oral 'bookouts' is a gross understatement, and inconsistent with the experience of electric operations staff operators in just this one industry.

An informal survey of electric utilities reveals that the number of oral bookouts per year for some electric utilities is not one or two annually, but hundreds per week during certain seasons, and thousands per year. For example, during peak summer months in geographic

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days after the proposed effective date of the Product Definitions Release containing this new regulatory documentation requirement.

regions where transmission is constrained, or where generation and load locations make scheduling electric transmission difficult, the operators need to make frequent adjustments in power flows and transmission paths in order to assure grid reliability. In these seasons and regions in particular, oral bookouts are the common operational method for managing physical delivery without service interruption. Such oral bookouts may take place multiple times per week or multiple times per day for each "respondent" entity involved in the physical flow of power. In certain seasons of the year and certain regions of the country (outside the geographic regions served by RTOs and ISOs), the number of oral bookouts is estimated to be exponentially higher. The documentation of such oral bookouts will take a significant amount of time and coordination among electric operations staff (not contracting staff) throughout the country. For many of the smaller electric operations, that have engaged in bookouts of forward power contracts for decades over the telephone, the new regulatory requirement will require new systems, new procedures and potentially new personnel.[40]

The regulatory burden of this new requirement will fall on all entities in the electric industry that deliver/receive electric energy (including APPA and NRECA members). Many of APPA and NRECA members may not execute any transactions for which they would otherwise be subject to the Commission's jurisdiction. Yet, this new regulatory requirement will fall on these small entities along with all other commercial market participants that deliver and receive electric energy.[41]

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[40] In addition to its statement that the documentation of oral bookouts is required to prevent abuse of the "safe harbor," the Commission hypothesizes in its cost/benefit analysis that the new regulatory requirement is consistent with prudent business practices and will promote good business practices. *See* page 48,316. The NFP Electric Associations respectfully submit that Congress did not authorize the Commission to impose its views, along with the costs and burdens associated with such views, of good and prudent business practices on electric companies that have been engaged in electric system operations and delivering/receiving energy commodities for decades.

[41] The NFP Electric Associations respectfully request a full analysis 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") be completed prior to the compliance date for this new regulatory requirement, due to the costs imposed by this new rule or rulemaking on "small entities."

If the Commission decides not to withdraw this interpretation, the NFP Electric Associations respectfully request a delay of the compliance dates for not less than 180 days after the effective date of the last to occur of the Commission's rulemakings implementing Section 721(a)(21) of the Dodd-Frank Act and the exclusion in CEA 1a(47)(B)(ii), as well as finalization of all 4(c)(6) public interest waiver proceedings. The NFP Electric Associations are aware that the International Energy Credit Association has a request on file with the Commission, dated September 21, 2012, requesting this relief. The NFP Electric Associations urge the Commission to act on such petition, or to act on the energy industry's request for comprehensive relief referenced in footnote 12, promptly in order to eliminate the operational disruption that this new regulatory requirement will impose as of October 12, 2012. Many of the nonfinancial commodity transactions in electric energy for which the Commission seeks documentation of oral "bookouts" are electric energy transactions that take place pursuant to FERC and state regulatory tariffs and rate schedules.

VIII. The Commission Should Clarify The *Entities* That Are Entitled To The Benefits Of The "Safe Harbor" Interpretation For Customary Operations-Related Transactions, And The "Safe Harbor" For Nonfinancial Commodity Forward Contracts.

In the "safe harbor" interpretation for customary operations-related transactions, the Commission indicates that the parties must be "commercial or non-profit entities," and the interpretation then questions the involvement of a "financial entity" in such a commercial arrangement.[42] Yet a real property lease (a customary operations-related transaction) may have a bank or an investment fund as one of the two contracting parties. The Commission should clarify that the focus of the "safe harbor" for customary operations-related transactions is on the commercial nature of the customary operations-related transaction that the parties are executing, not on the entities by type.[43]

Similarly, the NFP Electric Associations respectfully request the Commission to clarify its "safe harbor" interpreting CEA 1a(47)(B)(ii) that the parties must be "commercial market participants," where the interpretation incorporates without modification the Brent Interpretation's definition of the word "commercial." The Commission should clarify its interpretation of the parties entitled to such regulatory "safe harbor" in two ways. First, the NFP Electric Associations respectfully request the Commission to clarify that a non-profit or not-for-profit entity engaged in "commercial activities" described in the interpretation, such as an electric cooperative or a government entity, qualifies as a "commercial market participant."[44]

Second, the Commission should clarify the interpretation by confirming that a commercial ***user*** of a nonfinancial commodity (or its products or byproducts) qualifies as a "commercial market participant" for purposes of this regulatory "safe harbor." In the Commission's Brent Interpretation, the facts before the Commission dealt with wholesale Brent Oil markets. Consequently, the Brent Interpretation did not reference in its litany of "market

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42 See Section VI above.

43 See footnote 29 and accompanying text.

44 As noted in Section VI above, the Commission provides such clarity in its interpretation for customary operations-related transactions. Moreover the Commission provides such clarity elsewhere in its Dodd-Frank Act rules and rulemakings. For example, in the adopting release for the final rules implementing the End-User Exception to Clearing, 77 Fed. Reg. 42,560 (July 19, 2012), the Commission states that "the Commission confirms that the determination of whether the risk being hedged or mitigated is "commercial" will be based on the underlying activity to which the risk relates, not on the type of entity claiming the end-user exception. The Commission confirms that this distinction applies to all potentially electing counterparties, including governmental entities, both domestic and foreign, and non-profit entities. Their status as governmental or non-profit entities does not control whether they are hedging or mitigating "commercial" risk. Rather, that determination will depend on the nature of the underlying activity to which the risk being hedged or mitigated relates." See page 42,572 (internal citations omitted). The NFP Electric Associations also respectfully request that the Commission clarify that the term "commercial user" as such term is used in the Commodities Options Release includes non-profit and not-for-profit entities, such as an electric cooperative or government entity. See, Commodities Options Release at 25,329.

participants" the commercial end users of the oil being shipped. When interpreting the exclusion in CEA 1a(47)(B)(ii) consistent with the Brent Interpretation's definition of "commercial," the Commission must craft its interpretation to implement Congressional intent that commercial end users' transactions not be swept under the Commission's new swaps jurisdiction.[45] The NFP Electric Associations respectfully recommend that the Commission clarify this interpretation to expressly allow non-profit and not-for-profit entities (including electric cooperatives and government entities), as well as all commercial end users of the nonfinancial commodity (or its products or byproducts), to rely on the Commission's "safe harbor" interpreting CEA 1a(47)(B)(ii).[46]

The NFP Electric Associations also respectfully request that the Commission delete its statement of concern, in footnote 235, about the presence of a "non-commercial market participant" in the delivery chain for a nonfinancial commodity transaction. Such reference amplifies the confusion about what entities can execute nonfinancial commodity transactions under the statutory exclusion in CEA 1a(47)(B)(ii) and the Commission's regulatory "safe harbor," into confusion about the regulatory ramifications of a later operational decision as to ***how, not whether*** to physically settle (to perform or to deliver/receive) the transaction. The operational decisions about delivery chains are typically made well after the contract is executed. The decision as to what entities should be involved in the ultimate performance of the contract to most efficiently use limited electric transmission resources involves operational personnel at both the original contract parties and at other entities along the delivery chain. Such operational decisions, made to facilitate the efficient and cost-effective delivery and receipt (performance, physical settlement) of the nonfinancial commodity at a point in time typically well after the transaction is executed, cannot always be anticipated at the time the contract is executed. Such subsequent operational decisions should not be construed, in regulatory hindsight, as having (had) an effect on the regulatory nature of the transaction that CEA 1a(47)(B)(ii) excludes from the defined term "swap."

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[45] Notwithstanding the Dodd-Lincoln letter's direction that the Commission interpret CEA 1a(47)(B)(ii) consistently with its pre-Dodd-Frank Act precedent, the Commission's interpretation of the current statute must be appropriately modified to address the statute that is now being interpreted.

[46] The parallel provision in the Trade Options IFR allows a "commercial user" of the commodity (or the products or byproducts thereof) to engage in a commodity trade option, either as offeror or offeree, so long as the commercial user is entering into the option "solely for purposes related to the commercial user's business as such." The NFP Electric Associations assume that such language is intended to be parallel to the requirement in the Commission's regulatory "safe harbor" that the "market participant" be engaged in a "commercial" activity when it executes a transaction excluded from the defined term "swap" under CEA 1a(47)(B)(ii).

IX. The NFP Electric Associations Support The Commission's Statutory Interpretation Of The Term "Nonfinancial Commodity" In CEA 1a(47)(B)(ii) To Include Intangible Commodities, And Request That The Commission Confirm That Such Interpretation Applies To Interim Final Rule 32.3(f) On Trade Options As Well.

In Section II.B.2(a)(ii) of the Product Definitions Release, the Commission provides an interpretation regarding the scope of the term "nonfinancial commodity" as used in CEA 1a(47)(B)(ii). The Commission confirms that an intangible commodity (that is not an "excluded commodity") which can be physically delivered (or settled) qualifies as a nonfinancial commodity *if* ownership can be conveyed, such as by transfer of title in a registry, electronic settlement or contractual attestation, *and if* the commodity can be consumed, *e.g.* the commodity itself is required for some purpose such as regulatory compliance, and a payment in lieu of delivery is insufficient to satisfy the seller's obligation or the purchaser's needs. In the Product Definitions Release, the Commission gives examples of environmental commodities and renewable energy credits as intangible commodities that are "nonfinancial commodities."[47] The NFP Electric Associations appreciate the further definition of this important term in the CEA 1a(47)(B)(ii) statutory exclusion from the definition of "swap."

The NFP Electric Associations respectfully request that the Commission confirm that the statutory interpretation of the term "nonfinancial commodity" for purposes of CEA 1a(47)(B)(ii) in the Product Definition Release is equally applicable to describe the commodities eligible for the Commission's "trade option exemption" in Interim Final Rule 32.3.[48]

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[47] See pages 48316 through 48318 of the Product Definitions Release.

[48] The NFP Electric Associations made the parallel request for clarity in their comment letter on Interim Final Rule 32.3 (see Section VIII of that letter). However, in light of the increasingly obvious parallel nature of these two rulemakings, the importance of this request becomes clear. This interpretation seems to be what was anticipated by the Commission when it said, in the Commodity Options Release, that the trade option "would result in the sale of an exempt or agricultural *(i.e., nonfinancial)* commodity for immediate (spot)… or deferred (forward) shipment or delivery *(emphasis added),*" and that the parties should refer to the as-yet unpublished Product Definitions Release guidance "[t]o assist parties in determining whether the sale of the exempt or agricultural commodity is intended to be physically settled." See 77 Fed. Reg. at 25,326. However, since the Product Definitions Release did not itself refer back to either this provision in the Commodity Options Release or to the Trade Options IFR, the NFP Electric Associations would appreciate the regulatory clarity. For example, assume that a nonfinancial commodity option is executed between two commercial entities that meet the conditions set forth in the Trade Options IFR 32.3(1) and (2). Assume also the underlying commodity is NOT an agricultural commodity, but it is unclear whether such commodity is an "exempt" energy commodity, because the commodity is intangible. In such a case, it may be unclear whether the option is eligible for the "trade option exemption" in the Trade Options IFR. However, once the transaction is executed and the option is exercised, there is no question that the remaining transaction fits squarely within the statutory exclusion in CEA 1a(47)(B)(ii) for a "nonfinancial commodity," if the intangible commodity meets the conditions described in the Product Definitions Release. The nature of the commodity underlying the transaction does not change. Therefore, the interpretation provided in the Product Definitions Release that intangible commodities are nonfinancial commodities (and therefore presumptively not "excluded commodities" but "exempt commodities") so long as they meet the two conditions in the Product Definitions Release interpretation, should logically be applied to the Trade Options IFR.

X. The NFP Electric Associations Respectfully Request That The Commission Reconsider Its Statutory Construction Of Section 721(a)(21) Of The Dodd-Frank Act With Respect To Nonfinancial Commodity Option Transactions.

In Section II.B.2(b)(i) of the Product Definitions Release,[49] the Commission offers its statutory construction of Section 721(a)(21) of the Dodd-Frank Act, and concludes that "[t]he CFTC reaffirms that commodity options are swaps under the statutory definition, and is not providing an additional interpretation regarding commodity options in this [Product Definitions] release." The Commission recites in a footnote portions of the many comments it received about nonfinancial commodity options being excluded from the definition of "swap." But then the Commission summarily states that it "is not providing an interpretation that commodity options *qualify as forward contracts* in nonfinancial commodities."[50] The NFP Electric Associations respectfully explain below why the Commission's analysis may not stand up to judicial scrutiny, and request rehearing or reconsideration of the Commission's statutory construction analysis.

When a federal administrative agency interprets a statute, the agency must search for its plain meaning.[51] Under the first 'prong' of the *Chevron* analysis, where Congress has directly spoken to the precise question at issue, the agency "must give effect to the unambiguously expressed intent of Congress."[52] In addition, the fundamental duty of any federal agency under the Administrative Procedure Act ("APA") is to engage in reasoned decision-making. The Commission is required to ensure that its regulations are not arbitrary and capricious, to allow for a consideration of the relevant factors, and to articulate a "rational connection between the facts found and the choice made."[53]

As explained below, the NFP Electric Associations believe that the Commission's statutory construction of Section 721(a)(21) fails to address the plain language of the Dodd-Frank Act, and thus fails to meet the first 'prong' of the *Chevron* analysis. The NFP Electric Associations also believe that the Commission's oft-repeated statement that a commodity option falls within the definition of a "swap"[54] under new CEA 1a(47)(A) is incomplete, arbitrary and capricious decision-making. The NFP Electric Associations respectfully request that the Commission provide a reasoned analysis of the interplay between the words of new CEA 1a(47)(A)(i) referencing commodity options, the first 10 words of new CEA 1a(47)(A), and the

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49 See page 48236-48237 of the Product Definitions Release.

50 See footnote 319 and accompanying text on page 48237 of the Product Definitions Release. See also 77 Fed. Reg. 25,324 in the Commodity Options Release and the comments cited therein.

51 *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) ("*Chevron*").

52 See *Chevron* at 842-843. See also *International Swaps And Derivatives Association, et al., Plaintiffs, v. United States Commodity Futures Trading Commission, Defendant*, Civil Action No. 11-cv-2146 (RLW) (D. D.C. September 28, 2012).

53 *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal cites omitted).

54 See, for example, Product Definitions Release at 48237.

exclusion from the definition of "swap" in new CEA 1a(47)(B)(ii) of nonfinancial commodity transactions.[55]

A. Procedural Background

The Commission has chosen different dockets in which to first state its proposed statutory construction of CEA section 1a(47), and then to announce its final statutory construction analysis. The NFP Electric Associations first requested that the Commission clarify that nonfinancial commodity trade options are not "swaps" in response to the Commission's initial Advanced Notice of Proposed Rulemaking on Product Definitions in September of 2010 (the "Definitions ANOPR").[56] The Commission did not respond to the NFP Electric Associations' request or to the energy industry's repeated requests to define or further define "swap" and provide an analysis of CEA 1a(47) as a whole. Instead, in February of 2011, the Commission formally proposed one piece of its interpretation of Section 721(a)(21) of the Dodd-Frank Act. The Commission quoted CEA 1a(47)(A), which provides that in general commodity options are swaps, and on that basis the Commission withdrew its existing trade option exemption.[57]

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55 Alternatively, if the Commission believes that the statute is ambiguous, it does not say so. To the extent the Commission asserts that the statute is ambiguous, the NFP Electric Associations assert that the Commission has not provided a response to the reasoned interpretation of Congress' intent that commercial transactions involving nonfinancial commodities, including options transactions, should not be regulated as "swaps," as discussed above and in the comment letters cited in the Commodity Options Release and the Product Definitions Release. See footnote 50. In construing the meaning of Section 721(a)(21) of the Dodd-Frank Act in this docket, the Commission also construes the scope of its jurisdiction over nonfinancial commodity transactions, including nonfinancial commodity options transactions, in new CEA 1a(47). The NFP Electric Associations, and others in the energy industry, have repeatedly asked the Commission to articulate a reasoned basis for its jurisdiction over such transactions. If the Commission is construing the statute to expand its jurisdiction beyond what the statute clearly provides, and beyond what Congress intended (to give the Commission jurisdiction over nonfinancial commodity transactions that are options), it is not clear that the Commission's construction of the statute, regardless of its reasoning, is owed any deference whatsoever under Chevron, or the Chevron line of cases. The Supreme Court has granted certiorari in *City of Arlington, Texas, et al. vs. FCC*, No. 11-1545, to resolve a conflict in the Federal circuit courts on this precise issue. However, until the Commission explains its reasoning or why it has rejected the reasonable statutory construction analysis provided in the comments, the NFP Electric Associations are left with no administrative remedies on this issue should the Commission decide not to reconsider this issue.

56 *See* the comment letter dated September 20, 2010 by EEI and EPSA at 6. "The Commission should clarify that option contracts that settle into [nonfinancial commodity] forward contracts are not 'swaps.'" The Not-for Profit Energy End User Coalition added their support to the EEI and EPSA letter. *See* the comment letter dated September 20, 2010 by the Not-For-Profit Energy End User Coalition at 11. Weblinks to these comment letters are provided at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26193&SearchText and http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26217&SearchText.

57 *See* the Notice of Proposed Rulemaking on Commodity Options and Agricultural Swaps, 76 Fed. Reg. 6095 (Feb. 3, 2011) (the "Commodity Options NOPR").

The reaction of the NFP Electric Associations and many others in the energy industry to the Commission's controversial proposal on this issue was negative, and the energy industry's concerns were echoed by other commercial entities that use nonfinancial commodity options to hedge commercial risks of their operations.[58] The energy industry strongly disagreed with the Commission's proposed statutory construction of Section 721(a)(21) of the Dodd-Frank Act. Many energy companies asked the Commission to read the Dodd-Frank Act and new CEA Section 1a(47) in keeping with Congress' intent not to burden commercial end users with the new regulatory regime for "swaps," and to exclude commercial trade options from the Commission's new jurisdiction over "swaps." Alternatively, commenters requested that the Commission confirm a broad and comprehensive exemption from all regulatory requirements for nonfinancial commodity trade options.[59]

In the May 23, 2011 Product Definitions NOPR,[60] the Commission chose not to explain its statutory construction of Section 721(a)(21), but instead asked for comments on whether there was any issue with respect to the treatment of commodity options that the Commissions have not addresses and that should be addressed as a definition matter in this rulemaking. Again, the energy industry responded with comments requesting that the Commission interpret CEA 1a(47)(B)(ii) to apply to options.[61] More than a year later, in April of 2012, the Commission again firmly set aside the statutory construction question. In the Commodity Options Release, the Commission expressly deferred finalizing the basic statutory construction analysis on nonfinancial commodity options until the Product Definitions Release.[62] In the Commodity

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58 See comments in the Commodity Option NOPR docket.

59 See the various comments cited by the Commission in the Commodity Options Release at 25,324 and others cited in footnote 319 to the Product Definitions Release.

60 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, 76 Fed. Reg. 29,818 (May 23, 2011).

61 See Section V of the Electric Trade Associations comment letter dated July 22, 2011 in this docket, and cited in the Commodity Options Release (see page 25,323-25.324), and in footnote 319 of the Product Definitions Release, and the other energy industry comment letters cited in the two releases..

62 In footnote 6 to the Commodity Options Release, the Commission states unequivocally that it is ***not*** addressing the question of whether a commodity option is a "swap," or whether a trade option is a "swap" – but defers that Commission decision until the Product Definition Release. Instead, the Commission states that, in the Commodity Options Release, "the Commission uses the term 'commodity option' to apply solely to commodity options *not* excluded from the swap definition." *See* footnote 6 (emphasis added). Elsewhere in the Commodity Options Release, the Commission describes the various comments that challenged the Commission's statutory construction, including many from the energy industry, and repeatedly referred to the as-yet-unavailable Product Definitions Release. In the NFP Electric Associations' comment letter on the Interim Final Rule 32.3, we reserved further comments until publication and analysis of the Product Definition Release. *See* footnote 5 above. The rulemaking on Commodity Options is ongoing, and will not be complete until the Commission considers and responds to comments made on the Interim Final Rule, and considers these issues in conjunction with the ongoing Product Definitions rulemakings. See the Commission Staff No-Action Letter, dated August 14, 2012, at footnote 16 and the Product Definitions Release at footnote 374.

Option Release, the Commission proposed as an "interim final rule": a new trade option exemption from the definitions of both "for future delivery," as it applies to forward contracts excluded from the Commission's jurisdiction over futures contracts, and from the defined term "swap."[63]

It was not until August of 2012 that the Commission answered the question first asked in September of 2010 by the energy industry: is an option that, upon exercise, becomes a nonfinancial commodity forward or spot contract a "swap" for purposes of Section 1a(47), which was added to the CEA by Section 721(a)(21) of the Dodd-Frank Act? On page 48,237 of the Product Definitions Release, after taking two years to review the statute and Congressional intent, and after reviewing and considering comments submitted in the Definitions ANOPR docket, the Product Definitions docket and the Commodity Options docket, the Commission confirmed its statutory construction conclusion. The Commission interprets Section 721(a)(21) of the Dodd-Frank Act to say that an option transaction involving a nonfinancial commodity, where the parties intend physical settlement, is a "swap."

B. Statutory Construction Analysis

The Commission errs by first failing to analyze the plain language of new CEA section 1a(47) of the Dodd-Frank Act, by then ignoring some aspects and misreading other aspects of the legislative history, and finally by citing as the basis for its statutory construction reasoning a single 1985 opinion of the Commission's own General Counsel, which analyzes and provides an answer to a different and irrelevant question.

The Commission's statutory construction of Section 721(a)(21) fails to meet the first 'prong" of the *Chevron* analysis because it fails to address the plain language of the statute in new Section 1a(47) of the CEA. The Commission simply asserts that all commodity options are "swaps" under CEA Section 1a(47)(A), ignores the plain language of the same provision in the statute that provides that a transaction is a "swap" *except as such a transaction is excluded from the defined term "swap" pursuant to CEA 1a(47)(B),* and does not analyze the statutory exclusion in CEA 1a(47)(B)(ii) of a transaction involving a nonfinancial commodity.[64]

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[63] See new Rule 32.3, proposed in the Commission's Commodity Options Release, 77 Fed. Reg. 25320 (April 27, 2012)(the "Trade Options IFR")

[64] The Product Definitions Release does recite how other exclusions in 1a(47)(B), added by Section 722(a)(21) of the Dodd-Frank Act, override the general definition of "swap" provisions in (A). But the Product Definitions Release does not address (B)(ii). The Commission references the Commodity Options Release, including the recently-added Trade Options IFR 32.3, in a circular way. In the Product Definitions Release, the Commission cites a number of comments raising this issue both in the Product Definitions docket and in the Commodity Options docket, and then summarily declines to provide a response or a reasoned analysis for its statutory construction of Section 721(a)(21) of the Dodd-Frank Act. See 48,236-48,237.

The NFP Electric Associations agree that CEA section 1a(47)(A)(i) includes commodity options in the general definition of the term "swap."[65] However, the first ten words of CEA section 1a(47)(A) clearly indicate that the exclusions enumerated in CEA section 1a(47)(B) supersede the more general list of transactions in CEA section 1a(47)(A). As such, the term "swap" cannot rationally be fully defined by the Commission without reading CEA section 1a(47)(A) ***and*** CEA section 1a(47)(B) together. Thus, the Commission cannot rely on the general reference to commodity options in CEA section 1a(47)(A)(i), without analyzing the remaining language of (A) and the statutory exclusions in CEA section 1a(47)(B), including clause (ii).

In analyzing the statutory exclusion in CEA section 1a(47)(B)(ii), the Commission must first interpret the statute in light of the plain language. Legislative history may explain the Congressional intent behind such language, but only if the language itself is ambiguous. Legislative history does not substitute for reading the plain language of the statute. Accordingly, the question is not whether the Commission decides to provide an interpretation that nonfinancial commodity option transactions "qualify as forward contracts,"[66] or even whether the Commission decides to interpret nonfinancial commodity options as "swaps." The initial statutory construction question is "what did Congress intend in enacting Section 721(a)(21) of the Dodd-Frank Act and did ***Congress*** intend to regulate nonfinancial commodity option transactions as 'swaps'?" Among the fundamental precepts of statutory construction is that effect should be given "to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed."[67]

The Commission's statutory construction analysis ignores the foregoing premise in that it attempts to establish Congress' intent by reviewing the legislative history. In doing so, the Commission then presumes that the legislative history means that Congress left the word "forward" out of CEA 1a(47)(B)(ii). The Commission then moves on to study the Commission and its staff's historical precedent to interpret the statute as if it had been rewritten in light of the misinterpreted legislative history. The result is the Commission's assertion that CEA section 1a(47)(B)(ii) excludes nonfinancial commodity forwards from the definition of "swap," but does not exclude nonfinancial commodity options. The NFP Electric Associations respectfully request that the Commission refocus on the plain language of Dodd-Frank Act Section 721(a)(21), and reconsider this statutory construction.

In 2010, as Congress developed a new regulatory regime governing "swaps," nonfinancial commodity forward transactions and nonfinancial commodity option transactions,

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65 The Commission makes and remakes this same statement in various rulemakings. *See, for example,* Product Definitions NOPR at 29,829-20830, the Product Definitions Release at 48,236-48,237, 48,242, 48,258, 48,317, and 48,364, the Commodity Options Release at 25,321-25,323 and 25,344.

66 The Commission starts its statutory construction in the Product Definitions Release from this fundamentally wrong procedural premise. See page 48,237. The question at hand is whether the nonfinancial commodity option is a "swap."

67 *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883).

were both outside the jurisdiction of the Commission.[68] Forward contracts were "excluded" under Commission interpretations, so long as certain conditions were met. Commodity trade options were "exempted" from Commission jurisdiction under Commission rule 32.4, so long as certain similar conditions were met. But both the Commission's interpretation of the forward contract exclusion and the Commission's trade option exemption rule were based on the premise that such transactions were intended to facilitate "actual" physical delivery of the commodity, between entities with commercial or operational risks to hedge and that were capable of making and taking delivery. The predominant feature or overall nature of the transaction at issue, whether a commodity forward or a commodity trade option, was physical delivery, performance not payment, and physical (not cash or financial) settlement. Both commodity forwards and commercial trade options were and are an important fixture in the way commercial market participants hedge or mitigate commercial risks, and facilitate the delivery/receipt of nonfinancial commodities.

This was the regulatory backdrop against which Congress wrote Section 721(a)(21) of the Dodd-Frank Act. In its statutory construction analysis, the Commission does not respond to the comments raising this point, and has not cited any evidence for its belief that, in drafting Section 721(a)(21) of the Dodd-Frank Act, Congress intended to fundamentally change the way in which the Commission regulates these important commercial transactions.

The plain language of the statute implies the opposite. CEA section 1a(47)(B)(ii) does not differentiate between nonfinancial commodity forward transactions and nonfinancial commodity option transactions. The word "forward" does not appear in Dodd-Frank Act Section 721(a)(21). The word "forward" *does* appear in the Dodd-Lincoln letter[69] – where Congressional leaders evidenced several specific aspects of Congressional intent related to the Dodd-Frank Act. The first aspect was that Congress did not intend to impose new regulatory burdens on commercial end users of commodity or commodity derivative transactions. It was Congress' intent to preserve access for end users to cost-effective commercial risk management tools. Congress did not intend for the Commission to extend its new regulatory regime to cover every day commercial transactions. Moreover, where commercial end users did enter into "swaps" to hedge or mitigate commercial risks, the Commission was to avoid imposing unnecessary regulatory burdens.[70]

Another aspect of the Dodd-Lincoln letter was that Congress intended the Commission to interpret the definition of "swap" (and the exclusions therefrom) consistent with its prior interpretations of the forward contract exclusion, including its "bookout" interpretation. In

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[68] See Rule 32.4.

[69] See, for example, footnote 12.

[70] The example given in the Dodd-Lincoln letter of this aspect was margin – as a direct result of changes made at the last minute during the legislative process whereby important legislative language was inadvertently removed by legislative staff prior to endorsing the final text for approval by both houses of Congress.

making this statement, Congress did not instruct the Commission to ignore the plain language of the statute. Neither did Congress indicate that its statutory exclusion in CEA 1a(47)(B)(ii) was limited to nonfinancial commodity forwards, or should be read not to include nonfinancial commodity options. That is, legislative history for a statute cannot be read to introduce into the statute a word not found there, *i.e.*, "forward," or to introduce language into the statute that does not appear there, *i.e.*, "unless either party to the transaction has an option that is exercisable after the transaction is executed." Neither of those words and phrases appears in CEA 1a(47)(B)(ii).

In footnote 321 of the Product Definitions Release, the Commission cites as authority for its statutory construction of Dodd-Frank Act Section 721(a)(21) a single 1985 Interpretation by the Commission's Office of General Counsel. The citation is a further extrapolation of the Commission's error in failing to read the plain language of the Dodd-Frank Act, and the Commission's misinterpretation of the legislative history of the Dodd-Frank Act. Instead of asking whether Congress intended a nonfinancial commodity trade option to be a "swap" or intended to exclude nonfinancial commodity options under CEA 1a(47)(B)(ii), the Commission analyzes whether an option contract is a forward contract and concludes, unsurprisingly, that it is not.[71] However, the analysis has no bearing on the statutory construction question at hand.

C. Request for Rehearing or Reconsideration.

CEA 1a(47)(B)(ii) states a clear and simple statutory exclusion: the parties to a transaction involving nonfinancial commodities intend physical settlement of their obligations.[72] Nothing in Section 721(a)(21) of the Dodd-Frank Act indicates that Congress intended the new law to change the way the Commission regulates commercial entities executing nonfinancial

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[71] The 1985 OGC Opinion analyzes whether an agricultural commodity option is a forward contract, in the context of the agricultural markets at the time. At the core of the 1985 OGC opinion was the question of whether the holder of an option contract holds a limited-risk investment, akin to a nonfinancial commodity option, or a two-way risk investment, akin to a nonfinancial commodity forward. The question was an interesting one at the time, as the Commission was considering the scope of its commodity trade option exemption, and thus whether to treat a commodity trade option as exempted or excluded from the Commission's jurisdiction, or to consider it subject to the Commission's plenary jurisdiction over options in 4c(b). But in citing the 1985 OGC Opinion, the Commission does not argue that, in drafting Section 721(a)(21) of the Dodd-Frank Act, Congress intended that only two-way risk investment products should be excluded from the definition of "swap."

[72] Section 721(a)(21) of the Dodd-Frank Act provides an exclusion from the definition of "swap" with no indication that the nature of that initial contract between two parties (whose intent was to physically settle) as "not-a-swap," should change if the delivery or receipt (*i.e.*, physical settlement) does not, for whatever reason, later occur. This subsequent absence of actual delivery/receipt may occur due to a subsequent cancellation or extinguishment agreement between the two parties, or due to a choice by one party to breach (accompanied by payment for the contract breach), or due to one party's exercise (or "non-exercise") of an option based on a reason within or outside one or both of the parties' control. All commercial agreements, contracts and transactions involve ongoing choices, decision points and interactions between the two parties, unlike trading or financial instruments which contain static, fungible terms. See footnote 24.

commodity transactions with the intention that the transaction physically settle.[73] The NFP Electric Associations respectfully request the Commission to reconsider its view of the statutory exclusion in line with the fundamental canon of statutory construction and case law.

The NFP Electric Associations also believe that the Commission's oft-repeated statement that a commodity option falls within the definition of a "swap" under new CEA 1a(47)(A) is arbitrary and capricious decision-making. The NFP Electric Associations respectfully submit that the Commission's statement is the beginning, not the end, of the statutory construction of Section 721(a)(21) of the Dodd-Frank Act and new CEA Section 1a(47). As described above, the Commission does not provide a reasoned analysis of the interplay between the words of new CEA 1a(47)(A)(i) referencing commodity options, the first 10 words of new CEA 1a(47)(A), and the exclusion from the definition of "swap" in new CEA 1a(47)(B)(ii). The Commission is respectfully requested to explain why its analysis supports a reasonable construction of the statute to mean that ***nonfinancial*** commodity options are "swaps."[74]

The NFP Electric Associations and the energy industry have explained their analysis that, if the option transaction involves a nonfinancial commodity and if, at the time the transaction is executed, the parties intend physical settlement (or delivery/receipt of the nonfinancial commodity), the option is not a "swap," and Congress did not intend it to be.[75] For the aforementioned reasons, the NFP Electric Associations respectfully request the Commission to reconsider its statutory construction of Dodd-Frank Act Section 721(a)(21). The NFP Electric Associations do not believe that the Commission's statutory construction analysis could withstand judicial scrutiny.

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[73] If the Commission's fundamentally misguided statutory construction of Dodd-Frank Act 721(a)(21) is not reconsidered, the Commission should take note of the many ways in which such a fundamental error will find its way into myriad unintended places in the global regulatory scheme intended for "swaps" (financial derivatives and trading instruments). The Commission uses the word "swap" throughout its rulemakings, and other regulators incorporate the Commission's defined term "swap," with this embedded flaw. Financial regulations from capital and margin rules to the Volcker Rule will now include or exclude these nonfinancial option transaction, which are intended to by physically settled, not traded and "valued" on a regular basis due to the customized nature of their terms, and regulatory confusion will proliferate for commercial entities such as the NFP Electric Association's members. There will likely be nonfinancial commodity trade options, intended to settle physically, but that do not meet the conditions of the Trade Option IFR. The Commission's misguided statutory interpretation will bring these transactions within the defined term "swap" and raise questions about not just disclosure, but about margining, inter-affiliate transactions, parent guarantees, etc.

[74] If the Commission believes the statute is ambiguous, it must provide an analysis in response to commenters arguments that Congress did not intend the Commission to regulate commercial entities' nonfinancial commodity options transaction as "swaps."

[75] See footnote 12 above.

XII. The NFP Electric Associations Respectfully Request That The Commission Consider The Overall Impact Of Its Rules Implementing And Interpreting The Dodd-Frank Act (And In Particular Section 721(a)(21)) On "Small Entities" Including the Majority of NRECA And APPA Members.[76]

The Commission's cost-benefit analysis in the Product Definitions Release continues to assume that, since the regulatory interpretations in the Product Definitions Release relate only to definitions, and not to operable regulatory provisions, the regulatory interpretations have no independent costs, and instead only facilitate the benefits that Congress intended by the Dodd-Frank Act. The Commission also assumes that its regulatory interpretations would reduce costs, rather than impose costs, on market participants. We respectfully disagree. As the NFP Electric 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 implementing and interpreting 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" in Section 721(a)(21) of the Dodd-Frank Act, and the burdens that the Commission's rules place on nonfinancial entities, including small entities, that execute such nonfinancial commodity "swaps," and other commercial transactions that may or may not be "swaps," can ***only*** be determined once the rules and interpretations in this inter-related pair of fundamental rulemakings are finalized.

The Commission cannot assume the overarching regulatory benefit of its rules and interpretations to the markets as a whole, while pleading its inability to estimate the regulatory costs of those same rules and interpretations that it will be imposing on nonfinancial entities, for markets about which the Commission acknowledges it has insufficient information.

Each of the complex and interrelated rulemakings currently being proposed by the Commission has both an individual, and a cumulative, effect on such small entities. Hundreds of small entities, including the majority of NRECA and APPA members, seek to continue engaging in nonfinancial commodity transactions excluded from the definition of "swap" under new CEA Section 1a(47)(B)(ii) and under the Commission's various interpretation in the Product Definitions Release and the Commission's public interest waivers under Section 722(f) of the Dodd-Frank Act without regulatory uncertainty as to whether their everyday commercial and operations-related transactions are "swaps."[77] Such entities seek to continue to use nonfinancial

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[76] The vast majority of NRECA's 900 members meet the definition of "small entity" under 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.

[77] The Commission's estimate in footnote 1149 of the Product Definitions Release that it may cost as much as $20,000 ***per contract*** to determine if a particular commercial contract falls within the definition of "swap"

commodity "swaps" only to hedge the commercial risks of their not-for-profit public service operations, and without new regulatory costs to maintain a regulatory regime that is intended to regulate the activities of financial market participants that engage in standardized derivatives in interlocking markets that create systemic risks to the financial system. NRECA and APPA 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 rulemakings being promulgated by the Commission to implement and interpret 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 of these and other Commission rules and statutory interpretations addresses a different piece of the Commission's overall rulemaking challenge under the Dodd-Frank Act. The Commission's cost-benefit analysis in each rulemaking 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 NFP Electric 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 Commission's specific regulatory goals that would reduce the burdens imposed by the Commission's rulemakings under the Dodd-Frank Act on such small entities.

XII. Conclusion.

The NFP Electric Associations renew our requests for regulatory certainty, and express again our concern about the delay in the Commission's response to the electric industry's most basic jurisdictional questions. The NFP Electric Associations also express concern over the lack of reasoned and complete decision-making in implementing Section 721(a)(21) of the Dodd-Frank Act. The Commission should withdraw or clarify ambiguous regulatory interpretations of new CEA 1a(47), as enacted in Section 721(a)(21) of the Dodd-Frank Act. Moreover, the NFP Electric Associations respectfully request that the Commission reconsider its statutory construction of Section 721(a)(21) of the Dodd-Frank Act introducing Section 1a(47) into the CEA, as it relates to nonfinancial commodity option transactions where the parties intend physical settlement. Such transactions are not "swaps" under the Section 721(a)(21) of the Dodd-

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is an extraordinary statement for the electric industry to comprehend, much less for the NFP Electric Associations' small entity members to finance. Each member of the NFP Electric Associations may have hundreds or thousands of individual commercial contracts to analyze and these commercial contracts are the fundamental basis upon which its electric operations are conducted.

Frank Act, Congress did not intend such transactions to be "swaps" and the Commission has failed to provide a reasoned analysis for its determination.

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PRODUCT DEFINITION RELEASE

Respectfully submitted,

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ATTACHMENT A - DESCRIPTION OF THE NFP ELECTRIC 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 26 of the largest government-owned electric utilities in the nation. LPPC members own and operate over 86,000 megawatts of generation capacity and nearly 35,000 circuit miles of high voltage transmission lines, representing nearly 90% of the transmission investment owned by non-Federal government-owned electric utilities in the United States.

TAPS is an association of transmission-dependent utilities in more than 35 states, promoting open and non-discriminatory access to the transmission grid and regulatory policies to facilitate the participation of smaller utilities in the electricity markets.