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June 26, 2014

Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: COMMENTS OF ELECTRICAL DISTRICT NO. 3 REGARDING PROPOSED RULE: EXCLUSION OF UTILITY OPERATIONS-RELATED SWAPS WITH UTILITY SPECIAL ENTITIES FROM DE MINIMIS THRESHOLD FOR SWAPS WITH SPECIAL ENTITIES (RIN 3038–AE19, 79 FED. REG. 31,238 (JUNE 2, 2014))

To the Secretary:

In response to the Commodity Futures Trading Commission ("CFTC" or "Commission") June 2, 2014 solicitation for comments, Electrical District No. 3 ("ED3") takes this opportunity to comment on two issues: (1) the special entity sub-threshold for swap dealers, and (2) the proposed seven-factor test on volumetric optionality. As a utility special entity that is or may be directly impacted by the proposed rule, ED3 strongly supports the amendments proposed by the CFTC regarding the special entity sub-threshold for swap dealers, and urges the CFTC to modify the seven-factor test on volumetric optionality.

1. ***Support for Revision to Special Entity Sub-Threshold for Swap Dealers***

As stated in the petition prompting the Commission's proposed rule, utility special entities depend on nonfinancial commodity transactions, trade options and swaps, as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Without repeating each of the facts and arguments set forth in the petition, ED3 supports the reasoning outlined in the petition, and urges the adoption of the amendments proposed by this rule.

It is appropriate to treat utility-operations-related swaps with utility special entities differently from other swaps with special entities for purposes of determining whether a person is a swap dealer. Utility special entities are sophisticated participants in the energy industry's risk mitigation markets and do not require treatment different from investor-owned utilities engaging in the same markets. Utility special entities should not be limited to small numbers of available swap counterparties in regional or local markets that can be quite illiquid. The current rule has the effect of reducing the number of available counterparties, which harms the utility industry by diminishing risk-mitigation options, and puts utility special entities at a disadvantage compared to their investor-owned competitors.

ED3 supports the proposed amended threshold for utility operations-related swaps with special entities. Treating utility special entities equally with other utilities is appropriate and will put them on the same competitive footing. The proposal addresses an important need and will serve the public interest by facilitating necessary hedging and risk mitigation. Utility special entities play a significant role in the country's utility industry, and in some cases, serve otherwise underserved areas. Facilitating the participation of utility special entities in risk mitigation measures which have long been a central part of the industry will contribute to the overall stability of the utility industry. The Commission should enact each of the amendments that it proposes.

2. ***Support for Revising Seven-Factor Test of Volumetric Optionality***

The Commission's proposed seven-part test of volumetric optionality should be eliminated or modified in order to be meaningful. In particular, factor seven is highly problematic and should be removed. Factor seven provides that, in order to qualify for the forward contract exclusion from the swap definition, optionality embedded in any transaction that otherwise qualifies must be exercised primarily contingent upon nonfinancial factors such as physical factors (e.g., weather), or regulatory requirements (e.g., FERC directives), that are outside the control of the parties but may influence supply and demand.

Utility special entities, like other utility entities, regularly enter into forward contracts that contain flexibility in the volume term. The reasons for this are various, including the need to respond to fluctuations in demand caused by factors such as weather and changing circumstances such as plant and transmission outages, as well as the need to minimize costs in accordance with reasonable practice. While utility special entities such as ED3 are governmental entities lacking traditional profit motives, utility special entities would be remiss if they did not engage in generally accepted forms of cost-control, such as running locally sited generation when market demand and/or congestion drives up the cost of imported power, or conversely opting to schedule energy under a purchased-power contract when it is more economical than other available resources. The reality is that cost-savings and demand factors are interlinked in such a way that they are often inseparable; responsible utility managers consider many factors, including both weather and price, when making decisions as to which of a utility's available resources to utilize at any given time. While the CFTC's current interpretation focuses on non-financial motivations "that are outside the control of the parties," such as weather, congestion, or regulatory actions, cost is part of the decision-making process as well. Any utility making a reasoned decision must weigh all of these factors as elements of a single picture. The ability of a utility purchaser to decide when to schedule energy deliveries (and when not to) for reasons that include the relative price of the energy is a common, normal feature of many purchased-power contracts, and does not change the fundamental nature of the transaction from a physical forward contract to a financial one that should be regulated as a swap.

> While the intent of the CFTC in proposing the seven-factor test was to clarify when a transaction with optionality of the volume term should be considered a swap rather than remaining a forward contract, the seventh factor contributes to rather than resolves uncertainty. By failing to acknowledge the interlinked nature of factors such as weather and cost, as well as the fact that every reasonable utility must weigh all such factors when making decisions as to which of its available resources to utilize at any given time, the seventh factor makes it even harder to distinguish a forward contract from a swap when embedded volumetric optionality is present. This increase in uncertainty inevitably exacerbates the hazard of arbitrary or inaccurate distinctions on the part of regulated entities as well as CFTC enforcement staff. It requires that the CFTC not only identify the intent of the parties when exercising volumetric optionality, but distinguish accurately between a cost-based motive and a motive ostensibly "outside the control of the parties." Where both are present, it would require the CFTC to weigh the potential predominance of one over the other. (It appears the CFTC would ironically need to create a second seven-factor test just to apply the first one; how else will it distinguish a predominant motive?) Furthermore, it may be a hollow hope to presume that one factor predominates over another when reasoned utility decisions are necessarily multi-dimensional. Whereas this is not the case with financial speculators, multi-dimensional decision-making is a daily reality in the utility industry. Reliability, cost prudency, and public service obligations are necessarily interdependent.

ED3 also offers support for the comments of the American Public Power Association ("APPA") and the Not-for-Profit Electric Associations ("NFP Electric Associations") on this subject, both in RIN 3038-AD62 and in this proceeding. The comments of APPA and the NFP Electric Associations provide additional bases for eliminating the seventh factor. In particular, the NFP Electric Associations identify important additional ambiguities and false assumptions entailed by the seven-factor interpretation that are not detailed herein, but to which the Commission should be alert.

Thank you for the opportunity to comment on this important rulemaking. ED3 appreciates the Commission's attention to these matters. Please do not hesitate to contact us with any questions.

Sincerely,

William H. Stacy

William H. Stacy, P.E.
General Manager

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