July 2, 2014

Via Electronic Submission

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

Re: Proposed Rule Exclusion of Utility Operations-Related Swaps with Utility Special Entities from De Minis Threshold for Swaps with Special Entities (RIN 3038-AE19)

Dear Ms. Jurgens:

I. INTRODUCTION

The Edison Electric Institute ("EEI") submits these comments in response to the June 2, 2014, *Federal Register* notice requesting comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") Proposed Rule to "permit a person to exclude utility operations-related swaps with utility special entities in calculating the aggregate gross notional amount of the person's swap positions solely for purposes of the *de minimis* exception applicable to swaps with special entities.[1]

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 99 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI's diverse membership includes utilities operating in all regions and in all types of markets. EEI members are not financial entities; they are physical commodity market participants that rely on swaps primarily to hedge and mitigate their commercial risk. As such, regulations that make using swaps, the most effective risk-management tool for physical end-users, more costly will likely result in higher and more volatile energy prices for retail, commercial, and industrial customers. Many EEI members have longstanding commercial relationships with municipalities, power authorities and other special entities as part of their core electric generation and supply businesses. As such, EEI members have an interest in this issue and appreciate the opportunity to comment through a rulemaking process.

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[1] 79 Fed. Reg. 31238 (June 2, 2014) ("Proposed Rule").

Generally, EEI appreciates the issuance of the March 21, 2014 no-action letter[2] on the *de-minimis* limit applicable to special entities and the Commission's decision to codify the no-action relief through this rulemaking process. As discussed in more detail below, the Proposed Rule addresses many of the material concerns that prevented some EEI members from engaging in swap transactions with special entities. However, EEI does have concerns with some of the provisions in the Proposed Rule and would ask the Commission to remove the notice and recordkeeping requirements.

II. COMMENTS ON PROPOSED RULE

In its Final Rule and Interim Final Rule on the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," Major Security-Based Swap Participant," and "Eligible Contract Participant." ("Final Rule").[3] In the Final Rule, the Commission increased the overall *de minimis* threshold for consideration as a swap dealer to at least $3 Billion with an initial phase-in amount of $8 Billion. However, the *de minimis* threshold for swap-dealing transactions with special entities remained at $25 Million during any 12-month period.[4] Following the issuance of the Final Rule, utility special entity end users, the American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS"), and the Bonneville Power Administration ("BPA") filed a petition for rulemaking with the CFTC requesting that the CFTC undertake a rulemaking process and amend Regulation 1.3(ggg)(4) to exclude utility operations related swaps with utility special entities from the $25 Million *de minimis* threshold for swap dealer consideration.[5]

Many EEI members have longstanding commercial relationships with municipalities, power authorities and other special entities as part of their core electric generation and supply businesses. As such, EEI supported the Petition[6] and supports the Commission's proposal to subject utility operations-related swaps with utilities special entities to the General De Minimis Threshold. This proposal recognizes that utility special entities are sophisticated market participants and that they have a compelling need for liquidity in utility operations-related swaps. The changes in the Proposed Rule would no longer subject transactions with utility special entities to the $25 million swap dealing de minimis threshold. This will reduce regulatory risks

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[2] *Staff No-Action Relief: Revised Relief from the De Minimis Threshold for Certain Swaps with Utility Special Entities*, CFTC Letter No. 14-34 (March 21, 2014)

[3] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 Fed. Reg. 30596 (May 23, 2012).

[4] Final Rule at 30632.

[5] *Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4),,* (July 12, 2012).

[6] *See* e.g. EEI and EPSA Comments Definitions of Swap Dealer and Major Swap Participant (RIN 3038-AD06) (February 22, 2011); EEI Comments in Support of Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4) (September 24, 2012); April 2, 2014 Public Roundtable to Discuss End User Issues and Post Conference Comments (April 17, 2014).

and burdens for market participants and will increase the willingness of market participants to engage in swap transactions with utility special entities.

EEI also appreciates the statement in the preamble to the Proposed Rule that a person can in "good faith" rely on a representation from its counterparty that the counterparty qualifies as a utility special entity.[7] This clarification will help ensure that EEI members will not have to bear the significant regulatory risk of making an incorrect determination as to the status of a counterparty (*i.e.*, the counterparty is not a utility special entity but is instead a special entity for which the $25 million threshold applies). However, EEI requests that the Commission include good faith reliance on such a representation in the text of the regulation rather than just making that statement in the preamble. Our suggested approach is consistent with CFTC Rule 23.505, which requires swap dealers to obtain documentation from counterparty that the counterparty is eligible to elect the end-user clearing exception instead of requiring the swap dealer to make the eligibility determination.

Further, although EEI supports the inclusion of swaps with utility special entities in the General De Minimis Threshold, EEI is troubled by the new notice and recordkeeping requirements in the Proposed Rule which states that a :

> "person would be required to file a one-time notice to rely on the exclusion provided by the new rule. Specifically, the notice would be required to be filed electronically with the National Futures Association (NFA), to provide such information as the person's name, address, and a contact, and a representation that the person meets the criteria of the exclusion for utility operations-related swaps with utility special entities in Regulation 1.3(ggg)(4)(i)(B)…"[8]

> "Additionally, a person relying on the exclusion under the Proposal would be required to maintain in accordance with Regulation 1.31 books and records that substantiate its eligibility to rely on this exclusion."[9]

These requirements impose unnecessary regulatory risks and burdens on market participants seeking to engage in transactions with utility special entities with no discernable benefit. Although important for energy consumers, swap activity that EEI members engage in with utility special entities is somewhat limited and any additional regulatory risks and burdens, such as the proposed notice filing, will discourage EEI members from availing themselves of the Proposed Rule. In justifying the requirement, the Proposed Rule states that Congress has determined that special entities need additional protection and the notice filing will help the Commission monitor these transactions. [10] This rationale does not adequately address the need for the requirements for a number of reasons.

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[7] Proposed Rule at 31242.

[8] *Id*. at 31241.

[9] *Id*. at 31242.

[10] *Id*.

First, the Proposed Rule is narrowly tailored and only applies to a limited universe of swaps between market participants that the Commission believes do not need extra protections as special entities. As recognized in the Proposed Rule, utility special entities are sophisticated market participants who have expertise in physical and financial energy markets.[11] This point was also underscored at the April 3, 2014 End User roundtable at which a number of utility special entities indicated that managing electric operations, and hedging the associated commercial risks, is their core competency, and an area in which their utility operations management is highly-skilled. Thus, the Commission's rationale for requiring the filing appears to contradict its rationale for the relief in the Proposed Rule.

Second, the Proposed Rule is intended to reduce an unnecessary regulatory burden in order to increase the number of counterparties willing to engage in swaps with utility special entities. The notice requirement undercuts that intent by creating another regulatory burden which will limit market participants' willingness to engage in swaps with these counterparties. The attestation component of the notice requirement is especially troubling as it requires the individual to attest that the representation from a counterparty that the counterparty qualifies as a utility special entity. This undercuts the ability to rely on counterparty's "good faith" assertion as provided in the Proposed Rule. The attestation also requires the individual to attest to future activity as the language of clause (B)(1) explains the calculations for the exclusion, which are made during the course of relying on the exclusion, not before the person begins to rely. As such, the attestation requirement unduly subjects an individual to regulatory risk which will affect their willingness to entire into transactions with utility special entities.

Third, these transactions will be reported to the swap data repositories ("SDRs"). As such, the Commission can already see what entities are entering into swap transactions with utility special entities.

Fourth, the Commission does not require any other parties relying on any de minimis exclusion to make a notice filing. There is no justification for treating entities relying on the Proposed Rule any differently.

Fifth, the recordkeeping requirement is unnecessary and redundant. Under the proposed rule, utility operations-related swaps with utility special entities would no longer be subject to the lower $25 Million threshold and would be included in the General De Minimis Limit. Counterparties already need to maintain appropriate records for purposes of demonstrating compliance with that Swap Dealer threshold. As such, the Commission has access to this information and additional requirement for these transactions is not needed.

Thus, EEI encourages the Commission not to adopt the proposed notice, attestation and recordkeeping requirement in its final rule. In order to ensure that utility special entities will have access to all available counterparties, the Commission should not impose any additional

[11] *Id*. at 31241.

burdens on parties that wish to transact with utility special entities. In this manner, utility special entities will receive the full benefit of the relief in the form of increased number of counterparties and increased market liquidity.

III. RESPONSE TO QUESTIONS

8. ***The Proposal would allow persons to, in effect, treat utility operations-related swaps in which the counterparty is a utility special entity like swaps with a counterparty that is not a special entity in determining whether the person has exceeded a de minimis threshold under Regulation 1.3(ggg)(4)(i)(A). Thus, utility operations-related swaps with utility special entities would be subject to the General De Minimis Threshold under Regulation 1.3(ggg)(4)(i), which is currently set at the $8 billion phase in level. Is that an appropriate threshold, or should the de minimis threshold for such swaps be higher or lower? What considerations support using a different amount? Should the de minimis threshold for utility operations-related swaps be set at $3 billion, the level of the General De Minimis Threshold without application of the $8 billion phase-in level, in light of the special protections afforded to special entities under the CEA? Should the threshold be set at an amount equal to a percentage of the gross notional amount of the General De Minimis Threshold, such that an increase or decrease in the gross notional amount of the General De Minimis Threshold would result in a proportionate change in the de minimis threshold for utility operations-related swaps?***

EEI has previously indicated that there are concerns with the general *de-minimis* threshold and the current transition from $8 Billion to $3 Billion in 2017 absent Commission action in the interim. This sudden, arbitrary drop, impacts the ability of EEI members to engage in long-term planning. Commodity prices are unstable and may vary considerably over time; the certainty of having a stable, consistent threshold will assist EEI's members in managing their businesses. Having the Commission provide additional certainty on this issue by clarifying that Commission action, with the opportunity for comment, will be taken prior to making any change in the *de-minims level* will provide needed certainty to the market.

As such, EEI encourages the Commission to revisit the General De Minimis Threshold and eliminate any automatic reset to a lower threshold for all transactions. A dramatic reduction in the General De Minimis Threshold will not result in more entities registering as swap dealers, but will instead result in a dramatic reduction in market participants, fewer available counterparties who are not banks, less liquidity in energy swaps and potentially greater volatility in energy prices for consumers.

The Commission should not adopt a separate de minimis threshold for utility operations-related swaps with utility special entities. Such an approach would add needless complexity and compliance burdens by having three different *de minimis* thresholds that market participants would have to monitor. Such additional complication would likely serve only to limit the number of potential counterparties willing to enter into swaps with utility special entities and, instead of furthering any discernable regulatory purpose, would likely undercut the ultimate effect of the Proposed Rule. Based upon the Commission's rationale for the Proposed Rule, it would be illogical to create a separate de minimis threshold for utility special entities that is lower than the General De Minimis Threshold.

15. As noted above, it is important that the Commission be able to know who the persons are that rely on the exclusion under the Proposal to monitor compliance with the swap dealer registration requirement, and better ensure that the exclusion under the Proposal serves the intended purpose of enabling utility special entities to manage operational risks in a cost effective way. Will the notice requirement in proposed Regulation 1.3(ggg)(4)(i)(B)(4) enable the Commission to achieve these objectives? If not, why? Is there an alternative method for the Commission to obtain the relevant information and achieve the stated objectives without requiring a notice filing?

As discussed in Section II above, the Notice requirement is not needed to meet the Commission's objectives and should not be adopted in the final rule.

18. Will utility special entities benefit if the Commission revised its interpretation regarding forward contracts with embedded volumetric optionality as described in the swap definition adopting release? If so, how? Is the seven element interpretation appropriate for determining whether a forward contract with volumetric optionality qualifies for the forward contract exclusion from the definition of a swap? If not, should the Commission revise the interpretation or adopt an alternative standard? If so, what should the revised interpretation or standard be?

Yes, utility special entities and all end users will benefit if the Commission revises its interpretation regarding forward contracts with embedded volumetric optionality. The treatment of contracts with embedded volumetric optionality remains of concern to EEI members as well as to other end users. This is largely due to the manner in which electric utilities procure energy. Generally, utilities enter into a variety of contracts to serve their customers' needs. The decision to use a particular contract can be based on a variety of factors. These factors should not be relevant because forward contracts, even those with embedded optionality, that are intended to result in physical delivery of a commodity should be excluded from the swap definition under CEA Section 1a(47)(B)(ii).

Regulatory uncertainty increases transaction costs for end users and ultimately for consumers. The 7-factor test for physical forward contracts that have imbedded volumetric optionality is an area in which the Commission has created substantial uncertainty. End users have found the 7th factor unclear and difficult to implement which has resulted in uncertainty about how contracts should be treated. Counterparties to a transaction may view the same transaction differently with some viewing it as a forward, some as a trade option and some as a swap. Due to this ambiguity, some companies have defaulted to designating transactions as a trade option out of a desire to err on the side of caution especially since it is not clear whether the test is met if any entity has more than one contract alternative or supply choice. In some cases, this regulatory uncertainty has caused parties to walk away from transactions that would have served a legitimate commercial purpose. In other cases, parties are being asked to make vague representations that cannot be monitored in master agreements and, as a result, may lead to inadvertent breaches. The willingness of parties to agree and classify a given transaction as a trade option is further complicated by the inclusion of trade options in the position-limits proposed rule. In addition to causing uncertainty for market participants, the 7-factor test also affects the quality of data being reported to the Commission because one party to a transaction

may report the same data differently than the other party to the transaction based on their differing interpretations of how a transaction should be treated under the 7-factor test.

EEI has filed a number of comments on this issue and urges the Commission to provide clarity by removing the 7th factor of the 7 factor test. If the Commission declines to do so then EEI urges the Commission to adopt the clarification that EEI filed with the Commission in its Post Conference Comments on the Public Roundtable to Discuss Dodd-Frank End User Issues**.** [12] EEI would request that the Commission clarify that the 7th factor is satisfied:

- when the optionality – whether a put or a call – is intended to meet the commercial production or consumption requirements of the option owner's business, where these requirements can be reasonably affected by supply or demand conditions;

- regardless of whether the option owner arranges for multiple alternatives to address these requirements;

- including cases where business judgment is exercised in choosing among alternatives for which the value is driven primarily by external factors, including qualitative factors

This clarification would address the concerns with the 7th factor of the 7-factor test. There is also ambiguity regarding whether Factors 4 and 5 of the 7-factor test include both put and call optionality. Recognizing that, upon exercise of an option that calls for physical delivery of a commodity, the owner of the option is obligated to make delivery if the option is a put, but to take delivery if the option is a call, with the seller of the option bearing the opposite obligation in each instance, Joint Associations request clarification that the 4th and 5th factors are satisfied if:

- each party intends to satisfy its delivery obligations if the option is exercised, and

- the respective delivery obligations are consistent with the character of the embedded option as a put or a call**.**

IV. CONCLUSION

EEI appreciates the opportunity to submit comments and encourages the Commission to adopt the Proposed Rule without the notice, attestation and reordkeeping requirements. Utility special entities are sophisticated market participants and EEI members have regularly engaged in transactions with them. Recognizing and respecting the long-standing transactional relationships that have existed in the energy industry without imposing additional regulatory requirements or

[12] Post Conference Comments at 2-4.

adopting different rules for these transactions will help ensure that EEI members are able to continue to engage in these transactions going forward.

Please contact the undersigned if you have any questions on these comments.

Respectfully Submitted,

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