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July 2, 2014

VIA ELECTRONIC MAIL

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

Re: ***Exclusion of Utility Operations-Related Swaps with Utility Special Entities from De Minimis Threshold for Swaps with Special Entities, RIN 3038-AE19***

Dear Secretary Jurgens:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits these comments in response to the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") Proposed Rule, *Exclusion of Utility Operations-Related Swaps With Utility Special Entities*[1] *From De Minimis Threshold for Swaps With Special Entities* (the "**Proposed Rule**").[2] The Working Group

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[1] "Special entity" means:

(i) A Federal agency;

(ii) A State, State agency, city, county, municipality, other political subdivision of a State, or any instrumentality, department, or a corporation of or established by a State or political subdivision of a State;

(iii) Any employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974;

(iv) Any governmental plan, as defined in Section 3 of the Employee Retirement Income Security Act of 1974; or

(v) Any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986.

See Commission Regulation 23.401(c), 17 C.F.R. § 23.401(c) (2014).

[2] *See Exclusion of Utility Operations-Related Swaps With Utility Special Entities From De Minimis Threshold for Swaps With Special Entities*, Notice of Proposed Rulemaking, 79 Fed. Reg. 31,238 (Jun. 2, 2014), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2014-12469a.pdf

appreciates the Commission's Proposed Rule, which memorializes and codifies the regulatory relief granted to market participants engaged in swap dealing transactions with utility special entities[3] under two CFTC no-action letters.[4]

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

Set forth below, the Working Group provides its general comments and responses to specific questions provided in the Proposed Rule. The Working Group requests the Commission's consideration of these comments before it issues a final rule in this proceeding.

II. DISCUSSION.

A. General Comments in Support of the Commission's Proposed Rule.

The Working Group generally supports the Proposed Rule as it appropriately recognizes the distinct commercial needs and operations of utility special entities. More specifically, the Working Group believes that the regulation of swap dealing activity with utility special entities who use swaps to manage their exposure to commercial risks should not be subject to the $25 million *de minimis* threshold set forth in Commission Regulation 1.3(ggg)(4).[5] Rather, given the unique operations of utility special entities, swap dealing activity related to "utility operations-

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[3] 17 C.F.R. §1.3(ggg)(4)(B)(*2*) defines a "utility special entity" as a special entity that: "owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. § 796(19))."

[4] *See* Staff No-Action Relief: Revised Relief from the *De Minimis* Threshold for Certain Swaps with Utility Special Entities, Division of Swap Dealer and Intermediary Oversight, CFTC Letter No. 14-34 (Mar. 21, 2014); Staff No-Action Relief: Temporary Relief from the *De Minimis* Threshold for Certain Swaps with Special Entities, Division of Swap Dealer and Intermediary Oversight, CFTC Letter No. 12-18 (Oct. 12, 2012).

[5] In accordance with the Commodity Exchange Act ("**CEA**"), as amended by the Dodd-Frank Act, CFTC Regulation 1.3(ggg)(4) provides an exception from the "swap dealer" definition for a person engaged in a limited amount of swap dealing that, in the aggregate, does not exceed, during a twelve-month rolling period, either a gross notional amount of (i) a phased-in $8 billion, which automatically drops to $3 billion absent Commission action ("**General *De Minimis* Threshold**"), and (ii) $25 million with respect to swaps to which the counterparty is a special entity ("**Special Entity *De Minimis* Threshold**").

related swaps"[6] should be excluded from the Special Entity *De Minimis* Threshold, as set forth in the Proposed Rule.

As recognized by the Commission in the Proposed Rule, utility special entities have a unique functional role in energy commodity markets.[7] In particular, utility special entities have an obligation to provide continuous and reliable electric and natural gas service to the public that is crucial to public safety. Further, they depend on access to swaps markets to adequately manage their exposure to price risk related to their service obligations, but often, only physical energy market participants in a specific region or location are able to transact swaps with them, limiting the availability of potential counterparties. In this light, the Working Group believes that utility operations-related swaps with these entities should be treated and regulated differently than swap transactions with other types of special entities. The exclusion of utility operations-related swaps with utility special entities from the Special Entity *De Minimis* Threshold will allow utility special entities greater access to, and ease of transacting with, various counterparties, which ultimately will allow them to hedge more efficiently their physical exposure associated with their core businesses and regulatory obligations in providing energy to customers.

Accordingly, as a general matter, the Working Group recommends that the Commission adopt a final rule that would exclude utility operations-related swaps with utility special entities from the Special Entity *De Minimis* Threshold. The Working Group presents below some concerns with the specifics of the exclusion below.

B. Specific Responses to Questions Presented in the Proposed Rule.

Question 1. Will the Proposal enable utility special entities to adequately hedge their operational risks in a cost-effective manner by entering into utility operations-related swaps? If not, explain why, and indicate ways in which the Proposal could be modified in order to accomplish this goal.

Response. The Working Group generally believes the Proposed Rule will enable utility special entities to adequately hedge their operational risks in an efficient manner. *See* discussion in Section II.A., above.

Question 2. Are there factual errors or omissions in the Commission's understanding and analysis of the issues faced by utility special entities and the efforts to date to resolve those issues?

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[6] The Proposed Rule defines "utility operations-related swap" as a swap where (i) at least one counterparty is a utility special entity, (ii) the swap is being used to hedge or mitigate the utility special entity's commercial risk, (iii) the swap is related to an exempt commodity, and (iv) the swap is an electric energy or natural gas swap, or associated with the operations or compliance obligations of a utility special entity. *See* Proposed Rule at 31,242; proposed CFTC Regulation 1.3(ggg)(4)(i)(B)(*3*).

[7] *See* Proposed Rule at 31,241.

Response. The Working Group does not believe the Commission has a misunderstanding of the issues faced by utility special entities. *See* discussion in Section II.A., above.

Question 3. Is it appropriate to treat utility operations-related swaps with utility special entities differently than other swaps with special entities for purposes of determining whether a person is a swap dealer?

Response. The Working Group believes that it is appropriate to treat utility operations-related swaps with utility special entities differently than other swaps with special entities for purposes of determining whether a person is a swap dealer. *See* discussion in Section II.A., above.

Question 4. Does the definition of utility operations-related swap in proposed Regulation 1.3(ggg)(i)(4)(B)(*3*) adequately encompass the range of swap transactions with respect to which it is appropriate to, in effect, set a higher *de minimis* threshold in the context of persons dealing with utility special entities? If not, in what way(s) should the definition be expanded or narrowed and why? More specifically, should the scope of the swaps identified in Regulation 1.3(ggg)(i)(4)(B)(*3*)(*iv*) be expanded or narrowed? Are there swaps that would meet the requirements of Regulation 1.3(ggg)(i)(4)(B)(*3*)(*i*), (*ii*) and (*iii*), but not of Regulation 1.3(ggg)(i)(4)(B)(*3*)(*iv*) that should be included? Is Regulation 1.3(ggg)(i)(4)(B)(*3*)(*iv*) too restrictive or not restrictive enough?

Response. The Working Group believes the definition of "utility operations-related swap" adequately encompasses the range of utility supply commodities necessary to provide utility special entities the relief intended by the Proposed Rule. As such, the Working Group recommends that the Commission adopt the definition as proposed.

Question 5. One of the conditions to coming within the definition of the term ''utility operations-related swap'' is that the party to the swap that is a utility special entity is using the swap in the manner prescribed in Regulation 50.50(c)—*i.e.*, to hedge or mitigate commercial risk. What issues might there be in determining whether a swap constitutes hedging activity for purposes of complying with this proposed rule? Is reference to Regulation 50.50(c) for defining hedging activities appropriate? Are there alternative definitions that should be considered (*e.g.*, Regulation 1.3(ggg)(6)(iii))? Should the definitions for hedging activities in Regulation 50.50(c) and Regulation 1.3(ggg)(6)(iii) be harmonized? If so, how (*e.g.*, by following Regulation 50.50(c) or Regulation 1.3(ggg)(6)(iii) or some iteration of both) and why? Please provide any estimates of costs of compliance with any proposed alternative as compared to the cost of compliance with Regulation 50.50(c).

Response. Proposed CFTC Regulation 1.3(ggg)(4)(B)(*3*) requires a "utility operations-related swap" to meet certain conditions. One such condition as provided in proposed Regulation 1.3(ggg)(4)(B)(*3*)(*ii*) requires "[a] utility special entity [to be] using the swap in the manner described in § 50.50(c) of this chapter." The Working Group submits that this proposed regulation might be interpreted to mean that a utility operations-related swap must be used to

invoke an exception to the mandatory clearing requirement in order to qualify for the exclusion under proposed Regulation 1.3(ggg)(4)(B). As such, the Working Group recommends proposed CFTC Regulation 1.3(ggg)(4)(B)(*3*)(*ii*) be modified as follows:

"(*ii*) A utility special entity is using the swap ~~in the manner described~~ **to hedge or mitigate commercial risk as defined** in § 50.50(c) of this chapter."[8]

Additionally, the Working Group requests the CFTC to confirm that the exclusion under proposed CFTC Regulation 1.3(ggg)(4)(B) applies to a swap that unwinds an existing hedge. Market participants often hedge dynamically to optimize the value of underlying physical assets or portfolios, and may modify hedging structures related to a physical asset or position when the relevant pricing relationships applicable to the asset change. Dynamic hedging may involve leaving an asset or position unhedged when necessary to mitigate lost opportunity cost risk, which may require hedges to be established, unwound, and re-established on an iterative basis over time.[9] Importantly, in its final rule regarding Regulation 50.50(c), the CFTC stated that bona fide hedging does not require hedges, once entered into, to remain static, given entities may update their hedges periodically when pricing relationships or market factors applicable to the hedges change.[10]

Question 7. Should the definition of utility operations-related swap be limited to swaps in which both parties to the swap transact as part of the normal course of their physical energy businesses?

Response. The Working Group believes that the definition of "utility operations-related swap" should not be limited to swaps in which both parties to the swap transact as part of the normal course of their physical energy businesses. If the Commission modified the proposed definition to require this condition, the pool of eligible counterparties to a swap with a utility special entity will be unnecessarily limited and likely would result in less competitive pricing.

Question 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

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[8] The Working Group recommends the Commission to harmonize the definitions for hedging in Regulation 50.50(c) and Regulation 1.3(ggg)(6)(iii) by following Regulation 50.50(c), which more broadly defines hedging activity and appropriately reflects existing commercial practice.

[9] *See* Working Group of Commercial Energy Firms, *Comment Letter regarding End-User Exception to Mandatory Clearing of Swaps*, RIN 3038-AD10, at 12-13 (Feb. 22, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27866&SearchText. Note, in January 2012, the Working Group of Commercial Energy Firms reconstituted itself as The Commercial Energy Working Group.

[10] *See End-User Exception to the Clearing Requirement for Swaps*, Final Rule, 77 Fed. Reg. 42,560, n.69 (Jul. 19, 2012).

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?

Response. The Working Group recommends the CFTC maintain the General *De Minimis* Threshold at the current phase-in level of $8 billion gross notional and believes subjecting utility operations-related swaps with utility special entities to this level is appropriate. As a general matter, lowering the General *De Minimis* Threshold to $3 billion gross notional will push out nonfinancial companies from the business of offering their customers risk management products, decreasing choices for end-users and consolidating risk and swap activity in a smaller number of large financial institutions (and three non-bank swap dealers). As demonstrated with the Special Entity *De Minimis* Threshold, many commercial market participants were forced to stop all swap activity with utility special entities, hindering the utility special entities' abilities to hedge against operational risks and forcing them to transact mostly with banks. If the CFTC determined to lower the General *De Minimis* Threshold, it would undercut the effect of the Proposed Rule, which is intended to provide an adequate pool of potential counterparties for a utility special entity wishing to enter into a utility operations-related swap. A robust pool of potential counterparties to transact with utility special entities is essential in ensuring utility special entities may obtain competitive pricing for their hedging products, and, ultimately, helps ensure competitive and stable energy prices for consumers.

Question 9. Should the nature of the person entering into swaps with a utility special entity determine whether the person can rely on the exclusion for utility operations-related swaps under the Proposal (*e.g.*, by limiting the exclusion to persons who are not ''financial entities,'' as Staff Letter 12–18 limited relief to such persons)? If so, what characteristics or factors should be considered?

Response. As stated in its response to Question 7, the Working Group believes that any modification to the proposed exclusion should not unnecessarily limit the pool of eligible counterparties to a swap with a utility special entity. Doing so likely would have the unintended result of producing less competitive pricing. Accordingly, the Working Group recommends that the exclusion for utility operations-related swaps should not be conditioned upon entering into swaps with persons who are not "financial entities," especially given the ambiguity of the financial entity definition.

Question 10. Should the Commission specify the books and records a person must maintain to substantiate that the person may rely on the (proposed) exclusion for utility operations-related swaps?

Response. An additional requirement to keep books and records to substantiate a person's reliance on the proposed exclusion for utility operations-related swaps is unnecessary given market participants must keep "full, complete, and systematic records together with all pertinent data and memoranda" on all swap transactions under the CFTC's Part 45 recordkeeping regulations. Accordingly, the Working Group does not believe the Commission should specify the books and records a person must maintain to substantiate reliance on the proposed exclusion for utility operations-related swaps.

Question 11. Would the Proposal impact the Commission's ability to carry out its market oversight responsibilities with regard to the overall derivatives market? If so, how?

Response. The Working Group does not believe the Proposed Rule would impact the Commission's ability to carry out its market oversight responsibilities with regard to the overall derivatives market. The Commission has appropriate protections and safeguards in place to prevent any abuse of the proposed exclusion, such as access to all data for cleared and uncleared swap transactions under Part 45 of its regulations.

Question 12. To what extent, if any, would the Proposal reduce transparency with regard to utility operations-related swaps, counterparties to such transactions or the broader derivatives market?

Response. The Working Group does not believe the Proposed Rule would reduce transparency with regard to utility operations-related swaps, counterparties to such transactions, or the broader derivatives market. As stated above in its response to Question 11, the Commission has appropriate protections and safeguards in place to prevent the reduction of transparency and market oversight to the derivatives markets. The CFTC's Part 45 swap data repository ("**SDR**") reporting and recordkeeping requirements provide sufficient transparency to the swaps markets.

Question 13. Does the Proposal serve the public interest? In what ways? How could the Proposal be improved to better serve the public interest?

Response. The Working Group submits that the Proposed Rule indeed serves the public interest by increasing the availability of potential counterparties to a utility operations-related swap with a utility special entity, which likely will result in more competitive prices to consumers.[11] However, the Working Group requests the Commission to confirm that the definition of "utility special entity" includes governmental entities, such as, school districts, housing authorities, fire departments, water and waste management utilities, involved in large-scale competitive physical procurement of electric energy or natural gas. Providing the relief set forth in proposed CFTC Regulation 1.3(ggg)(4)(B) to these governmental entities would be in the public interest given these entities have a critical and continuous need for natural gas and electricity just as utility special entities do.

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[11] *See* discussion in Section II.A., above.

Governmental entities involved in large-scale competitive physical procurement of power and gas, such as the entities identified above, face unique, regional market structures wherein the universe of potential swap counterparties may be further limited to market participants active in a particular geographic region. So, as with utility special entities, the number of counterparties available to them may be greatly reduced.

To the extent governmental entities involved in large-scale competitive physical procurement of electric energy or natural gas are not included within the definition of "utility special entity," the Working Group requests the Commission to broaden the definition to apply to such entities. In doing so, the Commission will help ensure that large, sophisticated special entities that do not look like traditional utilities but are involved in physical energy markets can continue to effectively manage their risks.

Question 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?

Response. The Working Group recommends that the Commission decline to adopt as final any notice requirement in its final rule, as such requirement is unnecessary. The CFTC is able to monitor compliance with the swap dealer registration requirements and potential abuse of the proposed exclusion through swap data reported to SDRs pursuant to Part 45. These existing reporting requirements will allow the Commission to identify the counterparties transacting with utility special entities. Further, no notice requirement exists for parties transacting below the existing General *De Minimis* Threshold or Special Entity *De Minimis* Threshold and therefore should not be imposed upon counterparties transacting utility operations-related swaps with utility special entities under the Proposed Rule. The Commission should not adopt conditions that might unnecessarily burden and prevent potential counterparties from transacting such swaps. As stated above, limiting the availability of potential counterparties to utility special entities likely will result in less competitive pricing.

Question 16. Are there any special entities (or types of special entities) who come within the proposed definition of ''utility special entity'' (as set forth in proposed Regulation 1.3(ggg)(4)(i)(B)(*2*)), but are not likely to have expertise in utility operations related swaps? If yes, describe those entities. Should persons dealing in swaps with those entities be treated differently than persons dealing with other utility special entities under the Proposal?

Response. The Working Group does not believe there are any special entities that come within the proposed definition of "utility special entity" that likely do not have expertise in utility operations-related swaps. The Working Group submits that the entities falling within the proposed definition are involved in physical energy markets and therefore have adequate

expertise with respect to swaps that hedge these activities. Such entities are not obligated to enter into any swap if, in their business judgment, it is inappropriate.

Question 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?

Response. The Working Group submits that the "seven element interpretation" referenced above is not an appropriate construct to analyze whether a forward contract with volumetric optionality qualifies for the forward contract exclusion from the swap definition. As discussed in comments previously submitted to the Commission, the Working Group recommends that the Commission either eliminate this seven element interpretation or provide appropriate guidance that preserves the efficient operation of physical commodity markets.[12]

III. CONCLUSION.

The Working Group appreciates this opportunity to provide comments on the proposed exclusion of utility operations-related swaps with utility special entities from the Special Entity *De Minimis* Threshold and respectfully requests the Commission's consideration of these comments as it develops any final rulemaking in this proceeding.

If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ R. Michael Sweeney, Jr.
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Meghan R. Gruebner

Counsel to The Commercial Energy Working Group

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[12] *See* The Commercial Energy Working Group Letter to David A. Stawick, Secretary, Commodity Futures Trading Commission, in re: *Comments in Support of ConocoPhillips' Public Comments on the Commission's Interpretation Regarding Forwards with Embedded Volumetric Options; RIN No. 3038-AD46* (Oct. 12, 2012), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58888&SearchText; The Commercial Energy Working Group, Comments Regarding Forward Contracts with Embedded Volumetric Optionality in Response to the April 3, 2014, CFTC Staff Public Roundtable on Dodd-Frank End-User Issues (Apr. 17, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59826&SearchText.