

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D. C. 20426

OFFICE OF THE GENERAL COUNSEL

December 22, 2014

**VIA ELECTRONIC SUBMISSION**

Mr. Christopher J. Kirkpatrick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

**Re: Forward Contracts With Embedded Volumetric Optionality  
RIN 3235-AK65**

Dear Mr. Kirkpatrick:

On November 3, 2014, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission jointly issued the CFTC's proposed clarification of its interpretation regarding forward contracts with embedded volumetric optionality.<sup>1</sup> These comments on that proposed clarification are submitted by the staff of the Federal Energy Regulatory Commission (FERC).

In July 2012, the CFTC put forth and asked for comment on the interpretation regarding embedded volumetric optionality in its final rule further defining "swap" and related terms.<sup>2</sup> In response, FERC staff provided comments that focused on the seventh element of the CFTC's interpretation.<sup>3</sup> Under that element, a contract or transaction would fall within the forward contract exclusion, notwithstanding that it contains embedded volumetric optionality, if "[t]he exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors,[\*] or regulatory requirements,[\*] that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity.[\*]"<sup>4</sup> In its comments, FERC staff noted its concern that application of this seventh element to many conventional electricity and natural gas forward contracts may cause significant uncertainty as to their status as excluded forward contracts.

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<sup>1</sup> 79 Fed. Reg. 69,073 (Nov. 20, 2014).

<sup>2</sup> *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48,208 (August 13, 2012) (Product Definitions Rule).

<sup>3</sup> See FERC Staff Comments on Product Definitions Rule, filed Oct. 12, 2012.

<sup>4</sup> Product Definitions Rule at 48,238 (footnotes omitted).

The November 3, 2014 proposal would modify the seventh element of the initial interpretation to clarify that the embedded volumetric optionality must be primarily intended, at the time that the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity. Thus, the CFTC proposes to remove reference to the “exercise or non-exercise” of the embedded volumetric optionality, explaining that this language created problems during contract negotiations because certain parties felt pressure to specify the exact factors that could lead to the exercise or non-exercise of the volumetric optionality. By removing this language, the CFTC proposes to clarify that the focus of the seventh element is intent with respect to the embedded volumetric optionality at the time of contract initiation. The CFTC further would advise contracting parties that they may rely on counterparty representations with respect to the intended purpose for embedding volumetric optionality in the contract, provided that they are unaware, and should not reasonably have been aware, of facts indicating a contrary purpose.

The November 3, 2014 proposal also clarifies that the phrase “physical factors” should be construed broadly to include any fact or circumstance that could reasonably influence the parties’ supply of or demand for the nonfinancial commodity under the contract, including environmental factors, relevant “operational considerations,” and broader social forces, such as changes in demographics or geopolitics. Under the proposal, electric demand response agreements also would be characterized as the product of a regulatory requirement within the meaning of the seventh element.

FERC staff welcomes the CFTC’s proposed clarification. FERC staff’s view is that contracts widely used in physical energy markets – such as full requirements contracts, capacity contracts, transmission services agreements, tolling agreements, peaking supply agreements, and other similar types of agreements – more clearly fall within the interpretation under the proposed clarification. We appreciate the CFTC’s willingness to make this clarification to provide greater regulatory certainty for these agreements that are important for well-functioning energy markets and reliable and affordable energy supplies.

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We note that the CFTC has acknowledged that the interpretation is not intended to provide relief for all forms of embedded volumetric optionality, and that there are likely to remain concerns about the treatment of embedded volumetric optionality within forward contracts. We agree that more work is warranted to address such concerns, particularly with respect to the jurisdictional status of transactions in physical energy markets. We encourage the CFTC to further refine its interpretation to ensure that these transactions are treated as excluded forward contracts.

Sincerely,

A handwritten signature in black ink, appearing to read "David L. Morenoff". The signature is fluid and cursive, with the first name "David" and last name "Morenoff" clearly legible.

David L. Morenoff

General Counsel

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cc: Cheryl A. LaFleur, Chairman  
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