600 North 18th Street / GS 8259
Birmingham, AL 35203

June 22, 2015

***Via Electronic Submission***
Chris Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

**Re: Comments on Notice of Proposed Rulemaking on Trade Options (RIN 3038-AE26)**

Dear Mr. Kirkpatrick:

Southern Company Services, Inc., acting on behalf of and as agent for Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company and Southern Power Company (collectively, "Southern"), hereby submits Southern's comments in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") notice of proposed rulemaking on trade options, published on May 7, 2015, RIN 3038-AE26 ("Trade Options Proposal" or "NOPR"). As a member of the Energy and Environmental Markets Advisory Committee ("EEMAC")[1], Southern has been active in the Commission's efforts to refine and clarify the Dodd-Frank rules that are applicable to the energy industry. Southern believes that the changes set forth in the Commission's Trade Options Proposal are well-needed improvements that further the Commission's stated purpose of reducing the regulatory burden for trade options. As noted herein, however, there are less burdensome alternatives that can be implemented by the Commission that will satisfy Congress's intent behind the Dodd-Frank Act.

## I. Introduction.

Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company are retail electric service providers, each regulated by the public service commission ("PSC") in its respective state, as well as by the Federal Energy Regulatory Commission ("FERC"). Southern Power Company operates a competitive generation business (also regulated by FERC) that helps meet the needs of municipalities, electric cooperatives and investor-owned utilities. Southern buys and sells in the wholesale electric power markets,

[1] Mr. Paul Hughes serves as an associate member on the EEMAC on behalf of Southern.

pursuant to market-based rate authority granted by FERC. This authority requires Southern to transact in energy at "just and reasonable" prices regulated under the Federal Power Act. Southern seeks to provide excellent, reliable service to its customers at stable prices, and the comments made herein are aimed at allowing Southern to continue achieving this goal after the Commission adopts its final rule on trade options.

Correspondence with respect to these comments should be directed to the following:

Mr. Paul Hughes
Manager, Risk Control
Southern Company Services, Inc.
600 North 18th Street / GS 8259
Birmingham, AL 35203
email: phughes@southernco.com
Phone: (205) 257-3035
Fax: (205) 257-5858

K.C. Hairston, Esq.
Balch & Bingham LLP
1710 6th Ave. North
Birmingham, AL 35223
Email: kchairston@balch.com
Phone: (205) 226-3435
Fax: (205) 488-5862

## II. Comments on the Proposed Rule.

Southern greatly appreciates the Commission's efforts to reduce the regulatory burden for trade options. Southern believes that its participation on EEMAC, as a representative for the electric industry, provides Southern with an important role in assisting the Commission in this regard. Southern respectfully offers the following comments on how it believes the Commission could further reduce the regulatory burdens for trade options, while still maintaining the requisite oversight.

### 1. Proposed Elimination of the Form TO and Creation of a New Reporting Requirement.

As noted by the Commission in the Trade Option Proposal, "[c]ommenters have generally expressed the opinion that **the reporting requirements in § 32.3(b) are overly burdensome** for Non-SD/MSPs" and that "these costs have discouraged commercial end users from entering into trade options to meet their commercial and risk management needs, thereby reducing liquidity and raising prices."[2] Southern has witnessed first-hand the negative impact that the trade option regulations have had on liquidity and therefore agrees with the Commission's proposal to eliminate the Form TO.

By eliminating the Form TO, market participants will no longer have to track the amount of exercised "optionality" in their trade options for Dodd-Frank reporting purposes. However, because the Commission is proposing a new filing requirement for when companies exceed or are expected to exceed $1 billion in trade options, companies will still be required to classify,

[2] Trade Option Proposal at 26202 (emphasis added).

value and track their trade options for reporting purposes.[3] As a result, the Commission's proposal does not fully address the concerns described in the NOPR as follows:

> With respect to Form TO reporting, commenters have argued that **it is costly and burdensome for Non-SD/MSPs, particularly for small end users, to track, calculate and assemble the requisite data**. Commenters have explained that the costs involved with preparing the Form TO filing may be significant.

*See* Trade Option Proposal at 26203 (emphasis added).

To better address these concerns, Southern respectfully requests that the Commission allow market participants to either: (i) submit the notice to the Commission within 30 days after entering into trade options that have an aggregate notional value in excess of $1 billion in any calendar year (which is part of the Commission's current proposal) **or** (ii) submit a notice annually that states the market participant reasonably expects to enter into trade options in the current calendar year. Under this 2-part proposal, companies that want to classify, value and track their trade options for reporting purposes can forego any notice requirement as long as they do not cross the $1 billion threshold. Alternatively, companies that want to forgo classifying and tracking trade options for reporting purposes can submit a notice annually to the Commission that they plan to enter into trade options in the current calendar year. This 2-part proposal, while offering a method of compliance that does not require software or tracking systems, will continue to give the Commission insight into which market participants are transacting trade options.

Accordingly, this approach will accomplish the same intended purpose noted in the NOPR for the Commission's proposal: "the proposed Notice Requirement would help guide the Commission's efforts to collect additional information through its authority to obtain copies of books or records to be kept pursuant to the CEA and the Commission's regulations should market circumstances dictate."[4] Therefore, Southern respectfully recommends this 2-part proposal as a way to further reduce the industry's compliance burden for trade options.

2. No-Action Relief for Previously Submitted Form TOs.

As the Commission is aware, market participants were required to submit Form TOs covering their trade options for 2013 (due March 1, 2014) and 2014 (due March 1, 2015). Market participants were required to submit the prior Form TOs under an interim final rule and while the definitional rulemakings were still under development. To provide additional regulatory certainty, Southern respectfully requests that the Commission issue a No-Action letter relating to compliance with the first two Form TOs so long as a company's compliance determinations were made in good faith.

[3] Trade Option Proposal at 26203-26204.
[4] Trade Option Proposal at 26204.

3. Proposed Elimination of Part 45 Reporting Requirements for Trade Options.

Southern supports the Commission's proposal to eliminate the part 45 reporting requirements for trade options. Many market participants currently have to rely on No-Action relief to avoid implementing costly part 45 reporting systems. As described in the NOPR, "commenters have noted that Non-SD/MSPs may be required to comply with part 45 solely on the basis of the 'unusual circumstance' of having had to report a single historical or inter-affiliate swap during the same twelve-month period."[5] Southern shares this concern and has experienced the regulatory burdens of complying with the regulations and No-Action relief. The Commission's proposal to eliminate part 45 reporting of trade options for Non-SD/MSPs will offer a more permanent solution than the No-Action relief being utilized today.

4. Record Retention for Trade Options.

Southern appreciates the Commission's efforts to reduce and clarify the part 45 record retention requirements for trade options. As proposed by the Commission in the NOPR, Non-SD/MSPs would only be required to comply with section 45.2 and would not be required to identify their trade options in all recordkeeping by means of either a Unique Swap Identifier or a Unique Product Identifier (as required by §§ 45.5 and 45.7). According to the Commission, "**[t]hese amendments are intended to reduce recordkeeping burdens for Non-SD/MSP** trade option counterparties…."[6] Section 45.2(b), however, is a very broad, vague retention requirement that will result in a tremendous burden on Non-SD/MSPs. In this regard, section 45.2(b) states:

> All non-SD/MSP counterparties subject to the jurisdiction of the Commission **shall keep full, complete, and systematic records, together with all pertinent data and memoranda**, with respect to each swap in which they are a counterparty, including, without limitation, all records demonstrating that they are entitled, with respect to any swap, to elect the clearing requirement exception in CEA section 2(h)(7).

Pursuant to the requirements of section 45.2(b), Non-SD/MSPs will need to undergo a significant effort to ensure "full, complete, and systematic records, together will all pertinent data and memoranda" are maintained for every trade option. Although the Commission's proposal will reduce the recordkeeping burden for Non-SD/MSPs, Southern respectfully recommends that the Commission provide further relief by permitting Non-SD/MSPs to maintain the documents that they would otherwise already maintain in their ordinary course of business. For example, many Non-SD/MSPs are already maintaining certain documentation for these same agreements pursuant to the rules and regulations of the Federal Energy Regulatory Commission and other

[5] Trade Option Proposal at 26203.
[6] Trade Option Proposal at 26204 (emphasis added).

regulators, and have implemented costly customized systems to accomplish these tasks. A similar relief was provided by the Commission for pre-enactment swaps where the Commission stated, "[t]he final rule does not require counterparties to create or retain records of information regarding such [pre-enactment] swaps that was not in their possession as of those dates, or to alter how the records are organized or stored."[7] Moreover, Southern believes that the industry benefited from the enumerated approach taken by the Commission wherein certain documents relating to pre-enactment swaps were identified for retention such as: (i) primary economic terms data; (ii) confirmations; (iii) master agreements; and (iv) credit support agreements.[8] Southern believes that the enumerated approach, rather than the "keep almost everything" approach is appropriate and a more meaningful reduction of the compliance burden for trade options.

In addition to the part 45 record retention clarifications requested herein, Southern respectfully requests that the Commission clarify what, if any, additional requirements from rule 1.31 apply to trade options.

5. Applicability of Position Limits to Trade Options.

Southern agrees with Commissioner Giancarlo's support of the CFTC's proposed removal of the reference to part 151 (position limits) in § 32.3(c)(2). In addition, Southern joins Commissioner Giancarlo in his concern that the simple removal of the reference to part 151 does not go far enough. As noted by Commissioner Giancarlo, "position limits for trade options are not 'necessary to diminish, eliminate, or prevent' excessive speculation. The final trade options rule should make clear that trade options are exempt from position limits."[9] Southern concurs with the reasoning in Commissioner Giancarlo's statement and with his conclusion that the Commission has the authority to exempt trade options from position limits under § 4a(a)(7) of the CEA.[10]

In addition to the reasons included in Commissioner Giancarlo's statement, Southern believes that the exclusion of trade options from position limits should be covered in the trade options final rule because it will make the industry's feedback in the position limits rulemaking more targeted and meaningful. For example, the industry is currently proposing certain changes to the proposed position limits rule that might not be necessary if the proposed position limits rule excludes trade options. However, if the Commission elects not to clarify the application of position limits to trade options until the position limits final rule, then all the opportunities for feedback (and the dialogue between the CFTC and the industry) during the position limits rulemaking will not have the benefit of this clarification. Moreover, the industry's ability to adequately provide feedback to the Commission on the applicable burdens and costs of implementing position limits will be significantly impacted, which will serve as an impediment

[7] *See* Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35200, 35218 (June 12, 2012).
[8] *Id*. at 35227.
[9] *Notice of Proposed Rulemaking*, 80 Fed. Reg. 26200, 26210 (May 7, 2015)(citations excluded).
[10] *Id*.

to the Commission's and United States Office of Management and Budget's ("OMB") ability to conduct the required cost-benefit analysis and compliance with the Paperwork Reduction Act.

As was the case for the CFTC's swap definition rulemaking, many of the key Dodd-Frank rules were issued prior to defining the term "swap."[11] In this regard, it was difficult for impacted parties to provide meaningful comments to the Commission in these rulemakings prior to the Commission providing the swap definition because it was unclear what issues needed to be addressed. This same timing issue is reoccurring between the proposed position limits rule and the trade options rule. Accordingly, as noted by Commissioner Giancarlo, the Commission should clarify the applicability of position limits in the trade options final rule so that the position limits rulemaking can occur in a more targeted and meaningful manner.

6. Commissioner Bowen's Recommendations.

Southern greatly appreciates the efforts recently taken by Commissioner Bowen to reduce the burdens on commercial entities seeking to hedge risks associated with their physical businesses and we are encouraged by Commissioner Bowen's statements related to the importance of "legal certainty" on these issues.[12] Southern agrees with Commissioner Bowen's description of the manufacturing, agriculture, and energy sectors' contracts:

> In the manufacturing, agriculture and energy sectors, a wide variety of physically delivered instruments are used to secure companies' commercial needs for a physical commodity. These instruments, although they call for physical delivery, often contain some element of optionality that can lead to questions about their appropriate regulatory treatment. **These contracts, particularly in the energy sector, are all commonly referred to as physical contracts, and they, according to what I have been told, often receive similar treatment from both a business operations and an accounting standpoint** within the entities that use them. Further, these physical contracts are often handled and accounted for separately from other derivatives, such as futures contracts or cash-settled swaps, according to market participants.

*See* Trade Option Proposal at 26209 (emphasis added). Consistent with Commissioner Bowen's description, Southern believes the industry treats trade options as forward contracts for "business operations" purposes and from an "accounting standpoint."[13] As noted by Commissioner Bowen:

---

[11] For example, the rules relating to the end-user exception, swap dealer definition, commodity options, swap recordkeeping and swap reporting were issued before the CFTC issued the swap definition.

[12] Trade Option Proposal at 26209.

[13] In the comments submitted by Southern on December 22, 2014, in response to the CFTC's Proposed Interpretation Regarding Forward Contracts with Embedded Volumetric Optionality, Southern included a detailed description of how trade options are classified for accounting purposes under Accounting Standard Codification 815 (formerly referred to as "FAS 133") and described the complications and burdens of having a CFTC regulation that

> Treating some portion of these physical contracts as swaps simply because they may contain some characteristics of commodity options can lead to significant costs and difficulties. For instance, companies may have to reconfigure their business systems to parse transactions where there was, before Dodd Frank, no need to undertake such a reconfiguration.

*See* Trade Option Proposal at 26209. Southern concurs with Commissioner Bowen's informed conclusion that, "companies may have to reconfigure their business systems to parse transactions" that are trade options, which will result in significant cost to end-users. However, as noted herein, and in Southern's prior comments, Southern believes that the most effective and least burdensome manner to provide the clarifications sought by Commissioner Bowen is at the swap definition level, rather than individually across rulemakings at the requirement level.[14]

To the extent the Commission or Congress[15] elect not to provide this necessary legal certainty at the swap definition level, and physically delivered forward contracts that contain non-severable volumetric variability are somehow (either intentionally or unintentionally) subject to the trade option requirements, then Southern concurs with the addition of Commissioner Bowen's proposed 3-part test that would exclude from the trade options rule such contracts so long as they:

> *(1) Are not severable nor separately marketable from the forward contract component of overall instrument,*
>
> *(2) are related to and entered into concurrently with the forward contract component of overall instrument, and*
>
> *(3) for which the physical commodity underlying the trade option component is the same as that underlying the forward contract component of the overall instrument.*

---

classifies an agreement as a swap, that is not considered a derivative under the SEC endorsed accounting standards. Southern respectfully encourages the Commission to review those comments as part of its deliberation and consideration in this rulemaking.

[14] As noted by Commissioner Giancarlo in his Statement on the Proposed Interpretation on Forward Contracts with Embedded Volumetric Optionality, "a change to the underlying product definition would be strongly preferred." *See* Opening Statement of Commissioner J. Christopher Giancarlo, Open Meeting on Proposed Rule on Residual Interest Deadline for Futures Commission Merchants, Proposed Rule on Records of Commodity Interest and Related Cash or Forward Transactions, and Proposed Interpretation on Forward Contracts with Embedded Volumetric Optionality (November 3, 2014).

[15] *See* Commodity End-User Relief Act, H.R. 2289, 114th Cong. (2015). H.R. 2289 recently passed the House on June 9, 2015 and exempts the following from the swap definition: "(ii) any purchase or sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled, including any stand-alone or embedded option for which exercise results in a physical delivery obligation."

This test is similar to the 3-part test recommended by the Edison Electric Institute and the Electric Power Supply Association in 2012 during the swap definition rulemaking, which also focused on the severability of the embedded optionality from the contract.[16] Southern strongly agrees that if these contracts are not otherwise excluded at the swap definition level, then they should be excluded in this rulemaking for trade options. Southern believes subjecting these types of physical delivery agreements to the trade option requirements ***is not the outcome intended by the Commission or Congress***.

With regards to the 4-part test outlined in Commissioner Bowen's Concurring Statement, Southern believes that the addition of this test in the trade option final rule ***is unnecessary and will result in additional regulatory uncertainty***. As noted by Commissioner Bowen, to pass this 4-part test, contracts that are for a specified portion of an entity's physical need (for example, peaking supply contracts) would have to satisfy certain criteria such as:

- Be a "sole source" contract (*these contracts are generally already excluded at the swap definition level*[17]);
- The payment must be in nature of a reservation charge (*which would be a new requirement for peaking contracts and therefore could result in different outcomes than the other test(s) currently being used for peaking contracts*);
- The payment must be at the market price at the time of delivery (*which would be a new requirement for peaking contracts and therefore could result in different outcomes than the other test(s) currently being used for peaking contracts*); and
- The contract is required by regulation (*these contracts are generally already excluded at the swap definition level*[18]).

Based on the foregoing, although Southern greatly appreciates any additional clarity offered by the Commission, Southern believes that this 4-part test will result in less clarity. Therefore, Southern recommends that the Commission not adopt the 4-part test.

---

[16] *See* EEI and EPSA Comments on Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (RIN 3235-AK65)(October 12, 2012)("The Commission should adopt a single three-factor test for contracts with all types of embedded optionality rather than creating a separate seven-factor test for contracts with volumetric optionality as discussed below.").

[17] "Accordingly, full requirements contracts [] appear not to contain embedded volumetric options." *See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208, 48239 (Aug. 13, 2012).

[18] "The embedded volumetric optionality must [] be primarily intended as a means of securing a supply source in the face of uncertainty (arising from physical factors or regulatory requirements, such as an obligation to ensure system reliability)…." *Id*.

## III. Conclusion.

Southern appreciates the opportunity to provide the foregoing comments and information to the Commission. Southern joins the Commission in its goal of reducing burdens to business while strengthening protections for the public. Please contact us as indicated above if you would like to discuss these comments.

Yours truly,

Southern Company Services, Inc.

By: /s/ Paul Hughes
Title: Manager, Risk Control