

# Cogen Technologies Linden Venture, L.P. Linden Cogeneration Plant

May 9, 2016

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

**Re: *Certain Natural Gas and Electric Power Contracts; Proposed Guidance (RIN 3235-AL93)***

Cogen Technologies Linden Venture, L.P. (“Linden”) is pleased to respond to the request for comment by the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) on its proposed guidance relating to certain natural gas and electric power contracts (the “Proposed Guidance”).<sup>1</sup> Linden, an exempt wholesale generator selling electric power at market-based rates under the jurisdiction of the Federal Energy Regulatory Commission (“FERC”), owns and operates a combined cycle natural gas-fired cogeneration facility, located in Linden, New Jersey.

The electricity produced from Linden’s facilities is sold, under a power purchase agreement, to Consolidated Edison Company, which then uses the power to serve the electricity needs of consumers in New York City. Steam from Linden’s operation is sold, also under a contract, to the co-located Bayway Refinery, the largest refinery on the East Coast, for its industrial processes. In both cases, performance by Linden’s cogeneration plant is essential, especially during times of extreme weather.

Linden filed a comment letter to the Commission on December 22, 2014<sup>2</sup> on the Commission’s proposed interpretation relating to forward contracts with embedded volumetric optionality<sup>3</sup> and another comment letter to the Commission on June 22, 2015<sup>4</sup> on the Commission’s proposed rule relating to trade options,<sup>5</sup> in which we discussed why, among other things, the peaking supply contracts that Linden enters into to be assured of adequate natural gas supply when its primary supply source has curtailed delivery pursuant to regulatory requirements to prioritize heating customers, are not swaps or commodity options. Additionally, Linden

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<sup>1</sup> See Proposed Guidance, Certain Natural Gas and Electric Power Contracts, 81 Fed. Reg. 20583 (Apr. 8, 2016).

<sup>2</sup> See Comment Letter from Cogen Technologies Linden Venture L.P., Comment No. 60092 (Dec. 22, 2014), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60092&SearchText=>.

<sup>3</sup> See Proposed Interpretation, Forward Contracts With Embedded Volumetric Optionality, 79 Fed. Reg. 69,073 (Nov. 20, 2014).

<sup>4</sup> See Comment Letter from Cogen Technologies Linden Venture L.P., Comment No. 60441 (June 22, 2015), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60441&SearchText=>.

<sup>5</sup> See Proposed Rule, Trade Options, 80 Fed. Reg. 26200 (May 7, 2015).

further expressed its concerns on this issue and the need for clarification as a panelist at the Commission's Energy and Environmental Markets Advisory Committee meeting on July 29, 2015.<sup>6</sup>

We are very appreciative that the Commission has considered our comments in issuing this Proposed Guidance and we are pleased that the Proposed Guidance recognizes that there is a useful distinction between swaps and customary commercial arrangements such as the natural gas peaking supply contracts which Linden uses to assure adequate backup supply of natural gas. We urge the Commission to promptly adopt the Proposed Guidance as final to provide necessary clarity in this area; however, we would propose the following clarifications in adopting such final guidance.

## **I. Factual Clarifications**

### *Use of the term "electric utilities"*

We do not believe that the term "electric utilities" as defined in the Federal Energy Regulatory Commission's ("FERC") Glossary comprehensively covers all entities which are most likely to utilize these contracts. The FERC Glossary appears to be a non-technical and non-statutory compilation for lay users of FERC's website. We note that the term "electric utility" is defined differently under the Federal Power Act ("FPA") as "a person or Federal or State agency ... that sells electric energy."<sup>7</sup> We suggest replacing the definition set forth in the Proposed Guidance that makes reference to the FERC Glossary with the FPA definition because the latter definition includes generation companies, like Linden, as well as persons which are primarily regulated by state entities, such as utilities in Texas, Hawaii and Alaska. In addition, the FPA definition does not include the phrase "for use for the public" which might be viewed to limit coverage to retail power suppliers, such as the "load serving entities" described in Section A.1. of the Proposed Guidance.<sup>8</sup> Linden, by contrast, is regulated by FERC, but sells electric energy at wholesale, defined in the FPA as "a sale of electric energy to any person for resale."<sup>9</sup> Although Linden is an enterprise "engaged in the production ... of electricity," it does not fall into one of the enumerated categories in the balance of the Glossary definition.

### *Clarification relating to delivery of alternative supply*

We would suggest the Commission clarify that the alternative supplier's natural gas may be used if the electric utility's local distribution company ("LDC") curtails either natural gas supply availability or transportation availability.<sup>10</sup> As indicated in our comments, it is the case that Linden's LDC is required to prioritize its retail customers in providing the natural gas

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<sup>6</sup> See Agenda, CFTC Energy and Environmental Markets Advisory Committee (July 29, 2015), *available at* [http://www.cftc.gov/About/CFTCCcommittees/EnergyEnvironmentalMarketsAdvisory/eemac\\_072915agenda](http://www.cftc.gov/About/CFTCCcommittees/EnergyEnvironmentalMarketsAdvisory/eemac_072915agenda).

<sup>7</sup> 16 U.S.C. 796(22).

<sup>8</sup> 81 Fed. Reg. at 20584.

<sup>9</sup> 16 U.S.C. 824(d).

<sup>10</sup> In Linden's case, it is the commodity availability that is curtailed, not its distribution.

physical commodity as well as its delivery. In Linden’s case, when the alternative supply is made available to the LDC under Linden’s peaking supply contract, the LDC then delivers the alternative supply to Linden. To effectuate this clarification, we would suggest the following changes to the second sentence of Section A.2.:

The CFTC understands a peaking supply contract in this context to be a contract that enables an electric utility to purchase natural gas from another natural gas provider on those days when its local natural gas distribution companies (“LDCs”) curtail ~~its~~ the natural gas supply availability or transportation availability service.

Additionally, we would suggest the remaining references to interrupting “natural gas transportation service” be clarified to refer to “natural gas supply availability or transportation availability.”

## **II. Clarification Around Proposed Guidance’s Interaction with the CFTC’s Interpretation Regarding Forward Contracts With Embedded Volumetric Optionality**

The CFTC’s Final Product Definitions Rule,<sup>11</sup> as clarified by the CFTC’s Final Interpretation regarding forward contracts with embedded volumetric optionality,<sup>12</sup> provides a test to determine whether an agreement with embedded volumetric optionality would be considered a forward contract and not a “swap.” The second element of the Commission’s seven-part test for qualifying forward contracts with embedded volumetric optionality may be viewed to exclude those contracts where there is an option to take no delivery at all, creating some uncertainty. We appreciate that the Commission has recognized in the Proposed Guidance that the factors to determine whether end-user commercial arrangements for backup supply of a commodity are swaps should be distinguished from a determination under the seven-part test regarding forward contracts with embedded volumetric optionality and accordingly should not be characterized as “swaps.” Accordingly, we do not believe it is necessary for the Commission to address aspects of the seven-part test for forward contracts with embedded volumetric optionality in its final guidance.

Notwithstanding this distinction, because the Proposed Guidance covers commercial arrangements for backup supply of a commodity, it is possible that no physical delivery of the commodity will occur if there is sufficient primary supply of that commodity. Given the uncertainty around the second element of the test for qualifying forward contracts with embedded volumetric optionality and to foreclose any concern to end users, the CFTC should include an explicit statement in the final guidance that the possibility that zero delivery will occur under a commercial arrangement (e.g., a peaking natural gas contract) will not disqualify

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<sup>11</sup> See Final Rule, Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping. 77 Fed. Reg. 48207, 48238-42 (Aug. 13, 2012).

<sup>12</sup> See Final Interpretation, Forward Contracts With Embedded Volumetric Optionality, 80 Fed. Reg. 28239 (May 18, 2015).

such agreement from relying on the such final guidance. Such clarification will help to alleviate concerns regarding the application of the guidance to such commercial arrangements.

### **III. Clarification Regarding “Hedging”**

The Commission explicitly notes in the Proposed Guidance that the contracts are entered into “to assure availability of a commodity, not to hedge against risks arising from a future change in price for the commodity or to serve a speculative or investment purpose.”<sup>13</sup> However, the Proposed Guidance also notes that these contracts are important to “maintain reliable supplies” which could potentially be viewed as a “hedge” of sorts.<sup>14</sup> We would appreciate if the Commission could provide clarification that a party’s intent to “hedge” the risk that it will not have availability of a commodity when needed, as described in the Proposed Guidance and in our comments, is not tantamount to a speculative or investment intent or to hedge a future price risk.

### **IV. Responses to Questions**

*Are there natural gas and electric power contracts that would not qualify as trade options within the scope of CFTC regulation 32.3 but which would be covered by the proposed guidance? If so, should the proposed guidance be limited so that it encompasses only contracts that do qualify as trade options? Why or why not?*

We believe the Proposed Guidance is structured appropriately in excluding from coverage as trade options, those agreements entered into in the ordinary course of a commercial party’s business to assure it has adequate backup supply of a physical commodity, but which is not speculating on or hedging against the price of that commodity at a future time. That is, if the agreement qualifies as a commercial agreement under the Proposed Guidance it would not be a “swap” and therefore it would not be relevant, nor should it be relevant, whether such contract would qualify as an exempt class of “swaps” such as “trade options.” Accordingly, we do not view the interaction between contracts that qualify under the Proposed Guidance and contracts that qualify as “trade options” to be related. Further, because the agreements are, by their nature, backup supply assurance to meet regulatory requirements and other commercial needs, these agreements may result in zero delivery.

*Does the proposed guidance provide sufficient clarity on whether the specific types of natural gas and electric power contracts in question should or should not be considered to be swaps? If not, how should the guidance be revised to provide more clarity?*

With our suggested changes described above, we believe the Proposed Guidance provides sufficient clarity to cover the agreements which were the subject of Linden’s comments. However, the Commission may wish to describe other similar arrangements which could

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<sup>13</sup> 81 Fed. Reg. at 20586.

<sup>14</sup> 81 Fed. Reg. at 20585.

be included or referenced in the final guidance to may make the guidance as useful as possible for end users.

*Are there other facts and circumstances that the CFTC should consider in determining whether the contracts described in Part II.A. are swaps? If so, what are these factors and how should they be considered?*

We believe that the enumerated facts and circumstances discussed in the Proposed Guidance – specifically, as is the case with Linden’s peaking supply contracts, that (i) the arrangement is made to meet an independent business purpose, including regulatory and/or commercial requirements, to better assure the physical availability of a commodity when it is required; (ii) the arrangement is not traded on an organized market or over-the-counter; (iii) the arrangement is for purposes other than for speculative, hedging, or investment purposes; and (iv) the payment obligation to reserve supply is not severable from the arrangement (which we understand to mean that the option is not separately priced or marketed) – are appropriate to provide guidance to distinguish commercial arrangements from trade options. As we noted above, we believe that clarification is appropriate for some of the facts and circumstances set forth in the Proposed Guidance.

*Are there public interest considerations regarding the natural gas and electric power contracts in question that should be reflected in the proposed guidance? If so, why and how?*

We appreciate that the Commission has considered that long term practices prevail in the energy industry reflecting the federal and state public policy goal of assuring reliable electric power at just and reasonable rates. Electricity is a commodity which cannot now be stored and therefore load serving entities and their regulators have created unique business models to enable instantaneous balancing of electric supply and demand. These practices put great emphasis on conservative management and reserve supply to make sure that electricity can be generated in emergency conditions. Both products mentioned in the Proposed Guidance serve these purposes. The Commission’s careful consideration of the intention of end-user participants in the energy industry to meet these public policy requirements will be very helpful in providing continuity of existing business practices and certainty that the public policy goals can be accomplished.

Further, it is unclear what other future impacts the categorization of these commercial agreements in the same manner as financial transactions may have on end users in other regulatory contexts and rule sets.

*Does the proposed guidance provide sufficient clarity that it does not supersede or modify the CFTC OGC FAQ referenced in footnote 34? Is there any potential overlap between the proposed guidance and the CFTC OGC FAQ that should be further clarified? If so, what elements of the proposed guidance should be clarified to indicate that the proposed guidance does not supersede or modify the CFTC OGC FAQ?*

As discussed above, we would appreciate if the Commission could provide additional guidance that such commercial arrangements may result in zero delivery is explicitly contemplated in the Proposed Guidance.


## V. Conclusion

We thank the CFTC for addressing our comments and for providing the very important and thoughtful clarifications set forth in the Proposed Guidance and for the opportunity to provide comments. These clarifications will directly benefit and help to protect end users of derivatives. Accordingly, we urge the Commission to quickly finalize the Proposed Guidance as end users continue to face uncertainty around their supply contracts and final guidance would eliminate the uncertainties around how to categorize such contracts.

Sincerely,

COGEN TECHNOLOGIES LINDEN VENTURE, L.P.

By:

  
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