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VIA ELECTRONIC SUBMISSION

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

Re: Proposed Guidance with Respect to Certain Natural Gas and Electric Power Contracts

Dear Mr. Kirkpatrick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the “**Working Group**”), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the request for public comment on the Proposed Guidance, *Certain Natural Gas and Electric Power Contracts* (the “**Proposed Guidance**”) jointly issued by the Commodity Futures Trading Commission (“**CFTC**” or “**Commission**”) and the Securities and Exchange Commission.¹ The Working Group welcomes the CFTC’s ongoing efforts to clarify the treatment of physical commodity commercial transactions.

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.

¹ See Proposed Guidance, *Certain Natural Gas and Electric Power Contracts*, 81 Fed. Reg. 20,583 (Apr. 8, 2016), available at <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-08076a.pdf>.

II. COMMENTS OF THE WORKING GROUP.

A. The CFTC Uses the Proper Analysis to Correctly Conclude That the Specific Transactions Discussed in the Proposed Guidance Are Not Swaps.

Under the Proposed Guidance, two specific types of physical energy transactions – “capacity contracts”² and “peaking supply contracts”³ – would be excluded from the definition of “swap” because they are “entered into ‘[b]y commercial...entities as principals (or by their agents) to serve an independent commercial, business...purpose...[o]ther than for speculative, hedging, or investment purposes.’”⁴ In short, capacity contracts and peaking supply contracts would not be swaps because, consistent with other commercial contracts excluded from the definition of “swap,” they:

- do not contain payment obligations, whether or not contingent, that are severable from the transaction;
- are not traded on an organized market or over-the-counter; and
- are entered into:
 - by commercial entities to serve an independent commercial, business purpose, and
 - for purposes other than speculating, hedging, or investing (the “**Commercial Contract Analytical Framework**”).⁵

In this circumstance, the Commission was correct in its use of the Commercial Contract Analytical Framework as well as in its conclusion. Capacity contracts and peaking supply contracts are bilaterally negotiated, commercial agreements that are entered into to address real

² The Proposed Guidance describes a “capacity contract” as a contract “used in situations where regulatory requirements from a state public utility commission (“PUC”) obligate load serving entities (“LSEs”) and load serving electric utilities in that state to purchase ‘capacity’...from suppliers to secure grid management and on-demand deliverability of power to consumers.... A LSE...will be recognized by the PUC and the Federal Energy Regulatory Commission as having purchased capacity and, therefore, having satisfied that portion of its obligation to purchase the ability to supply electricity when and as needed.... In each of these instances...the purchaser...will be considered to have purchased the supplier’s capacity to generate...electric power, regardless of whether the electricity underlying the capacity contract is called upon and delivered.” Proposed Guidance at 20,584.

³ The Proposed Guidance describes a “peaking supply contract” as “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 [] curtail its natural gas transportation service.” *Id.*

The CFTC’s description of a peaking supply contract varies from how many in the market would describe such contracts. To members of the Working Group, peaking supply contracts are best defined as “a contract under which one counterparty has a firm obligation to the other counterparty when called upon.” These contracts are generally used to secure a contingency supply during, for example, periods of peak demand or transmission constraints.

⁴ Proposed Guidance at 20,586.

⁵ *Id.* at 20,585.

business needs, such as the need for natural gas to operate a power plant. These transactions are not substitutes for, nor are they used like, financial contracts. As the CFTC states, capacity contracts and peaking supply contracts are entered into “other than for speculative, hedging, or investment purposes,”⁶ and, therefore, are not swaps.

B. The CFTC Should Make Clear That the Commercial Contract Analytical Framework Is Available to Determine if Other Commodity Transactions Are Not Swaps.

The CFTC should make clear that market participants are able to apply the Commercial Contract Analytical Framework to any physical commodity transaction when trying to determine whether a transaction is a swap. Capacity contracts and peaking supply contracts are not unique. The CFTC notes that both types of transactions are

entered into by commercial market participants, who contemplate physical settlement of the transactions, in response to regulatory requirements, the need to maintain reliable supplies, and practical considerations of storage or transport. In each case, the particular commodities covered by the contract are needed by at least one of the parties for the normal operation of its business, and the specific identity of the counterparty is an important consideration....⁷

There are many types of physical commodity transactions that fall into that scope, such as the following three examples:

- a contract for the purchase and sale of crude oil to supply the needs of a refinery which provides a high degree of volume flexibility to account for the business needs of the refiner;
- an option for a natural gas producer to call on additional storage capacity; and
- a call option on power sold to an aluminum smelter.

There is little to differentiate the above three examples from capacity contracts and peaking contracts in the context of the Commercial Contract Analytical Framework. The transactions (i) are entered into by commercial market participants, (ii) who contemplate physical settlement of the transactions, (iii) either in response to (a) a need to maintain reliable supplies of a commodity or (b) practical considerations of storage or transport, (iv) are necessary for the normal operation of a counterparty’s business, and (v) the specific identity of the counterparty is an important consideration.

The one difference between the above three examples and the capacity contracts and peaking supply contracts analyzed by the CFTC is the absence of a regulatory requirement connected to the transaction. However, the absence of a regulatory requirement does not mean

⁶ *Id.* at 20,586.

⁷ *Id.* at 20,585.

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these three examples are not commercial contracts. Therefore, it would be appropriate to use the Commercial Contract Analytical Framework to analyze whether physical commodity transactions in this scope are swaps.⁸

III. CONCLUSION.

The Working Group appreciates this opportunity to provide comments regarding the Proposed Guidance and respectfully requests that the CFTC consider the comments set forth herein.

If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ Alexander S. Holtan

Alexander S. Holtan

Blair Paige Scott

Counsel to The Commercial Energy Working Group

⁸ The Working Group would also like to confirm that the Proposed Guidance would not limit or supersede existing, relevant Commission guidance or relief, such as the following:

- Final Order, *Final Order in Response to a Petition from Certain Independent System Operators and Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas from Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act*, 78 Fed. Reg. 19,880 (Apr. 2, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-07634a.pdf>; or
- Joint Final Interpretation, *Forward Contracts with Embedded Volumetric Optionality*, 80 Fed. Reg. 28,239 (May 18, 2015), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2015-11946a.pdf>.