



May 9, 2016

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

**Re: Comments on Proposed Guidance on Certain Natural Gas and Electric
Power Contracts, RIN 3235-AL93**

Dear Kirkpatrick:

I. INTRODUCTION

The Edison Electric Institute ("EEI"),¹ the American Public Power Association ("APPA")² and the National Rural Electric Cooperative Association ("NRECA")³ (hereafter

¹ EEI is the association of U.S. shareholder-owned electric companies. Our members provide electricity for 220 million Americans, operate in all 50 states and the District of Columbia, directly employ more than 500,000 workers and serve over 70 percent of the ultimate customers in the United States. With more than \$85 billion in annual capital expenditures, the electric industry is responsible for millions of jobs related to the delivery of power, including the construction of modified or new infrastructure. Reliable, affordable, and sustainable electricity powers the economy and enhances the lives of all Americans.

² APPA is the national service organization representing the interests of government-owned electric utilities in the United States. More than two thousand public power systems provide over fifteen percent of all kilowatt-hour sales to ultimate electric customers. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Some government-owned electric utilities generate, transmit, and sell power at wholesale and retail, while others purchase power and distribute it to retail customers, and still others perform all or a combination of these functions. Government-owned utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a government-owned electric utility is to provide reliable and safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

³ The National Rural Electric Cooperative Association (NRECA) is the national service organization for America's Electric Cooperatives. The nation's member-owned, not-for-profit electric co-ops constitute a unique sector of the electric utility industry – and face a unique set of challenges. NRECA represents the interests of the nation's more than 900 rural electric utilities responsible for keeping the lights on for more than 42 million people across 47 states. Electric cooperatives are driven by their purpose to power communities and empower their members to improve their quality of life. Affordable electricity is the lifeblood of the American economy, and for 75 years

(continued...)

“Joint Trade Associations”) submit the following comments in response to the Commodity Futures Trading Commission’s (hereafter “CFTC” or “Commission”) Proposed Guidance on certain natural gas and electric power contracts.⁴

Joint Trade Associations’ members are physical commodity market participants in the energy industry and rely on commodity derivative contracts primarily to hedge or mitigate commercial risks arising from ongoing electric operations. As commercial end users, Joint Trade Associations’ members rely on commodity derivative contracts to protect themselves and their customers from volatile changes in the prices of electricity, natural gas and other commodities related to the generation, purchase, sale, and transmission of electricity with the ultimate goal of providing safe, affordable electricity at just and reasonable rates. Regulations that make effective risk management opportunities more expensive for commercial end users of swaps will likely lead to higher energy prices if the costs associated with those regulations are passed through to consumers, commercial and industrial electricity and natural gas consumers, or will result in more volatile energy prices if commercial end users decide to hedge a smaller portion of their commercial risks of ongoing operations. Accordingly, the Joint Trade Associations’ members have a direct and significant interest in the Commission’s rules and interpretations that may adversely affect commercial end users’ ability to cost-effectively hedge or mitigate commercial risk which includes the classification of natural gas and electric power contracts as contained in the Proposed Guidance.

Section II.B of the Products Release⁵ further defined the scope of the terms “swap” and “security-based swap” in the Commodity Exchange Act as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).⁶ Section II.B.2 provided a number of interpretations with respect to the defined term “swap” in Section 1(a)(47) of the

electric co-ops have been proud to keep the lights on. Because of their critical role in providing affordable, reliable, and universally accessible electric service, electric cooperatives are vital to the economic health of the communities they serve. America’s Electric Cooperatives bring power to 75 percent of the nation’s landscape and 12 percent of the nation’s electric customers, while accounting for approximately 11 percent of all electric energy sold in the United States. NRECA’s member cooperatives include 65 generation and transmission (G&T) cooperatives and 840 distribution cooperatives. The G&Ts are owned by the distribution cooperatives they serve. The G&Ts generate and transmit power to nearly 80 percent of the distribution cooperatives, those cooperatives that provide power directly to the end-of-the-line consumer-owners. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. Both distribution and G&T cooperatives share an obligation to serve their members by providing safe, reliable, and affordable electric service.

⁴ *Certain Natural Gas and Electric Power Contracts*, Proposed Guidance, 81 Fed. Reg. 20583 (April 8, 2016) (“Proposed Guidance”).

⁵ *Further Definition of Swap, Security-Based Swap, and Security-Based Swap Agreement, Mixed Swaps*, Joint Final, Interpretations, Request for Comments on an Interpretation, 77 Fed. Reg. 48207 (August 13, 2012) (“Products Release”).

⁶ Pub. L. No. 111-203 (2010).

Commodity Exchange Act (“CEA”), which excludes from the definition of swap “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.” In this section, the Products Release contained an interpretation for forward contracts that included a three-factor test for contracts with embedded options and a seven-factor test for forward contracts with embedded volumetric optionality.⁷ This interpretation is used to determine when such forward contracts should not be considered “swaps.” In this Section of the Products Release, the Commission also withdrew the 1993 Energy Exemption,⁸ concluded that commodity trade options were swaps,⁹ and stated that their treatment would be addressed through a separate rulemaking.¹⁰

Since publication of the Products Release, the Commission has addressed many energy industry end user concerns with the seven-factor test and with the treatment of commodity trade options through the recent issuance of the Final Interpretation on Forward Contracts with Volumetric Optionality¹¹ and the Trade Option Final Rule which exempts commodity trade options from all sections of the CEA other than certain enumerated sections.¹² The Joint Trade Associations appreciate the Commission addressing energy industry concerns through these issuances, which have provided end users with regulatory certainty. As such, first and foremost, the Joint Trade Associations request that the Commission continue to provide regulatory certainty by clearly stating that the Commission does not intend the Final Guidance to affect the ability of end users to continue to rely on and apply the clarifications previously provided by interpretation or order, including the Forward Contracts with Volumetric Optionality Interpretation, the amended Trade Option Final Rule and other interpretations/guidance provided in the Products Release.

Section II.B.3 of the Products Release addressed “commercial agreements” that involve customary business arrangements and provided a non-exhaustive list of transactions that may be customary commercial arrangements falling outside the definition of “swap” in CEA 1a(47) as well as describing certain criteria considered by the Commission in determining whether other transactions meet the interpretation set forth in the Products Release so as not be considered to be swaps.¹³ The Commission recognized that an ordinary course commercial transactions may contain embedded choices for the parties or “optionality” and that those contract provisions, which do not undermine the overall nature of the customary business arrangement, should not result in “commercial loans or mortgages with embedded interest rate options” falling within the scope of the definition of swap. Through the Proposed Guidance, the Commission now proposes

⁷ *Id.* at 48227-48245.

⁸ *Id.* at 48,227.

⁹ *Id.* at 48,236.

¹⁰ *Id.*

¹¹ *Forward Contracts with Embedded Volumetric Optionality*, Final Interpretation, 80 Fed. Reg. 28239 (May 18, 2015).

¹² *Trade Option*, Final Rule, 81 Fed. Reg. 14966 (March 21, 2016).

¹³ *Id.* at 48,246 – 48252..

to include certain capacity contracts and natural gas peaking contracts in the enumerated list of commercial agreements that are excluded from the swap definition as customary commercial agreements in keeping with the interpretation provided in Section II.B.3 of the Products Release.

As discussed below and in the Proposed Guidance, these commercial contracts are often tied to regulatory requirements or reliability commitments that Joint Trade Associations' members must meet, or to the need to maintain reliable supplies or practical considerations of storage or transport which arise in the course of the normal operation of a Joint Trade Associations' member's business. As such, the Joint Trade Associations agree with the Commission that capacity contracts and peaking supply contracts should be excluded from the definition of swap. However, the Joint Trade Associations are concerned with the extremely narrow scope of the Proposed Guidance, especially in regards to peaking supply contracts. As discussed herein, the Joint Trade Associations would respectfully request that the Commission's proposed guidance on peaking supply contracts be expanded to encompass the broad range of peaking supply arrangements that are customary commercial agreements in both the natural gas and electric industries.

II. COMMENTS ON PROPOSED GUIDANCE

A. Joint Trade Associations Agree that Capacity Contracts Are Not Swaps

The Joint Trade Associations agree with the Commission that a capacity contract is not a swap. There is a difference between energy and capacity, and power plants are compensated separately for capacity because it is critically important to maintaining the reliability of the electrical system. As noted in the Proposed Guidance, capacity is the ability of a generating unit to produce power and reflects the fixed costs of operating and maintaining the physical facility so that it can produce the physical commodity.¹⁴ The requirement to maintain a certain amount of capacity is sometimes referred to as the need to maintain resource adequacy in the particular geographic region of the country so that the generation resources that are needed to meet customer demand are available and adequate no matter the operating conditions and constraints at the time such resources are needed. All regions of the country have a resource adequacy requirement, implemented by the local state regulator, the local Regional Transmission Operator ("RTO")/Independent System Operator ("ISO") or by the local balancing authority or reliability organization, which ensures that there is adequate generation resource availability to produce power supply to meet customer demand at peak times and to ensure that there is energy available to accommodate unexpected system conditions in the region.

¹⁴ Proposed Guidance at 20584-20585.

B. The Definition of Peaking Contract is Unduly Narrow

In the Proposed Guidance, the Commission responds to an individual market participant's request to address whether certain "peaking supply contracts" should be considered swaps.¹⁵ The Commission indicates that it understands that peaking supply contracts are those which "enable 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 natural gas transportation service."¹⁶ This understanding is unduly restrictive as it does not encompass the customary manner in which these commercial contracts are used every day in the natural gas and electricity industries. The Proposed Guidance seems narrowly structured to only address a situation in which an LDC is curtailing natural gas supply to an electric generator in order for the LDC to meet its regulatory requirements, and the LDC's electric customer is preparing for that possibility or contingency. Natural gas peaking supply contracts, however, are used routinely in the natural gas and electric industries by many different types of commercial entities to meet many different types of variable peak demand requirements or supply constraints that are customary in the electric and natural gas industries..

"Peaking supply contracts" is not a defined term within the energy industry. The term has generally been used to refer to contracts that are entered into by commercial market participants to provide a contingency supply of a physical commodity during times of extreme weather, supply constraints or, by utilities, in utility system emergencies due to unpredictably high demand, such as the polar vortex, hurricanes, extended and broad geographic droughts or other heat emergencies, transmission or transportation constraints, curtailments on the natural gas utility distribution system or the electric transmission or distribution systems, or an unexpected outage of a generation facility among other contingencies. In its June 22 comment letter, Linden provides just one example of a contingency for which these contracts are customarily used in the electric and natural gas industries, but it is not the only example or the most common one.¹⁷

Most electric utilities source their natural gas fuel supply from a number of suppliers, and do not rely on LDC's for their natural gas supply. An LDC is customarily a utility that provides natural gas distribution services to residential, commercial and industrial facilities, and it is rare for an electric utility to be served solely by an LDC.¹⁸ Supply curtailments which would lead an electric utility to call on its natural gas peaking supply contracts include curtailments in contracted natural gas supply from a number of entities including midstream gas marketers, gas production companies, electric utilities, natural gas suppliers or providers of wholesale electric

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ See *Trade Options*, Notice of Proposed Rulemaking, Comments of Cogen Technologies Linden Venture, L.P. (June 22, 2015) ("Linden").

¹⁸ As noted in the Proposed Guidance, Linden is an exempt wholesale generator not an electric utility.

power as well as others. Supply curtailments are not the sole reason a utility or another commercial entity would utilize a customary natural gas peaking supply arrangement. Demand for electricity at a particular geographic location, interconnection point or node also tends to play a large role. During times when actual load at a particular location exceeds forecasted load, a utility's firm natural gas supply available at that location may not be able to generate sufficient electricity to meet actual demand.

Many natural gas peaking supply arrangements are structured for these contingencies. They allow a utility to purchase a specified volume of gas over a period of time, often the winter months when demand volatility is highest, subject to a maximum daily quantity and delivered to a specific geographic location. All such natural gas peaking supply contracts intend physical delivery of the commodity, and the contracts do not allow for alternative financial settlement.

In addition, the concept of peaking supply contracts may apply to commodities other than natural gas. In the electric industry, power generation units are generally referred to as one of three types: baseload, intermediate and peaking. Baseload generation units run at all times through the year except in the case of scheduled or unscheduled maintenance or force majeure. In the past these units have generally been fueled by coal and nuclear power, and are used to meet the predictably constant level of seasonal, regional customer demand. Intermediate units fill the gap between baseload and peaking units and they typically operate between 30 and 60 percent of the time, during predictably higher demand seasons or during scheduled maintenance on baseload units. Peak load power plants (commonly referred to as peakers) provide power during localized, peak utility system demand periods. They are highly responsive, and can be started up relatively quickly and vary the quantity of electrical output by the minute.

Generally, peakers are natural-gas fired plants but it should be noted, while it may not be the most efficient use of the generation resource due to its physical attributes, any type of generation facility can and has been used to meet localized peak load, especially during utility system or weather emergencies. As such, peaking supply contracts may not be limited to fuel commodities such as natural gas. In fact, if the operating contingency is related to a disruption or constraint in the natural gas infrastructure, i.e. pipeline related constraints, then the constraint itself mitigates any usefulness of a natural gas peaking supply contract option since the needed gas could not reach the load. Thus, peaking arrangements that are customary in the electric industry may also call for physical delivery of diesel fuel, heating oil, propane, or for physical power from neighboring electric utilities to ensure that even absent sufficient generation owned by the electric utility itself, demands of a utility's residential, industrial and commercial customers can be met with power from another generator in a different location or utilizing a different fuel source to power a different generator. Once again, these types of peaking supply contracts are often structured to allow for a utility to purchase a specified volume of physical power delivered at a specified delivery point during a limited time period, such as during a hot summer season in the Southern United States. As with natural gas peaking supply agreements, these transactions are always intended to be physically delivered, and are not financial instruments. Commercial entities, like Joint Trade Associations' members, do not trade these

types of contracts on a trading facility, and do not use them to hedge against financial markets risks like a future change in price for the commodity, or for a speculative or investment purpose. They are utilized to ensure that physical power supply matches actual demand in real time, despite the occurrence of operational contingencies.

In order to meet demand or accommodate supply system constraints on a contingent basis, supply contracts may not require delivery of any amount or require nominal delivery of such nonfinancial commodity (e.g., there is the possibility for zero delivery under such a contract). These contracts are commercial arrangements are customary in the natural gas and electric industries and help ensure that the commercial end-user utility will obtain supply of nonfinancial commodities at the spot market price or other negotiated price when there are certain operational contingencies. In the Linden example, the peaking supply contract may only be needed if the curtailment occurs. For an electric utility, a peaking supply contract might be needed in the event of a supply constraint, unexpected regional or seasonal weather patterns, or unanticipated load requirements. The contingency aspects of a peaking supply contracts are not included for speculative purposes. Such provisions are included because the commercial market participant's normal supplier may not be able to guarantee the availability of sufficient natural gas or another commodity that will be needed on any particular day in the future or may be needed to address utility system contingencies. Typically, these types of contracts provide an end-user of the commodity, such as natural gas, the right to take delivery of natural gas "up to" the maximum daily quantity agreed to by contract on any day during the term of the contract for up to a specified quantity of gas at the then-current market or another negotiated price. End-users enter into peaking supply contracts to ensure that they can maintain an adequate supply of a commodity needed to operate their businesses, particularly in situations where their customary supplier is not able to deliver. If the end-user elects to take zero delivery on any given day there is no cash settlement—rather, the delivery obligation and the right to receive simply lapses.

Due to the factors discussed above, the Joint Trade Associations respectfully request that the Commission's proposed guidance on peaking supply contracts that are customary commercial agreements in the electric and natural gas industries be expanded to encompass the broad range of peaking supply arrangements, customary in both the natural gas and electric industries, and designed to cover operating contingencies. The Joint Trade Associations agree that potentially treating these peaking supply contracts as "swaps" creates regulatory uncertainty and increases the regulatory burden and costs associated with these ordinary course commercial transactions. As such, the Joint Trade Associations request that the Commission revise the common characteristics to make it clear that any one of the three reasons for entering into these contracts is sufficient: in response to regulatory requirements, or to maintain reliable supplies or for practical considerations of storage or transport.

C. The Commission Should Incorporate the OGC FAQ, by Reference in the Final Guidance

On November 14, 2012, the Commission's Office of General Counsel ("OGC"), in response to energy industry comments, issued a response to frequently asked questions ("OGC FAQ") clarifying the circumstances under which certain physical commercial agreements for the supply and consumption of energy, such as tolls on power plants, transportation agreements on natural gas pipelines, and natural gas storage agreements ("Facility Usage Agreements") should not be considered "swaps".¹⁹ The OGC FAQ provided guidance clarifying that "the however paragraph" in Section II.B.2 of the Products Release "was not intended to apply to agreements, contracts or transactions in which the buyer pays for a commodity in two parts, paying the seller's fixed/known costs upfront and the seller's variable costs associated with that commodity later once those costs are established or incurred."²⁰ Joint Trade Associations' members appreciate the issuance of this clarification by OGC, and are currently relying on this guidance. However, since the OGC is not the Commission and cannot speak for or bind the Commission, the Joint Trade Associations respectfully request that the Commission provide regulatory certainty by formally adopting the clarification provided by the OGC FAQ by reference in the Final Guidance as a formal Commission action.

III. CONCLUSION

The Joint Trade Associations appreciate the opportunity to comment on the Proposed Guidance and the Commission's interest in addressing energy industry end user issues. The Joint Trade Associations agree with the Commission that capacity contracts and peaking supply contracts, as described herein, should be excluded from the definition of swap. The Joint Trade Associations also request that the Commission continue to provide regulatory certainty by (1) specifically indicating that the Commission's other interpretations, orders and guidance relevant to the definition of "swap," including the Final Interpretation on Forward Contracts with Volumetric Optionality and the amended Trade Option Final Rule are not impacted or changed by the Proposed Guidance and (2) incorporating the OGC FAQ by reference in the Final Guidance as an interpretation by the Commission.

Respectfully submitted,

¹⁹ Office of General Counsel Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy (November 12, 2012).

²⁰ *Id.* at 2.

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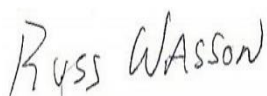


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