CAPITAL AND MARGIN

December 14, 2010

Via email to: CapMargin@CFTC.gov

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Pre-NOPR Comments on Regulatory Capital and Margin Requirements Under the Wall Street Reform and Consumer Protection Act

Dear Secretary Stawick:

The trade associations comprising the "Not-For-Profit Electric End User Coalition"[1] respectfully submit these advance comments to the Commodity Futures Trading Commission (the "Commission") on the capital and margin requirements for swap dealers and major swap participants that the Commission is establishing under the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[2] and the Commodity Exchange Act as amended by the Dodd-Frank Act (the "CEA"). The coalition's members include municipal and cooperative electric utilities. None of the coalition's members anticipate being regulated by the Commission as "swap dealers" or "major swap participants" ("MSPs") for any category, class or type of swap. None of the coalition's members is a "financial entity" to which the end user exception to clearing would be unavailable. The coalition's members use energy and energy-related "swaps"

[1] The coalition includes the National Rural Electric Cooperative Association, American Public Power Association, and the Large Public Power Council. The comments contained in this filing represent the initial position of the Coalition, but not necessarily the views of any particular member with respect to any issue. The Coalition, any of the individual associations, or any individual association member may submit additional comments in response to the Commission's proposed rules related to capital and margin requirements.

[2] Public Law No: 111-203 (enacted July 21, 2010).

("Energy Commodity Swaps")[3] solely to manage the commercial risks inherent in their core public service activities. None of the coalition's members "speculate" in Energy Commodity Swaps.[4]

Our comments are limited to the markets for Energy Commodity Swaps in which our coalition members participate, and our comments may or may not be applicable to other types of non-cleared swaps markets. It is in the Energy Commodity Swaps markets that our members' position as end users is unique -- our members' assets and activities, and their public service mission, require that they engage in Energy Commodity Swaps to hedge their commercial risks. The Commission is respectfully asked to consider this unique NFP Electric End User perspective, and to facilitate and protect the continuing ability of the NFP Electric End Users to cost-effectively hedge their commercial risks using Energy Commodity Swaps.

The coalition respectfully requests the Commission not to promulgate capital or margin requirements which would directly or indirectly increase the costs of the Energy Commodity Swaps in which the NFP Electric End Users engage. Moreover, the coalition respectfully requests the Commission not to promulgate regulatory capital or margin requirements which would disincentivize swap dealers or MSPs from engaging in Energy Commodity Swaps.

The NFP Electric End Users did not cause the financial crisis of 2008-2009. Our Energy Commodity Swaps reduce our commercial risks and do not increase systemic risk. If our members are required to incur incremental direct or indirect costs relative to the Energy Commodity Swaps in which they engage, they will have been denied the principal benefit of the end user exception that Congress provided in the Dodd-Frank Act. Our members will be required to divert capital resources from building electric infrastructure and creating jobs. And

---

[3] The coalition notes the energy industry's continuing concerns about the definition of the term "swap," as noted in the comments submitted by the Not-For-Profit Energy End Users dated September 20, 2010 in response to the Commission's Advance Notice of Proposed Rule-Making. A copy of that letter is attached for convenience of reference. The comments included in this letter are predicated on certain assumptions about how the Commission will define that term, and we reserve the right to change or expand our comments once the Commission's final rules in respect of that definition are issued. In this letter, we use the term "Energy Commodity Swap" to include (a) those non-cleared swaps referencing or derived on energy commodities such as electric energy, natural gas, and all other fuels for electric generation, including coal and heating oil, (b) those non-cleared swaps referencing or derived on transmission, transportation, generation capacity or storage concepts or services which are intrinsically related to the energy commodities used by our members in their core public service activities and which continue to be subject to the jurisdiction of regulators other than the Commission, and (c) those non-cleared swaps referencing or derived on environmental or emissions regulations, or renewable energy or other environmental attributes, and which continue to be subject to the jurisdiction of regulators other than the Commission. All of these "Energy Commodity Swaps" are based on "nonfinancial commodities" and are intrinsically related to our members' core public service activities.

[4] The term "speculate" as used herein means deliberately taking a position, and then offsetting it with another position, for the purpose of profiting from favorable movements in market prices. Speculation is a risk-increasing activity in which commodity traders commonly engage. An NFP Electric End User may enter into a swap transaction that settles favorably (i.e., "in the money"). But that favorably-settling swap transaction offsets a correlated unfavorable price movement/settlement in the commercial risk being hedged.

American businesses and consumers will pay more for their electric service. Or, if swap dealers or MSPs choose not to engage in Energy Commodity Swaps with end users such as the NFP Electric End Users, the NFP Electric End Users will simply be foreclosed from hedging their commercial risks using Energy Commodity Swaps. These unintended consequences can be avoided by a careful and analytical approach to establishing and applying capital and margin rules under the CEA as amended by the Dodd-Frank Act for swap dealers and MSPs, and particularly for swap dealers and MSPs that engage in Energy Commodity Swaps.

I. THE COALITION MEMBERS

The coalition is comprised of three trade associations representing the interests of not-for-profit, consumer-owned electric utilities in the United States (collectively, the "NFP Electric End Users").[5] The primary business of these NFP Electric End Users has been for well over 75 years, and still is today, to provide reliable electric energy to their retail consumer customers every hour of the day and every season of the year, keeping costs low and supply predictable, while practicing good environmental stewardship. The NFP Electric End Users are public service entities, owned by and accountable to the American consumers they serve.

A. NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION ("NRECA")

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other under take and pay "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the

[5] The Coalition is grateful to the following organizations and associated entities who are active in the legislative and regulatory policy arena in support of the NFP Electric End Users, and who have provided considerable assistance and support in developing these comments. The Coalition is authorized to note the involvement of these organizations and associated entities to the CFTC, and to indicate their full support of these comments and recommendations: the Transmission Access Policy Study Group (an informal association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative owner-members, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members.

The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act ("SBREFA"). 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. The RFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (the "SBA"). The SBA's small business size regulations state that entities which provide electric services are "small entities" if their total electric output for the preceding fiscal year did not exceed 4 million megawatt hours. 13 C.F.R. §121.201, n.1.

B. AMERICAN PUBLIC POWER ASSOCIATION ("APPA")

APPA is the national service organization representing the interests of publicly-owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. These systems take various forms, including departments of a municipality; a utility board or a public utility district formed under state or local law; a joint action agency or joint power agency formed under state law to provide wholesale power supply and transmission service to distribution entity members; a state agency, authority or instrumentality; or other type of political subdivision of a state. Like the members of NRECA, the vast majority of APPA's members are "small entities" under SBREFA.

Public power utilities perform a variety of electric utility functions. Some 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. All these systems work together pursuant to their common statutory and regulatory mandates. Some are "vertically integrated" electric utilities (engaging in generation, transmission, distribution and retail sales), while others are vertically integrated by contract with other "201(f) entities" (entities that are exempt from full Federal Power Act rate regulation under Section 201(f) of that statute), or by contract with third parties.

Public power utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a public power utility is to provide reliable, safe

electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

C. LARGE PUBLIC POWER COUNCIL ("LPPC")

The Large Public Power Council is an organization representing 24 of the largest locally owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly 90% of the transmission investment owned by non-federal public power entities in the U.S. Our member utilities supply power to some of the fastest growing urban and rural residential markets in the country. Members are located in 11 states and Puerto Rico -- and provide power to some of the largest cities in the country including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando and Austin.

Members of the LPPC are also members of APPA. LPPC members are larger in size than other APPA members due to the size and population density of the communities to which they provide power. LPPC members often require larger, more complex and more diverse types of resources to serve their communities as well, and therefore LPPC members own and operate more complex generation and transmission assets than many other APPA members. However, despite being larger in size and resources, LPPC members' public service mission remains the same -- to provide reliable, safe electricity service, keeping costs low and predictable for its customers while practicing good environmental stewardship.

D. THE COALITION'S MEMBERS ARE UNIQUE, AS ARE THE "MARKETS" IN WHICH THEY TRANSACT AND THE TRANSACTIONS IN WHICH THEY ENGAGE.

The NFP Electric End Users represented by the coalition include public power utilities and rural electric cooperatives. Some are quite large, but most of these NFP Electric End Users are very small, reflecting the communities they serve, the success of those communities in providing reliable essential services for their citizens at the lowest reasonable rates and, in the case of rural electric cooperatives, the contribution to Americans' quality of life of the Rural Electrification Act of 1936.

Some NFP Electric End Users generate, transmit and sell electric energy to their fellow public power systems and cooperatives and to third parties at wholesale, while others purchase electric energy (from associated public power systems and cooperatives or from third parties), and distribute it to retail consumers. Still others perform all or a combination of these commercial functions. The coalition's members are unique among "end users" whose transactions are potentially subject to CFTC regulation as "swaps" (even among those who are "end users" of energy and energy-related commodities and swaps) in that the public power entities which are NFP Electric End Users have no stockholders and are accountable to elected and/or appointed officials, and ultimately to the consumers of their services. Similarly, the electric cooperatives which are NFP Electric End Users are directly accountable to their

consumer-members and boards. Any gains or losses on an NFP Electric End User's energy transactions result in higher or lower energy costs to American businesses and consumers. The NFP Electric End Users do not seek profit for shareholders or investors. Their public service mission is the singular purpose and reason for their existence, and the interconnected Federal, state and local system of laws and financial regulation within which they operate is designed specifically to support this public service mission.

The market for power in North America is comprehensively regulated at the Federal, state and local level, with a focus on reliability of service and regulated rates payable by the retail customer. In addition, the electric industry in North America (including the NFP Electric End Users) is subject to extensive environmental regulations and, in many states, renewable energy standards. Unlike other markets for over-the-counter ("OTC") derivatives and/or "swaps" (as newly defined by the Dodd-Frank Act), these are not unregulated markets. They are comprehensively regulated, and any new regulatory structure must be carefully tailored so as not to conflict with existing regulatory structures.

Some of the NFP Electric End Users' energy transactions are conducted through, "on," or "in" the "markets" operated by various regional transmission organizations or independent system operators (collectively, "RTOs"). RTOs operate their "markets" in certain defined geographic areas of the United States under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC"). The FERC-regulated markets are established by tariff in many instances, rather than by contract, and analogies between these FERC-created/FERC-regulated "markets," and the bilateral contract markets between independent and arm's length third parties, are inapt. Although in some ways, the markets conducted by the various RTOs are similar in structure, no two RTO markets are exactly alike and their "products" or "transactions" are not fungible between RTOs. Each RTO also has in place credit risk mitigation policies and procedures to protect market participants from credit risk from other market participants, and to protect the RTO markets from disruption due to market participant default. These RTO credit risk mitigation policies are established and maintained in accordance with the principles established by FERC.[6]

FERC's mandate from Congress under the Federal Power Act is to regulate in the "public interest" -- which is interpreted as the delivery of reliable electric energy to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate the FERC-regulated markets. The markets are intrinsically tied to the reliable physical transmission and ultimate delivery of electric energy in interstate commerce at just and reasonable rates.

Most of the Energy Commodity Swaps in which the NFP Electric End Users are engaged are currently conducted under exemptions or exclusions from the Commodity Exchange Act (the

[6] Such policies were recently updated by FERC in its Final Rule on Credit Reforms in Organized Wholesale Electric Markets, 18 CFR Part 35, Docket No. RM10-13-000, Order No. 741 (issued October 21, 2010).

"CEA"), whether conducted in the bilateral OTC contract market (as most are, including RTO transactions) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial characteristics, or by virtue of their involvement in the underlying cash commodity markets relevant to their businesses (as "eligible commercial entities"). Other than a few large industrial companies, retail energy consumers generally do not participate in these markets directly. The physical and financial commodity transactions occur principal to principal, through agents and energy brokers, with a wide range of counterparties.

The transactions contain customized, non-quantitative operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between commercial businesses. Although some legal and administrative terms are standardized through the use of master agreements, the negotiated schedules to such master agreement and individual transaction confirmations are highly negotiated and differ based on the needs and preferences of each pair of contract counterparties. These are commercial transactions, when viewed through the traditional lens of "goods" and "services" used by American businesses. It is only when the transactions are viewed through the financial markets lens that these transactions are described using the financial market regulatory labels such as "exempt commodities," "swap agreements," "swaps" or "nonfinancial commodities" -- and analogized to "futures contracts" or "positions" created or engaged in by financial entities on a transaction-by-transaction basis for profit or speculation, and potentially subject to regulation traditionally applicable to such financial market professionals.

Credit risk management in the bilateral contract world of non-cleared Energy Commodity Swaps is grounded in broad-based, continuing and reciprocal credit risk analysis and credit risk management between each set of counterparties, backstopped by credit support and collateralization principles. This type of credit risk management is not analogous to the transaction-by-transaction margining (without regard to counterparty identity) that takes place in today's CFTC-regulated futures and options markets. In fact, most of the Energy Commodity Swap transactions take place without the involvement of the financial intermediaries which enable the CFTC-regulated market structure, but as bilateral, unsecured or collateralized contracts, and part of longstanding and wide-ranging commercial relationships.

The NFP Electric End Users currently have the risk management choice to conduct some of these Energy Commodity Swap transactions on CFTC-regulated contract markets, or to clear some of these transactions through CFTC-regulated centralized clearing entities. CFTC-regulated exchanges have only recently begun to list these types of contracts; and central clearing entities have only recently begun to clear energy transactions. Listed and cleared transactions are those delivered at "hubs," in tradable increments and for tradable duration -- that are "standardized" and "fungible" in financial market terms, and with sufficient contract trading liquidity to allow for financial markets to function. As the CFTC-regulated financial markets have evolved, some of the larger NFP Electric End Users have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments. But the vast majority of NFP Electric End Users' commercial commodity transactions and Energy Commodity Swaps are still

conducted "the old fashioned way:" under tariffs within the public power and cooperative systems or by contract with known and reliable suppliers and customers, and not with CFTC-regulated financial intermediaries or on exchanges or with clearing entities. And the vast majority of NFP Electric End Users do not either post collateral to their counterparties or require that their counterparties post collateral to them.[7]

Due to the Dodd-Frank Act's wholesale deletion of applicable exemptions in the CEA, and the potentially sweeping nature of the Dodd-Frank Act's new definitions, these everyday business transactions of the NFP Electric End Users are at some risk of being redefined as "swaps." Although Congress has repeatedly indicated that its intention was NOT to reduce risk management options for end users or to impose new regulatory costs on end users hedging the risks of traditional commercial enterprises, Congress is relying on the regulators to implement understandable rules consistent with that intent. Congress did not intend for the regulators to read the expansive language of the Dodd-Frank Act without regard to legislative intent or to regulate and impose costs on end users as if they were professional financial market participants.[8]

---

[7]To give the Task Force some examples of the diversity of credit support and collateral (or "margin") relationships which the NFP Electric End Users have in place with their Energy Commodity Swap counterparties, as well as the diversity of assets, load (customers served within the utility's geographic service territory), energy hedging and risk management policies, and swap usage within the coalition's membership, we have attached seven "profiles" of individual NFP Electric End Users. These same profiles were attached to the NFP Energy End User's comment letter to the End User Exception Task Force, dated November 22, 2010. When we met with the Capital and Margin Task Force, we explained our coalition's membership in terms of a "pyramid." The entire membership pyramid shares the not-for-profit, no speculation, public service mission that unites the coalition. By far the largest number of our members, at the "base tier" of the pyramid, use very few, if any, financial energy or energy-related transactions, but buy and sell physical forward energy "commodities" (and commercial options) every day in the ordinary course of fulfilling their public service obligations. Virtually all these members' transactions are unsecured. A "middle tier" of members uses financial energy and energy-related derivatives periodically, all still predominantly on an unsecured basis. A very small number of members in the "top tier" of NFP Electric End Users (mostly G&T cooperatives and public power utilities who are LPPC members) regularly uses financial energy and energy-related derivatives. Of those "top tier" members, most transact in the OTC energy and energy-related swaps markets, rather than on exchanges. But some choose to hedge their commercial risks with energy futures and exchange-traded options. Some "top tier" members clear a portion of their OTC transactions. When collateral or "margin" is required (over varying, negotiated collateralization thresholds in certain counterparty relationships) for non-cleared swap transactions, most "top tier" members post letters of credit or cash. Most of the membership pyramid is prohibited (contractually, by outstanding mortgages, or legally) from pledging physical generation assets. Many of the middle tier and top tier members also transact with, in or on the particular RTO in their geographic region, if the region has an RTO. None of these profiles purport to be "typical" of large, medium or small NFP Electric End Users (by number of customers). No NFP Electric End User is typical, given their diverse commercial profiles. However, the Commission's regulations have to work for <u>all</u> NFP Electric End Users who share the identical public service mission.

[8] The Commission should not, in its rule-making under the Dodd-Frank Act, be distracted and convinced to impose regulatory burdens or incremental capital and margin costs on end users by those commentators who intone or invoke the names "AIG" or "Enron," without analysis. Neither AIG nor Enron would be entitled to the end user exception under the CEA as amended by the Dodd-Frank Act. AIG, whose substantial position in non-cleared credit

II. CONGRESS DID NOT AUTHORIZE THE COMMISSION TO IMPOSE REGULATORY CAPITAL OR MARGIN REGULATIONS ON END USERS

In Section 731 of the Dodd-Frank Act, Congress amended the CEA to add new Section 4s, entitled "Registration and Regulation of *Swap Dealers and Major Swap Participants* (*emphasis added*)." As part of authorizing the Commission to register and regulate such newly-defined entities, Subsection 4s(d) directs the Commission to "adopt rules for persons that are registered as swap dealers or major swap participants." Immediately thereafter, Subsection 4s(e) describes the "Capital and Margin Requirements" that the Commission is authorized to promulgate for swap dealers and MSPs. Congress intended the Commission's capital and margin rules to be applicable to swap dealers and MSPs in their capacity as newly-defined "regulated entities."

Nowhere in the Dodd-Frank Act does the statute contemplate end users setting aside regulatory capital for their swaps positions at the direction of the Commission, or end users being required to adhere to regulatory margin rules. The entities for which the Commission is authorized under the CEA as amended by the Dodd-Frank Act to establish regulatory capital and margin rules are those entities newly-defined in the statute as swap dealers and MSPs, not all participants in the "swaps" markets.

To the contrary, Congress' intent was to protect end users from new regulatory requirements and costs, as perhaps most clearly stated in the letter sent by Senators Dodd and Lincoln (as chairs of the two Senate Committees principally responsible for drafting Title VII) to Representatives Frank and Peterson (as chairs of the corresponding House Committees) immediately after the close of the Conference Committee they chaired (the "Dodd-Lincoln Letter"). There was extensive colloquy in both houses of Congress about the Dodd-Lincoln Letter when it was introduced into the Congressional Record.[9]

The NFP Electric End Users urge the Commission not to go beyond its statutory authority under the CEA by establishing regulatory capital or margin requirements applicable to end users of swaps.

---

default swaps allegedly endangered the financial system, would be registered and regulated as an MSP in credit default swaps. Enron, with its notorious "one-to-many" electronic interface offering to engage in swaps from energy to broadband, is the poster child for the Dodd-Frank Act's definition of "swap dealer," and would be registered and regulated as such. The NFP Electric End Users, and other end users hedging commercial risk with Energy Commodity Swaps, do not represent the types of systemic risk that the mere mention of those entities' names implies.

[9] 156 Cong. Rec. H52248. Letter from Senator Christopher Dodd and Senator Blanche Lincoln to the Honorable Barney Frank and the Honorable Colin Peterson (June 30, 2010).

III. IMPORTANT STATUTORY LANGUAGE RELEVANT TO BOTH REGULATORY CAPITAL AND MARGIN RULES FOR SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

In order to understand the principles to be followed for imposing capital and margin requirements on swap dealers and MSPs under new CEA Section 4s(e), the Commission is first directed to the "in general" provisions in Section 4s(e)(3)(A), entitled "Standards for Capital and Margin":

> IN GENERAL.—To offset the greater risk to the swap dealer or major swap participant *and the financial system* arising from the use of swaps that are not cleared, the [capital and margin] requirements imposed . . . shall—
>
> (i) help ensure the *safety and soundness* of the swap dealer or major swap participant; and
>
> (ii) *be appropriate* for the risk associated with the non-cleared swaps *held as a swap dealer or major swap participant.(emphasis added)*[10]

The Commission must first, "in general," identify the "greater risk[11] to the swap dealer or major swap participant *and the financial system* (*emphasis added*) from the use of swaps that are not cleared." The "greater risk" must be to <u>both</u> the CFTC-regulated entity and to the financial system as a whole, not just to one or the other. It must be a two-pronged risk, and only after identifying such "greater (two-pronged) risk" is the Commission to then establish capital and margin rules -- to offset such greater risk. The Commission cannot simply assume that the CFTC-regulated entity's use of non-cleared swaps creates such a greater (two-pronged) risk. To do so would result in overbroad capital and margin rules.

In addition, before the Commission begins to establish capital and margin rules, it must identify the non-cleared swaps *for which the swap dealer or MSP is designated as a regulated entity* (the "CFTC-regulated business"). Again, the statutory language of new CEA Section 4s(e) is the guide. In the words of CEA Section 4s(e)(3)(A)(ii), these are the non-cleared swaps, or the class, category or type of non-cleared swaps, that are "held as" a swap dealer or MSP. In the words of CEA Section 4s(e)(3)(B), these are the non-cleared swaps which constitute "activities as a swap dealer or MSP." This CFTC-regulated business (these "activities") may not be all of the non-cleared swaps to which the regulated entity is a party, or even all the non-cleared swaps in a particular class, category or type of non-cleared swaps to which the regulated entity is a

---

[10] 7 U.S.C. § 4s(e)(3)(A) "Standards for Capital and Margin."

[11] Presumably this is shorthand for a greater risk to the regulated entity and the financial system *than the risk represented by a similar cleared swap*.

party. And these activities do not include cleared swaps to which the CFTC-regulated swap dealer or MSP might be a party.

For a non-financial company that registers and is regulated as a swap dealer or an MSP for just one class, category or type of non-cleared swaps, the Commission is not authorized to establish capital or margin rules for all of such swap dealer's or MSP's businesses, as a bank regulator or other prudential regulator might establish broad-based rules for entire entities over which it has compete jurisdiction. The CFTC-regulated non-cleared swaps business may be a very small portion of such a non-financial company's overall business enterprise. Congress did not intend for the Commission to establish capital or margin rules for all of a CFTC-regulated entity's activities -- only for those non-cleared swaps activities over which the Commission has jurisdiction. To regulate more broadly would, again, be to go beyond the authority given to the Commission by the statute.

We will comment first on the Commission's rules establishing and applying regulatory capital requirements, and then on the rules establishing and applying regulatory margin requirements, for swap dealers and MSPs. We urge the Commission to view the two risk mitigation tools as complementary, and not to establish or apply the rules in such a way that they would overlap or be duplicative in accomplishing the policy objectives.

IV. CAPITAL REQUIREMENTS FOR SWAP DEALERS AND MSPS MUST NOT INCREMENTALLY BURDEN END USERS

The Commission should start its analysis of appropriate capital rules for swap dealers and MSPs by utilizing the risk assessment principles which underlie the Commission's regulation of financial market firms that are formed to participate in the futures and exchange-traded options markets, such as futures commission merchants. But the Commission's analysis cannot end there. To do so would be to ignore several important differences between the financial markets currently regulated by the Commission and the newly-regulated non-cleared swaps markets over which the Commission was given jurisdiction under the Dodd-Frank Act.

In evaluating a swap dealer's or MSP's CFTC-regulated business for purposes of determining regulatory risk exposure and establishing capital requirements, the Commission should differentiate between the risks posed by non-cleared swaps (as compared with cleared swaps) based on the identity and objective of the counterparty to the non-cleared swap:

A. those non-cleared swaps entered into *between* and among financial entities (including swap dealers and MSPs for that category, class or type of swap, whose activities are not entitled to the end user exception to clearing), and

B. those non-cleared swaps entered into by a swap dealer or MSP (for a particular category, class or type of swap), and to which an end user hedging a commercial rislk is the counterparty.

This segmentation of the regulatory risk analysis based on counterparty or counterparty type is not possible in the futures or exchange-traded options markets for which the Commission presently sets capital requirements for regulated entities like futures commission merchants. In those markets, the transaction counterparty is anonymous -- instead, the central clearing entity and its clearing members typically sit between the buyer and the seller of a "position," with the clearing entity acting as buyer to all sellers and seller to all buyers. The clearing entity's (and clearing members) margin requirements eliminate any differences in bilateral counterparty credit risk. Consequently, in those markets, the Commission is able to set regulatory capital rules for types of futures transactions, regardless of counterparty identity or counterparty credit risk.

The non-cleared swaps market is structured in a fundamentally different way. There are no tiers of financial disintermediation to absorb and eliminate counterparty credit risk. The relative counterparty credit risk analysis by the parties regarding any non-cleared swap plays a significant role in each counterparty's decision whether to transact at all with a counterparty, whether to transact again with the same counterparty, and in each instance at what price. Such relative counterparty credit risk analysis affects both transaction risk pricing and/or credit support requirements for the non-cleared swap transaction in an overall counterparty relationship.

Swap dealers and MSPs face a different risk exposure with non-cleared swaps when compared to similar cleared swaps, based on the counterparty to the non-cleared swap and the reason the swap is excused from what are otherwise mandatory clearing requirements. Swaps in category A above are "non-cleared" because the swap has not been accepted for clearing by a clearing entity and because the swap or category, type or class of swap has not been designated by the Commission as clearable. Reasons for this "non-cleared/non-clearable" status may include: the terms of the swap are "customized" not "standardized," or the swap remains subject to the jurisdiction of another regulator which may change its economic terms prior to settlement, and therefore it is not "fungible" or "clearable." Or the Commission has not yet made a determination that the swap <u>should</u> <u>be</u> subject to mandatory clearing. In keeping with the Congressional intent to bring as many of these non-cleared swaps into clearing as possible to reduce systemic risk, these non-cleared swaps may reflect "greater risk" to the swap dealer or MSP than similar cleared products.[12]

However, the same analysis does not hold for non-cleared swaps in category B above. When the non-cleared swap is one to which the end user hedging a commercial risk is a party, Congress gave the end user the statutory right to except that swap from the clearing requirement. Congress did so in recognition of the fact that the non-cleared swap does not increase risk to the financial system. Non-cleared swaps to which end users are a party by definition fail the second

[12] In such cases, the two financial entity parties to the non-cleared swap may be said to have entered into the non-cleared swap (the "greater risk") where they <u>could</u> <u>have</u> entered into a similar standardized, exchange-traded and cleared swap (which would be subject to the clearing entity's margin requirements and therefore be of a "lesser risk").

prong of the two-pronged "greater risk" analysis. To the contrary, when swap dealers and MSPs engage in swap transactions with end users, instead of with other financial entities, the transactions in fact reduce systemic risk because they do not create the potential for cascading financial entity defaults.

For example, the NFP Electric End Users engage in Energy Commodity Swaps to hedge or mitigate the commercial risks that arise naturally and inevitably in their commercial enterprises. For the NFP Electric End Users, the commercial risks they face in their public service enterprises arise from the "natural short" position in which they find themselves in respect of electric power. The NFP Electric End Users are load-serving entities for an essential service necessary to run American homes and businesses -- electric power. The NFP Electric End Users have ongoing public service obligations to serve electric loads (retail electric customers) within their service territories. Unless and until the supply is acquired and the purchased power price (or cost of generation, including fuel) is fixed, the NFP Electric End Users are "short" and exposed to market price, availability and other commercial risks associated with their public service obligations. The sole purpose of the NFP Electric End Users' transactions in the forward commodity and swaps markets is to mitigate those commercial risks.

The NFP Electric End Users are clearly identifiable in the marketplace for Energy Commodity Swaps as "natural shorts" (load serving entities in geographic service territories), and as entities for which it is politically and practically untenable at the time of delivery to be actually "short" of the deliverable energy commodity. As the delivery month approaches, the NFP Electric End Users and other load serving entities in the marketplace become more and more dependent on their risk management and energy procurement abilities to fill any gaps in their energy supply portfolios.

The commercial risks are identifiable for each NFP Electric End User, and each management team then chooses the extent to which to mitigate such risks through hedging. Energy commodities and Energy Commodity Swaps are subject to unparalleled price volatility, due in part to the effects of weather on demand, the uncertainty of supply interruptions, the complex regulatory (energy and environmental) framework within which the markets operate, and other physical ("nonfinancial" in the terminology of the CEA as amended by the Dodd-Frank Act) and commercial factors. The NFP Electric End Users have a public service obligation to deliver electricity 24/7 and year-round. Because the commercial risks to NFP Electric End Users are substantial, the imperative to hedge such commercial risks is critical to the public service enterprise.

When NFP Electric End Users act as "end users," they are readily distinguishable from "traders" who take a position in order to take another position (or sell the first position) to make a profit. For NFP Electric End Users, hedging is not just about managing price risk of "positions," it is about fulfilling their public service mission, while managing commercial risks and moderating the effect of price volatility on the retail customers in their service territories. The NFP Electric End Users have inherent "positions" to hedge (or "inchoate positions" in the case of projected generation that may be subject to physical output variances or outages, or load

projections that may or may not materialize depending on weather and economic conditions affecting customer demand).

An end user using an Energy Commodity Swap to hedge commercial risk does not increase systemic risk, since the swap transaction is "settled" (or offset) against the commercial risk that was hedged. When the NFP Electric End User's hedge is "settled," an "in the money" position on the Energy Commodity Swap is offset against an "out of the money" commercial risk "position" that was hedged. There is no open "greater risk" position to be offset by capital and margin rules. And there is no open risk of cascading defaults to the financial system. Rather, a transaction to which an end user is a party operates as a "systemic risk mitigant," a "risk ground" or a "risk sink" that operates to stop a systemic risk cascade as the swap risk is simultaneously offset by a commercial risk in the physical, commercial world.

The coalition urges the Commission to establish analytically sound, principles-based and flexible capital rules, appropriate to the very different commercial and business profiles that may fall within the definitions of swap dealer or MSP for any category, class or type of swap. The NFP Electric End Users urge the Commission to establish and apply capital requirements only in respect of a swap dealer or MSP's CFTC-regulated business, and to analyze the relevant non-cleared swap portfolio carefully, differentiating the risk analysis based on the counterparty to the non-cleared swap. For non-cleared swap transactions to which end users are a party, which represent no increase in systemic risk, there should be no regulatory capital requirement imposed on swap dealers or MSPs.

As Senators Dodd and Lincoln observed, "Regulators must carefully consider the potential burdens that Swap Dealers and Major Swap Participants may impose on end user counterparties -- especially if those requirements will discourage the use of swaps by end users or harm economic growth."[13] If swap dealers or MSPs incur capital charges for end user transactions, they will undoubtedly pass those charges on to the end user counterparty or decline to engage in non-cleared swaps to which end users are counterparties. The Commission's rules implementing Section 4s(e) of the CEA should be written in a way that protects the swap dealer or MSP and the financial system, while not imposing unnecessary incremental burdens on end users.[14]

The coalition believes that the Commission's capital requirements for swap dealers and MSPs should reflect the following:

---

[13] Dodd-Lincoln Letter at 3.

[14] *See* Treasury Deputy Secretary Neal S. Wolin, Remarks at the New England Council, Boston, Massachusetts (Aug. 5, 2010) ("Third, the reforms establish a comprehensive regulatory framework for the derivatives markets – the source of so much risk and uncertainty in the recent crisis. And at the same time, through a narrowly tailored end user exemption, the reforms ensure that commercial firms will be able to hedge their risks effectively and efficiently.").

- The Commission should establish capital requirements for swap dealers and MSPs only for the CFTC-regulated non-cleared swaps business, and only where there is evidence that the specific non-cleared swaps represent a "greater risk" to the safety and soundness of the swap dealer or MSP *and* a greater risk to the financial system than a similar cleared swap with the same counterparty or type of counterparty (swap dealer or MSP or other financial entity).
- The Commission should draft broad principles-based rules that reflect the statutory intent to consider other non-financial businesses in which the swap dealer or MSP may engage, and other aspects of the regulated entity's non-financial business profile, as important factors to offset the need for the regulatory capital requirements imposed on its non-cleared swaps business.
- The Commission should ensure that no regulatory capital requirements are imposed on a swap dealer or MSP for non-cleared swaps to which end users are parties. Such non-cleared swaps represent no "greater risk" to the financial system.

The Dodd-Frank Act does not mandate that the Commission establish and impose one-size-fits-all capital requirements on swap dealers or MSPs. The Commission must carefully analyze the risks presented by a regulated entity's non-cleared swaps, use the information available to it about those non-cleared swaps and the counterparties to such swaps, and impose capital requirements only where appropriate to achieve the statutory requirements of Section 4s(e).

V. THERE SHOULD BE NO REGULATORY MARGIN, CREDIT SUPPORT, COLLATERAL OR CREDIT RISK MITIGATION REQUIREMENTS ON SWAP DEALERS OR MAJOR SWAP PARTICIPANTS FOR NON-CLEARED SWAPS WHERE THE COUNTERPARTY IS RELYING ON THE END USER EXCEPTION TO CLEARING

Consistent with our analysis in Section IV above, the clear Congressional intent expressed in the Dodd-Lincoln Letter,[15] and as reflected in Chairman Gensler's comments expressed at the December 1, 2010 open Commission meeting, the Commission should not adopt rules that require regulatory "margin" on non-cleared swaps that a swap dealer or MSP enters into with counterparties who are relying upon the end user exception to clearing under CEA Section 2(h)(7). As Chairman Gensler noted, non-cleared swaps to which end users are counterparties "do not present the same risk to the financial system as those solely between financial entities." The rules on margin requirements "should focus only on transactions

[15] Congress was concerned about protecting end users from "burdensome costs associated with margin requirements and mandatory clearing." Dodd-Lincoln Letter, at 2. To protect end users from mandatory clearing with one hand while imposing margining costs with the other hand would be directly contrary to Congressional intent.

between financial entities rather than on those transactions that involve non-financial end users."[16]

The coalition also urges the Commission not to impose aggregate regulatory margin requirements on a swap dealer or MSP, based either on an absolute dollar amount of non-cleared swaps, or on presumptions about collateralization thresholds (or lack of collateralization thresholds) establishing "unsecured exposure" limits on a swap dealer or MSP's non-cleared swap relationships. Such an arbitrary limit is simply inconsistent with Congress' intent not to impose direct or indirect margin obligations or costs on end users hedging commercial risk. Such requirements would also be inconsistent with the concept in Section IV above that transactions to which end users are parties present no systemic risk. Any aggregated regulatory limit on "unsecured credit" for transactions to which end users are counterparties is simply inappropriate without evidence that such transactions represent systemic risk. Finally, non-cleared Energy Commodity Swaps are currently transacted under master agreements, which master agreements govern both physical and financial transactions, some of which will not be "swaps," but the master agreements include collateralization thresholds calculated on net exposures from both physical and financial transactions. For such a master agreement, it would be impossible to determine the amount of aggregate net "unsecured credit" allocable to non-cleared swaps (or swaps of a particular category, class or type) versus "non-swaps" in order to calculate such an aggregate regulatory margin requirement.

VI. "MARGIN" RULES FOR SWAP DEALERS AND MAJOR SWAP PARTICIPANTS SHOULD BE PRINCIPLES-BASED AND SHOULD BUILD ON MARKET BEST PRACTICES

The Commission should adopt "margin" rules under new CEA Section 4s(e)(2)(B) that recognize the differences in market structure between the exchange-traded futures and options markets and the markets for non-cleared swaps. Although new CEA Section 4s(e) uses financial markets terms, and calls for imposing "initial margin" and "variation margin" rules for swap dealers and MSPs, those terms are not defined in the CEA. The Commission should consider how best to establish appropriate credit risk mitigation principles to achieve the statutory purpose of reducing counterparty credit and systemic risk, and define those terms in the context of the markets to which they are intended to be applied.[17]

In the exchange-traded markets, the concepts of "initial margin" and "variation margin" have historically functioned well. In the markets for non-cleared swaps, different but similarly effective and time-tested credit support and collateral concepts have also functioned well.[18] As

---

[16] Opening Statement of Chairman Gary Gensler, December 1, 2010 Open Commission Meeting.

[17] The Commission has the authority to define terms incorporated into the CEA by the amendments in the Dodd-Frank Act as may be necessary to effectuate the statutory intent. See Section 721(b)(2) of the Dodd-Frank Act.

[18] Numerous crises have challenged the electric power (and the related natural gas) industries in the United States since 2000: energy company bankruptcies and liquidity "crunches," the August 2003 blackout, hurricanes on the

discussed in Section III above, the regulatory market structure in the exchange-traded futures and options markets (which includes various tiers of financial intermediaries) is different than in the bilateral contract, "non-cleared" markets for Energy Commodity Swaps, where counterparty identity is known at the time a swap is entered into, and counterparty credit risk analysis is a key component of the pricing and credit support for each swap transaction.[19]

The market structures also differ in that the non-cleared swap markets are not "settled" daily. For that reason among others, transactions in such non-cleared swap markets should not be "margined" daily, as the exchange-traded markets are, to eliminate counterparty credit risk on a transaction-by-transaction basis. When a pair of counterparties to a master agreement relationship calculates "net (unsecured) exposure" between the pair of counterparties -- for purposes of credit risk management in non-cleared swaps markets -- the net exposure between the counterparties is hypothetical (calculated *as if* there was a termination event and settlement as of that exposure calculation date). Whether that net exposure has fluctuated outside previously-agreed collateralization thresholds is also, therefore, hypothetical. Moreover, even if net exposures and collateral thresholds are monitored daily for non-cleared swaps, in most counterparty relationships (especially when non-cash collateral is permitted), collateral is not posted daily, and minimum transfer amounts and rounding conventions are applicable to reduce the collateral administration costs.

New regulatory margin requirements should not be analogized to bank regulatory concentration limits, which are put in place to manage concentration risk by restricting a bank from entering into a new loan transaction with a borrower. The hypothetical net exposure for a non-cleared swap or counterparty swap relationship may fluctuate solely due to market price movements, not due to changes in the creditworthiness of either counterparty and not as a result of any new transaction between the parties. For all the foregoing reasons, net exposure calculations between OTC swaps counterparties are simply <u>not</u> analogous to daily futures "margining" calculations or bank regulatory concentration limits.

In order to recognize the differences in market structure and so as not to disrupt well-functioning non-cleared swaps markets, the Commission should define the terms "initial margin" and "variation margin" as follows:

"Initial margin" shall mean:

Gulf Coast, the volatile and high natural gas and power prices in the spring and summer of 2008. None of these crises affecting the Energy Commodity Swaps markets has resulted in risk to the financial system.

[19] Market participants who use both the futures markets and the markets for non-cleared swaps sometimes use each others' credit risk mitigation terminology loosely and interchangeably. But from an economic and legal perspective, the markets are structured differently and the ways in which the credit risk mitigation tools (<u>e.g.</u>, margin, credit support, collateral, security interests, unsecured credit and lines of credit) operate is different.

> 1. in the context of a cleared swap, the collateral required to be posted by a market participant to a clearing entity on or prior to the date of the swap in order to induce the clearing entity to clear the swap, as such initial margin may be further defined or determined by Commission rules or the rules established by a designated clearing organization; and
>
> 2. in the context of a non-cleared swap, or the relationship between swap counterparties to a non-cleared swap, the "independent amount," if any, required by one counterparty to be posted by the other counterparty on or prior to the date on which the swap is transacted or relationship is initiated, in order to provide credit support for such non-cleared swap or to establish an initial credit support level for swaps to be entered into between the swap counterparties.
>
> "Variation margin" shall mean:
>
> 1. in the context of a cleared swap, the collateral required to be posted by a market participant to a clearing entity from time to time in order to secure the variable exposure attributable to the change in the market price of the swap during the period prior to the settlement date; and
>
> 2. in the context of a non-cleared swap, or the relationship between counterparties to a non-cleared swap or swaps, the credit support or collateral, if any, required by one counterparty to be posted by the other counterparty from time to time during the term of the swap or the swap relationship to secure the net exposure of one counterparty to the other counterparty in respect of all non-cleared swaps and other financial or physical transactions subject to the ongoing counterparty relationship.

The Commission should establish flexible credit risk mitigation or “margin” rules that are principles-based and which endorse the best credit risk management and mitigation practices in the markets for identified categories, classes or types of non-cleared swaps. Principles-based “margin” rules are an important means for avoiding unintended adverse consequences which would arise from applying inappropriate and rigid credit risk mitigation requirements to unique market structures.

The coalition urges the Commission not to adopt margin rules that are based on the unsupported and incorrect assumption that it is always necessary or “prudent” to impose limits on the amount of “unsecured credit” in a counterparty relationship. The markets for Energy Commodity Swaps have had a long history of allowing counterparties to negotiate whether and how to “extend unsecured credit.” Such relationships are based on decades of mutually-beneficial and default-free commercial and/or financial transactions. It is important that there be no assumption by the Commission that wholly-unsecured non-cleared swap relationships are somehow “imprudent.”

We also urge that there be no mandatory, across the board regulatory aggregate limit on "unsecured credit" or exposure that would restrict or disincentivize a swap dealer or MSP from engaging in non-cleared swaps on an unsecured basis (with no collateralization thresholds). We urge the Commission not to impose such aggregate limits either in absolute dollar terms or in terms of a percentage of the swap dealer or MSP's regulatory capital.

The coalition recommends that the Commission incorporate the following market best practices when establishing margin rules for swap dealers and MSPs for Energy Commodity Swaps:

- Do not establish regulatory margin requirements for non-cleared swaps to which an end user is a counterparty. Such transactions create no systemic risk. The swap dealer or MSP's credit risk management policies and credit documentation with each identified end user counterparty adequately protects the safety and soundness of the swap dealer or MSP.
- Define "initial margin" and "variation margin" in the context of the market to which the terms, and the credit risk mitigation principles implicit in such terms, are to be applied. To define the terms narrowly, as they have been used colloquially in the cleared futures and options markets, and then apply them to the newly-regulated non-cleared swap markets, would unnecessarily place a regulatory round hole over a well-functioning square-peg market structure.
- Recognize individually-tailored credit support and collateralization arrangements. Swap dealers, MSPs and their counterparties in non-cleared swaps have historically relied on individually-negotiated credit support and collateral arrangements. The Commission should maintain a principles-based, flexible approach, adopting best practices in the markets for specific categories, classes or types of swaps, and avoid adopting rules that would require inappropriate one-size-fits-all regulatory "margin."[20]
- Permit the extension by swap dealers and MSPs of unsecured credit (subject, if and where deemed appropriate by the counterparties, to negotiated collateralization thresholds). Prudent credit risk management allows market participants to rely for credit support on parent guarantees, or to extend "unsecured credit" or transact without requiring collateral at all in appropriate circumstances. Credit risk analysis in the market for non-cleared swaps is based on initial and continuing quantitative and qualitative review of the counterparty relationship and the nature of the anticipated transactions between the counterparties. Quantitative factors might include financial ratios routinely relied upon when assessing commercial credit risk (*i.e.*, debt or leverage ratios, debt service, interest or fixed charge coverage ratios, minimum asset values or guaranty amounts for the counterparty). Qualitative factors in the market

[20] The coalition also believes this principles-based approach will make the best use of limited agency resources.

for Energy Commodity Swaps might include regulatory support or rate recovery mechanisms, such as capacity payments for must-run generation, a fuel cost adjustment or purchased power mechanism that allows for rate recovery of hedge settlements, the ability of a market participant to pass through the costs of its hedging transactions to its own customers, or a "right-way risk" analysis whereby the exposure under a counterparty's swap transactions have a direct correlation to the value of a pledged asset, product or business.

- Recognize that "margining" in the non-cleared swaps market is on a counterparty relationship basis, not on a transaction-by-transaction basis. In a non-cleared swap market, all credit risk assessment is reciprocal and based on the overall relative creditworthiness of the counterparties, depending on which counterparty is expected to be the seller and which is anticipated to be the buyer in one or more transactions between the parties. It is not negotiated or managed on a transaction-by-transaction, daily settlement, anonymous counterparty basis, as is the case in cleared markets. Credit risk is analyzed both in terms of performance risk and payment risk when some of the anticipated transactions are physical rather than financial. Credit risk management is founded on principles of netting and setoff, and master agreements cover both physical and financial transactions, multiple commodities and transactions, and may also reference or cross-collateralize other commercial relationships between the parties. The Commission's rules should allow flexibility for swap dealers or MSPs to require an independent amount for transactions with a particular counterparty, if and as appropriate. But, as with all other credit risk management tools in the non-cleared swap relationship, each counterparty is in control of who it transacts with. It can decide not to enter into the next swap with that counterparty unless and until an independent amount is posted. But an independent amount is not analogous to "initial margin" as that term is used in the futures markets, and is not required or appropriate in the vast majority of non-cleared swap transactions or counterparty relationships.

- Permit use of non-cash collateral. The Commission's rules should permit the swap dealer or MSP flexibility to accept (or post) non-cash collateral as "margin."[21] Such non-cash collateral may include government or corporate debt or equity securities, letters of credit or physical assets. Such credit support mechanisms are important for market participants which are asset rich, but may need the ability to allocate available cash resources for purposes other than credit support for swaps. On the other hand, some market participants secure their long-term debt using first mortgage bonds on physical assets, or are prohibited by statute or jurisdictional documents from pledging their physical assets, and so may not be able to pledge physical assets. Companies may also be restricted in their access to or ability to pledge non-operating cash reserves as "margin" for financial hedging transactions. The Commission should not restrict swap dealers and MSPs from negotiating flexible and appropriate credit risk

[21] 7 U.S.C. § 4s(2) and (3)(C).

management and credit support structures as appropriate for the particular counterparty relationship.

VII. THE COMMISSION MUST CONSIDER THE IMPACT OF ITS REGULATORY CAPITAL AND MARGIN RULES ON SMALL BUSINESS

The coalition's members include many "small entities" as that term is defined in the Small Business Regulatory Flexibility Act. 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). 13 C.F.R. §121.201, n.1. If the Commission does not appropriately tailor its capital and margin rules for swap dealers and MSPs to avoid imposing incremental direct or indirect costs on NFP Electric End Users, the coalition requests a full analysis be conducted under SBREFA. Once we understand the Commission's new capital and margin paradigm, we will be in a position to effectively estimate any incremental regulatory costs.

The Commission is requested to provide economic support for any determination that capital and/or margin requirements are the appropriate means for managing identified "greater risks" associated with non-cleared swaps. All such new regulatory requirements should be supported by economic analysis showing that such requirements are structured to be effective and not burdensome. Imposing strict one-size-fits-all regulatory requirements on swap dealers or MSPs should be the exception, not the rule, especially where such rules will affect end users' access to cost-effective commercial risk management tools or result in unnecessary incremental burdens.

VIII. ALL COMMENT PERIODS SHOULD REMAIN OPEN UNTIL ALL THE BASIC RULES UNDER TITLE VII OF THE DODD-FRANK ACT HAVE BEEN PROMULGATED. THEREAFTER, ONCE THE RULES ARE FINALIZED, THE COMMISSION SHOULD PROVIDE EXTENDED TRANSITION PERIODS TAILORED TO THE NEEDS OF END USERS IN THE DIVERSE MARKETS FOR DIFFERENT CATEGORIES, CLASSES AND TYPES OF SWAPS USED AS RISK MANAGEMENT TOOLS FOR END USERS.

The coalition urges the Commission to hold open the comment periods on all initial rules being promulgated under the Dodd-Frank Act, to enable various industries such as the energy industry, and various types of market participants in the diverse markets for swaps, to consider the regulations as a whole. The rules are complex and interconnected, and create a new market structure within which end users will need to conduct their commercial enterprises and hedge their commercial risks.

In the case of the markets for Energy Commodity Swaps, the new market structure will need to be integrated with the existing regulatory structures within which the energy end users currently conduct their commercial enterprises. Once the rules are finalized, end users will need substantial time to analyze their operations and install new systems, staffing and operating procedures to adapt to the new market structure, while delivering reliable and affordable electricity to American consumers and businesses. We urge the Commission to allow time for comprehensive review of the new market structure prior to making the complex new rules

effective, and transition times that are adequate for end users to adapt their commercial enterprises to the new market structure.

IX. THE MARKETS FOR NON-CLEARED "ENERGY COMMODITY SWAPS," AND THE CREDIT RISK MITIGATION, CREDIT SUPPORT AND COLLATERAL, OR "MARGIN," PRINCIPLES APPLIED IN SUCH MARKETS, ARE UNIQUE

The markets for non-cleared Energy Commodity Swaps, and the time-tested, well-functioning "margin" principles applicable thereto, may be unique when compared to the other non-cleared swaps markets being analyzed by the Commission in its rule-making. And the FERC regulatory structures (including markets and credit risk mitigation principles) applicable to many parts of such markets may also be unique when compared with other regulators with which the Commission works regularly. The Commission should defer application of its capital and margin (and other) rules until a more detailed study of the Energy Commodity Swaps markets can be conducted. Congress specifically charged the Commission and FERC with avoiding duplicative and overlapping jurisdiction in the energy markets.[22] Given the economic importance of the energy industry and the NFP Electric End Users' public service mission, we urge the Commission to defer regulating these existing, well-functioning markets rather than disrupt or impose unnecessary costs and burdens on the delivery of reliable, affordable electric power to American businesses and consumers.

X. CONCLUSION

For the reasons stated above, the coalition respectfully urges the Commission not to establish capital and margin rules on swap dealers or MSPs which will result in any incremental direct or indirect costs on end users. The coalition encourages the Commission to define "initial margin" and "variation margin" in relation to the markets to which those terms are to be applied, and to establish principles-based credit risk management and credit support rules appropriate to the swap dealers and major swap participants being regulated, the counterparties to such CFTC-regulated entities, and the best practices in the relevant swaps markets. Preserving end users' ability to access the Energy Commodity Swap to hedge and mitigate their commercial risks is fundamental to energy companies being able to continue to invest in energy infrastructure, provide affordable electricity to American consumers and businesses, and maintain the overall long-term reliability of the electric grid.

[22] See Dodd-Frank Act Section 720.

CAPITAL AND MARGIN

Respectfully yours,

"NOT-FOR-PROFIT ELECTRIC END USER COALITION":

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: Russ Wasson

Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: _____

Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

LARGE PUBLIC POWER COUNCIL

By: _____
Its: _____

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

CAPITAL AND MARGIN

Respectfully yours,

"NOT-FOR-PROFIT ELECTRIC END USER COALITION":

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: Susan N Kelly
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

LARGE PUBLIC POWER COUNCIL

By: _____
Its: _____

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

CAPITAL AND MARGIN

Respectfully yours,

"NOT-FOR-PROFIT ELECTRIC END USER COALITION":

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: _____
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

LARGE PUBLIC POWER COUNCIL

By: Noreen Roche-Carter
Its: Chair, Tax and Finance Task Force

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

COMMENT LETTER OF THE COALITION DATED SEPTEMBER 20, 2010

See Attached

September 20, 2010

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
Email to secretary@cftc.gov, dfadefinitions@cftc.gov and otcdefinitions@cftc.gov with Definitions in Subject line;

Re: Proposed Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Mr. Stawick:

The trade associations comprising the "Not-For-Profit Energy End User Coalition" (the "Coalition") respectfully submit these comments to the Commodity Futures Trading Commission (the "CFTC") in response to the Advanced Notice of Proposed Rulemaking entitled "Definitions contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act."[1] This rulemaking is part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Given the nature of our members' commercial businesses, our comments focus primarily on the aspects of the definitions that will affect end users of energy and energy-related commodities. [2]

---

[1] 75 Fed. Reg. 51,429 (Aug. 20, 2010).

[2] The comments contained in this filing represent the initial comments and recommendations of the organizations comprising the "Coalition," but not necessarily the views of any particular member with respect to any issue.

As the CFTC (along with the Securities and Exchange Commission and the prudential regulators) embarks on the complex and interrelated rule-makings necessary to implement the Act, the Coalition respectfully requests that the regulators keep in mind at each step along the way how these rule-makings will ultimately impact the commercial businesses that are "end users" of commodities and "swaps." These are not financial entities, and they have not previously been regulated by the CFTC. Under current law, if an end user chooses to buy or sell CFTC-regulated futures contracts or options or to utilize a CFTC-regulated clearing entity to manage its commercial risk, this represents one commercial choice among many. In many circumstances, small businesses in particular choose to manage their risks in less expensive ways. On the day after the effective date of the Act, each of these end users will still have a business to run, commercial risks to manage and customers to serve. The Act was intended by Congress to regulate the financial markets more effectively, and to provide regulatory oversight to financial entities. The rule-makings must not leave commercial businesses uncertain as to which of their ongoing activities will now be regulated by the CFTC. Nor should the rule-makings impose on these businesses unnecessary regulatory costs and burdens.

I. THE COALITION MEMBERS[3]

The Coalition is comprised of four trade associations representing the interests of not-for-profit, consumer-owned electric and gas utilities in the United States (collectively, the "NFP Energy End Users"). The primary business of these NFP Energy End Users has been for well over 75 years, and still is today, to provide reliable natural gas and/or electric energy to their retail consumer customers every hour of the day and every season of the year, keeping costs low and predictable, while practicing good environmental stewardship. The NFP Energy End Users are public service entities, owned by and accountable to the American consumers they serve.

A. NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION ("NRECA")

Formed in 1942, NRECA is the national service organization for more than 900 not-for-profit rural electric utilities and public power districts that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for-profit, consumer-owned cooperatives which distribute electricity to consumers. NRECA's members also include

[3] The Coalition is grateful to the following organizations and associated entities who are active in the legislative and regulatory policy arena in support of the NFP Energy End Users, and who have provided considerable assistance and support in developing these comments. The Coalition is authorized to note their involvement to the CFTC, and to indicate their full support of these comments and recommendations: The Transmission Access Policy Study Group (an informal association of transmission dependent electric utilities located in more than 30 states), ACES Power Marketing and The Energy Authority.

approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&T cooperatives are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost. All these cooperatives work together pursuant to their common public service mandate from their members, often without the type of contracts that exist between for-profit entities. Rather, many cooperatives deal with each other under take and pay "all requirements contracts" which set forth the terms of service/energy sales, but not necessarily the price for such service/energy sales. For example, as between a G&T cooperative and its distribution cooperative owner-members, the price is often determined based on a "cost of service" rate, with no market price component.

Electric cooperatives own approximately 43% of the distribution lines in the U.S., reaching some of the country's most sparsely populated areas, from Alaskan fishing villages to remote dairy farms in Vermont. In an electric cooperative, unlike most electric utilities, its owners -- called "members" of the cooperative -- are also customers, who are able to vote on policy decisions, directors and stand for election to the board of directors. Because its members are customers of the cooperative, all the costs of the cooperative are directly borne by its consumer-members.

The vast majority of NRECA's members meet the definition of "small entities" under the Small Business Regulatory Enforcement Fairness Act (the "SBREFA"). Only four distribution cooperatives and approximately 28 G&Ts do not meet the definition. Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 601-612 (as amended Mar. 29, 1996). The RFA incorporates by reference the definition of "small entity" adopted by the Small Business Administration (SBA). The SBA's small business size regulations state that entities which provide electric services are "small entities" if they dispose of 4 million MWh or less per year. 13 C.F.R. §121.201, n.1.

B. AMERICAN PUBLIC POWER ASSOCIATION ("APPA")

APPA is the national service organization representing the interests of publicly-owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. These systems take various forms, including departments of a municipality; a utility board or a public utility district formed under state or local law; a joint action agency or joint power agency formed under state law to provide wholesale power supply and transmission service to distribution entity members; a state agency, authority or instrumentality; or other type of political subdivision of a state. Like the members of NRECA, the vast majority of APPA's members are considered "small entities" under the RFA.

Public power utilities perform a variety of electric utility functions. Some 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. All these

systems work together pursuant to their common statutory and regulatory mandates. Some are "vertically integrated" electric utilities (engaging in generation, transmission, distribution and retail sales), while others are vertically integrated by contract with other "201(f) entities" (entities that are exempt from full Federal Power Act rate regulation under Section 201(f) of that statute)[4], or by contract with third parties.

Public power utilities are accountable to elected and/or appointed officials and, ultimately, the American public. The focus of a public power utility is to provide reliable, safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

C. AMERICAN PUBLIC GAS ASSOCIATION ("APGA")

The APGA is the national association for publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. The purpose of a public gas system is to provide reliable, safe and affordable natural gas service to the community it serves. Public gas systems depend on the physical commodity markets, as well as financial market transactions, to meet the needs of their consumers. Together, these markets play a central role in public gas utilities securing natural gas supplies at reasonable and stable prices. Specifically, many public gas utilities purchase firm gas supplies in the physical delivery market at prevailing market prices, and enter into OTC derivatives customized to meet their specific needs to hedge their customers' exposure to future market price fluctuations and stabilize rates. As with APPA-member systems, the APGA members work together pursuant to their common statutory and regulatory mandates, often without the types of contracts that exist between for-profit entities, but instead under tariff arrangements or all requirements contracts.

D. LARGE PUBLIC POWER COUNCIL ("LPPC")

The Large Public Power Council is an organization representing 24 of the largest locally owned and operated public power systems in the nation. LPPC members own and operate over 75,000 megawatts of generation capacity and nearly 34,000 circuit miles of high voltage transmission lines. Collectively, LPPC members own nearly 90% of the transmission investment owned by non-federal public power entities in the U.S. Our member utilities supply power to some of the fastest growing urban and rural residential markets in the country. Members are located in 11 states and Puerto Rico -- and provide power to some of the largest cities in the country including Los Angeles, Seattle, Omaha, Phoenix, Sacramento, Jacksonville, San Antonio, Orlando and Austin. Members of the LPPC are also members of APPA.

[4] For more discussion of 201(f) entities, see the comment in Section IIA3 below.

E. THE COALITION'S MEMBERS ARE UNIQUE, AS ARE THE "MARKETS" IN WHICH THEY TRANSACT, AND THE TRANSACTIONS IN WHICH THEY ENGAGE.

The NFP Energy End Users represented by the Coalition include public power entities, public gas entities and rural electric cooperatives. Some are quite large, but most of these NFP Energy End Users are very small, reflecting the communities they serve, the success of those communities in providing reliable essential services for their citizens at the lowest reasonable rates and, in the case of rural electric cooperatives, the contribution to Americans' quality of life of the Rural Electrification Act of 1936.

Some NFP Energy End Users generate, transmit and sell electric energy to their fellow public power systems and cooperatives at wholesale, while others purchase natural gas and/or electric energy, and distribute it to retail consumers. Still others perform all or a combination of these commercial functions. The Coalition's members are unique among "end users" whose transactions are potentially subject to CFTC regulation as "swaps" (even among those who are "end users" of energy and energy-related commodities and swaps) in that the public power and gas entities have no stockholders and are accountable to elected and/or appointed officials, and ultimately to the consumers of their services. Similarly, the electric cooperatives are directly accountable to their consumer-members and boards. The NFP Energy End Users' public service mission is the singular purpose and reason for their existence, and the interconnected Federal, state and local system of laws and financial regulation within which they operate is designed specifically to support this public service mission.

NFP Energy End Users have a different credit profile than your average "trader" or financial market participant. Due to their consumer-owned and public service nature, most do not have significant assets available to post as margin (due to statutory or government financing restrictions) or significant non-operating accounts, investments or lines of credit available to post "margin" for their long-term infrastructure transactions, especially in the volatile natural gas and power markets. In this way, the NFP Energy End Users are fundamentally different from other entities the CFTC regulates or is charged with regulating under its new jurisdiction.

The markets for natural gas and power in North America are comprehensively regulated at the Federal, state and local level, with a focus on reliability of service and regulated rates payable by the retail customer. In addition, the natural gas and electric industries in North America (including the NFP Energy End Users) are subject to extensive environmental regulations and, in many states, renewable energy standards. Unlike other markets for over-the-counter ("OTC") derivatives and/or "swaps" (as newly defined by the Act), these are not unregulated markets. They are comprehensively regulated, and any new regulatory structure must be carefully tailored so as not to conflict with existing regulatory structures.

A substantial number of the NFP Energy End Users manage the commodity and other commercial risks associated with their business by entering into "contracts, agreements and transactions" in energy and energy-related "exempt commodities," including, without limitation, transactions in electric power, natural gas and, in the case of electric utilities, other fuels for

generation. Other commercial risks are managed using options on natural gas, power or other exempt commodities, or "swap agreements." Some of these transactions are conducted through, "on" or "in" the "markets" operated by regional transmission organization or independent system operator (collectively, "RTOs"). These markets operate in certain geographic areas of the United States under a comprehensive regulatory structure established by the Federal Energy Regulatory Commission ("FERC"). The FERC markets are established by tariff in many instances, rather than by contract, and analogies between this system and the bilateral contract markets between independent and arm's length third parties are inapt.

FERC's mandate from Congress under the Federal Power Act and the Natural Gas Act is to regulate in the "public interest" -- which is interpreted as delivering reliable electric energy and natural gas to American consumers at "just and reasonable" rates. It is under this regulatory mandate that the RTOs (overseen by FERC) have established, and currently maintain and operate the FERC-regulated markets. The markets are intrinsically tied to the reliable physical transmission and ultimate delivery of electric energy in interstate commerce at just and reasonable rates.

All these energy contracts, agreements and transactions are currently conducted under exemptions or exclusions from the Commodity Exchange Act (the "CEA"), whether conducted in the bilateral over-the-counter contract market (as most are) or on exempt commercial markets. The participants in these markets are "eligible contract participants" either by virtue of their size and financial strength, or by virtue of their involvement in the underlying cash commodity markets relevant to their businesses (as "eligible commercial entities"). Other than a few large industrial companies, retail energy consumers do not participate in these markets directly. The physical and financial commodity transactions occur principal to principal, through agents and energy brokers, with a wide range of counterparties. As distinguished from other markets regulated by the CFTC, many of these energy transactions do not involve financial intermediaries. The transactions contain customized, non-standardized operating conditions, transmission or transportation contingencies, and operating risk allocations that one would expect between commercial businesses. They are commercial transactions, when viewed through the traditional lens of "goods" and "services" used by American businesses. It is only when they are viewed (as the Act does) through the financial markets lens that they are characterized with the financial market regulatory labels such as "exempt commodities," "swap agreements," "options, "swaps" or "nonfinancial commodities" -- and analogized to "futures contracts" or "positions" created by financial entities for profit or speculation, and potentially subject to regulation traditionally applicable to such financial market professionals.

The NFP Energy End Users currently have the risk management choice to conduct some of these everyday transactions on CFTC-regulated contract markets, or to clear the transactions through CFTC-regulated centralized clearing entities. But NFP Energy End Users make that choice relatively rarely. The exchanges have only recently begun to list a significant number of these types of contracts; and central clearing entities have only recently begun to clear energy transactions, especially those which are not standardized or "fungible" in financial market terms. Compared to markets for other commodities, natural gas, power and related transactions are

often highly customized, and contain longer terms as necessary for these infrastructure businesses, as necessary to serve retail customers, and significant operating conditions or contingencies, reflecting the inherent physical and commercial nature of the business. As the CFTC-regulated financial markets have evolved, some of the larger NFP Energy End Users have chosen to manage certain of their commercial risks using exchange-traded and cleared instruments. But the vast majority of NFP Energy End Users' commercial commodity transactions are still conducted "the old fashioned way": under tariffs within the public power and cooperative systems or by contract with known and reliable suppliers and customers, and not with CFTC-regulated financial intermediaries or on exchanges or clearing entities.

Due to the wholesale deletion of applicable exemptions in the CEA, and the potentially sweeping nature of the new definitions, these everyday business transactions of the NFP Energy End Users may suddenly, unexpectedly, be redefined as "swaps." Physical forward commodity transactions, commercial option transactions, and option-like aspects of ordinary course "full requirements" natural gas and electric energy transactions could be captured within the new regulatory paradigm. Although Congress has repeatedly indicated that its intention was NOT to capture commercial transactions or to impose new costs on end users hedging risks of traditional commercial businesses, Congress is relying on the regulators to implement that intent and write clear rules. Congress did not intend for the regulators to read the expansive language of the Act without regard to legislative intent, nor to regulate and impose costs on end users as if they were professional financial market participants.[5]

The NFP Energy End Users are relying on the CFTC to draft clear rules, to make clear how current interpretations, no action positions and precedent under the CEA should be read in light of the Act's new and different regulatory structure, and to conduct all necessary exemption proceedings prior to the effective date of the Act (and with appropriate regulatory transition periods thereafter). We stand ready to help the CFTC understand our businesses, our industry and our "markets." If the CFTC ignores the effect of the Act on end users, NFP Energy End Users will face a wall of regulatory uncertainty on the day the Act is effective. Such a result would be a classic example of the unintended and harmful consequences of sweeping legislation and regulation drafted without careful attention to the potential adverse impacts for industries outside the traditional financial markets that Congress intended to stabilize.

II. COMMENTS

A. DEFINITION OF "SWAP"

The Coalition agrees with the comments and recommendations made regarding the definition of "swap" by the Edison Electric Institute in its comment letter to the CFTC dated September 20, 2010. In addition:

[5] See 156 Cong. Rec. H5248 (the "Dodd-Lincoln letter")

1. Definition of "nonfinancial commodity"

The Coalition respectfully requests that the CFTC define the term "nonfinancial commodity," which is not otherwise defined in the CEA. Moreover, the Coalition requests that the CFTC identify in its regulations (subject to public notice and industry comment) each of the cash "commodities," "nonfinancial commodities," and "swaps" now being transacted in the natural gas and electric energy industries in North America. The NFP Energy End Users are not financial market professionals. They manage ongoing commercial businesses and provide an essential service to American consumers and businesses. They transact in commercial goods and services every day, and they hedge commercial risks using the identifiable economic tools available to them in the marketplace. NFP Energy End Users do not "create" new transaction types or financially engineer "contracts" or take and trade "positions" to make a profit. They should not have to ask, transaction by transaction, for a CFTC determination as to whether a commonplace commercial transaction falls under the new CFTC jurisdiction. The NFP Energy End Users need regulatory certainty in order to continue conducting their business as usual on the day after the Act's effective date. The NFP Energy End Users should not have to engage in such transactions without being told, in advance, if the CFTC sees such a commercial transaction as a "commodity," or a "swap," or a "financial commodity" (as opposed to a nonfinancial commodity). The Coalition requests that the CFTC grant certainty to end users in the energy industry, by definitively stating in its rule-making which energy and energy-related products and services currently transacted in the marketplace are "commodities," which are "swaps," and which are "nonfinancial commodities."

The Coalition proposes that the definition of "nonfinancial commodities" should include all products and services related to the production, generation, transmission, transportation, storage, delivery or regulation of natural gas or electric energy delivered to North American consumers by commercial businesses in any part of that commodity chain, including all fuels used to produce electric energy, and all services, transactions, allowances, credits, licenses or intangibles defined by an energy or environmental regulator. These types of transactions are used to hedge, mitigate or manage the commercial risks inherent in physical (nonfinancial) delivery of energy commodities, including natural gas and electric energy. "Nonfinancial commodities" should also include all energy and energy-related products and services sold pursuant to "tariffs" approved by Federal, state or local energy regulators, a regulatory process focused on reliability and rate regulated service -- concepts in many ways inconsistent with the concepts that underlie financial market regulation. Finally, "nonfinancial commodities" should also include all contracts, agreements and transactions related to transmission, transportation and storage of energy and energy-related commodities.[6]

[6] We request that the CFTC clarify this point in the definition of "nonfinancial commodity," which appears in the exclusions to the definition of "swap." The ambiguity actually emanates from the CEA's definition of "commodity," where the word "services" appears. Services agreements in the energy industry, including transmission, transportation and

The NFP Energy End Users deserve clear guidance with respect to each type of energy transaction. Understanding which transactions fall under the new regulatory scheme will be critical to commercial decisions the NFP Energy End Users need to make now and continue to make on the day after the effective date. NFP Energy End Users cannot be expected to stop doing business, develop and submit a request to the CFTC for a rule-making or an exemption on each commercial transaction, and await the CFTC's decision. The energy industry deserves to know in advance, and as soon as possible, which transactions need to be cleared, which need to be transacted on exchanges or swap execution facilities, which need to be recorded for later reporting and in what form, which need to fit within regulatory compliance programs, and which need to be reported, when and to whom. Addressing these issues early in the CFTC regulatory rule-making process will allow NFP Energy End Users to understand the scope of changes that the Act will require to the way in which they conduct their businesses. It will also allow input from the other regulators who have authority over the NFP Energy End Users, their transactions and the energy markets they utilize.

2. Tariff Transactions -- Exemption Process

As part of the definition of "swap," the Coalition requests that the CFTC, in conjunction with FERC, the RTOs, the Texas Public Utilities Commission, the Electric Reliability Council of Texas ("ERCOT") and other government and quasi-government energy tariff regulators, articulate an industry-wide exemption process, filing procedures, timelines and other related matters for the "Tariff Transaction" exemption provided for in Section 722(f) of the Act (CEA section 4(c)(6)(A)(B)). Although this exemption is found in a different section of the Act from the definition of "swap," and it refers to the CEA Section 4(c) exemption process, it is unclear how the exemption process is intended to work for transactions which exist currently under tariffs and, in particular, under the RTO and ERCOT rules. There are hundreds, if not thousands, of such tariff transactions, and all electric utility industry participants, including NFP Energy End Users, doing business in the applicable geographic regions use them every day. It is burdensome and unreasonable to expect individual market participants who utilize RTO products and services to request individual 4(c) transaction exemptions, or even product-by-product exemptions from the CFTC. The CFTC should initiate a process similar to the process outlined in the Act for currently cleared "swaps." Good public policy requires a timely, orderly and comprehensive process for exempting already-regulated transactions from duplicative regulation.

Moreover, the industry-wide exemption process should take place well before the effective date of the Act, and should include input from the regulators who approved the tariffs, as well as industry-wide input and public hearings on any transactions for which the CFTC does NOT intend to grant an exemption. The public interest invoked in Section 722(f) of the Act echoes the "public interest" mission of FERC described in Section IE above -- the public interest in reliable natural gas and power, delivered to the American public at just and reasonable rates. The NFP Energy End Users will continue to need to engage in tariff transactions the day after the

---

storage contracts, are commercial transactions which should in almost all circumstances be excluded from the CFTC's jurisdiction under the CEA's forward contract exclusion(s).

Act's effective date in order to deliver energy to their customers. They cannot be left to wonder if these products will be deemed "swaps" by the CFTC on that effective date or retroactively at some later date.[7] After the effective date, there should be a clear and expeditious process whereby such exemptions will be filed by the entity or regulator authorized to approve the tariff, and promptly acted upon by the CFTC, to enable the tariff energy markets to continue to function with a focus on the public interest in delivering reliable and affordable energy delivered to the American consumer.

3. FPA 201(f) Transactions -- Exemption Process

The Coalition requests that the CFTC grant a blanket exemption from all aspects of the Act for all transactions between entities exempted from FERC regulation under Section 201(f) of the Federal Power Act.[8] These transactions are between entities in the public power and cooperative community, with no possibility of or incentive for profit at the counterparty's expense. They facilitate the public power system's, or the electric cooperative system's, public service mission, and have been generally exempt from most aspects of FERC jurisdiction for decades on the express understanding and regulatory determination that they are critical to the delivery of power to the American consumer, and do not represent an opportunity to profit to the detriment of either the counterparty or the ultimate consumer. These transactions are clearly distinguishable from transactions between independent arm's length for-profit parties.

B. DEFINITION OF "SWAP DEALER"

The Coalition agrees with the comments and recommendations made regarding the definition of "swap dealer" by the Edison Electric Institute in its letter to the CFTC dated September 20, 2010.

[7] To be clear, the NFP Energy End Users believe such transactions should NOT be considered "swaps," as this would introduce burdensome, costly, duplicative and potentially conflicting regulation.

[8] FPA Section 201(f) can be found at 16 U.S.C. § 824, and states as follows:

(f) United States, State, political subdivision of a State, or agency or instrumentality thereof exempt. No provision in this subchapter shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

C. DEFINITION OF "MAJOR SWAP PARTICIPANT"

The Coalition agrees with the comments and recommendations made regarding the definition of "major swap participant" by the Edison Electric Institute in its letter to the CFTC dated September 20, 2010. We agree with EEI's request that the CFTC define the term "commercial risk" for purposes of the definition of "major swap participant" and for consistent use throughout the CEA, as amended by the Act. We recommend the following definition:

> (___) **Commercial Risk**. This term means any risk that a person or governmental entity incurs, or anticipates incurring, in connection with operating a commercial business as distinguished from a financial entity, including, but not limited to: commodity risk; market risk, credit risk; operating risk; transportation and storage risk; liquidity risk; financial statement risk; regulatory risk; and any other risk that can be hedged or mitigated with a swap. Hedging and mitigating commercial risk does not include any activity undertaken to assume the risk of changes in the value of a commodity.

D. DEFINITION OF "ELIGIBLE CONTRACT PARTICIPANT"

1. "Eligible Contract Participants" that are also "Eligible Commercial Entities"

Under the changes to the CEA effected by the Act, it is unlawful for any person who is not an eligible contract participant ("ECP") to enter into a swap, unless the swap is entered into on a designated contract market. The NFP Energy End Users are public power and public gas entities, or electric cooperatives, that operate electric energy or natural gas utility businesses. They currently engage in contracts, agreements and transactions in energy and energy related "exempt commodities," which may or may not be determined to be "swaps" under the Act's sweeping definition. The NFP Energy End Users engage in such transactions in the course of their everyday commercial businesses to fulfill their obligation to deliver energy to retail consumers and to hedge, mitigate or manage commercial risk. It would not be cost-effective to conduct all their hedging transactions on an exchange. But some of these NFP Energy End Users do not meet the financial hurdles established in the definition of ECP due to their status as electric cooperatives or public power or gas entities. See the third paragraph of Section IE above. Accordingly, it is important that the CFTC confirm that such commercial entities qualify as ECPs, so that they can continue to engage in transactions which may be "swaps" under the Act, without transacting on an exchange. The NFP Energy End Users and other commercial entities will also need to be able to confirm the CFTC's interpretation to their counterparties and prospective counterparties.

For electric cooperatives, the relevant portion of the definition of "eligible contract participant" is found in clause (v) of Section 1a(18) of the CEA, which reads as follows:

> (v) *A corporation, partnership, proprietorship, organization, trust or other entity*
>
> (I) That has total assets exceeding $10,000,000;
>
> (II) The obligations of which under an agreement, contract, or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by an entity described in subclause (I), in clause (i), (ii), (iii), (iv), or (vii), or in subparagraph (C); or
>
> (III) *That --*
>
> *(aa) Has a net worth exceeding $1,000,000; and*
>
> *(bb) Enters into an agreement, contract, or transaction in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity's business;* (*Emphasis added*)

Under this definition, an electric cooperative can qualify as an ECP if it has $1,000,000 net worth and engages in transactions to manage commercial risk. But some of the smallest NFP Energy End Users may not meet the financial test due to their status as a consumer-member owned entity. But such a small electric cooperative would meet the definition of "eligible commercial entity" ("ECE") but for the requirement that an ECE must also be an ECP. See below. Accordingly, we request that the CFTC interpret the definition of ECP so as to include electric cooperatives that satisfy any one of the criteria in clauses (i), (ii) or (iii) of Section 1a(17)(A) of the CEA.

For governmental entities who engage in the delivery of natural gas and/or power, the relevant portion of the definition of "eligible contract participant" is found in clause (vii) of Section 1a(18) of the CEA, which reads as follows:

> (vii) (I) *a governmental entity (including the United States, a State, or a foreign government) or political subdivision of a governmental entity;* (II) a multinational or supranational government entity; or (III) *an instrumentality, agency, or department of an entity described in subclause (I) or (II);*
>
> except that such term does not include an entity, instrumentality, agency, or department referred to in subclause (I) or (III) of this clause unless (aa) the entity, instrumentality, agency, or department is a person *described in clause (i), (ii), or (iii) of*

> *paragraph (17)(A)*[9]; (bb) the entity, instrumentality, agency, or department owns and invests on a discretionary basis $50,000,000 or more in investments; or (cc) the agreement, contract, or transaction is offered by, and entered into with, an entity that is listed in any of subclauses (I) through (VI) of section 2(c)(2)(B)(ii). *(Emphasis added)*

Under this definition, a public power or gas entity can qualify as an ECP if it qualifies as an ECE under Section 1a(17)(A)(i), (ii) or (iii).[10]

Each of the criteria in Section 1A(17)(A)(i), (ii) and (iii) is independent of the others, and a public power and/or gas entity can qualify as an ECE, and therefore an ECP, if it meets any one of them. We believe that a public power or gas entity that distributes electric energy or natural gas to the public at retail as its commercial business clearly meets the criteria found in Section 1a(17)(A)(i)-(iii) of the CEA in that it "has a demonstrable ability, directly or through separate contractual arrangements, to make or take delivery of the underlying commodity," and/or it "incurs risks, in addition to price risks, related to the commodity."

Finally, in clause (C) of the definition of ECP, the CFTC is given the authority to determine that any other person may be an ECP "in light of the financial or other qualifications of the person."

We respectfully request the CFTC to confirm that a public power or gas entity that meets one or more of the criteria set forth in Section 1a(17)(A)(i)-(iii) automatically qualifies as an ECP, regardless of its size or the value of assets that it owns or invests on a discretionary basis. In addition, we respectfully request that the CFTC determine, as permitted by Section 1a(18(C) of the CEA, that an electric cooperative that enters into a transaction to hedge, mitigate or

---

[9] See definition of "eligible commercial entity," below.

[10] The relevant section defining an "exempt commercial entity" reads as follows:

"The term 'eligible commercial entity' means, with respect to an agreement, contract or transaction in a commodity -- (A) *an eligible contract participant described in clause . . . (v)[electric cooperative] . . . or (vii)[public power and/or gas entity] . . . of paragraph (18)(A) that, in connection with its business --*

> (i) *has a demonstrable ability, directly or through separate contractual arrangements, to make or take delivery of the underlying commodity;*
>
> (ii) *incurs risks, in addition to price risk, related to the commodity*; or
>
> (iii) [not relevant to NFP Energy End Users]." *(Emphasis added)*

manage commercial risk associated with its business and meets one or more of the criteria set forth in Section 1a(17)(A)(i)-(iii) automatically qualifies as an ECP regardless of its net worth.

2. Related Comments Regarding Treatment of "Special Entities"

Although the CFTC has not, at this time, sought comments on the definition of "Special Entity," due to the interrelationship of this definition with the definition of "eligible contract participant," we submit these comments here and plan also to submit them to the CFTC's Task Force charged with Regulation of Swap Dealers and Major Swap Participants. The NFP Energy End Users must rely on the CFTC's staff to be mindful of the interrelationship of all of the regulations. We understand the complexity of the CFTC staff's challenge under the tight statutory timeframe for rule-makings. But the complexity of the provisions of the Act, and the lack of clarity as to how the various sections were meant to work both together and with the CEA as in effect prior to the Act, creates a challenge for NFP Energy End Users who are struggling to understand whether, how and why this new regulatory scheme will apply to their commercial businesses.

The term "special entity" is defined in the Act to include, among other entities, a State, State agency, city, county, municipality, or other political subdivision of a State. The Act imposes new duties on swap dealers and major swap participants in their dealings with special entities.

The Coalition believes that it is not necessarily an advantage to be treated as a special entity. To the extent that swap dealers or major swap participants face higher costs when dealing with special entities, they may choose not to deal with special entities for certain types of transactions, or they may increase the fees that they (directly or indirectly) charge special entities for engaging in swap transactions. We believe that an entity that is both an ECP and a special entity should be able to "opt out" of the protections afforded by whatever duties the CFTC may establish for swap dealers and major swap participants in their dealings with special entities. This approach is consistent with the traditional CEA use of the ECP definition, which identifies an ECP by financial strength and permits the ECP to act for itself in the exempt markets. It is also consistent with other provisions of the Act in which ECPs are allowed to engage in certain types of transactions that retail customers or smaller entities are not. This proposal would also be consistent with the ability that end users have to opt out of mandatory clearing for their swap transactions.

If the CFTC does not accept our recommendation that all ECPs should be able to opt out of being treated as a special entity, then at the very least an eligible commercial entity should not be treated as a special entity with respect to transactions in the commodities in respect of which the eligible commercial entity operates a commercial business. For example, a public gas or power entity that operates commercial businesses distributing natural gas and/or electric energy to retail consumers would potentially be both an eligible commercial entity (and so an ECP) and a special entity as those terms are defined under the CEA, as amended by the Act. In our view, the very fact that the public power entity is engaged in a commercial business activity involving the distribution of natural gas or electric energy means that it is not appropriate to treat the public

power entity as a special entity with respect to swap transactions intrinsically related to its commercial energy activities. Being treated as a special entity would most likely make it more difficult (and certainly more expensive) for the public power or natural gas entity to engage in the types of hedging transactions it needs in order to protect against the risks associated with its commercial activities.

III. CONCLUSION

The Coalition strongly encourages the CFTC and the SEC to consider the effect on end users of "swaps" at every step of the regulatory rulemaking process. We respectfully request that, as the CFTC drafts its rules, it carefully consider the consequences to those who operate commercial businesses and are drawn into this new regulatory environment only because of the broad statutory language which could be read to redefine traditional commercial contracts as "swaps." All of the NFP Energy End Users' natural gas, electric energy and energy-related transactions are intrinsically tied to the physical commodities they deliver to American businesses and consumers -- there is no speculation and, given the NFP Energy End Users' not-for-profit public service business, they have no incentive to speculate. NFP Energy End Users transact only to obtain and deliver energy to retail consumers and to manage commercial risks, so that the ultimate cost of reliable natural gas and electric energy to consumers is as low and predictable as possible, consistent with their environmental stewardship standards. Any new regulatory burdens, direct or indirect costs or requirements will result, dollar for dollar, in higher costs to the NFP Energy End Users' customers and owners -- approximately 87 million (electric) and 5 million (gas) American retail consumers of electric energy and natural gas.

The NFP Energy End Users do not pose a threat to the United States banking or financial system. It was not Congress' intent that the Act should impose regulatory burdens on commercial business by treating them like the financial market professionals who participate voluntarily in CFTC-regulated markets. Regulatory policy-making and rule-making must be tailored to achieve Congressional objectives without creating uncertainty as to who will be regulated and what transactions will be regulated once the effective date for the Act arrives. The rules should be tailored to fit the differing market structures, and to exclude, exempt or treat appropriately, the business entities that engage in commercial transactions which might be determined to fall within the Act's sweeping new definitions.

If the CFTC decides not to clarify whether its regulations under the Act extend to commercial transactions that electric cooperatives and public power and gas systems utilize in their everyday business, the NFP Energy End Users respectfully request that an analysis be performed (pursuant to rule-making and with an opportunity for public hearing) on the potential impact of such regulations on "small entities" under the Regulatory Fairness Act, as noted above, to determine whether less burdensome alternative forms of regulation can be developed for small entities.

Respectfully yours,

THE "NOT-FOR-PROFIT ENERGY END USER COALITION"

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: _____
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

AMERICAN PUBLIC GAS ASSOCIATION

By: _____
Dave Schryver
Executive Vice President

LARGE PUBLIC POWER COUNCIL

By: _____
Name: _____
Its: _____

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

Respectfully yours,

THE "NOT-FOR-PROFIT ENERGY END USER COALITION"

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: Susan N. Kelly
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

AMERICAN PUBLIC GAS ASSOCIATION

By: _____
Dave Schryver
Executive Vice President

LARGE PUBLIC POWER COUNCIL

By: _____
Name: _____
Its: _____

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

Respectfully yours,

THE "NOT-FOR-PROFIT ENERGY END USER COALITION"

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: _____
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

AMERICAN PUBLIC GAS ASSOCIATION

By: _____
Dave Schryver
Executive Vice President

LARGE PUBLIC POWER COUNCIL

By: _____
Name: _____
Its: _____

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

Respectfully yours,

THE "NOT-FOR-PROFIT ENERGY END USER COALITION"

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

By: _____
Russell Wasson
Director, Tax, Finance and Accounting Policy

AMERICAN PUBLIC POWER ASSOCIATION

By: _____
Susan N. Kelly
Senior Vice President of Policy Analysis and General Counsel

AMERICAN PUBLIC GAS ASSOCIATION

By: _____
Dave Schryver
Executive Vice President

LARGE PUBLIC POWER COUNCIL

By: _____
Name: Noreen Roche-Carter
Its: Chair, LPPC Tax and Finance Task Force

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (File Number S7-12-10 or S7-16-10 (unclear in the Federal Register Notice) – filed by e-mail per Federal Register Notice

“PROFILES” OF INDIVIDUAL NFP ENERGY END USERS

See Attached

CH2\9347081.8

Hypothetical Electric Distribution Cooperative in Midwest[*]

Type of utility: Hypothetical Electric Distribution Cooperative

Description of customer base: Serving 22,000 members in suburban and rural areas of a Midwest. No owned generation assets; member of a generation and transmission cooperative.

Risk management/hedging policy description: Prohibition against speculation following guidelines and regulations of the Rural Utilities Service of the US Department of Agriculture

Recordkeeping procedures: All contracts and records are retained in accordance with the records retention policy of the Rural Utilities Service of the US Department of Agriculture

Types of counterparties: Typically other utilities (cooperative, municipal, or investor-owned)

Types of commodities/products used: Forward contracts and options for physical delivery of electricity. Zero to ten fixed to RTO price swaps for small amounts of power.

What happens to gains/losses from these activities: passed through to members of the cooperative through changes in rates for electric service

Current collateral posting requirements

What is the typical collateral threshold amount in your hedging contracts, if there is one? No thresholds on contractual obligations. All obligations are unsecured.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding?
N/A

In what form do you post collateral for your hedging transactions?
N/A

---

[*] For this smaller NFP Energy End User profile, we have provided a hypothetical. This profile represents the vast majority of NFP Energy End Users, who may (or may not) enter into one or a few "price protection" or other energy or fuel supply or energy sales financial hedging transactions from time to time. Again, we refer you to our comment letter on the Definitions ANOPR. We assume for purposes of this profile, that physical forward gas, power and other nonfinancial commodity transactions and commercial options are not "swaps." Nonetheless, the small NFP Energy End Users need the ability to enter into non-cleared financial price hedging transactions, which may fall within the definition of "swap" as an important risk management tool. These small NFP Energy End Users need to maintain their ability to cost-effectively use "non-cleared swaps" to manage their commercial risks without burdensome or costly new regulatory requirements.

Approximately what percentage of your hedging contracts involve collateral obligations?

N/A

Credit ratings: Not rated by a credit rating agency. Our lenders and contract counterparties perform internal credit assessment and may monitor our ability to meet our mortgage covenants.

Ability of system to raise rates if needed to ensure fiscal stability: Our mortgage covenants require us to raise our rates to meet our minimum mortgage financial covenants. Our board of directors must approve any changes in rates.

Use of outside advisors: We utilize engineering firms for cost of service studies and our legal counsel assists us with contractual matters. We do not use outside advisors for power supply advice. We sometimes consult with our G&T cooperative.

Public Power Utility in the Pacific Northwest

Region: Pacific northwest portion of the Western Electricity Coordinating Council (WECC).

Type of utility: Mid-size municipal corporation with service to over 180,000 customers.

Description of customer base: Mix of residential, commercial and industrial. Estimated to be about 53% residential, 30% commercial and 17% industrial.

Owned generation: 248 megawatt (MW) combined cycle combustion turbine generator fired with natural gas.

Purchased generation and transmission – The utility's power supply portfolio includes purchased power contracts with the Bonneville Power Administration (BPA) and, to meet the state renewable energy requirements, a power supply contract for energy from a wind generator. The electric system has contractual rights to over 48 MMBtus per day natural gas transportation capacity on the Northwest Pipeline, and has contractual point-to-point and network integration transmission rights from BPA for electric transmission requirements.

Risk management/hedging policy description: The utility has adopted by resolution a hedging policy to meet the utility's energy loads. The policy prohibits speculative trading; the net supply position cannot exceed the utility's forecasted load requirements. Any displacement of the generation facility must result in an increase in savings over the original position. Multiple hedging tools may be used – including options, swaps, swaptions, and futures – however, the utility's hedging tool of choice is a swap. Our risk management time horizon is five years, although few transactions extend beyond 3 years.

Recordkeeping procedures: Every transaction is conducted on a recorded telephone line and entered into our system of record. The transaction is followed up with a written "confirm" executed by both parties and retained and transmitted pursuant to the underlying umbrella contract, which in our case is normally an ISDA contract.

Types of counterparties: Balanced counterparty portfolio, including utilities, marketers, producers, and banks.

Types of commodities/products used: Natural gas and electricity – other products are allowed under the risk policy, however. For natural gas, we use nearly 100% OTC swaps (with ISDA or NAESB master agreements) rather than NYMEX contracts to hedge.

What happens to gains/losses from these activities: Transactions are not entered into in order to make a profit. We need fuel supply, and so we lock in our forward prices with a financial product. We do not speculate so there is no gain or loss over our original position. We may unwind a hedge if we determine that we can save money by not running the plant. Those savings are a reduction in costs in the budget, and the monies would be applied to future fuel needs.

Current collateral posting requirements: The utility is subject to posting cash, letters of credit or other forms of security. However, our internal collateral management procedures have successfully avoided any posting of collateral or margin call in the utility's hedging history. The utility almost always is a net buyer so we have never had a counterparty's credit exposure to us exceed more than a few million dollars. The utility's commercial gas hedging transactions do not result in any threat to the United States' banking and financial systems. If the utility's commercial hedging transactions are included as regulated swaps or commodities, the end result will not be increased stability for the banking and financial systems, but rather will be significant financial distress to the utility and its customers.

What is the typical collateral threshold amount in your hedging contracts, if there is one? There is a collateral threshold. It is dynamic and is based on the ratings of the counterparties.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? Collateral and margin are evaluated daily and would be exchanged only if a credit event occurs or if a threshold is exceeded.

In what form do you post collateral for your hedging transactions? To date, the district has avoided posting collateral, however we would prefer to post in cash or letter of credit, if required.

Approximately what percentage of your hedging contracts involve collateral obligations? We could be required to post collateral – and we have the right to request collateral – in 100% of our contracts, but in fact, have never had to post collateral because of our credit management procedures.

Credit ratings: Rated "A" by Standard & Poor's and Moody's.

Ability of system to raise rates if needed to ensure fiscal stability: Can raise rates with a public meeting, and have done so in less than 3 weeks.

Use of outside advisors: None that assist us in hedging our power supply risk. We have a risk management department with experience in credit, collateral, market, default, and pricing risk management, and a demonstrated ability in maximizing the use of unsecured credit (under collateral thresholds of our ISDAs) while protecting our ratepayers from default risk. We have a gas department – with experience with financial products – that manages our forward hedging portfolio.

Pledge of Assets: The utility has outstanding approximately $220 million of Electric System revenue bonds and $180 million of Generating System revenue bonds. The bond resolutions pledge to holders of its revenue bonds that the utility will not encumber either the Electric System or the Generating System with any lien except for certain parity revenue obligations, none of which provide an exception for pledging the assets of either system for commercial hedging transactions. Extending the pledge of assets against over

the counter transactions would be an impairment of the pledge previously given to bondholders.

Mid-sized Generation and Transmission Cooperative in the Midwest

Region: Midwestern United States, Midwest ISO (MISO)

Type of utility: Mid-size Generation & Transmission Cooperative

Description of customer base: 28 Rural Electric Coops and 2 non-coop members serving approximately 374,000 customer meters

Owned generation and transmission: This coop has a 25% interest in a 625 MW coal-fired unit, a 50% interest in a gasification plant providing steam and synthetic gas to the coop's 260 MW plant, a 50% interest in a 630 MW combined-cycle plant, 33MW of landfill gas generation, and 246 MW of gas-fired peaking power.

Purchased generation and transmission: A portfolio of purchase power agreements is used to satisfy the remainder of the cooperative's load requirements. These agreements total approximately 950 MWs and include fixed price, unit contingent, and cost-based transactions, all of which expire on or before December 31, 2032. The coop also has network transmission service agreements with various utilities to ensure delivery of the power.

FTRs (or comparable transactions in the specific RTO) holdings to support transmission/power supply transactions: As a firm transmission customer the cooperative is eligible to participate in MISO's Auction Revenue Rights Allocation (ARR) and Financial Transmission Rights (FTR) auction market. FTRs are a financial hedging tool and do not convey physical transmission rights. The cooperative purchases and sells FTRs to match the current energy supply to the current energy demand with the goal of hedging, or fixing, the price differential for a month or year(s) between power sources (where generation is located) and load "sinks" (where the customers are located). This may include selling FTRs that were based on historical ARR rights that are no longer applicable to the current energy portfolio. The cooperatives hedge policies do not allow speculative positions.

Energy risk management/hedging policy description: The cooperative has an energy risk management policy that outlines the following objectives: maintain risk within desired tolerances for a defined period in the future, mitigate price volatility, optimize the value of power supply assets/resources, participate in commodity markets and derivative instruments for hedging only and not for speculative purposes, and to develop a risk management culture.

The cooperative has a hedge policy that guides disciplined hedging of forward power supply portfolio components. This hedge policy is designed to reduce member wholesale rate volatility and to maintain rates within desired tolerances. The hedge policy identifies specific time and volume (as a % of total projected native load) criteria for procuring projected power supply portfolio components. This policy largely employs a price-averaging strategy of declining percentage of power supply portfolio components held over forward time periods. This strategy protects the cooperative from potential adverse impacts that could result in either significant price increases or decreases. Reporting policy compliance to the Board is a key component of the hedge policy.

The cooperative uses a total energy hedging approach for their hedge policy. For policy compliance, energy needs are considered hedged or procured to the extent that the projected need is met by; i) Authorized power transactions, as defined in the cooperative's trading authority policy, or ii) Authorized fuel transactions combined with physical generation unit ownership, heat rate transactions, or physical capacity transactions. Option transactions with out of the money strike prices may be used to hedge forward volumes, provided that they do not account for more than a small defined % of the projected energy needs in any given month.

The cooperative utilizes a full array of hedging instruments, including physical and financial derivatives. The cooperative has a trading authority policy that outlines the allowable trading instruments, procedures, and authority approval requirements to enter transactions. This cooperative has ISDA master agreements in place under which the cooperative transacts in financial derivatives.

Recordkeeping procedures: All transactions are executed via recorded phone lines or on-line brokers. All phone lines of traders are recorded and stored electronically. Traders capture all transactions in the energy trading and risk management (ETRM) system promptly after execution. Traders generate, review, sign, and date transaction reports from the ETRM system each day. Written confirmations are automatically generated out of the ETRM system each day. The middle office prepares, reviews, signs, and faxes to the counterparty a hard copy confirmation letter for each transaction, except for those executed with a clearing broker. Clearing broker transactions are reconciled daily to broker statements. The middle office verifies all external confirmations to ensure the transaction details match the ETRM system. The back office checks out with counterparties on a monthly basis and generates invoices directly from the ETRM system. For clearing broker transactions, the back office reconciles monthly broker statements to the ETRM system. All transactional records are retained in compliance with FERC records retention requirements.

Types of counterparties: This coop currently uses 73 counterparties including the MISO, banks, utilities, producers, and marketers

Types of commodities/products used: NYMEX natural gas futures, OTC natural gas swaps, long-term power purchase agreements for physical power, wind, long-term point to point and network transmission, Financial Transmission Rights (FTRs), Renewable Energy Credits, SO2 and NOx emission allowances

What happens to gains/losses from these activities: Unrealized gains and losses from financial transactions are recorded on the balance sheet as a deferred asset or liability. Once the positions are cash settled, any gain or loss is taken against income as a component in determining net power costs.

Current collateral posting requirements: None

What is the typical collateral threshold amount in your hedging contracts, if there is one? Collateral thresholds vary from $10 million to $40 million. The cooperative manages its

transactions with various counterparties in order to avoid having to post collateral by keeping net exposures below the applicable threshold.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? Collateral or margin requirements are calculated daily and, if required, margins would be posted or called daily.

In what form do you post collateral for your hedging transactions? This coop posts both cash and Letters of Credit.

Approximately what percentage of your hedging contracts involve collateral obligations? None of the hedging contracts currently have collateral obligations.

Credit ratings: A-/Stable S&P Long Term Rating

Ability of system to raise rates if needed to ensure fiscal stability: The coop is governed by the FERC for rate making purposes and has a formulary rate that defines the calculation and types of expenditures that are included for rate setting purposes. The coop's Board of Directors, made up of member-owners, has responsibility for approving the inputs into the approved formula with no further action required by FERC. Rates are set annually based on the current year's operating budget (formula inputs), as approved by the Board. Quarterly, the Board makes a determination on whether to modify the current rate level. Their decision is based on actual results to date and the latest financial projections.

Use of outside advisors: Consulting services of ACES Power Marketing are used for all risk management activities.

Mid-Sized Generation and Transmission Cooperative in the Midwest

Region: Midwestern United States, Midwest ISO (MISO)

Size/Type of utility: Mid-size generation and transmission cooperative

Description of customer base: Provides wholesale electric service and transmission to 18 member distribution cooperatives who in turn serve approximately 800,000 customers consisting of residential, business, industrial, and farms.

Owned generation and transmission: 1,320 megawatts of coal generating capacity, 350 megawatts of natural gas generating capacity, and 2 MW Landfill Methane renewable energy generation. Joint ownership in a 627 megawatt combined cycle plant. Owns over 1,400 miles of transmission lines.

Purchased generation and transmission: The cooperative has power purchase agreements with another utility to receive 200 megawatts (MW) of power. The cooperative is a member of the Midwest Independent System Operator (MISO) which ensures delivery of the power.

FTRs (or comparable transactions in the specific RTO) holdings to support transmission/power supply transactions: As a firm transmission customer the cooperative is eligible to participate in MISO's Auction Revenue Rights Allocation (ARR) and Financial Transmission Rights (FTR) auction market. FTRs are a financial hedging tool and do not convey physical transmission rights. The cooperative purchases and sells FTRs to match the current energy supply to the current energy demand with the goal of hedging, or fixing, the price differential for a month or year(s) between power sources (where generation is located) and load "sinks" (where the customers are located). This may include selling FTRs that were based on historical ARR rights that are no longer applicable to the current energy portfolio. The cooperatives hedge policies do not allow speculative positions.

Energy risk management/hedging policy description: The cooperative has an energy risk management policy that outlines the following objectives: maintain risk within desired tolerances for a defined period in the future, mitigate price volatility, optimize the value of power supply assets/resources, participate in commodity markets and derivative instruments for hedging and not for speculative purposes, and to develop a risk management culture.

The cooperative has a hedge policy that guides disciplined hedging of forward power supply portfolio components. This hedge policy is designed to reduce member wholesale rate volatility and to maintain rates within desired tolerances. The hedge policy identifies specific time and volume (as a % of total projected native load) criteria for procuring projected power supply portfolio components. This policy largely employs a price-averaging strategy of declining percentage of power supply portfolio components held over forward time periods. This strategy protects the cooperative from potential adverse impacts that could result in either significant price increases or decreases. Reporting hedge policy compliance to the Board is a key component of the policy.

The cooperative uses a total energy hedging approach for its hedge policy. For policy compliance, energy needs are considered hedged to the extent that the projected need is met by; i) Authorized power transactions, as defined in the cooperative's trading authority policy, or ii) Authorized fuel transactions combined with physical generation unit ownership, heat rate transactions, or physical capacity transactions. Option transactions with out of the money strike prices may be used to hedge forward volumes, provided that they do not account for more than a small defined % of the projected energy needs in any given month.

The cooperative utilizes a full array of hedging instruments, including physical and financial derivatives. The cooperative has a trading authority policy that outlines the allowable trading instruments, procedures, and authority approval requirements to enter transactions. This cooperative has ISDA master agreement in place under which it transacts financial derivatives.

Recordkeeping procedures: All transactions are executed via recorded phone lines or on-line brokers. All phone lines of traders are recorded and stored electronically. Traders capture all transactions in the energy trading and risk management (ETRM) system promptly after execution. Traders generate, review, sign, and date transaction reports from the ETRM system each day. Written confirmations are automatically generated out of the ETRM system each day. The middle office prepares, reviews, signs, and faxes to the counterparty a hard copy confirmation letter for each transaction, except for those executed with a clearing broker. Clearing broker transactions are reconciled daily to broker statements. The middle office verifies all external confirmations to ensure the transaction details match the ETRM system. The back office checks out with counterparties on a monthly basis and generates invoices directly from the ETRM system. For clearing broker transactions, the back office reconciles monthly broker statements to the ETRM system. All transactional records are retained in compliance with FERC records retention requirements.

Types of counterparties: Counterparty portfolio consists of banks, cooperatives, and power producers. This cooperative has 5 ISDA counterparties.

Types of commodities/products used: NYMEX (natural gas futures, natural gas options, heating oil futures, heating oil options), OTC natural gas swaps, long-term power purchase agreements for physical power, long-term point to point and network transmission, Financial Transmission Rights (FTRs), Renewable Energy Credits, SO2 and NOx emission allowances

What happens to gains/losses from these activities: Gains/losses from financial hedging activities are netted against physical transactions which ultimately determine the net commodity cost for the cooperative.

Current collateral posting requirements: No margin posted, not currently applicable.

What is the typical collateral threshold amount in your hedging contracts, if there is one? The typical range is $2.5 to $15 million, with an average of approximately $5 million. The cooperative manages its transactions with various counterparties in order to avoid having to post collateral by keeping exposures to any counterparties below the applicable threshold.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? Daily when applicable.

In what form do you post collateral for your hedging transactions? Cash

Approximately what percentage of your hedging contracts involve collateral obligations? None of the hedging contracts currently have collateral obligations.

Credit ratings: Standard and Poor's rating: A
Moody's rating: Baa2

Ability of system to raise rates if needed to ensure fiscal stability: The members of the cooperative are also its ultimate rate-payers. The cooperative has autonomous authority to establish the rates charged for all services, with broad oversight performed by the Rural Utilities Service under the U.S. Department of Agriculture. Changes in rates occur by action of the cooperative's Board of Directors, which is elected by the members. The cooperative's rate structure also includes an automatic power cost adjustment mechanism whereby rates are adjusted on a quarterly basis for changes in commodity costs and the associated costs of hedging without additional action by the Board.

Use of outside advisors:
Consulting services of ACES Power Marketing are used for risk management activities.

Large Generation and Transmission Cooperative in the Southeast

Region: Southeastern United States, PJM

Type of utility: Large Generation and Transmission Cooperative

Description of customer base: Provides wholesale electric service and transmission to 25 electric distribution cooperatives serving approximately 1 million customer meters.

Owned generation and transmission: Generation portfolio includes 682 MW of nuclear generation, 18 MW of diesel generation, and 620 MW of natural gas fired combustion turbines. Additionally, the utility owns approximately 500 MWs of import transmission capacity.

Purchased generation and transmission: The cooperative has a diverse power supply portfolio to supply the power requirements and obligations of its members. The portfolio includes purchased power agreements (PPAs) with investor-owned utilities and merchant generation resources

FTR holdings to support transmission/power supply transactions: As a load serving entity the cooperative is eligible to participate in PJM's Auction Revenue Rights Allocation (ARR) and Financial Transmission Rights (FTR) auction market. FTRs are a financial hedging tool and do not convey physical transmission rights. The cooperative purchases and sells FTRs to match the forecasted member load to the portfolio energy supply with the goal of hedging, or fixing, the price differential for a month or year(s) between power sources (where the generator is located) and "sinks" (where the customers are located). The cooperative's hedge policies do not allow speculative positions.

Risk management/hedging policy description: The cooperative has energy risk management, trading authority and credit policies that outline the following objectives: maintain risk within desired tolerances for a defined period in the future, mitigate price volatility, optimize the value of power supply assets/resources, participate in commodity markets and derivative instruments for hedging and not for speculative purposes, and develop a risk management culture.

The cooperative has a hedge program that guides disciplined hedging of forward power supply portfolio components. This hedge policy is designed to reduce commodity price volatily which provides member wholesale rate stability.. The hedge policy identifies specific time and volume (as a % of total projected native load) criteria for procuring projected power supply portfolio components. The cooperative utilizes a full array of hedging instruments, including physical and financial derivatives. The cooperative has a trading authority policy that outlines the allowable trading instruments, procedures, and authority approval requirements to enter transactions. This cooperative has ISDA master agreements in place under which the coop transacts in financial derivatives.

Recordkeeping procedures: All transactions are executed via recorded phone lines or on-line brokers with the exception of the PJM ARR and FTR transactions which are executed through the PJM administered web portal. All transactions are captured in the energy trading and risk

management (ETRM) system and reviewed and verified by middle office personnel. Written confirmations are automatically generated out of the ETRM system each day. The back office checks out with counterparties on a monthly basis and generates invoices directly from the ETRM system. For clearing broker transactions, the back office reconciles monthly broker statements to the ETRM system. All transactional records are retained in compliance with FERC records retention requirements.

Types of counterparties: This cooperative transacts with roughly 20 counterparties. The counterparties include utilities, marketers, banks, Regional Transmission Organization and government agencies.

Types of commodities/products used: NYMEX (natural gas futures and options, heating oil futures), OTC (natural gas swaps, options, heating oil swaps), long-term power purchase agreements for physical power and renewable energy, long-term point to point and network transmission, Financial Transmission Rights (FTRs), Renewable Energy Credits, SO2 and NOx Emission Allowances

What happens to gains/losses from these activities: Gains or losses from financial hedging activities are netted against the cost of the underlying power supply resource.

Current collateral posting requirements: This cooperative is using Letters of Credit as its only form of collateral/margin, other than a small amount of cash posted with the RTO for FTRs.

What is the typical collateral threshold amount in your hedging contracts, if there is one? Collateral thresholds vary from $5 million to $50 million. The cooperative manages its transactions with various counterparties in order to avoid having to post collateral by keeping exposures to any counterparty below the applicable threshold.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? Collateral or margin requirements are calculated daily.

In what form do you post collateral for your hedging transactions? Letters of Credit for OTC transactions; cash for NYMEX transactions.

Approximately what percentage of your hedging contracts involve collateral obligations? None of the OTC hedging contracts currently have collateral obligations.

Bond ratings: Not Rated

Ability of system to raise rates if needed to ensure fiscal stability: The utility has autonomous authority to establish rates charged for all services. Rates are approved annually by the utility's Board of Directors and are not subject to rate regulation by the state public utilities commission. Rates must be sufficient to recover all costs and to meet financial covenants contained in the mortgage with the primary lender, the Rural Utilities Service, and loan agreements with other lenders.

Use of outside advisors:
Consulting services of ACES Power Marketing are used for trading and risk management activities.

Public Power Utility in the South Central Region

Region: Southwest Power Pool (SPP) region.

Type of utility: Joint Action Agency (JAA) providing power supply to 37 municipal utilities. Our Board of Directors is made up of representatives of the cities and municipalities we serve.

Description of customer base: The JAA's member utilities have a projected 2011 peak demand of approximately 743 megawatts (MWs) and total energy requirements of 2,521,000 megawatt-hours (MWHs).

Owned generation: The JAA owns approximately 575 MWs of generating capacity: 120 MWs of coal, 380 MWs of natural gas, 75 MWs of hydro and wind facilities.

Purchased generation and transmission: The JAA has power purchase agreements with other utilities to receive approximately 293 MWs of power. The JAA also has network transmission service agreements with the Southwest Power Pool to ensure delivery of the power. The JAA's financial hedging is in natural gas swaps.

Risk management/hedging policy description: JAA staff can enter into swaps for electricity and fuels for terms of one year or less, as long as the amount is within the generally approved budget, the credit rating of the counterparty is investment grade or better, and the transaction is "matched" by the projected physical requirements of the commodity being hedged. All agreements that are greater than one year or exceed the budget require advance approval of the Board of Directors.

The JAA typically hedges 50 percent or less of the projected May-September volume of natural gas, although specific pre-approved volumes for the entire year can be hedged. The JAA does not typically hedge natural gas volumes more than two years in the future. The purpose of the JAA's natural gas hedges is to lock in a fixed price for the volumes approved.

Recordkeeping procedures: Every transaction is conducted on a recorded telephone line and entered into the JAA's records. The transaction is followed up with a written confirmation executed by both parties in accordance with the underlying ISDA contract. The JAA receives mark-to-market reports from its counterparties at each month-end, and reports monthly to its Board on the amount and volume of hedging transactions.

Types of counterparties: The JAA has ISDA contracts with two bank counterparties, and is in the process of adding contracts with an energy company and another bank.

Types of commodities/products used: Natural gas. All are over-the-counter transactions. None are on CFTC-regulated exchanges. The JAA typically has a 2-year planning horizon.

What happens to gains/losses from these activities: Generally, annual gains/losses would be reflected in the JAA's rates. The financial effect of our hedges is disclosed by footnotes in our financial statements. In all likelihood, for yearend 2010 and forward, the JAA will show a deferred asset on its balance sheet for the net effect of the hedges. Once the hedges are cash settled, the gain/loss is taken against income.

Current collateral posting requirements

What is the typical collateral threshold amount in your hedging contracts, if there is one? Collateral is determined by the credit rating of the JAA's bonds. It is a sliding scale: the higher the credit rating, the higher the threshold that must be exceeded before margin has to be posted.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? The mark-to-market value on the hedge and the threshold required in the ISDA determines the collateral that would be posted; the mark-to-market value is continuously monitored.

In what form do you post collateral for your hedging transactions? Collateral can be posted in the form of cash, U.S. Treasury obligations, or high-rated commercial paper (rated "A1" by Standard & Poor's or "P1" by Moody's).

Approximately what percentage of your hedging contracts involve collateral obligations? 100% of the JAA's hedges have "threshold" collateral requirements, as previously described. Currently, none of the JAA's hedges exceeds the threshold that would require collateral.

Credit ratings: Rated "A" by Standard &Poor's and A2" by Moody's.

Ability of system to raise rates if needed to ensure fiscal stability: The JAA's Board of Directors has the ability to make a rate change with 60 days notice. The JAA reviews its rates and revenue requirements periodically and will implement rate changes as necessary to comply with its rate covenants.

Use of outside advisors: The JAA does not use outside advisors for its hedging program because it has significant in-house expertise. The JAA's general manager and finance manager have experience with financial management products, including energy derivatives. In addition, the JAA's Board of Directors, which is made up of representatives from the JAA's member cities and municipalities, includes directors with banking and financial management experience. To require the JAA to use outside advisors for its hedging program would add little or nothing to the JAA's ability to structure a hedging program to meet its financial goals and is counter to the JAA's mission of delivering power to customers at a reasonable cost. Instead, it would increase our cost of service in the form of the rates that the JAA passes on to the cities and municipalities that it serves.

Public Power Utility in California

Region: California The utility purchases services, such as transmission and power, from the California Independent System Operator (CAISO), but its transmission assets are not within the geographic boundaries of the CAISO Region.

Type of utility: Electric municipal utility run by a Board of Directors elected by consumers in its service territory. The utility serves approximately 600,000 customers (population of 1.4 million people).

Description of customer base: Serves approximately 522,000 residential and 79,000 commercial customers. The utility has a peak load of 3,300 megawatts (MWs).

Owned generation and transmission: Generating capacity of 1,000 MWs natural gas, 684 MWs hydro, and 147 MWs wind; 2,000 MWs of import transmission capacity (approximately 500 MW of potential export capacity limited by system resource constraints). To source natural gas for fuel, also owns natural gas reserves of 150 billion cubic feet (BCF), with 25,000 decatherms (DTH)/day production capacity; gas storage of 2.25 BCF.

Purchased generation and transmission: Purchased power contracts totaling approximately 1,100 MWs; long term transmission capacity contracts totaling 624 MWs, with approximately 400 MWs of daily spot market transmission capacity purchases. Also gas transportation contracts on seven pipelines, totaling 130,000 DTH/day in capacity.

Congestion Revenue Right (CRR) holdings to support transmission/power supply transactions: As a load-serving entity (LSE), the utility is eligible to participate in the CAISO CRR market. Similar to financial transmission rights (FTRs) in other regions, CRRs are a financial hedging tool and do not convey any physical transmission rights.

Energy Risk management/hedging policy description: Hedging and commodity procurement activities are closely regulated by the utility's Energy Risk Management and Energy Trading Standards. These documents were developed by the utility's executive management to prohibit activities – such as speculative trading and market manipulation – that could cause financial harm to the utility. Only transactions that pertain to serving electric load or procuring gas supply are allowed, and the sale of uncovered call or put options is specifically prohibited. In addition to these control procedures, staff of the utility's energy trading department must complete annual training to maintain certificates allowing them to trade.

Hedges are procured with the intent of locking the price of the utility's future commodity costs. Once a sufficient share of the future commodity costs are hedged for multiple years forward, the utility's future retail electricity rates are then set to ensure that sufficient revenues are collected to cover these costs. In essence, the retail rate setting process locks the revenues and matches the expected hedged costs. This effort of matching and locking revenues with costs is performed for two-year time blocks. By following this procedure,

the utility is comfortable with a covenant in its ISDA agreements that it will set retail rates sufficient to cover the financial obligations of any hedge transacted under the ISDA.

Recordkeeping procedures: All energy transactions are validated internally on a (business) daily basis by back office function, via logs and cross-system reconciliation. Within days of the end of each month, the utility's energy settlements staff checks out with representatives from each counterparty the utility has transacted with during that month to verify that both parties are in agreement for invoicing. Checking out and invoicing are done on a monthly basis consistent with industry standards, where invoices are issued and payment is due the month following the transactions month.

Types of counterparties: The utility has 20 ISDA counterparties – 14 banks and 6 producer or utility-based trading operations.

Types of commodities/products used: Financial NYMEX natural gas; financial natural gas basis (AECO, Malin, NW Rocky Mountain, Socal); financial power (NP15, Mid-Columbia).

What happens to gains/losses from these activities: Gains or losses from financial hedging activities are netted against physical transactions, which ultimately determine the net commodity cost for the utility.

Current collateral posting requirements

What is the typical collateral threshold amount in your hedging contracts, if there is one? All of the utility's financial hedging contracts are supported with a Credit Support Annex (CSA) to an ISDA contract, and both of these are negotiated between the utility and each individual counterparty. A collateral threshold table, which associates different collateral thresholds with different credit ratings, is applied to all CSAs. Because the utility restricts hedge trading to those counterparties with at least A- credit rating (better than investment grade), the typical collateral threshold is $20 million. This is the dollar amount the utility is able to manage within its annual budget without having to raise its customers' rates to cover the unsecured credit loss. This $20 million collateral threshold would be reduced when the utility or the counterparty's credit rating is reduced, per the collateral threshold table.

How often is collateral or margin reevaluated and exchanged while a transaction is outstanding? Mark-to-market values are calculated on a weekly basis, and collateral/margin is transferred weekly. However, if the credit rating for the utility or its counterparty falls below a certain level (pre-determined in the CSA), then collateral/margining becomes daily.

In what form do you post collateral for your hedging transactions? The utility posts letters of credit (LOCs) and cash exclusively. We estimate the breakdown is 50% LOCs and 50% cash. It could also post cash-equivalent assets, but chooses not to do so. The utility cannot and does not post physical assets.

Approximately what percentage of your hedging contracts involve collateral obligations?

All of the utility's financial hedges are backed by an ISDA contract with a CSA that involves the posting of collateral. Some of the utility's large-volume, long-term, physical purchase transactions have deal-specific collateral agreements as well.

Credit ratings: The utility is currently rated "A+" by Standard and Poor's, "A1" by Moody's and "A" by Fitch. It is extremely important to maintain our current ratings levels to ensure full access to credit markets. The utility's ratings are based, in part, on its ability to manage commodity risk, maintain its cash liquidity position and service its overall debt level. Given current market conditions and the scarcity of available bank facilities at a reasonable cost for lines of credit or LOCs, in the short run, any additional collateral posting requirements would force the utility to issue long-term debt to maintain liquidity. In the long run, the utility could not continue to access the long-term debt market to maintain liquidity for collateral postings without degrading its ratings and would have to either raise rates to fund collateral postings, or discontinue its hedging program and rely on additional reserves to provide a cash cushion to account for the risk of fluctuating commodity prices. Under either scenario, the utility's rate payers would face greater costs for energy.

Ability of system to raise rates if needed to ensure fiscal stability: The utility has autonomous authority to establish the rates charged for all services. Unlike investor-owned utilities and some other municipal utility systems, retail rate and revenue levels are not subject to review or regulation by any other governmental agencies, be they federal, State or local. Changes in rates require formal action, after public hearing, by the utility's Board of Directors. The utility is also not required by law to transfer any portion of its collections from customers to any local government.

Use of outside advisors: The utility relies on in-house expertise to manage commodity hedges, but does use an outside financial advisor to oversee the market bidding process on its interest rate hedges to ensure that bids are structured and priced within market parameters.