



3333 K Street, NW, Suite 110
Washington, D.C. 20007
Tel: 202-333-3288
Fax: 202-333-3266

July 21, 2011

The Honorable David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

RE: File No. S7-16-11

RIN 3038-AD46 – Notice of Proposed Rulemaking:

Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement,” Mixed Swaps; Security-Based Swap Agreement Recordkeeping (76 Fed. Reg. 29818)

Dear Secretary Stawick:

The National Energy Marketers Association (“NEM”)¹ appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“Commission”) above-referenced notice of proposed rulemaking (“NOPR”) regarding the further definition of “swap,” “security-based swap,” and “security-based swap agreement,” as well as mixed swaps and security-based swap agreement recordkeeping. NEM’s comments are directed to the issue of the definition “swap,” in particular the Commission’s proposed forward contract exclusion using the Brent Interpretation and the exemption of environmental commodities from the definition of “swap.”

NEM’s membership is primarily comprised of Retail Energy Marketers (and suppliers who serve them), who sell electricity and natural gas to consumers as a competitive alternative to the local utility. Retail Energy Marketers primarily buy physical energy and hedges necessary to provide consumers with the physical energy they want at a price (or price structure) they want. For example, Retail Energy Marketers often purchase wholesale physical natural gas and electricity on a spot (delivery) month (day) basis and also purchase swaps to lock in prices for any consumers who want a long-term fixed

¹ NEM is a non-profit trade association representing both leading suppliers and major consumers of natural gas and electricity as well as energy-related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM’s membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, global commodity exchanges and clearing solutions, demand side and load management firms, direct marketing organizations, billing, back office, customer service and related information technology providers. NEM members also include inventors, patent holders, systems integrators, and developers of advanced metering, solar, fuel cell, lighting and power line technologies.

price contract. Energy marketers as well as their suppliers are not financial entities and are not dealers as contemplated in the legislative history of the Dodd-Frank Legislation.²

I. Energy-Specific Clarifications to the Application of the Forward Contract Exclusion to Nonfinancial Commodities from the Definition of “Swap”

The term “swap” is defined in the Commodity Exchange Act³ and is the linchpin of the framework set forth in the Dodd-Frank Act for the regulation of swaps. As such, the Commission’s decisions on this rulemaking inform all of the other rulemakings it has instituted to implement the Dodd-Frank Act. NEM requested in previously filed comments that the Commission consider a safe harbor or transitional period for compliance for affected entities under Dodd-Frank, particularly because the key term “swap” had remained undefined and accordingly would interfere with entities ability to meaningfully anticipate their potential compliance obligations.⁴

The Commission remarked in this NOPR that it believes the statutory definitions of “swap” and other relevant terms are detailed and comprehensive. (NOPR at 29821). Therefore, the Commission is utilizing the rulemaking to provide guidance as to what constitute excluded transactions from the statutory definition of “swap”, and thereby, the clearing and recordkeeping requirements imposed by Dodd-Frank. (Id.).

Of particular interest to NEM, the Commission is proposing interpretive guidance on the scope of the forward contract exclusion for nonfinancial commodities from the statutory “swap” definition.

[T]he CFTC believes that: i) the forward contract exclusion from the swap definition with respect to nonfinancial commodities should be interpreted in a manner that is consistent with the CFTC's historical interpretation of the forward contract exclusion from the definition of the term "future delivery;" ii) intent to deliver is an essential element of a forward contract excluded from both the swap and future delivery definitions, and such intent in both instances should be evaluated based on the CFTC's established multi-factor approach; and iii) book-out transactions in nonfinancial commodities that meet the requirements specified in the Brent Interpretation, and that are effectuated through a subsequent, separately-negotiated agreement, should qualify for the forward exclusion from the swap definition. (NOPR at 29829).

Because of its proposal to extend the Brent Interpretation to all non-financial commodities, the Commission is proposing to withdraw the Energy Exemption. (Id.).

² See NEM Comments RIN 3038-AD06, RIN 3038-AD10, RIN 3038-AC98, dated February 22, 2011, at pages 2-3.

³ Commodity Exchange Act § 1a(47)(A), 7 U.S.C. § 1a(47)(A).

⁴ See NEM Comments RIN 3038-AD06, RIN 3038-AD10, RIN 3038-AC98, dated February 22, 2011, at pages 3-4.

NEM supports the Commission's decision to apply the forward contract exclusion to all non-financial commodities under the Brent Interpretation subject to the following energy industry-specific clarifications to aid in the Commission's implementation of the rule:

- The Commission should not set a minimum contract size for a transaction in a nonfinancial commodity in order for a transaction to qualify as a forward contract under the Brent Interpretation with respect to the future delivery and swap definitions.
 - The forward contract exclusion from the definition of swap should apply to environmental commodities such as carbon offsets/credits and renewable energy certificates.
 - Capacity contracts should be excluded from the definition of swap.
- A. The Commission should not set a minimum contract size for a transaction in a nonfinancial commodity in order for a transaction to qualify as a forward contract under the Brent Interpretation with respect to the future delivery and swap definitions. (NOPR at 29831, Question 27).**

The CFTC should not set a minimum contract size for a transaction under the Brent Interpretation. Energy marketers can purchase power at 1/100 of the standard lot size in wholesale power markets. For instance, there are mini-lots on NYMEX and Intercontinental Exchange.

Indeed, an energy marketer may add and subtract from a base contract multiple times before a transaction is completed, but this does not fundamentally alter the underlying obligation to deliver under the contract. This is not unusual in situations where an energy marketer has contracted to sell physical natural gas to an industrial or commercial user and then due to unforeseen changes in production schedules or the economic climate, the industrial or commercial user no longer requires the contracted volume of gas and must sell a portion of the gas back to the marketer. Subjecting such an ordinary business transaction in physical natural gas to the complex regulatory treatment proposed for swaps would be extremely burdensome to both the industrial or commercial user of gas and the energy marketer, would not further any of the purposes for which Dodd-Frank was adopted and would be injurious to the U.S. economy as a whole.

Moreover, NEM questions the reasonableness in instituting a system by which there would be a minimum contract size below which a transaction would become regulated but otherwise would not. This seems contrary to the purposes of Dodd-Frank in regulating transactions that would affect systemic risk.

B. The forward contract exclusion from the definition of swap should apply to environmental commodities such as carbon offsets/credits and renewable energy certificates. (NOPR at 29832, Question 32).

Environmental commodities such as carbon offsets, renewable energy certificates (RECs) and demand response should be included within the exclusion from the definition of swap because these transactions are increasingly being required of physical energy companies to perform their normal operations because of, for example, state renewable portfolio standards. The Commission asked how these transactions can be physically settled where the commodity lacks a physical existence or lacks a physical existence other than on paper. Environmental commodities are a part of the physical commodity sale and delivery obligation. RECs are traded as a physical commodity that must be physically settled through a REC registry, such as RGGI and WREGIS. The REC registries ensure that there is a physical megawatt-hour from a green generator “behind” the REC. The EEI Master Power Agreement, in common use in the energy industry, includes a REC Annex, which treats RECs as a physical commodity.⁵

There is also a comparable effort underway for carbon off-sets. And, in the case of demand response, you are “delivering” load-shaving. To be sure, futures and swaps can be constructed off these commodities (just like they are for power and natural gas), but these underlying environmental commodity contracts are physical.

C. Capacity contracts should be excluded from the definition of swap. (NOPR at 29832, Question 35).

The CFTC should include capacity contracts within the forward contract exclusion even though there is an optionality on whether there is a right to delivery. Such capacity contracts include natural gas pipeline transportation and storage contracts as well as electricity transmission contracts. The Commission proposes to apply the Wright approach to the treatment of nonfinancial commodities that contain embedded options under the Dodd-Frank Act. (NOPR at 29830). Under this “facts and circumstances” approach, the Commission would examine, “the transaction as a whole to evaluate whether any embedded optionality operates on the price or delivery term of the contract, and whether an embedded commodity option is marketed or traded separately from the underlying contract, to determine whether that transaction qualifies for the forward contract exclusion from the swap definition for nonfinancial commodities.” (Id.). NEM suggests that reliance on the Wright standard on price optionality is not adequate to ensure capacity contracts are excluded from the definition of swap. Because electricity cannot be stored and is instantly perishable, capacity contracts (with the right to not take delivery when the load is lower than expected) have long been a necessary tool for the physical players to maintain physical reliability as well as economic supply. Likewise, pipeline capacity is retained to ensure physical reliability of the natural gas system. NEM submits that a Commission finding that capacity contracts are excluded from the definition of swap would be consistent with its reasoning in the Brent Interpretation, where it recognized that the buyer and seller to the transaction must be prepared at any

⁵<http://www.eei.org/ourissues/ElectricityGeneration/Documents/EEI%20RECs%20Annex%20v1%200.doc>

time to make or take delivery based on physical market conditions. In addition, such capacity contracts are already subject to pervasive regulation by FERC. Including such contracts under the definition of “swap” may lead to numerous conflicting regulations between FERC and CFTC, such as open season and capacity release posting requirements as well as collateral requirements required under pipeline tariffs approved by FERC.

II. Application of the Public Interest Standard to FERC-Regulated Energy Products

The Commission addressed the issue of FERC-regulated transactions in RTOs/ISOs in the NOPR and the treatment of such transactions as provided for under Section 722(f)⁶ of the Dodd-Frank Act.

The Commissions received a comment letter in response to the ANPR requesting clarification regarding the status of transactions in RTOs and ISOs, including financial transmission rights (“FTRs”), under the swap and security-based swap definitions. Section 722 of the Dodd-Frank Act, though, specifically addresses how the CFTC should approach products regulated by FERC that also may be subject to CFTC jurisdiction, Section 722 of the Dodd-Frank Act amended CEA section 4(C)154 to provide that, if the CFTC determines that an exemption for FERC-regulated instruments or other specified electricity transactions would be in accordance with the public interest, then it shall exempt such instruments or transactions from the requirements of the CEA. Given this specific provision regarding these FERC-related products, the CFTC believes the treatment of these products should be considered under the standards and procedures specified in section 722 of the Dodd-Frank Act for a public interest waiver, rather than through this joint rulemaking to further define the terms ‘swap’ and ‘security-based swap.’

Consequently, the Commissions are not addressing FTRs or other transactions in RTOs or ISOs within this joint definitional rulemaking. Instead, persons with concerns about whether FERC-regulated products

⁶ Section 722(f) provides that:

PUBLIC INTEREST WAIVER.—Section 4(c) of the Commodity Exchange Act (7 U.S.C. 6(c)) (as amended by section 721(d)) is amended by adding at the end the following:

“(6) If the Commission determines that the exemption would be consistent with the public interest and the purposes of this Act, the Commission shall, in accordance with paragraphs (1) and (2), exempt from the requirements of this Act an agreement, contract, or transaction that is entered into—

“(A) pursuant to a tariff or rate schedule approved or permitted to take effect by the Federal Energy Regulatory Commission;

“(B) pursuant to a tariff or rate schedule establishing rates or charges for, or protocols governing, the sale of electric energy approved or permitted to take effect by the regulatory authority of the State or municipality having jurisdiction to regulate rates and charges for the sale of electric energy within the State or municipality; or

“(C) between entities described in section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).”.

may be considered swaps (or futures) should request an exemption pursuant to section 722 of the Dodd Frank Act. (NOPR at 29839).

The Commission did clarify that this approach was not to be construed as a finding as to whether or not FTRs or other FERC-regulated transactions are swaps or futures. (NOPR at Note 155).

NEM supports the Commission's proposal to exempt the regulation of RTOs/ISOs under the public interest standard set forth in Section 722 of Dodd-Frank. RTOs/ISOs and the market participants that do business with the RTOs/ISOs are subject to the oversight and regulation of FERC and state Public Utility Commissions that have the extensive subject matter expertise as well as long-standing precedent to ensure the proper functioning of competitive energy markets. As such, imposing an additional, duplicative regulatory framework to govern RTO/ISO transactions is unnecessary.

NEM appreciates this and other opportunities provided by the Commission for stakeholders to provide input as the Commission undertakes the significant and complex task of implementing the Dodd-Frank Act. We would be pleased to provide any additional information that the Commission may need.

Respectfully submitted,

Craig G. Goodman, Esq.
President
National Energy Marketers Association
3333 K Street, NW, Suite 110
Washington, DC 20007
Telephone: (202) 333-3288
Fax: (202) 333-3266
E-Mail: cgoodman@energymarketers.com