November 19, 2012

Honorable Gary Gensler, Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Chairman Gensler,

We are writing today to express our appreciation for the Commodity Futures Trading Commission's October 12th no-action letter that would allow a counterparty to deal in up to $800 million in swaps with government-owned utilities without being required to register as a swap dealer. However, we remain concerned with the sub-threshold for special entities contained in the swap dealer definition in light of the conditions in the no-action letter and the continuing regulatory uncertainty surrounding some of the transactions with relatively large "gross notional values" in the energy industry.

As American Public Power Association President Mark Crisson relayed to you on your October 24th phone call with him, we have heard little from our members' nonfinancial counterparties indicating that the relief provided in the no-action letter is sufficient: what we have heard has been mixed, trending to negative. Nothing we have heard since the October 24 call counters that trend. As one of our members put it, counterparties had already changed their policies regarding transactions with special entities and aren't adjusting them based on the no-action letter. Given the significant consequences to counterparties if they are determined to be swap dealers, we understand their cautious approach in evaluating the no-action letter conditions before re-engaging in utility operations-related swaps with our members.

Therefore, we are renewing our request to you that the Commission act on our July 12th petition for relief as quickly as possible. The petition was designed to provide narrow relief only to government-owned utilities engaging in operations-related swaps. It would allow counterparties to enter into such swaps with utility special entities on the same basis as with other electric and natural gas utilities. In contrast, under the Commission's no-action relief, counterparties have to consider whether they meet certain conditions and whether to develop separate, specialized compliance programs for dealing with government-owned utilities.

In general, little has been heard in terms of specifics from counterparties as to why they are not coming back to the table to do business with government-owned utilities. Certain counterparties have expressed general concerns over one or more of the conditions imposed in the no-action letter. It could also be that counterparties, in general, are not willing to spend the time and money to create a separate compliance process and adjust their policies and procedures in order to facilitate transactions with the small segment of any particular regional market that utility special entities represent. This is especially likely now as counterparties are focused on implementing compliance programs dealing with the whole range of Dodd-Frank requirements. Whatever the reasons, the no-action letter has not produced the hoped-for effect.

Based upon the limited information received from counterparties, we identified key conditions in the no-action letter that we believe inhibit counterparties' willingness to enter into swap transactions with utility special entities. These conditions either require counterparties to adopt additional procedures in order to do business with a utility special entity or cause uncertainty as to whether a counterparty can take advantage of the no-action relief.

- The special entity must be using the swap to hedge a "physical position" as defined in the swap dealer rule. Among other requirements, the swap must represent "a substitute for transactions made or to be made or positions taken or to be taken by the person at a later time in a physical marketing channel." This definition is narrower than the "hedging or mitigating commercial risk" definition in the "end-user" rule (government-owned utilities all qualify for the end user exception). As you know, many energy industry counterparties are on record questioning the need for the different "hedging a physical position" standard in the swap dealer rule and have asked the Commission to use a standard consistent with that in the end user exception.

  When an end user enters into an uncleared swap with a counterparty, the swap is reported to a swap data repository. The report includes the end user's assurance that the swap was entered into to hedge the end user's commercial risk. But to comply with the no-action letter's condition, a counterparty has the additional burden of obtaining assurance from the utility special-entity end user that the swap is used to "hedge a physical position."

- A "financial entity," as defined in section 2(h)(7)(C)(i) of the Commodity Exchange Act, is not eligible to use the no-action letter. Clause (VIII) of that definition includes "a person *predominantly* engaged… in activities that are *financial in nature*, as defined in section 4(k) of the Bank Holding Company Act of 1956 (emphasis added)." For a counterparty to be sure it is not a "financial entity" under this clause requires analysis of prudential regulators' interpretations of the Bank Holding Company Act, as well as an assessment of what measure is to be used in determining the "predominantly" standard. For a private equity firm that may directly or indirectly own regional energy assets, or a marketing affiliate of a large energy holding company that offers swaps in a region where another subsidiary of such holding company owns assets, a determination that an entity is "not a financial entity" and can rely on the no-action letter requires regulatory analysis, interpretation, and risk. Counterparties that are not certain whether or not they meet this "financial entity" definition will not rely on the relief provided in the no-action letter.

- The swap must be in an exempt commodity in which both parties transact as part of the "normal course of their physical energy businesses." Yet the swaps being measured are part of a regular business of "swap dealing activity" and not those that might be ancillary to a natural gas production or an electric operations business. (Note, too, that it would be clearer and more consistent if the relief applied to "nonfinancial commodities" – the term used in the Dodd-Frank Act's definition of "swap" – rather than to "exempt commodities.") Moreover, under the terms of the no-action letter, "the relief would not be available to a person that does not enter into physical transactions in the exempt commodity to which the swap relates." Counterparties that are uncertain as to whether they meet this condition will be unlikely to take the risk of entering into a swap with a utility special entity.

  For example, "power marketers" play a large role in meeting utilities' demand for electricity, but typically do not themselves take delivery of the electricity. Will the CFTC consider power marketers' electricity transactions to be "*physical* transactions"? If not, then the power marketer could not take advantage of the no-action relief. Similarly, a potential counterparty can have a physical business in oil or natural gas, but may also buy and sell electricity under market-based rate authority (as approved by the Federal Energy Regulatory Commission) and offer electricity-related swaps. Will the CFTC deem that the counterparty is transacting in electricity as part of the normal course of its *physical* energy business? If not, then the counterparty could not take advantage of the no-action relief in regard to electricity swaps.

- Counterparties wanting to take advantage of the relief provided by the no-action letter must file with the CFTC a notice that it is making use of the relief and provide, by December 31, 2012 (and quarterly thereafter), a list of each utility special entity with which it has entered into swaps in reliance on the no-action relief, and the total gross notional value of those swaps. This is a unique requirement, as there is no similar notification requirement for either the overall *de minimis* threshold or the $25 million special entity sub-threshold. This requirement is in addition to the standard reporting of transactions to a swap data repository. The notice seems to invite Commission review or audit of each instance of the counterparty's use of the no-action relief. It also highlights for counterparties the increased compliance cost and risk of any transaction with a utility special entity over the $25 million sub-threshold.

Finally, we believe that the temporary nature of the no-action relief is likely to discourage counterparties from familiarizing themselves with the requirements of the relief regime provided by the CFTC, from expending legal resources to determine whether they and their potential swap transactions meet those requirements, and from creating new internal mechanisms for ensuring continued compliance.

Again, we thank you for reaching out to the public power community in your October 24 call with APPA and in your November 2 call with CEOs from the Large Public Power Council. We appreciate your willingness, as expressed in these calls, to address some of these concerns via interpretive guidance, such as a "Frequently Asked Questions" release. However, such steps still

may be insufficient to address the spoken and unspoken concerns of potential counterparties, would require these counterparties to engage in a level of analysis they might not be willing to undertake given other demands, and, as a result, may still fail to provide the relief intended.

Thus, we urge you to act promptly on the July 12th petition seeking to exclude from the special entity *de minimis* threshold swaps that relate to government-owned utilities' operations (these swaps would continue to apply against the overall *de minimis* threshold), or to provide similar permanent relief that would give counterparties the certainty they need to enter into the transactions that government-owned utilities need to manage commercial operations risks. If the concern is that the Securities and Exchange Commission would object to such a narrow modification to the *de minimis* exception related only to nonfinancial commodity swaps and not to either financial swaps or security-based swaps, we are happy to meet jointly with the CFTC and SEC to discuss the petition.

Respectfully submitted,

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