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October 12, 2012

Ms. Stacy Yochum, Acting Secretary
Commodity Futures Trading Commission
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Re: Comments of the International Energy Credit Association ("IECA") to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Rule entitled Further Definition of Swap, Security-Based Swap, and Security-Based Swap Agreement; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (the "Swap Definition Rule," 17 CFR Part 1, RIN 3038-AD46, 77 Federal Register 48207, August 13, 2012)

Ladies and Gentlemen:

The Commission, as part of the above-referenced Swap Definition Rule, included a Request for Comment in relation to the seven-part volumetric option test. Through this letter, the IECA provides its responses to the Commission's questions and provides additional comments on other related sections in the Swap Definition Rule.

I. Introduction.

The IECA is not a lobbying group. Rather, we are an association of several hundred energy company credit management professionals grappling with credit-related issues in the energy industry. Our members' concerns regarding the Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA" or "Dodd-Frank Act") have led us to submit numerous comments to the Commission on its rule-makings under the DFA.

Correspondence with respect to these comments should be directed to the following individuals:

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II. IECA's Responses to the Commission's Request for Comment.

The IECA appreciates the opportunity to respond to the CFTC's Request for Comment regarding its interpretation on forward contracts with volumetric optionality. Regulated utilities and other gas and electric service providers are in need of a volumetric option test that will provide clarity and one that is not subject to differing interpretations. Moreover, the more cumbersome and complicated the regulation, the greater the expense of complying, which expense is passed through directly to the retail consumer, and the greater the risk of disruption to the reliable and continuous delivery of such energy commodities to the retail user. As the Commission decides how it will regulate forward contracts with embedded volumetric options for the electric industry, the IECA respectfully reminds the Commission that it must not forget that wholesale power, transmission and gas agreements – with or without embedded volumetric options - had nothing to do with the financial crisis of 2008 that led to the law being implemented by these regulations.

Responding in turn to each of the CFTC's questions set forth in its Interpretive Guidance (*see* 77 Fed. Reg. 48,208 at 48,238) on optionality in forward contracts,[1] the IECA provides the following answers:

1. *Are the elements set forth in the interpretation to distinguish forwards with embedded volumetric optionality from commodity options appropriate? Why or why not?*

Yes, based on the Commission's current treatment of commodity options, the interpretation to distinguish "forwards with embedded volumetric optionality" from "commodity options" is appropriate. As the Commission noted in the Swap Definition Rule, "it is well-established that the *intent to make or take delivery* is the critical factor in determining whether a contract qualifies as a forward." *See* 77 Fed. Reg. at 48,238. The fact that a contract allows for volumetric optionality should not prevent a contract from being treated as a forward contract as long as such optionality does not undermine the original intent for delivery. Contracts where the parties have the requisite "intent to make or take delivery" are not commodity options and

[1] Although the primary focus of the comments herein relate to forward contracts, the IECA requests that the CFTC clarify what products qualify as "spot" transactions, and therefore not subject to the Dodd-Frank Act regulations, including the application of the forward contract tests provided in the Swap Definition Rule.

therefore deserve a separate test. In response to Question Nos. 2 and 3, the IECA suggests certain changes and/or clarifications to the volumetric option test to accomplish this review.

2. *Are there additional elements that would be appropriate? Please describe and provide support for why such elements would serve to distinguish forwards with embedded volumetric optionality from commodity options.*

No additional factors are needed. Adding further elements to an already complicated test will not benefit the industry or the Commission.[2] Rather, the IECA believes that the volumetric option test can be simplified by limiting it to the first three factors, and deleting factors four through seven. In this regard, the IECA believes that factors four through six are duplicative of factor two because they all relate to the predominant feature being actual delivery. In other words, if factor two ("*the predominant feature of the agreement, contract, or transaction is actual Delivery*") is passed, then factor four ("*the seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the optionality is exercised*"), factor five ("*the buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if it exercises the embedded volumetric optionality*") and factor six ("*both parties are commercial parties*") will also be passed. As a result, the IECA believes that factors four through six can be deleted because they are duplicative and unnecessary. Factor seven should also be deleted for the reasons provided below.

This proposed streamlined three-part test for volumetric options will eliminate confusion and duplication, while still ensuring that contracts that pass the test contain the requisite intent for physical delivery. In the alternative, the Commission could eliminate the seven-part volumetric option test altogether, and clarify that the three-part embedded option test may also be used to evaluate types of embedded optionality other than price optionality. *See* 77 Fed. Reg. at 48,238 ("The first two elements of the interpretation for embedded volumetric optionality, which mirror the CFTC's historical embedded option interpretation discussed above, have been modified to reflect that embedded volumetric optionality relates to delivery <u>*rather than price*</u>.") (emphasis added).

3. *Is the seventh element that, to ensure that an agreement, contract, or transaction with embedded volumetric optionality is a forward and not an option, the volumetric optionality is based primarily on physical factors, or*

[2] For example, does element five, "the buyer ... intends ... to take delivery ... if it exercises" require that the buyer not resell the commodity rather than receive it if it has exercised the option? Does it mean that when a wholesale electric contract quantity is specified from a generator in the day ahead market, the buyer must take delivery, and not resell the energy to a third party in the real time market if the quantity turns out to be in excess of the buyer's real-time requirements? Such a requirement would introduce needless complications and compromises to the functioning of wholesale electric power markets. If element five is retained, it should be clarified to provide that the buyer may itself resell the commodity for physical delivery rather than physically receive the commodity itself.

regulatory requirements, that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity, necessary and appropriate? Why or why not? Is the statement of this element sufficiently clear and unambiguous? If not, what adjustments would be appropriate?

No, the seventh element of the volumetric option test is not appropriate and should be deleted. As discussed below, the Dodd-Frank Act, and the CFTC's interpretation of the Dodd-Frank Act, requires that the parties "intend" for physical delivery to occur. An event that happens after the contract is executed, regardless of the cause, that limits actual delivery is irrelevant as long as it does not undermine the original intent for delivery. Moreover, for the electric industry, parties will generally not know at the point of contract execution what reasons will impact the volumetric optionality and whether such reasons are in or out of the parties' control. Accordingly, the seventh factor should be deleted as irrelevant and non-functional.

If the Commission chooses not to delete the seventh factor, the IECA recommends that the CFTC provide an interpretation that entities pass the seventh factor even if the circumstance is within the party's control <u>*so long as the optionality does not undermine the overall nature of the contract as a forward contract*</u>.

4. ***Are there circumstances where volumetric optionality is based on other factors? Please describe. Would such factors, if made a part of the interpretation, serve to distinguish forwards with embedded volumetric optionality from commodity options? If so, how?***

Yes. As discussed above, if the Commission chooses not to delete the seventh factor, the IECA recommends that the CFTC provide an interpretation that entities also pass the seventh factor even if the circumstance is within the party's control so long as it does not undermine the overall nature of the contract as a forward contract. Of significance, this proposed clarification is similar to the Commission's test for embedded options (see Element 1 of 3 "may be used to adjust the forward contract price, <u>*but do not undermine the overall nature of the contract as a forward contract*</u>"). *See* 77 Fed. Reg. at 48,237. Accordingly, adopting this clarification will add consistency to the various tests.

Below is an example of a party utilizing volumetric optionality based on factors that are within the parties' control, which should not result in the contract being deemed a swap.

> *Party A (over its 100 year history) has only purchased power from a single counterparty, Party B. The contracts have always been 10 year agreements that include an Energy payment and a Capacity payment. The Energy component includes variable amounts depending on the amount requested by Party A. The parties have always intended that these contracts would involve physical delivery, and they have always resulted in physical delivery. The current 10 year contract is in its last year, however the contract price for Energy of $500 MWH is well above the $25 MWH market price. For the first time in the parties' 100 year relationship, Party A decides not to request the power from Party B for the last year and instead purchases the cheaper power out of the market.*

Does Party A's economic-based decision to purchase energy at a lower price out of the market rather than utilize the energy from Party B result in all the contracts executed between Party A and Party B not qualifying as a forward contract (*i.e.*, Party A's decision was based on an economic analysis rather than a factor beyond its control)? Wouldn't the facts and circumstances analysis described by the Commission in the Swap Definition Rule demonstrate an "intent to physically deliver" based on the 100 year history? IECA believes that the facts and circumstances surrounding the parties' use of this volumetric optionality *does not* undermine the contract from being a forward.

Accordingly, if the seventh factor is retained, the IECA believes that the CFTC should provide an interpretation that entities pass the seventh factor even if the circumstance is within the party's control *so long as it does not undermine the overall nature of the contract as a forward contract*.

5. ***Does the interpretation provide sufficient guidance as to whether agreements, contracts, or transactions with embedded volumetric optionality permitting a nominal amount, or no amount, of a nonfinancial commodity to be delivered are forwards or options, viewing the agreements, contracts, or transactions as a whole, if they satisfy the seven elements of the interpretation? Why or why not? Does this interpretation encourage evasion, or do the seven elements sufficiently distinguish forwards from agreements, contracts, and transactions that may evade commodity options regulation?***

No, the Commission's interpretation does not provide sufficient guidance for contracts that were intended to be physically delivered, but that over the life of the contact resulted in a "nominal amount, or no amount," to be delivered. In the Swap Definition Rule, the Commission appropriately stated, "[t]he CFTC recognizes that the nature of commercial operations are such that supply and demand requirements *cannot always be accurately predicted* and that forward contracts that allow for some optionality as to the amount of a nonfinancial commodity actually delivered *offer a great deal of value to commercial participants*." *See* 77 Fed. Reg. at 48,238. The IECA strongly agrees and believes that it is fundamentally necessary that the electric industry continue to utilize contracts that can volumetrically adjust to the supply and demand needs in order to prevent shortfalls and disruption to the reliable and continuous delivery of electricity to homes and businesses in the United States. Since these contracts ultimately relate to physical production or delivery, flexibility enables efficient use of resources, and regulatory disincentives to efficient use of resources dramatically increases costs to consumers. In this regard, the IECA believes that the Swap Definition Rule discourages the electric industry from utilizing contracts with volumetric optionality due to the regulatory uncertainty and increased regulatory risks and costs that the CFTC is unnecessarily imposing.

In the Swap Definition Rule, the Commission continuously takes the position that the Dodd-Frank Act requires "intent to deliver" in order to qualify for the forward contract exclusion. In other words, there must be "intent to deliver," not "actual delivery." In the Swap Definition Rule, the Commission stated:

> As noted in the Proposing Release, because a forward contract is a commercial merchandising transaction, *intent to deliver* historically has been an element of the CFTC's analysis of whether a particular contract is a forward contract. In assessing the *parties' expectations or intent regarding delivery*, the CFTC consistently has applied a "facts and circumstances" test. Therefore, the CFTC reads the "intended to be physically settled" language in the swap definition with respect to nonfinancial commodities to reflect a directive *that intent to deliver* a physical commodity be a part of the analysis of whether a given contract is a forward contract or a swap, just as it is a part of the CFTC's analysis of whether a given contract is a forward contract or a futures contract.

See 77 Fed. Reg. at 48,228 (emphasis added). The Commission stated further in the Swap Definition Rule:

> The CFTC observed in its decision in *In re Wright* that "it is well-established that the *intent to make or take delivery* is the critical factor in determining whether a contract qualifies as a forward….In *Wright*, the CFTC noted that "[i]n distinguishing futures from forwards, the [CFTC] and the courts have assessed the transaction as a whole *with a critical eye toward its underlying purpose*. Such an assessment entails a review of the overall effect of the transaction as well as a determination as to *what the parties intended*."

id. (emphasis added).

The importance of the parties having "intent to deliver" is discussed in numerous other sections throughout the Rule. There is not a mandate for actual delivery under the Dodd-Frank Act. Whether actual delivery occurs is irrelevant as long as the parties intended for there to be delivery when the contact is executed. Accordingly, the Commission should clarify that what is required is that there be an "intent" to deliver, and that a contract that results in non-delivery or minimal delivery can still qualify as a forward contract as long as the parties can demonstrate that there was an intent for physical delivery at the time the contract was executed and that the optionality does not undermine the overall intent for physical delivery.

6. ***Is the interpretation sufficiently clear with respect to capacity contracts, transmission (or transportation) services agreements, peaking supply contracts, or tolling agreements? Why or why not? Do capacity contracts, transmission (or transportation) services agreements, peaking supply contracts, or tolling agreements generally have features that satisfy the forwards with volumetric options interpretation included in this release? If so, which ones? If not, why not? Could these types of agreements, contracts, and transactions qualify for the forward exclusions under other parts of the interpretation set forth above? Are there material differences in the structure, operation, or economic effect of these types of agreements, contracts, and transactions as compared to full requirements contracts that are relevant to whether such agreements, contracts,***

and transactions are options under the CEA? Please explain. If so, what are the material differences?

No, the interpretation is not sufficiently clear with regards to capacity contracts, transmission service agreements, peaking supply agreements and tolling agreements. However, a helpful clarification will be provided if, as discussed herein, the Commission removes the seventh factor or clarifies that the factor is still met for circumstances within the parties' control as long as the optionality does not undermine the overall intent for physical delivery. The IECA believes that these types of contracts are very similar to full requirements contracts (which the Commission correctly notes qualify for the forward contract exclusion) as long as the volumetric optionality does not undermine the overall intent for physical delivery.

7. ***Do the agreements, contracts, and transactions listed in question no. 6 above have embedded optionality in the first instance? Based on descriptions by commenters, it appears that they may have a binding obligation for delivery, but have no set amount specified for delivery. Instead, delivery (including the possibility of nominal or zero delivery) is determined by the terms and conditions contained within the agreement, contract, or transaction (including, for example, the satisfaction of a condition precedent to delivery, such as a commodity price or temperature reaching a level specified in the agreement, contract, or transaction). That is, the variation in delivery is not driven by the exercise of embedded optionality by the parties. Do the agreements, contracts, and transactions listed in question no. 6 exhibit these kinds of characteristics? If so, should the CFTC consider them in some manner other than its forward interpretation? Why or why not?***

Some of these referenced contracts may contain provisions that dictate when delivery will occur. These contracts are no different than a full requirements contract because there is no optionality on when delivery occurs. Accordingly, the Commission should not require further analysis for these types of agreements as long as they otherwise meet the requirements to be classified as a forward contract.

In addition, each of the contracts referenced above have a similarity in that they are each regulated by the Federal Energy Regulatory Commission ("FERC"), who by statute under the Federal Power Act specifically regulates *physical-delivery contracts* (and not financial contracts) in the wholesale power market. FERC's oversight of these types of contracts includes consideration of the effects on grid reliability and other continuity of service considerations that are unique to the electric industry and should not be underestimated. To provide additional clarity for the electric industry, the IECA proposes that the CFTC issue an interpretation that would provide a rebuttable presumption that a contract that is FERC jurisdictional is a forward contract, unless the facts and circumstances demonstrate otherwise.[3] This one clarification would greatly benefit the electric industry, while preserving the CFTC's ability to review the

[3] The IECA believes that this would have been one of the likely provisions included in the FERC/CFTC Memorandum of Understanding required as of January 2011 under Section 720 of the Dodd Frank Act.

total facts and circumstances to ensure that the intent of the Dodd-Frank Act is captured.[4] In addition, the Commission's whistle-blower, anti-evasion and anti-manipulation regulations would further serve to protect the swaps market to the extent such products are embedded in a FERC jurisdictional contract.

III. <u>IECA's Comments on Other Tests in the Swap Definition Rule</u>.

Although the Commission limited its Request for Comment to the seven-part volumetric option test, based on discussion the IECA members have had with Commission Staff, we understand that the Commission is interested in comments related to the other tests provided for in the Swap Definition Rule. In this regard, the IECA provides the following comments related to the "option-like" features test and the embedded option test.

1. Option-like Features Test

As written in the Swap Definition Rule, the three-part option-like features test contains the following "however clause" after the enumerated three elements:

> However, in the alternative, if the right to use the specified facility is only obtained via the payment of a demand charge or reservation fee, and the exercise of the right (or use of the specified facility or part thereof) entails the further payment of actual storage fees, usage fees, rents, or other analogous service charges not included in the demand charge or reservation fee, such agreement, contract or transaction is a commodity option subject to the swap definition.

Although the option-like features test is intended to apply to tolling agreements, transportation agreements on natural gas pipelines, and natural gas storage agreements, the "however clause" generally prohibits these types of agreements from passing the test – which calls into question its usefulness. More specifically, these types of agreements usually contain additional charges that occur based on the usage.

It is important to note these agreements generally have two payment components. One is a reservation or capacity fee and the other is a commodity fee. The capacity fee is usually paid to acquire the rights to the facility so that the purchasers can make plans with the purchased capacity as if it was their own (*i.e.*, can include it in resource planning, reliability studies, FERC market-share analysis, etc.). Based on this reason, the IECA believes that the capacity charge is not an option payment. The commodity fee is based on the volumetric usage of the capacity and is generally used to recover pass-through costs (*i.e.*, variable operations and management fees, water usage, etc.).

Perhaps, the Commission could provide some form of interpretive guidance that concludes, along the lines of the Commission's comments in the Swap Definition Rule with respect to "full requirements contracts," which explained:

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[4] In the alternative, based on comments filed by FERC and others, the CFTC could issue an interpretation that energy commodities regulated by FERC will not be subject to regulation as swaps by the CFTC.

> Accordingly, full requirements contracts, as described above, appear not to contain embedded volumetric options. Therefore, a full requirements contract may qualify for the forward exclusion under the same facts and circumstances analysis applicable to all other agreements, contracts, and transactions that might be forwards."

For the foregoing reasons, the IECA believes that the three-part option-like features test is sufficient without the "however clause" and recommends that this "however clause" be removed from the interpretive guidance portion of the Swap Definition Rule. In the alternative, the IECA recommends that the Commission clarify <u>through some additional form of interpretive guidance</u> that the payment of additional fees identified in the "however clause" are acceptable as long as they do not undermine the overall nature of the contract as a forward contract.

2. Embedded Option Test

Of the three individual tests included in the Swap Definition Rule (the "option-like features;" "embedded option;" and "volumetric option" tests), the IECA believes that the embedded option test is the most useful for the electric industry. This is because it allows an entity to effectively review and evaluate the optionality of a contract and determine whether the clause "undermine[s] the overall nature of the contract as a forward" or changes the "predominant feature of the contract [from being] physical delivery."

IECA submits that these are the key questions Congress intended to be reviewed when determining which agreements should be excluded from the swap definition. However, the IECA believes that the Commission has unnecessarily restricted the application of this test.[5] Accordingly, the Commission should clarify in some additional form of interpretive guidance that the embedded option test can be used to evaluate any optionality that is included in a forward contract (*i.e.*, volumetric or otherwise).

IV. <u>Statutory/Regulatory Interpretations and Potential Impacts</u>.

The IECA believes that the Swap Definition Rule, and the fact that it was issued after many of the key rulemakings (i.e., Swap Dealer, Commodity Option, etc. rules), has lead to wide-spread confusion in the energy industry resulting in various interpretations of the CFTC's new regulations. This section highlights some of the interpretation issues facing IECA's members.

1. The Statute Uses the Word "Settled," Not "Delivered"

In addition to the comments provided above, the IECA believes that it is also important to discuss what Congress intended to exclude from the term "swap" in the text of the Dodd-Frank Act.

[5] *See* 77 Fed. Reg. at 48,238 ("The first two elements of the interpretation for embedded volumetric optionality, which mirror the CFTC's historical embedded option interpretation discussed above, have been modified to reflect that embedded volumetric optionality relates to delivery <u>*rather than price*</u>.")(emphasis added).

The Dodd-Frank Act itself does not use the word "deliver," but rather the word "settle." CEA §1a47(A)(i) provides "Except as provided in [§1a47](B), the term "swap" means any agreement, contract or transaction that is a put, call, cap, floor, collar or similar option of any kind that is for the purchase or sale … of 1 or more … commodities … ." In other words, §1a47(B) controls §1a47(A). And CEA §1a47(B)(ii) provides: "The term 'swap' does not include … any sale of a nonfinancial commodity … for deferred shipment or delivery, so long as the transaction is intended to be *physically settled* … ." (emphasis supplied).

Therefore, the statute provides that if the parties to a nonfinancial commodity transaction intend to physically settle it, the CFTC was not given jurisdiction over such commodity options as "swaps." The CFTC has jurisdiction over such commodity options pursuant to CEA §4c and provisions of the CEA pre-dating DFA, but not as "swaps" pursuant to DFA.

The CFTC discusses in the Swap Definition Final Rule Interpretive Guidance how "intent" to deliver may be "inferred," (*e.g.*, Intent to make or take delivery can be inferred from the binding delivery obligation for the commodity referenced in the contract and the fact that the parties to the contract do, in fact, regularly make or take delivery of the referenced commodity in the ordinary course of their business.) *See* 77 Fed. Reg. at 48,228. However, this does not fully reflect the plain meaning of 1a47(B)(ii). If a "transaction" can only be physically settled, it must also be "intended" to be physically settled.

Accordingly, if one cannot contractually financially settle through a mechanism other than liquidated damages for breach of the right to take more or less of a commodity independent of payment for that commodity, the transaction is completely outside of the CFTC's purview of regulation as a swap on account of §1a47(B)(ii).

This is consistent with Congress's intent: physical commodity option transactions are not exchanges of cash flows, like swaps, nor did they have or present any risk of deleterious effect on the economy or contribute to the 2008 financial crisis. The Dodd-Frank Act was not intended to give the CFTC jurisdiction over the broad physical "real economy."

Therefore, there is potentially only one question to be answered to determine if there is a CFTC-regulated "commodity option" under 1a47(A)- is there an embedded option to cash settle, rather than physically settle, the nonfinancial commodity forward transaction? If not, the contract is "intended" to be physically settled, because it "can only" be physically settled. The pre-Dodd Frank Act precedent cited by the CFTC in its Interpretive Guidance, including that cited in footnote 396, does not address the new dividing line provided by Congress in the Dodd-Frank Act in 1a47(B)(ii). The reasons why the transaction can only be physically settled are irrelevant. If it can be only physically settled, it is excluded from CFTC jurisdiction as a swap, although subject to CFTC's anti-manipulation and other oversight.

2. *The Trade Option Final Rule Would Force Natural Gas Pipelines To Violate Their Transportation Tariffs*

Under the Final Rule and Interim Final Rule on Commodity Options, for a transaction not to be considered a swap, an option seller would have to ensure, among other things, that:

The offeree must be a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or byproducts thereof, and such offeree is offered or entering into the commodity option transaction solely for purposes related to its business as such…[6]

In other words, a natural gas pipeline or storage provider would have to perform due diligence to ensure that a potential shipper or storage customer satisfies the above rule requirement. Since most of the transportation tariffs are either FERC or state PUC regulated agreements, any changes to those agreements are subject to a very complex, lengthy approval process. From a practical standpoint, this rule creates unprecedented operational uncertainty and regulatory risk for natural gas pipelines and storage providers. For example, if a potential shipper A desires to obtain a firm service on an interstate pipeline and A is a new shipper and not familiar to the pipeline, the pipeline would have to make sure that the shipper meets the above rule requirements. While the pipeline is conducting its due diligence, shipper B could obtain the capacity in question by simply visiting the pipeline's web site and clicking on it. Shipper A could now have a complaint against the pipeline for not performing its due diligence quickly enough. On the other hand, if the pipeline grants the capacity to shipper A and shipper A turns out to fail to meet the above rule requirements, the pipeline could be violating the above rule.

3. The Final Rule Transforms Natural Gas Transportation and Storage Transactions Into Speculative Products

Since natural gas transportation and storage transactions do not have the characteristics of a commodity, they have never been subject to speculation or unwarranted price fluctuation. Coupled with the FERC requirements that "shippers must have title" to the gas being transported or stored, natural gas transportation and storage transactions provide market participants with operational and financial reliability and consistency by ensuring that only those market participant who have physical gas positions can obtain natural gas transportation or storage capacity service (shippers never get title to, or even the option/opportunity to take title to, transportation services or even the related capacity, just the right to use that service). However, if these products were to be deemed swaps, it could create an impetus to commoditize this segment of the industry and to introduce volatility and operational uncertainty.

For example, in 2001 the FERC rejected a proposal by an interstate pipeline to offer a call and put options on its capacity. [7] FERC determined, in the Natural Gas Act context, that the sale of options on pipeline capacity could lead to an unjust and unreasonable tying up of future capacity through the speculative purchase of options, thereby disadvantaging others who may ultimately value the capacity more.[8] Similarly, a designation of natural gas transportation or storage agreements could create an artificial, speculative market in those products, unsupported by the operational and financial realities in a particular geographic footprint. For example, if a natural gas pipeline attempts to expand capacity on its pipeline system, a swap trading on that

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[6] Part 32.3(a)(2).
[7] 95 FERC P 61165, 2001 WL 470009 (F.E.R.C.).
[8] Id at 5.

anticipated capacity could create an artificial price for such capacity and prevent the legitimate shippers from obtaining it, or, force them to pay a higher price. Also, any pipeline attempting to obtain financing would have a difficult time securing such a financing because it could be impossible to determine, with any confidence, the value of such capacity if the capacity is subject to speculative trades, outside of the pipelines influence.

4. *Exempting Natural Gas Transportation And Storage Agreements From Swap Regulation Is Consistent With The Dodd-Frank Act Savings Clause*

Even if the Commission does not agree with the above stated reasons that natural gas transportation and storage services are not commodity options because such products do not meet the statutory definition of "Commodity" under the CEA, the Commission should exempt such products from the Dodd-Frank regulations consistent with the saving clause. The Dodd-Frank Act includes a savings clause that clarifies the roles of the CFTC, FERC, and state regulatory agencies with respect to certain agreements, contracts, or transactions entered into to the tariff of an RTO and ISO.[9] The savings clause provides, in relevant part, that:

> *(I)(i) Nothing in this Act shall limit or affect any statutory authority of the Federal Energy Regulatory Commission or a State regulatory authority (as defined in section 3(21) of the Federal Power Act (16 U.S.C. 796(21)) with respect to an agreement, contract, or transaction that is entered into pursuant to a tariff or rate schedule approved by the Federal Energy Regulatory Commission or a State regulatory authority and is—*
> *(I) not executed, traded, or cleared on a registered entity or trading facility; or*
> *(II) executed, traded, or cleared on a registered entity or trading facility owned or operated by a regional transmission organization or independent system operator.*
> *(ii) In addition to the authority of the Federal Energy Regulatory Commission or a State regulatory authority described in clause (i), nothing in this subparagraph shall limit or affect—*
> *(I) any statutory authority of the Commission with respect to an agreement, contract, or transaction described in clause (i); or*
> *(II) the jurisdiction of the Commission under subparagraph (A) with respect to an agreement, contract, or transaction that is executed, traded, or cleared on a registered entity or trading facility that is not owned or operated by a regional transmission organization or independent system operator (as defined by sections 3(27) and (28) of the Federal Power Act (16 U.S.C. 796(27),796(28)).*

Similar to the RTO and ISO electricity products, a great majority of natural gas transportation and storage contracts are governed by either FERC (for interstate and 311 contracts) or a state PUC for most intrastate agreements. Further, as already stated above, these services are not executed, traded, or cleared on any registered entity or trading facility. Ironically, if they were to be commoditized in form of swaps, these products could become traded on exchanges and undermine the physical reliability and operational liquidity in the natural gas markets.

[9] 7 U.S.C. 2(a)(1)(I).

For the reasons stated above, we respectfully request that the Commission clarify that the natural gas transportation capacity and storage agreements are not commodities and, thus, not commodity options with the meaning of the Dodd-Frank Act. In the alternative, we respectfully request that the Commission exempt these service from the Dodd-Frank act pursuant to its exemptive authority and consistent with the statutory intent.

IV. <u>Conclusion</u>.

The IECA respectfully submits the foregoing comments in response to the Commission's Swap Definition Rule. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member thereof.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/	/s/
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