Dodd-Frank and Electric Utilities

Understanding the new mosaic of commodities trading regulations.

By Matthew J. Agen

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act)[1] amended the Commodity Exchange Act (CEA)[2] and greatly expanded the jurisdiction of the Commodity Futures Trading Commission (CFTC or the commission) over financial instruments used in energy transactions. At the time of its enactment, there was great uncertainty about how Dodd-Frank and the related CFTC-implementing regulations would affect retail electric utilities and local natural gas distribution companies. Even after several years of CFTC clarification, the CEA's applicability to specific retail utility transactions requires constant vigilance by utilities.

Retail utilities and large end-users who purchase energy often enter into associated financial transactions that shift the price risk of the energy from the utility purchaser to a third party. Implementation of Dodd-Frank potentially exposed retail utilities and other energy purchasers to the same regulatory burden as large financial institutions[3] when such entities enter into financial and physical commodity transactions.[4]

Over the past few years, the CFTC has issued a whole mosaic of interrelated implementing rules.[5] As part of this mosaic, the CFTC has issued several rules and interpretive guidance notifications that clarify the extent to which it will regulate the activities of electric and natural gas utilities (and other end-users). In large part, retail utilities can rely on these labyrinthian exemptions and no-action determinations to avoid the full regulatory burdens of Dodd-Frank. However, the CFTC's general anti-fraud and anti-manipulation authority, and scienter-based prohibitions under CEA continue to apply.[6] Moreover, the CEA-exemptions that apply to retail utilities generally require case-by-case scrutiny, because they are determined by the facts and circumstances of each transaction.

> Concerns raised by the senators were muddled in the translation of the requirements under Dodd-Frank from statute to regulation.

Unintended Targets

Before the individual tiles in the Dodd-Frank mosaic can be fully interpreted as applicable to utilities, the overarching intent of the Act must be understood. Electric and natural gas utilities provide utility services to retail customers in accordance with the rates and conditions approved by state regulatory commissions. While utilities purchase natural gas and electricity for physical delivery, they also use financial tools to hedge risks associated with providing retail service.[7] In other words, most utilities are end-users, and they use financial instruments to mitigate the price volatility of the commodities needed to provide service to customers and mitigate the effect of potential commodity price fluctuations on customers.[8] The

1. *See* Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376 (2010).
2. 7 U.S.C. § 1, *et seq.*
3. The regulatory burdens include, *inter alia,* new margin, clearing and reporting requirements for certain transactions.
4. *See, e.g.,* the individual comments of Edison Electric Institute, American Gas Association, Electric Power Supply Association filed on Sept. 20, 2010 in response to the *Advance Notice of Proposed Rulemaking and Request for Comments, Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act*, 75 Fed. Reg. 51,429 (Aug. 20, 2010).
5. *See* Testimony of Chairman G. Gensler, before the U.S. Senate Committee on Agriculture, Nutrition & Forestry, (March 3, 2011) *available at* www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-72.
6. *See, e.g.,*7 U.S.C. §§ 2, 6, 6b, 6c, 6o, 6s, 9, 9a, 12, 13, 13a-1, 13a-2, 13b and 13c.
7. *See,* n. 4, *supra*.
8. As discussed in detail below regarding the *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42560 (July 19, 2012) , the term "end-user" refers to a counterparties to a swap that "(i) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, … , how it generally meets its financial obligations associated with entering into non-cleared swaps." 7 U.S.C. § 2(h)(7)(A).

Matthew J. Agen (MatthewAgen@Postschell.com) is a member of Post & Schell P.C.'s energy group. The author acknowledges the assistance of Douglas Canter of Post & Schell P.C.'s energy group.

financial instruments include exchange traded futures contracts and energy derivatives.[9]

Prior to Dodd-Frank, financial instruments associated with a physical energy transaction and used by a regulated purchaser to hedge its price risk were largely unregulated by the CFTC. Moreover, except for the CEA's anti-manipulation provisions, the CFTC expressly exempted contracts for the purchase and sale of crude oil, condensates, natural gas, and natural gas liquids.[10] Specifically, certain oil, natural gas, and electricity related transactions were primarily subject to oversight by the Federal Energy Regulatory Commission (FERC) and the various states, as applicable.[11] The CFTC didn't actively regulate the energy transactions that were subject to FERC's authority. However, the CFTC's jurisdiction to prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, continued to apply.[12]

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During the Congressional debate and enactment of Dodd-Frank, one of the major concerns for electric and natural gas utilities was whether their activities would be subject to the same regulatory burdens applicable to large banks or financial institutions, or whether their status as end-users would lighten the regulatory load.[13] This concern continued during the CFTC rulemaking and implementation process. In other words, prior to the issuance of the CFTC's implementing regulations, the pending question was whether utilities could enter into transactions in order to provide utility service in the same manner as during the pre-Dodd-Frank period or would these traditional endeavors be regulated in some way by the commission.[14]

While the Act doesn't specifically exempt electric and natural gas utility operation from the regulatory burdens of the revised CEA, some legislators did support the concept that utilities wouldn't be subject to the same regulatory burdens as a financial institution. In June 2010, prior to Dodd-Frank being signed into law, Senators Dodd and Lincoln sent a letter to Representatives Frank and Peterson explaining that electric and gas utilities weren't the intended target of the then-pending legislation.[15] The Dodd-Lincoln Letter explained that the law was intended to preserve the ability of end-users to enter into hedging transactions to mitigate the risk of market volatility. Moreover, the intent of the bill, according to the senators, wasn't to regulate end-users such as electric and gas utilities that purchase commodities to provide service to customers and use swaps to manage

9. *See* the March 1, 2012 joint letter of Edison Electric Institute, American Gas Association, and the Electric Power Supply Association, supporting the Petition for Exemptive Relief for Certain Bona Fide Hedging Transactions Under Section 4a(a)(7) of the Commodity Exchange Act. http://www.epsa.org/forms/uploadFiles/20897000000D4.filename.EEI_-_AGA_-_EPSA_Comments_in_Support_-_Petition_Re_Bona_Fide_.pdf
10. *Exemption for Certain Contracts Involving Energy Products*, 58 Fed. Reg. 21286 (April 20, 1993) (1993 Energy Exemption).
11. *See,e.g.,* Interstate Commerce Act, 49 U.S.C. App. § 1, *et seq.*; Natural Gas Act 15 U.S.C. 717, *et seq.*; Federal Power Act, 16 U.S.C. 791a, *et seq.*
12. *See* 1993 Energy Exemption. As previously discussed, even if a transaction is exempt from certain requirements, the CFTC's general anti-fraud and anti-manipulation authority, and scienter-based prohibitions under CEA continue to apply. Notably, Section 720 of Dodd-Frank requires that the CFTC and FERC negotiate a memorandum of understanding to establish procedures for applying their respective authorities; resolving conflicts concerning overlapping jurisdiction; and avoiding conflicting or duplicative regulation. The CFTC and FERC have yet to enter into such a memorandum of understanding. Therefore, the exact jurisdiction of the two agencies concerning energy related transactions is still an open question. In *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013), however, the court held that the CFTC has exclusive jurisdiction over futures contracts and, therefore, FERC lacked jurisdiction to charge a market participant with manipulation of natural gas futures contracts.
13. *See* "Financial reform bill wins final approval in Senate, now awaits president's signature," *Inside FERC,* (July 19, 2010) (discussing how the energy industry had concerns that end-users would be caught up in a requirement to clear trades and be subject to stricter requirements).
14. *See* "Energy industry groups urge CFTC to limit reform's impact, reach deal with FERC," *Inside FERC,* (June 13, 2011).
15. Letter from Senator C. Dodd and Senator B. Lincoln to Rep. B. Frank and Rep. C. Peterson (Dated June 30, 2010) (Dodd-Lincoln Letter).

risk associated with their business.

The senators encouraged the CFTC to exclude from the definition of swaps any sale of a nonfinancial commodity for deferred delivery when the transaction is intended to be physically settled, even where the parties could agree to book-out the delivery obligation under such a forward contract. For example, power purchase agreements or natural gas supply contracts that provided for delivery at a later date, but that also permitted the potential for a booking out of the delivery obligation, were, according to the senators, to be exempt from the swap definitions. However, since the Dodd-Lincoln Letter itself didn't carry the full force of law – and it was left to the CFTC to interpret the text of the revised CEA and determine what utility activities would be regulated under the forthcoming regulations – many of the concerns raised by the senators were arguably muddled in the translation of the requirements under Dodd-Frank from statute to regulation.

Threshold Regulatory Questions

In large part, the CFTC, through the rulemaking and the statutory interpretation process, and via no-action letters, has attempted to stay true to the intent of Dodd-Frank, as embodied in the Dodd-Lincoln Letter. However, uncertainties and pitfalls remain that could result in electric and natural gas utilities being subject to the full regulatory burden of Dodd-Frank. While the CFTC's actions have provided certain exemptions applicable to electric and natural gas utilities that generally protect utilities' historic activities from burdensome regulation, exemption isn't guaranteed. Utilities must be aware of the pathways that might lead to their required compliance with all of the regulatory burdens of Dodd-Frank.

There are two critical and integrated inquiries that utilities must undertake in order to determine if full compliance with all the requirements of Dodd-Frank are necessary or whether any existing exemptions are applicable: Is the transaction being entered into a swap? And is the utility a swap dealer or major swap participant?

> The CFTC implemented various *de minimis* thresholds, below which entities would be excluded from the definition of swap dealer.

The answers to these questions will determine whether, and to what extent, an exemption applies or whether a utility must comply with all applicable Dodd-Frank requirements. Therefore, the critical tiles in the mosaic that must be examined are the CFTC's interpretation of the definition of "swap" and its separate interpretation of the definitions of "swap dealer" and "major swap participant."

Section 721 of Dodd-Frank[16] amended the CEA by adding definitions for the term "swap,"[17] "swap dealer,"[18] and "major swap participant,"[19] among others. The definitions in the Act are quite broad and Section 712 Dodd-Frank required that the CFTC, in conjunction with other agencies, further clarify and refine the relevant definitions,[20] therefore the CFTC had the authority to clarify what are and are not considered swaps.

In the revised CEA a swap is defined, *inter alia*, as any transaction that contains optionality related to the purchase or sale of commodities or property of any kind or that provides for any purchase, sale, or delivery that is dependent on the contingent on the occurrence of an event.[21] Importantly, however a swap isn't "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled."[22] On the face of it, a broad interpretation of the statutory Dodd-Frank swap definition could be interpreted to include certain power »

16. Dodd-Frank, § 721.
17. 7 U.S.C. § 1a(47). A swap includes, *inter alia*, any transaction that is a "put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind" or "that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence." However a swap isn't "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled." 7 U.S.C. § 1a(47)(B)(ii).
18. 7 U.S.C. § 1a(49). A swap dealer includes any swap person that "holds itself out as a dealer in swaps;" "makes a market in swaps;" "regularly enters into swaps with counterparties as an ordinary course of business for its own account;" or "engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps."
19. 7 U.S.C. § 1a(33). A major swap participant includes any person who isn't a swap dealer, and "maintains a substantial position in swaps for any of the major swap categories;" "whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets;" or "is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency;" and "maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission."
20. Dodd-Frank, §712(d)(1).
21. *See* 7 U.S.C. §1a(47)(A).
22. 7 U.S.C. § 1a(47)(B)(ii).

purchase agreements, full requirements contracts, and agreements that could be booked-out or financially settled. The statutory definition of a swap, the CFTC's interpretation of the definition, and the related exclusions are critical because Dodd-Frank makes it unlawful to enter into a swap without complying with the full regulatory requirements of the Act. As such, how the CFTC interpreted the swap definition in the Act was essential in determining to what extent energy related transaction would be subject to all of the regulatory requirements of the revised CEA.

Nonfinancial Commodities and Forward Contracts

In August 2012, the CFTC published a Final Rule defining "swap." The rule clarified the extent to which "nonfinancial commodities forward contracts" are included in the swap definition under Dodd-Frank.[23] An example of a nonfinancial commodities forward contract is a contract between an electric utility and a marketer that includes a present price to be paid by the utility but defers the marketer's delivery of power until a future time.

A critical question for utilities was how the CFTC would interpret the term "nonfinancial commodity" as it's used in the blanket exemption from the swap definition in the revised CEA. In short, the CFTC generally determined that the term "nonfinancial commodity" means a commodity that can be physically delivered.[24] However, certain intangible commodities that can be physically delivered also qualify as nonfinancial commodities (such as an emission allowance) if ownership of the commodity can be conveyed and the commodity can be consumed.[25]

The basis of the CFTC interpretation of what nonfinancial commodities meet the exclusion from the swap definition is consistent with CFTC precedent regarding the forward contract exclusion. This approach generally excluded from regulation transactions involving market participants that regularly make or take delivery of the commodity at issue in the ordinary course of business.[26] In short, the CFTC stated that the forward exclusion in nonfinancial commodities would be interpreted by the commission consistent with its historical interpretation of the existing forward exclusion with respect to futures contracts.[27] For the forward contract exclusion to apply, a transaction must include a nonfinancial commodity, be for future or deferred delivery, and the parties intend for the transaction to be physically settled.[28] This determination by the CFTC went a long way in implementing the intent embodied in the Dodd-Lincoln Letter. As a practical matter, and as applicable to utilities, this interpretation means that supply agreements, such as full requirements contracts to meet provider of last resort or default service obligations, generally would meet the forward contract exclusion to the swap definition and wouldn't be regulated by the CFTC. As the CFTC explained "any variability in delivery amounts under the contract appears to be driven directly by the buyer's commercial requirements and is not dependent upon the exercise of any commodity option by the contracting parties."[29]

> While the CFTC's actions have provided certain exemptions applicable to electric and natural gas utilities that generally protect utilities' historic activities from burdensome regulation, exemption isn't guaranteed.

Furthermore, the CFTC's treatment of book-outs with regard to the forward exclusion from the definition of "future delivery", *i.e.*, the Brent Interpretation,[30] would also be applicable to the forward exclusion from the swap definition for nonfinancial commodities under Dodd-Frank.[31] Under the Brent Interpretation, which is applicable to transactions entered into between commercial participants in connection with their business,[32] counterparties with offsetting positions may forego delivery and instead negotiate payment-of-differences pursuant to a separate, individually negotiated cancellation agreement referred to as a "book-out."

Because of the application of the Brent Interpretation by the CFTC to nonfinancial commodities, the commission withdrew the 1993 Energy Exemption because it's no longer necessary.[33] Notably, however, the CFTC explained that the alternative delivery procedures, such as netting, discussed in the 1993 Energy Exemption would continue to apply.[34] Regarding netting agree-

23. *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement;" Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012) (Swap Definition Rule).
24. Swap Definition Rule at 48232.
25. *Id.* at 48233.
26. *Id.* at 48229.
27. *Id.* at 48227.
28. *Id.* at 48227, 48228
29. *Id.* at 48239.
30. *Statutory Interpretation Concerning Forward Transactions*, 55 Fed. Reg. 39188 (Sept. 25, 1990) (Brent Interpretation).
31. Swap Definition Rule at 48228.
32. Brent Interpretation at 39192.
33. Swap Definition Rule at 48229-48230; *see,* n. 10, *supra*.
34. *Id.*

ments that had been permitted by the 1993 Energy Exemption,[35] the CFTC explained the Edison Electric Institute Master Power Purchase and Sale Agreement, which contemplates a reduction to a net delivery amount of future, unintentionally offsetting delivery obligations, is consistent with the intent of the book-out provision in the Brent Interpretation. However, when entering into transactions, the parties must have a bona-fide intent to make or take delivery of the commodity covered by the agreement for the exclusion to apply.[36]

Volumetric Optionality

Another major concern in the utility industry when Dodd-Frank was enacted was whether agreements that provided for some level of optionality would be considered swaps and regulated as such by the CFTC. As discussed, the commission generally exempted various types of energy contracts, with some levels of optionality, from the swap definition, provided the various conditions are met. In its swap definition interpretation the CFTC explained that a forward contract containing an embedded commodity option or options will be considered an excluded nonfinancial commodity forward contract (and not a swap) if the embedded option(s): i) may be used to adjust the forward contract price, without undermining the overall nature of the contract; ii) don't target the delivery term, *i.e.*, the predominant feature of the contract is actual delivery; and iii) can't be severed and marketed separately from the contract.[37]

In order to evaluate whether a transaction qualifies for the forward contract exclusions from the swap definition for nonfinancial commodities, the commission looks to the "specific facts and circumstances" to evaluate whether any optionality operates on the price or delivery term, and whether a commodity option is marketed or traded separately from the underlying contract.[38] The CFTC's initial interpretation is that transactions with embedded volumetric optionality may satisfy the forward exclusions. Specifically, the CFTC stated that, if a transaction meets seven specific factors, then it would satisfy the forward exclusion.[39] Pertinent to utilities, the types of transactions that include optionality – but that would meet the forward exclusion to the swap definition, and hence generally not be regulated by the CFTC – include capacity contracts, transmission or transportation services agreements, tolling agreements, and peaking supply contracts.[40]

RTO-ISO Exemption

Separate from the generic exclusions noted above, since the enactment of Dodd-Frank, the CFTC has exempted from broader regulation certain transactions that were historically and are currently regulated by FERC or by state commissions. Specifically, in an order effective April 2, 2013, issued in response to a petition by various regional transmission organizations (RTO) and independent system operators (ISO) (RTO-ISO Exemption Order),[41] the CFTC exempted specific electric energy-related agreements, contracts, and transactions, as well as any person offering and entering into such transactions from all of the provisions of the CEA.[42] The exempted transactions include those related to financial transmission rights, energy, forward capacity, and reserve or regulation transactions.[43] To be eligible for the exemption granted in the RTO-ISO Exemption Order the transaction must be offered or entered into in a market administered by a one of the RTOs or ISOs[44] covered by the Order pursuant to a said organization's FERC-approved and effective tariff, rate schedule, or protocol.

Notwithstanding the important RTO-ISO exemption, the CFTC's anti-fraud and anti-manipulation authority, and scienter-based prohibitions continue to apply to RTO-ISO transactions. The RTO-ISO Exemption Order is expressly limited to market participants transacting in the requesting RTO-ISO markets that qualify

35. 1993 Energy Exemption at 21293.
36. Swap Definition Rule at 48230.
37. *Id.* at 48237.
38. *Id.*
39. *Id.* at 48238. The seven part test is: (1) The optionality does not undermine the overall nature of the transaction as a forward contract; (2) The predominant feature of the transaction is actual delivery; (3) The optionality cannot be severed from the overall transaction; (4) The seller of a nonfinancial commodity underlying the transaction intends, at the time it enters into the transaction to deliver the underlying nonfinancial commodity if the optionality is exercised; (5) The buyer of a nonfinancial commodity underlying the transaction intends, at the time it enters into the transaction, to take delivery of the underlying nonfinancial commodity if it exercises the embedded volumetric optionality; (6) Both parties are commercial parties; and (7) The exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors, or regulatory requirements, that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity.
40. *Id.* at 48240.
41. *Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations To Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act*, RIN 3038–AE02, 78 Fed. Reg. 19880 (April 2, 2013).
42. The RTO-ISO Exemption Order didn't grant an exemption to the Commission's general anti-fraud and anti-manipulation authority. RTO-ISO Exemption Order at 19912.
43. RTO-ISO Exemption Order at 19882-19883.
44. The RTOs and ISOs include: Midwest Independent Transmission System Operator.; ISO New England.; PJM Interconnection, California Independent System Operator and New York Independent System Operator. The RTO-ISO Exemption Order also applies to the Electric Reliability Council of Texas.

as appropriate persons,[45] or eligible contract participants,[46] as those terms are defined in the CEA, *e.g.*, financial institutions, banks, and investment companies, *inter alia.* Additionally, the RTO-ISO Exemption Order also applies to "persons who are in the business of: (i) generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system."[47]

The RTO-ISO Exemption Order includes three conditions to the effectiveness of the included exemption. First, the requesting RTO-ISOs must demonstrate compliance[48] with FERC's tariff creditworthiness provisions.[49] Second, the requesting RTO-ISOs must submit a legal memorandum[50] that provides assurance that the RTO-ISOs satisfy the standards set forth in FERC's netting regulations[51] and will provide the requesting RTO-ISOs with enforceable rights of set off against any of its market participants under the Bankruptcy Code, in the event of the bankruptcy of a market participant. The third condition concerns information sharing and the requesting RTO-ISOs must comply with the commission's requests to share positional and transactional data.[52]

Retail Transaction Exemption

In December 2011, the CFTC issued an interpretation[53] concerning its new jurisdiction over certain retail commodity transactions. The CFTC explained that the new jurisdiction broadly applied to any transaction in any commodity as if the transaction was a contract of sale of a commodity for future delivery.[54] The December 2011 interpretation also explained that it if actual delivery of the entire quantity of the commodity purchased occurred within 28 days, such transaction would be exempt from the retail commodity transactions definitions.[55] However, will the CFTC consider an agreement to supply electric or natural gas retail customers for a period of one year or more a "retail commodity transaction"?

> Exemptions that apply to retail utilities generally require case-by-case scrutiny, because they are determined by the facts and circumstances of each transaction.

Late this summer, the CFTC clarified that sale and delivery of physical energy commodities to industrial, commercial, or retail customers on a recurring basis wouldn't be considered retail commodity transactions as defined in the revised CEA[56] and, therefore, aren't, *inter alia*, required to be conducted on a regulated exchange.[57] The potential risk to utilities and retail suppliers concerning what transactions would be deemed retail commodity transactions was that it was unclear whether retail residential gas and electric supply contracts met the narrow exemption provided in the Act.[58]

Therefore, in August 2013 the CFTC issued a further interpretation explaining that the term "retail commodity transactions" as defined by the CEA wouldn't encompass electricity or natural gas supply contracts intended to provide service to residential or business customers where the customer consumes the electricity or natural gas and subsequently pays for that usage, on a periodic basis.[59] The CFTC explained that it doesn't interpret the new retail commodity transactions provisions as applying to such an electricity or natural gas supply contract, because the customer regularly receives delivery of and consumes energy commodity during the term of the contract and periodically pays for usage.[60]

Dodd-Frank and End-Users

Dodd-Frank exposes end-users to potential regulatory requirements as a result of entering into certain types of transactions, such as being subject to the clearing requirements, under Dodd-Frank.[61] This is of critical importance because the revised CEA provides that it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization, if the swap is required to be cleared.[62]

However, the CEA includes an end-user exception that provides that the aforementioned requirement doesn't apply to a swap if one of the counterparties to the swap: "(i) is not a finan-

45. 7 U.S.C. §§ 6(c)(3)(A)–(J).
46. 7 U.S.C. § 1a(18).
47. RTO-ISO Exemption Order at 19912.
48. *Id*. at 19889.
49. 18 C.F.R. § 35.47 (2013).
50. RTO-ISO Exemption Order at 19890.
51. 18 C.F.R § 35.47(d).
52. RTO-ISO Exemption Order at 19892.
53. *Retail Commodity Transactions Under Commodity Exchange Act*, 76 Fed. Reg. 77670 (Dec. 14, 2011).
54. *Id.* at 77671.
55. *Id.* at 77672; *see* 7 U.S.C.§ 2(c)(2)(D)(ii)(III)(aa).
56. 7 U.S.C.§ 2(c)(2)(D).
57. *Retail Commodity Transactions Under Commodity Exchange Act*, 78 Fed. Reg. 52426 (Aug. 28, 2013) (August 2013 Retail Commodity Transactions Interpretation).
58. *See* Comments of Constellation Energy Group, *et al.*, filed on Feb. 13, 2013 on the Interpretation Regarding Retail Commodity Transactions Under the Exchange Act.
59. August 2013 Retail Commodity Transactions Interpretation at 52426.
60. *Id.* at 52428.
61. 7 U.S.C. § 2(h).
62. *Id.*

cial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared swaps."[63] Additionally, if the end-user is a public company, Section 2(j) of the CEA[64] requires that for the exemptions to be applicable an appropriate committee of the issuer's board or governing body is required to have reviewed and approved the decision to enter into swaps that are subject to end-user exception. In a Final Rule issued by the CFTC in July 2012,[65] the commission established rules that non-financial entities, such as energy companies, must follow if they choose to claim the end-user exemption. By satisfying the requirements end-users will be able to enter into swaps without having to comply with the mandatory clearing requirements. In addition to the requirements contained in the CEA for the exemption, quoted above, an end-user is required to satisfy certain reporting requirements. For example, an end-user may elect to make an annual filing that describes the counterparties to the transactions, explains whether the swaps are used to hedge or mitigate risk, how any financial obligations related to the uncleared swap will be satisfied. Therefore, as end-users, utilities may enter into swaps without the transactions being subject to the full panoply of the swaps regulations.

Dealer or Major Participant?

Another significant tile in the Dodd-Frank regulatory mosaic, and an important threshold question, is whether electric or natural gas utilities would be considered swap dealers or major swap participants under the CFTC regulations. As stated above, Dodd-Frank added a definition for the terms "swap dealer" and "major swap participant" to the CEA,[66] and the CFTC issued a Final Rule further clarifying the terms.[67] Generally, a swap dealer is a person that i) holds oneself out as a dealer in swaps, ii) makes a market in swaps, iii) regularly enters into swaps, or iv) engages in any activity causing that person to be commonly known in the trade as a dealer or market maker in swaps.[68]

A major swap participant generally includes a person who isn't a swap dealer, but i) maintains a substantial position in swaps; ii) whose outstanding swaps create substantial counterparty exposure; or iii) is a financial entity that is highly leveraged and maintains a substantial position in outstanding swaps.[69] Electric and natural gas utilities should be concerned about being labeled "swap dealers" or "major swap participants" because of the reporting, recordkeeping, margin, and business conduct rules that apply to these types of entities, thus increasing regulatory costs.

Swap Dealers' *de Minimis* Thresholds

Dodd-Frank requires that the CFTC "exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers."[70] In clarifying its definition of swap dealer, the CFTC implemented various *de minimis* thresholds, below which entities would be excluded from the definition of swap dealer. In other words, an entity that engages in a *de minimis* level of swap dealing wouldn't be considered a swap dealer and thus wouldn't have to meet many of the capital, margin, and reporting and recordkeeping requirements.[71] Therefore, if a utility engages in transactions that are considered swaps, as defined above, as long as the aggregate amount of the swaps are below the threshold, said utility won't be subject to regulation as a swap dealer. The issue is that not all utilities have the same threshold values.

The CFTC determined that a prudent approach would be to phase in the implementation of the *de minimis* thresholds. Moreover, as applicable to the energy industry, the CFTC implemented different *de minimis* thresholds for investor-owned utilities as compared to municipal utilities and other utilities considered special entities. Therefore, different thresholds apply for different types of utilities.

Once the phase-in is complete, an entity won't be considered a swap dealer if its swap dealing activity during the preceding 12 month period results in swap positions with an aggregate gross notional amount of no more than $3 billion.[72] This *de minimis* threshold will be phased-in over time to facilitate orderly implementation of swap dealer requirements. During the phase-in period, the *de minimis* threshold will effectively be $8 billion.[73] The phase-in period will terminate five years after certain data starts to be reported to the swap data repositories, *i.e.*, 2018, or the CFTC has the ability to revise the *de minimis* thresholds, prior to the expira-

63. 7 U.S.C. § 2(h)(7); *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42560 (July 19, 2012).
64. 7 U.S.C. § 2(j).
65. *End-User Exception to the Clearing Requirement for Swaps*, n. 63, *supra*.
66. 7 U.S.C. § 1a(33) and (49).
67. *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30596 (May 23, 2012) (Swap Dealer Final Rule).
68. 7 U.S.C. § 1a(49)(A).
69. 7 U.S.C. § 1a(33).
70. 7 U.S.C. § 1a(49)(D).
71. Swap Dealer Final Rule at 30597.
72. *Id.* at 30726; *see also* 17 C.F.R §1.3(ggg)(4).
73. *Id.* at 30634.

tion phase-in period.[74] Importantly, it isn't entirely clear from the Swap Dealer Final Rule[75] how the lower threshold will be implemented once the phase-in period is concluded. The CFTC hasn't explained how it will analyze the data collected during the phase-in period, or if it will provide regulated entities the ability to comment on the CFTC's findings and whether the implementation of the lower threshold is appropriate.

As noted above, the *de minimis* threshold is different for special entities. A "special entity" is a federal agency, state, state agency, city, county, municipality, other political subdivision of a state, employment benefit plan, government plan or endowment.[76] This definition would include a municipal utility or other public power agency. Initially the CFTC set the *de minimis* threshold for special entities at aggregate gross notional amount of no more than $25 million with no phase-in period for this threshold. The discrepancy between the $25 million special entity threshold and the initial $8 billion threshold creates a unique issue for the government owned electric and gas utilities. The intent behind the lower threshold for municipal energy companies is to protect these special entities from excessive losses, which the public ultimately would shoulder.[77] The reality is that, by implementing a $25 million threshold, the CFTC limited the number of market participants that were willing to deal with special entities.[78] Counterparties that would be below the initial $8 billion threshold might not be willing to trade with special entities out of concern for exceeding the special entity $25 million *de minimis* threshold, which could, in turn, trigger regulatory issues for the non-special entity counterparties.[79]

> Unfortunately, this no-action relief is limited to only entities that provided required notice to the CFTC.

In response to repeated requests from various special entities, the commission issued no-action relief allowing the *de minimis* threshold to be increased to $800 million for utility commodity swaps.[80] Specifically, the no-action relief stated that commission wouldn't recommend the commencement of an enforcement action against a person for failure to apply to be registered as a swap dealer, if: i) the utility commodity swaps[81] have an aggregate gross notional amount of no more than $800 million over a 12 month period; ii) the person isn't otherwise a swap dealer; and iii) the person isn't a financial entity, as defined in the CEA. Unfortunately, this no-action relief is limited to only those entities that provided the required notice to the CFTC. Specifically, to take advantage of the no-action relief and avoid the swap dealer registration, an entity was required to provide notice to the CFTC by Dec. 31, 2012.[82] As such, if an entity that desired to be a counterparty in certain utility commodity swaps with municipal utilities or other public power agencies didn't provide such notice, based on a strict reading of the relief granted, the special entity $25 million *de minimis* threshold, and not the higher $800 million threshold, applies. Therefore, if an entity desires to rely on the higher threshold, but didn't provide the required notice, separate authorization from the CFTC is required.

Dodd-Frank Mosaic

As the Dodd-Lincoln Letter indicates, the intent of Dodd-Frank wasn't to regulate the activities of end-users, such as electric and natural gas utilities. The mosaic of rules and interpretations issued by the CFTC implementing the Act has generally provided a pathway for utilities to follow, whereby these types of end-users won't be subject to every layer of Dodd-Frank's comprehensive regulatory regime. In order to mitigate the regulatory burdens, a utility must be mindful to avoid transactions that would be considered swaps or aren't covered by one of the many exemptions. Furthermore, if a utility enters into financial transactions that are swaps, the utility must be cognizant of the thresholds that, if crossed, would render such entities swap dealers or major swap participants. F

74. *Id.* at 30641.
75. *See* n. 67, *supra.*
76. 7 U.S.C. § 6s(h)(2)(c).
77. Swap Dealer Final Rule at 30628, n. 410.
78. Testimony of the Commissioner Scott D. O'Malia Before the Subcommittee on General Farm Commodities and Risk Management House Committee on Agriculture (July 23, 2013): "While this rule was written with the best of intentions, by reducing the de minimis threshold to $25 million, the end result has been a reduction in the number of market participants that are willing to do business with Special Entities." http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-28
79. *Id.*: "Many counterparties that would fall well below the $8 billion de minimis threshold are not willing to trade with Special Entities for fear of exceeding the $25 million cap and then having to register with the Commission as swap dealers."
80. Staff No-Action Relief: Temporary Relief from the *De Minimis* Threshold for Certain Swaps with Special Entities, CFTC Letter No. 12-18 (Oct. 12, 2012) (CFTC Letter No. 12-18).
81. For purposes of the no-action relief, the term "utility commodity swap" means any swap that meets all of the following conditions: a) a party to the swap is a utility special entity; b) a party to the swap that is a utility special entity is using the swap in the manner described in 17 C.F.R. § 1.3(ggg)(6)(iii); and c) the swap is related to an exempt commodity in which both parties to the swap transact as part of the normal course of their physical energy businesses.
82. CFTC Letter No. 12-18 at 5.