



June 11, 2010

To: House and Senate Conferees

The undersigned associations represent utilities and energy companies that provide natural gas and electric service to almost every consumer in the United States. We greatly appreciate your commitment to ensuring an end-user exemption from mandatory clearing of over-the-counter (OTC) derivatives as part of financial reform efforts. Our industry makes use of derivatives, both over-the-counter and through exchanges, to manage commercial risks on behalf of our consumers to keep rates stable and affordable. Because our longstanding activity is focused on hedging, it does not pose systemic risk and was not at issue in the financial crisis. **For these reasons, it is critically important that the final bill include an end-user exemption.**

We support the passage of strong financial reform that would increase oversight of derivatives and enhance the transparency of these markets through mandatory reporting requirements of all swap transactions and the mandatory clearing of standardized transactions between for-profit financial entities such as banks and hedge funds. We believe the proposed end-user exemptions included in H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, and S. 3217, the Restoring American Financial Stability Act of 2010, are largely consistent with our long-held assertion that end-users do not pose a systemic risk to the financial system. Moreover, we believe that a clear end-user exemption is absolutely critical for us to maintain stable and affordable rates while continuing to invest in America's energy infrastructure, resulting in the creation of more jobs and a cleaner, more efficient and globally competitive economy.

To ensure that commercial end-users can rely upon the end-user exemption, it is critical that these commercial entities are not inadvertently misclassified as either a Swap Dealer or a Major Swap Participant and that not-for-profit cooperative lenders to rural electric cooperatives are not forced to clear. We ask for the following clarifications:

- The legislation should clarify the definition of Swap Dealer so that it clearly states that a Swap Dealer, by definition, excludes Commercial End-Users. Alternatively, this concern can also be addressed by modifying the existing definition to provide that a Swap Dealer is “any person who – (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly engages in the purchase and sale of swaps in the ordinary course of *its primary* business **as a market maker or dealer, and** (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps” instead of as any person meeting any one of those criteria. There are other possible solutions to ensure that commercial end-users are not considered Swap Dealers; however, our main concern is that this uncertainty be addressed. More generally, in terms of the definitions included in the current bills, we clearly prefer the definitions for Swap Dealer and Major Swap Participant in H.R. 4173.
- The definition of “swap” in CEA § 1a should expressly exclude “**any sale of a nonfinancial commodity or security for deferred shipment or delivery.**” This modification will make the exclusion consistent with the exclusion of forward or deferred delivery contracts from the

definition of “future delivery”. Clarifying the exclusion will ensure that physical forward contracts in which the parties later agree to book-out their delivery (but not payment) obligations for commercial convenience are unambiguously excluded from the definition of a swap.

- Under Section 731(h)(2) of S. 3217, swap dealers would be charged with a fiduciary duty towards state and local governments (as well as pension plans, endowments and retirement plans). However, swap dealers and end-users enter into swap transactions on an arm’s length basis as counterparties. By definition, the two parties to a swap (or any other commodity transaction) have conflicting interests, *i.e.*, one party wants to buy low and the other wants to sell high. Mandating a fiduciary responsibility on swap dealers will prevent them from entering into swap transactions with state and local governments and create conflicts with pension plan requirements. For these reasons, we believe that this provision should be either removed from the final legislation or modified in such a way that it doesn’t create such conflicts for pension plans or for state or local governments.
- Consumer-owned rural electric cooperatives rely on two cooperative lenders, the National Rural Utilities Cooperative Finance Corporation (CFC) and CoBank, for financing. These two lenders use derivatives to manage interest rate risk in order to provide rural electric cooperatives affordable financing and greater loan options. These entities do not use derivatives for investment or speculative purposes, nor are they brokers or dealers in derivatives. They only use derivatives to hedge and mitigate their business risk. Requiring these lenders to clear these transactions could result in tens of millions of dollars in additional annual costs to rural electric cooperatives and their consumer members. Accordingly, it is imperative that cooperative lenders are provided a clear exemption from the clearing and margining requirements in the bill.

We believe that clarification of these issues is essential to ensure that commercial end-users are all classified appropriately under the legislation, and to avoid any costly and unintended consequences.

We also urge the Conference to adopt the provision to resolve the jurisdictional issues between the Federal Energy Regulatory Commission (FERC) and the Commodity Futures Trading Commission (CFTC) contained in S. 3217. With respect to margin requirements for existing derivatives, we urge the conferees to clarify that the legislation applies only prospectively.

Once again, we greatly appreciate your work to ensure meaningful financial reform that includes a robust end-user clearing exemption.

Sincerely,

American Gas Association  
 American Public Gas Association  
 American Public Power Association  
 American Wind Energy Association  
 Edison Electric Institute

Electric Power Supply Association  
 Independent Petroleum Association of America  
 Large Public Power Council  
 Natural Gas Supply Association  
 National Rural Electric Cooperative Association

cc: The United States House of Representatives

The United States Senate