

Alerts

Exempt Order Relaxes Regulatory Swap Rules for Some Energy Entities

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Government-owned utilities and electric cooperatives received final relief from the Commodities Future Trading Commission ("CFTC") and will not be required to comply with the regulatory swap proscriptions set forth in Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010¹ (the "Dodd-Frank Act") on April 2, 2013 (the "Exempt Order").

The Exempt Order generally provides that when government-owned utilities and electric cooperatives are engaged in certain electric transactions among themselves that they will not be required to comply with the requirement of the Commodities Exchange Act² (the "CEA") as amended by Dodd-Frank Act, and the regulations promulgated thereunder by the CFTC.³ Dodd-Frank establishes a regime in which swaps will be cleared through a clearinghouse. In addition, margining associated with clearing and trading will apply and most likely increase the costs of a company to hedge. The associated trade reporting, record keeping requirements and development of complimentary internal controls will impose additional costs on a company.

The Exempt Order applies only to certain entities that fall within the definition of an "Exempt Entity," which is defined as (i) any electric entity as described in the Federal Power Act ("FPA") section 201(f), (ii) any electric facility or utility that is wholly owned by an Indian tribe recognized by the federal government, (iii) any electric facility or utility that is wholly owned by a cooperative, that is treated as a not-for-profit entity or a cooperative under Internal Revenue Code, and exists for the primary purpose of providing electricity to its member/owner customers at cost, or (iv) any other entity that is wholly owned, directly or indirectly, by any one of the foregoing entities.⁴

The CFTC initial proposal did not include non FPA Section 201(f) such as Indian tribes and non section 201(f) cooperatives as exempt entities (the "Proposed Order").⁵ However, the CFTC accepted the argument by the applicants in the final definition of an Exempt Entity in that such entities deserve exempt treatment because FERC traditionally treated federally recognized Indian tribes as FPA Section 201(f) entities, and non-FPA section 201(f) cooperatives are owned and operated in the same matter as not-for-profits, and self-regulated as FPA section 201(f) cooperatives, and have the same underlying public service mission to provide affordable and reliable electric service to its customers. The CFTC confirmed that an electric cooperative's FPA 201(f) status is not necessarily determinative of its ability to avail itself of the relief provided in the Exempt Order so long as the cooperative continues to meet the criteria for relief. Depending whether the mission of the cooperative changes to a profit driven one or fails to be treated as a not-for-profit will be important criteria for the cooperative to monitor in order to take advantage to the Exempt Order.

The CFTC also modified the Proposed Order by removing the reference to the "lowest cost possible" in the definition of the electric cooperatives that qualify as an Exempt Entity. The Exempt Order requires that the primary purpose of a cooperative is providing electric service to its members/owner customers at cost. This modification is intended to reflect the CFTC's view that cost means to encompass the lowest cost possible in light of the cooperative's objectives,

reliability and environmental standards. The cost requirement is a flexible requirement depending on the nature of the cooperative.

The CFTC declined to provide a categorical relief for any energy transaction between Exempt Entities. The CFTC, however, limited the relief to transactions entered into by an Exempt Entity's purpose to manage supply and/or price risks arising from its public service obligations to generate, transmit, and/or deliver electric energy service to its customers, and the transaction falls within one of six categories: (1) Electric energy delivered; (2) Generation Capacity; (3) Transmission Services; (4) Fuel Delivered; (5) Cross-Commodity Pricing; and (6) Other Goods and Services (collectively, the "Exempt Non-Financial Energy Transaction"). An Exempt Non-Financial Energy Transaction does not include a transaction based on or referencing an interest rate, credit, and equity or currency asset class. It also does not include any grade of metal, or any agricultural product, or any grade of crude oil or gasoline that is not used as fuel for electric energy generation. A transaction entered into by an Exempt Entity that is subject to the rules of a registered entity, such as a swap dealer, does not qualify as an exempt transaction under the Exempt Order. The Exempt Order and to the extent that the Exempt Non-Financial Energy Transactions are swaps, the Exempt Entity is excepted from complying with the swap data reporting and recordkeeping requirements of the CFTC's regulations. The CFTC views these transactions as executed bilaterally within closed-loop non-financial, cooperative electric utilities entities, and having little impact, if any, to affect trading in derivative products traded on regulated exchanges. The categories represent arrangements entered into by Exempt Entities in order to manage price and/or supply arising from their public service role. The transactions that lack any relationship to physical generation, transmission, and/or delivery will be viewed by the CFTC as purely financial arrangements and fall outside the safe harbor of the Exempt Order.

The Electric Energy Delivered transaction is an arrangement in which an Exempt Entity agrees to provide electric energy to another Exempt Entity within a geographic service area, load or electric system for a period of time. Examples of arrangements are "full requirements" contracts or "all requirements" agreements or arrangements. The Exempt Entity obligates itself to provide to another Exempt Entity its "full requirements" that is, to provide electric service to the recipient's fluctuating electric load over a period of time at one or multiple delivery locations. This type of arrangement can exceed a period of 30 years or more.

Generation Capacity agreements involve transactions in which an Exempt Entity purchases an option or right to call upon another Exempt Entity's electric energy generation asset to supply electric energy. The exercise of the option may never occur. Shared resources agreements are recognized to fall within this category.

Transmission services arrangements permits an Exempt Entity, which is the owner of transmission lines, selling to another Exempt Entity the right to deliver electricity power from one designated point on the transmission lines to another point. The Exempt Order includes related ancillary services such as congestion management and system losses.

Fuel Delivered transactions are arrangements used by Exempt Entities to buy, sell, transport, deliver, or store fuel used in the generation of electric energy. The arrangements may include other types of services such as fuel transportation. The Final Order expressly recognizes that these transactions may include ancillary services to manage the operational basis or exchange risk of an Exempt Entity that arises from its location-specific, seasonal or otherwise variable operational need for fuel to be delivered.

Cross-Commodities transactions are arrangements in which the price of electric energy delivered is based upon the price of the fuel source used to generate the electric energy. Examples of such arrangements include heat rate transactions and tolling agreements and fuel delivered agreements.

Other Goods and Services involve agreements to share property rights, equipment, supplies and services such as construction, operation and maintenance agreements, facilities management, construction management, and

energy managements.⁶

The Exempt Order states that the CFTC reserves its anti-fraud, anti-manipulation, and enforcement authority and its authority to inspect books and records of Exempt Non-Financial Energy Transactions.⁷

¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010)

² 7 U.S.C. §1, et seq.

³ Application for an exemptive order was made by a group of trade associations and other organizations representing the interests of government and/or cooperatively-owned electric utilities on June 8, 2012. [click here](#)

⁴ An Exempt Entity does not include any "financial entity" as defined in the CEA.

⁵ "Proposal To Exempt Certain Transactions Involving Not-for-Profit Electric Utilities: Request for Comment", 77 FR 50998 (August 23, 2012).

⁶ The CFTC determined that "Fuel Delivered" transactions would be covered by the forward exclusion from the swaps definition. In addition, Environmental Rights, Allowances or Attributes are covered by the forward exclusion from the swap definition. (Products Release, 77 FR 48233-36)

⁷ CEA sections 2(a)(1)(B), 4b, 4c(c), 4o, 6(c), 6(d), ^{(3), 6c, 6d, 8, 9, and 12 and CFTC rules 32.4 and Part 180.S