COMMODITY FUTURES TRADING COMMISSION

Proposal to Exempt Certain Transactions Involving Not-for-Profit Electric Utilities; Request for Comments

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or the "Commission") is proposing to exempt certain transactions between not-for-profit utilities (entities described in section 201(f) of the Federal Power Act ("FPA")), and other electric utility cooperatives, from the provisions of the Commodity Exchange Act ("CEA" or "Act") and the regulations there under, subject to certain antifraud, anti-manipulation, and recordkeeping conditions. Authority for this exemption is found in section 4(c) of the CEA. The Commission is requesting comment on every aspect of this Notice of Proposed Order ("Notice").

DATES: Comments must be received on or before **[insert date 30 days after publication in Federal Register]**.

ADDRESSES: You may submit comments by any of the following methods:

- Agency Web site, via its Comments Online process: http://comments.cftc.gov. Follow the instructions for submitting comments through the Web site.
- Mail: David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Courier: Same as mail above.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to http://www.cftc.gov. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations.[1]

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from http://www.cftc.gov that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: David Van Wagner, Chief Counsel, (202) 418-5481, dvanwagner@cftc.gov, or Graham McCall, Attorney Advisor, (202) 418-6150, gmccall@cftc.gov, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

[1] 17 CFR 145.9.

SUPPLEMENTARY INFORMATION:

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I. Introduction

On June 8, 2012, the Commission received a petition ("Petition')[2] from a group of trade associations that represent government and/or cooperatively-owned electric utilities requesting relief from the requirements of the CEA[3] and Commission's regulations there under,[4] pursuant to CEA section 4(c),[5] for certain electric energy-related transactions between not-for-profit electric energy utilities. In this Notice, after summarizing and reviewing the representations made in the Petition, the Commission proposes conditional relief pursuant to CEA section 4(c) for non-financial energy transactions between not-for-profit utilities described in FPA section 201(f) and other electric cooperatives.

A. CEA Section 4(c)

Section 4(c) of the CEA provides the Commission with broad authority to exempt certain transactions and market participants from the requirements of the Act. When adding section 4(c) to the CEA, Congress noted that the goal of the provision "is to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner."[6] The House-Senate Conference Committee reconciling the provision's language noted that:

> The Conferees do not intend that the exercise of exemptive authority by the Commission would require any determination beforehand that the agreement, instrument, or transaction for which an exemption is sought is subject to the [CEA]. Rather, this provision provides flexibility for the Commission to provide legal

[2] The Petition is available on the Commission's website at http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nrecaetalltr060812.pdf.

[3] 7 U.S.C. 1 et seq.

[4] The Commission's regulations are set forth in title 17 of the Code of Federal Regulations ("CFR").

[5] 7 U.S.C. 6(c).

[6] HOUSE CONF. REPORT NO. 102-978, 1992 U.S.C.C.A.N. 3179, 3213 ("4(c) Conf. Report").

> certainty to novel instruments where the determination as to jurisdiction is not straightforward. Rather than making a finding as to whether a product is or is not a futures contract, the Commission in appropriate cases may proceed directly to issuing an exemption.[7]

Specifically, CEA section 4(c)(1) empowers the CFTC to "promote responsible economic or financial innovation and fair competition" by exempting any transaction (or class thereof) that otherwise would be subject to CEA section 4(a), or any person (or class thereof) dealing in such transaction(s), from any or all of the provisions of the CEA where the Commission determines that the exemption would be consistent with the public interest.[8] The Commission may grant such an exemption by rule, regulation or order, after notice and opportunity for hearing, and may do so on application of any person[9] or on its own initiative.

CEA section 4(c)(2) provides that the Commission shall not grant any exemption under section 4(c)(1) from any of the requirements of section 4(a) unless the Commission determines, among other things, that: (i) the exemption would be consistent with the public interest and the purposes of the CEA; (ii) the exempt agreement, contract, or transactions will be entered into

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[7] 4(c) Conf. Report at 3214-3215.

[8] Section 4(c)(1) of the CEA, 7 U.S.C. 6(c)(1), provides in full that:

> In order to promote responsible economic or financial innovation and fair competition, the Commission by rule, regulation, or order, after notice and opportunity for hearing, may (on its own initiative or on application of any person, including any board of trade designated or registered as a contract market or derivatives transaction execution facility for transactions for future delivery in any commodity under section 7 of this title) exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to subsection (a) of this section (including any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction), either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, from any of the requirements of subsection (a) of this section, or from any other provision of this chapter . . . if the Commission determines that the exemption would be consistent with the public interest.

[9] CEA section 1a(38) defines "person" to include "individuals, associations, partnerships, corporations, and trusts." 7 U.S.C. 1a(38).

solely between "appropriate persons;" and (iii) the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA.[10]

CEA section 4(c)(3) outlines which entities may constitute "appropriate person[s]" for purposes of a CEA section 4(c) exemption, including (as relevant to this Notice): (i) any governmental entity (including the United States, any State, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;[11] or (ii) such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.[12]

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[13] added new subparagraph 4(c)(6)(C) to the CEA.[14] CEA section 4(c)(6)(C) builds upon the Commission's general exemptive authority in section 4(c)(1) as follows:

> (6) If the Commission determines that the exemption would be consistent with the public interest and the purposes of this Act, the Commission shall, in accordance with [CEA sections 4(c)(1) and

[10] See 7 U.S.C. 6(c)(2).

[11] See 7 U.S.C. 6(c)(3)(H).

[12] See 7 U.S.C. 6(c)(3)(K).

[13] Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm. Title VII of the Dodd-Frank Act amended the CEA to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers ("SDs") and major swap participants ("MSPs"); (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

[14] 7 U.S.C. 6(c)(6)(C) (as added by section 722(f) of the Dodd-Frank Act).

> 4(c)(2)], exempt from the requirements of this Act an agreement, contract, or transaction that is entered into—
> [. . .]
> (C) between entities described in section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).

Thus, section 4(c)(6)(C) explicitly spotlights transactions between entities within the scope of FPA section 201(f) as being eligible for exemption pursuant to the Commission's 4(c) authority. However, whether an exemption is considered under 4(c)(1), 4(c)(6)(C), or both,[15] the CFTC must first determine that the proposed exemption meets certain threshold criteria including, for example, that the exemption would be consistent with the public interest and the purposes of the Act.

B. FPA Section 201(f)

The FPA[16] authorizes and, along with other statutes, governs the Federal Energy Regulatory Commission ("FERC"), the federal agency that regulates the interstate transmission and sale at wholesale in interstate commerce of electric energy by public utilities, as well as natural gas and hydropower projects.[17] Section 201(f) of the FPA, which Congress referenced in new CEA section 4(c)(6)(C), provides broad-based relief from most provisions of Part II[18] of the FPA for certain government and cooperatively-owned electric utility companies and states that:

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[15] For any exemption involving CEA section 4(c)(6), the Commission believes "both" is the correct characterization because CEA section 4(c)(6) explicitly directs the Commission to consider any exemption proposed under 4(c)(6) "in accordance with [sections 4(c)(1) and 4(c)(2)]."

[16] 16 U.S.C. 791a et seq.

[17] See www.ferc.gov.

[18] Part II of the FPA governs the transmission and sale at wholesale of electric energy in interstate commerce, including the facilities used for such transmission or sale. See 16 U.S.C. 824 et seq. Section 201(f) does not, however, provide an exemption from FPA parts I or III. Part I of the FPA deals with the establishment and functioning of FERC and the regulation of hydroelectric resources. See 16 U.S.C. 792 et seq. Part III of the FPA deals with recordkeeping and reporting requirements and FERC's procedural rules concerning complaints, investigations, and hearings. See 16 U.S.C. 825 et seq. Additionally, section 201(f) does not provide an exemption

> [n]o provision in this subchapter [Part II of the FPA] shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.[19]

II. Petition

A. Relief Requested

As noted above, on June 8, 2012, the Commission received the Petition[20] from a group of trade associations representing government and/or cooperatively-owned electric utilities. Those Petitioners consisted of the National Rural Electric Cooperative Association ("NRECA"),[21] the American Public Power Association ("APPA"),[22] the Large Public Power Council ("LPPC"),[23]

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from FERC's refund authority, 16 U.S.C. 824e, reliability standards, 16 U.S.C. 824o(b)(1), or jurisdiction over transmission facilities and services, 16 U.S.C. 824(i)-(j).

[19] 16 U.S.C. 824(f).

[20] The Petition is available on the Commission's website at http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nrecaetalltr060812.pdf.

[21] According to the Petition, NRECA is the national service organization for more than 900 not-for-profit rural electric cooperatives and government-owned power districts. NRECA's members provide electric energy to approximately 42 million consumers in 47 states, or thirteen percent of the nation's population. See Petition at 3.

[22] According to the Petition, APPA is the national trade association that represents the interests of government-owned electric utilities in the United States. APPA's member utilities are not-for-profit utility systems that were created by state or local governments to serve the public interest. Approximately 2,000 government-owned electric utilities provide over fifteen percent of all kilo-watt hour ("KWh") sales to retail electric customers. See Petition at 3-4.

[23] According to the Petition, LPPC is an organization representing 24 of the largest government-owned electric utilities in the nation. LPPC members own and operate over 86,000 megawatts of generation capacity and nearly 35,000 circuit miles of high voltage transmission lines, representing nearly 90 percent of the transmission investment owned by non-Federal government-owned electric utilities in the United States. See Petition at 4.

the Transmission Access Policy Study Group ("TAPS"),[24] and the Bonneville Power Administration ("BPA")[25] (collectively, the "Petitioners"). The Petition requests that the Commission provide categorical exemptive relief from the requirements of the CEA, pursuant to CEA section 4(c)(6), in accordance with CEA sections 4(c)(1) and 4(c)(2), for all "Electric Operations-Related Transactions" between "NFP Electric Entities," retroactive to the enactment of Dodd-Frank, outstanding now, or that may be developed and executed in the future.[26] The Petitioner's definition and scope of the terms "Electric Operations-Related Transactions" and "NFP Electric Entities" is summarized below.[27]

B. Definition and Scope of Electric Operations-Related Transactions

The Petition defines Electric Operations-Related Transactions to mean:

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[24] According to the Petition, TAPS is an association of transmission dependent electric utilities located in more than 30 states. All of TAPS member electric utilities except one are FPA section 201(f) entities. See Petition at 4.

[25] According to the Petition, BPA is a self-financed, non-profit Federal agency created in 1937 by Congress that primarily markets electric power from 31 federally owned and operated projects, and supplies 35 percent of the electricity used in the Pacific Northwest. BPA also owns and operates 75 percent of the high-voltage transmission in the Pacific Northwest. BPA's primary statutory responsibility is to market its Federal system power at cost-based rates to its "preference customers." Per the Petition, BPA has 130 preference customers made up of electric utilities which are not subject to the jurisdiction of FERC, including Indian tribes, electric cooperatives, and state and municipally chartered electric utilities, and other Federal agencies located in the Pacific Northwest. See Petition at 4.

[26] See Petition at 1-2; 4 (emphasis added). The Petition also requests that the Commission determine that no Electric Operations-Related Transaction will affect any NFP Electric Entity's regulatory status under the CEA (e.g., as a swap dealer or major swap participant). Id. at 28. The Petition specifically asks that, if the Commission declines to provide the categorical relief as requested, the Commission would i) include an additional category of approved Electric Operations-Related Transactions that includes all "trade options" referencing the goods or services described in the categories of transactions currently outstanding between Exempt Entities (see infra sections II.B.1-7), and ii) delegate to Commission staff the authority to review on an expedited basis and approve as eligible for the benefit of the exemptive order any new Electric Operations-Related Transactions between NFP Electric Entities. Id. at 13. Finally, the Petition invites the Commission to determine that any Electric Operations-Related Transaction described in the Petition does not need an exemption because such transaction is not a "swap," is a "commercial merchandising arrangement" or "trade option," or is not an agreement, contract or transaction involving a "commodity." See id. at 13, note 26.

[27] In this Notice, the Commission describes the Petition by referencing Petitioners' defined terms. Such references, however, are not to be interpreted as the Commission proposing to adopt such terms for the purpose of the exemption proposed herein. Rather, the proposed exemption establishes its own defined entities and transactions for which relief is being provided.

> any agreement, contract or transaction involving a "commodity" (as such term is defined in the CEA) and whether or not such agreement, contract or transaction is a "swap," so long as the NFP Electric Entity is entering into any such agreement, contract or transaction "to hedge or mitigate commercial risks" (as such phrase is used in CEA Section 2(h)(7)(A)(ii)) intrinsically related to the electric facilities or electric operations (or anticipated facilities or operations) of the NFP Electric Entity, or intrinsically related to the NFP Electric Entity's public service obligation to deliver reliable, affordable electric energy service to electric customers. For the avoidance of doubt, "intrinsically related" shall include all transactions related to (i) the generation, purchase or sale, and transmission of electric energy by the NFP Electric Entity, or the delivery of reliable, affordable electric energy service to the NFP Electric Entity's electric customers, (ii) all fuel supply for the NFP Electric Entity's electric facilities or operations, (iii) compliance with electric system reliability obligations applicable to the NFP Electric Entity, its electric facilities or operations, (iv) compliance with energy, conservation or renewable energy or environmental statutes, regulations or government orders applicable to the NFP Electric Entity, its electric facilities or operations, or (v) any other electric operations-related agreement, contract or transaction to which the NFP Electric Entity is a party. Electric Operations-Related Transactions shall ***not*** include agreements, contracts or transactions executed, traded, or cleared on a registered entity, nor shall such defined term include an agreement, contract or transaction based or derived on, or referencing, a "commodity" in the interest rate, credit, equity or currency asset class, or of a product type or category in the "Other Commodity" asset class that is based or derived on, or referencing, metals, or agricultural commodities or crude oil or gasoline commodities of any grade not used as fuel for electric generation.[28]

In general, the Petitioners represent that all Electric Operations-Related Transactions covered by the proposed definition are intrinsically related to the needs of both NFP Electric Entities engaged in a transaction "to hedge or mitigate commercial risks" which arise from their respective electric facilities and ongoing electric operations and public service obligations.[29] The

[28] Petition at 4-5.

[29] See Petition at 12.

Petitioners state that, at the time two NFP Electric Entities enter into an Electric Operations-Related Transaction, the terms of the transaction contemplate performance of an electric operations-related obligation by one party, in exchange for payment or reciprocal performance of an electric operations-related function by the other party.[30]

The Petition, which is summarized herein, specifically describes seven categories of transactions that currently occur between NFP Electric Entities, and which are covered by the Petition's proposed definition.[31]

1. Electric Energy Delivered

In these transactions, NFP Electric Entities agree for one such entity to provide another such entity with electric energy delivered to an identified geographic service territory, load,[32] or electric system. Petitioners note that since electric energy is not currently storable in commercial quantities, the delivery location is critical to the transaction—electric energy delivered elsewhere is not usable or valuable for the receiving entity's operational needs.

As described by the Petitioners, this transaction type includes the most prevalent type of Exempt Electric Operations-Related Transaction between NFP Electric Entities, i.e., the "full

[30] See id. The Petition notes that the terms "physically-settled," "financially-settled," and cash-settled," as such terms are used in the futures industry, do not translate easily into a commercial context where NFP Electric Entities enter into bilateral contracts governed by state law or by FERC, PUCT or state public utility tariffs to buy and sell goods and services. It is not readily apparent to the Commission why the terms do not translate conceptually. Nevertheless, as previously noted, the Petition represents that Electric Operations-Related Transactions between NFP Electric Entities are always intrinsically related to the electric facilities and operations, and/or the public service obligations, of each of the NFP Electric Entities involved. See id. at 12, n. 24.

[31] The following transaction category descriptions come from the Petition at 6-12.

[32] The Commission understands that "load" is an energy industry term for "demand." See, e.g., Current Energy, Supply of and Demand for Electricity in California, available at http://currentenergy.lbl.gov/ca/index.php <last visited July 9, 2012> (explaining that "[t]he current demand (or 'load') depends on how much power consumers are using right now").

requirements" contract, or "all requirements" agreement or arrangement[33] that is often executed between a generation and transmission ("G&T") cooperative (i.e., a cooperative that generates and transmits electricity) and each of its constituent NFP Electric Entity members/owners, or between a Joint Action Agency (an agency formed under state law to provide wholesale power supply and transmission service to member entities) and each of its constituent NFP Electric Entity members. In some instances, the G&T cooperative or the Joint Action Agency is formed by its constituent members for the singular purpose of providing its constituent members with their "full requirements" obligations to deliver electric energy over an agreed delivery period at one or multiple delivery points or locations to their retail electric customers).

In such an arrangement, the provider NFP Electric Entity agrees by bilateral contract or, in some long-standing relationships established by governing or legal documents of the G&T cooperative or Joint Action Agency as the provider NFP Electric Entity, that it will provide for a recipient NFP Electric Entity's "full requirements" to provide reliable electric service to the recipient's fluctuating electric energy load over an agreed delivery period at one or multiple delivery points or locations. In some cases, the delivery period, term, or "tenor" of such agreements can be for thirty years or more.

In addition to providing the recipient's full requirements for electric energy, the arrangement may also include providing services that are ancillary to the delivery of the electric energy, such as operating or dispatching one or more of the recipient's owned generation units, generation capacity or balancing services, or any of the other goods, services, or commodities required by the recipient described under other categories below.

[33] Per the Petition, the "full" or "all" requirements contract is a bilateral commercial arrangement that is customized to the two NFP Electric Entities that are parties thereto.

The Petition notes that quantities of electric energy will also vary during the delivery period. If a recipient NFP Electric Entity owns some generation itself, the quantity of supplemental electric energy or capacity to meet its "full requirements" during some seasons, months, or days of the year (net of its owned generation) may be zero. Some ancillary services or "commodities" under such a transaction may be optional. Pricing may vary on a seasonal, monthly, daily or on-peak/off-peak basis, or may be tied to the cost at which the provider NFP Electric Entity can generate or purchase electric energy. Alternatively, the price may be tied to the fuel that the provider uses for generating the electric energy provided.

2. Generation Capacity

In describing this transaction category, the Petition initially notes that the term "capacity," in connection with generation capacity transactions, has varying meanings across the electric industry, and that electric operations professionals may reference any of a number of "capacity" agreements, contracts, transactions, or arrangements.[34] More generally, the Petition notes that when two NFP Electric Entities agree that one will provide "generation capacity" or "capacity" for another, either a mutual understanding of the engineering context or a customized bilateral commercial contract further defines the parties' respective rights and obligations. Generation capacity is always location-specific and is monitored by the regional transmission

[34] Counsel for Petitioners represented in subsequent conversations that generation capacity, generally, can mean the capability or adequacy of specific owned generation units to supply fluctuating load requirements within a defined geographic region (e.g., an RTO region or an electric utility system) at an estimated or capacity rating level measured in megawatts. The basic concept of generation capacity can be understood as a separate "commodity" from electric energy delivered (or other ancillary service or reserve), such that the purchase and sale of generation capacity may exist as a stand-alone transaction or as one component of a "bundled energy" service or transaction, such as a full requirements contract. When viewed as an "option-like" commodity transaction, generation capacity can be "delivered" if the "holder" (or relevant reliability authority) calls on the corollary electric energy to be delivered. In some circumstances, the "premium" component can be priced separately and referred to as a "demand charge." In others, the generation capacity component can be a contingent or option-like aspect of a seller's obligation to provide the "full requirements" that a load serving entity ("LSE") needs to serve the electric consumers and businesses in its regions, including fulfillment of any generation capacity obligations that the LSE has to its local reliability authority.

organization ("RTO") or independent system operator ("ISO")[35] or, outside the RTO/ISO regions, by balancing authorities or reliability coordinators under the supervision of the North American Electric Reliability Corporation ("NERC") and FERC.[36] Deliverability of generation capacity to a particular geographic point or electric system interface is such an important concept that FERC requires each RTO, ISO, and balancing authority to establish a framework of engineering studies to demonstrate/confirm that a particular generation unit's electrical energy output is deliverable. If generation capacity from a particular unit does not satisfy the relevant RTO, ISO or balancing authority's deliverability requirements, that generation capacity has no value in meeting reliability requirements in that reliability area. If generation capacity is purchased from a generation unit located outside the relevant reliability area, the correlated electric energy (which, if "called on," must be delivered) nonetheless must be deliverable to the relevant reliability area.

Some generation capacity agreements or arrangements among NFP Electric Entities may include operational reserves attributable to the identified generation unit. A generation capacity arrangement or transaction also may be called a "shared resources agreement," whereby NFP Electric Entities agree conditionally to share capacity resources as needed. The contract may relate to multiple identified units owned or operated by both NFP Electric Entities. For example,

[35] More information is available at http://www.ferc.gov/industries/electric/indus-act/rto.asp. The current ISO/RTO entities operating in North America are PJM Interconnection, Midwest Independent Transmission System Operator, Southwest Power Pool, ISO New England, California ISO, New York Independent System Operator and the Electric Reliability Council of Texas (ERCOT). Each of these entities, other than ERCOT, was either formed at the direction of FERC or designated by FERC to direct the operation of the regional electric transmission grid in its specific geographic area. ERCOT is fully regulated by the Public Utility Commission of Texas (the "PUCT").

[36] Counsel for Petitioners in subsequent conversations represented that generation capacity can be a reliability requirement that, in some areas, owners of generation units must maintain in order to provide voltage and frequency support to the electric grid for reliability purposes. In other areas, generation capacity reliability requirements may be imposed on LSEs that must, if they own no generation assets, purchase generating capacity from third-party generators to fulfill the LSEs' reliability requirements.

some state or regional programs to manage limited generation capacity and maintain voltage support for the electric grid in a geographic area may allow NFP Electric Entities subject to such program to utilize "demand-side resources" as part of the generation capacity required by the specific balancing authority, or to meet the reliability authority's requirements in the relevant geographic region.

In general, a generation capacity transaction between two NFP Electric Entities in one region cannot be presumed to be fungible with any other generation capacity transaction between two other NFP Electric Entities, even in the same region.

3. Transmission Services

As with the other transaction categories described by the Petitioners, the Petition notes that electric transmission services transactions between NFP Electric Entities will vary by geographic region and by assets owned and transmission services required by the operations of different NFP Electric Entities. In some cases, these transmission services agreements include congestion management services, system losses, and ancillary services.[37] Some NFP Electric Entities own significant transmission facilities (e.g., BPA owns 75 percent of the transmission

[37] The Petition notes that the concept of generation capacity is distinguishable from "transmission capacity," which relates to the limited amount of electric energy transmission available over the interconnected electric transmission grid, and which is generally defined as a measure of the transfer capability or "capacity" remaining in the physical electric energy transmission network for further commercial activity over and above already committed uses. Additionally, Exhibit 2 of the Petition provides the following example:

> Federal power agency K sells to G&T cooperative J 100 MWs of monthly "firm point-to-point transmission service" from location X to location Y in the southeast U.S. for a term of 3 months at the tariff rate of $2,000/MW-Month for a total transaction value of $600,000. The geographic area in which such transmission service takes place is outside the "footprint" of an RTO, and therefore the transmission service is reserved on the Open Access Same Time Information System ("OASIS") website of the transmission owner, K. J intends to use the transmission service to deliver wholesale electric power to its distribution cooperative member-owners to supply a portion of its distribution cooperative constituents' retail electric load.

Petition Exhibit 2 at 3.

lines in the Pacific Northwest). In some cases, Federal law and the regulations pursuant to which the Federal power agencies are formed and operate require a particular Federal power agency to allocate a portion of the transmission to particular electric entities, including NFP Electric Entities, located within its geographic area.

In certain areas of the country, the RTOs/ISOs control allocation of transmission assets, rights and services, and the individual owners of transmission assets do not have the ability to engage in bilateral services arrangements involving those transmission assets, which are under RTO/ISO management and control. In other areas of the country, historical transmission services agreements, including those between NFP Electric Entities, are "grandfathered" from the RTO/ISO rules and procedures otherwise applicable to electric transmission services in that region.

4. Fuel Delivered

The Petition describes a fourth category of transactions in which one NFP Electric Entity delivers to another NFP Electric Entity fuel to power electric generation facilities. The electric facilities owned and operated by NFP Electric Entities vary widely in terms of the fuel used by such facilities for generation. Fuel types may include nonfinancial commodities such as coal, natural gas, uranium products, heating oil, and biomass or waste products including wood chips, tires, and manure. In addition to the fuel, one NFP Electric Entity may provide to another NFP Electric Entity other services related to the fuel commodity, such as fuel procurement, fuel transportation over pipeline, rail, barge and truck, fuel storage, or fuel waste handling and storage services.[38]

[38] Petitioners also described a scenario in which one NFP Electric Entity may agree to manage for another NFP Electric Entity the operational basis or exchange (location/time of delivery) risk that arises from the recipient's NFP

5. Cross-Commodity Transactions

The Petition describes such transactions as commercial agreements entered into between two NFP Electric Entities, including options, heat rate transactions and tolling arrangements, whereby the electric energy delivered to the recipient NFP Electric Entity is priced by reference to the fuel source used or useable by the provider NFP Electric Entity for generating such electric energy. Alternatively, the price paid for the fuel by the recipient NFP Electric Entity may be calculated by reference to the amount of electricity that the recipient NFP Electric Entity generates using such fuel.

6. Other Goods and Services

The Petition notes that these agreements may involve sharing property rights, equipment, supplies and services, including construction, operation, and maintenance agreements, facilities management, construction management, energy management or other energy-related services tied to the electric facilities owned by, or operations of, one or both of the NFP Electric Entities, including emergency assistance or "mutual aid" arrangements.

In some regions of the country, state regulators or RTOs/ISOs have established "demand side management programs" to assist utilities in managing the supply/demand balance that is

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Electric Entity's location-specific, seasonal, or otherwise variable operational need for fuel delivered. Another example from Exhibit 2 of the Petition provides that:

> Joint power agency L supplies to municipal utility M a long-term supply of natural gas from a natural gas project (Project Entity Z) developed by L and other NFP Electric Entities for the purpose of fueling L's and M's (and other NFP Electric Entity owners of Project Entity Z's) natural gas-fired electric generating facilities in the California ISO market. M pays L for the cost of acquiring, developing and improving the natural gas Project Entity Z through direct "capital contributions" to Project Entity Z. In addition M pays L a monthly fee for the natural gas supplied from the natural gas project, composed of an operating cost fee component, an interstate pipeline transportation cost fee component and an operating reserve cost fee component. The natural gas-fired electric generating facility is to be used by M to supply a portion of its expected retail electric load.

Petition Exhibit 2 at 3-4.

essential to delivering reliable electric energy (which is not currently storable in commercial quantities). Therefore, some NFP Electric Entities engage in joint demand-side management programs with their retail electric customers whereby the customers agree to reduce service/load requirements during certain weather or emergency conditions. NFP Electric Entities may agree with each other to engage in joint demand-side management programs to conserve their collective generation resources and reduce costs, and to comply with their collective obligations to RTOs/ISOs, regional balancing authorities, and state or local regulators.

The Petition also notes that NFP Electric Entities may provide each other with services related to the generation, transmission, and/or distribution facilities owned by each, or with respect to the maintenance (ongoing, outage, or emergency) or dispatch of generation units. Especially when there is a weather event or other unexpected outage which interrupts electric energy service to an NFP Electric Entity's customers, other NFP Electric Entities (and other electric utilities) in the geographic area will provide goods and services on an immediate basis, often without the opportunity of negotiating pricing or payment terms until the electric energy service has been restored to retail electric energy customers. These agreements between NFP Electric Entities may involve operating each other's facilities, sharing equipment, supplies and employees (e.g., line crews), and interfacing on each other's behalf with suppliers/vendors, regulators and reliability authorities and customers.

7. Environmental Rights, Allowances or Attributes

The last category of transactions described in the Petition relates to a wide variety of Federal, regional, state, and local environmental rights, allowances or attributes required to operate a particular NFP Electric Entity's electric facilities or operations, or to fulfill a particular NFP Electric Entity's regulatory requirements. NFP Electric Entities may transact among

themselves in environmental emissions allowances, offsets or credits (including carbon), renewable energy, distributed generation, clean energy or energy efficiency credits or attributes (which can be regional or state specific in nature, including "green tags"). NFP Electric Entities in a particular geographic region, whose available allowances may be directly useable to fulfill the needs of another NFP Electric Entity in the same region, often will directly transact with each other, rather than go to a non-NFP Electric Entity to negotiate a particular transaction.

C. Definition and Scope of NFP Electric Entities

The Petition defines NFP Electric Entities as:

> (i) the United States, a State or any political subdivision of a State, or (ii) an "electric cooperative" that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or [(iii) any other electric cooperative, whether or not such electric cooperative meets the requirements of clause (ii) above,][1] or (iv) any agency, authority, instrumentality or department of any one or more of the foregoing, or a federally-recognized Indian tribe, or (v) any entity which is wholly owned, directly or indirectly, by any one or more of the foregoing. For purposes of this definition, an "electric cooperative" shall mean an "electric membership corporation" or an "electric power association" organized under State law, a "rural electric cooperative," "cooperative providing electric services to consumers and farmers" or any similar entity referenced in other Federal, State and local laws and regulations, so long as any such entity is formed and continues to operate for the primary purpose of providing electric service to its members on a not-for-profit, cooperative basis, and is treated as a cooperative under the Federal tax law.[39]

Generally, the Petition represents that all NFP Electric Entities are "nonfinancial end users of Electric Operations-Related Transactions, and enter into such transactions only to hedge or

[39] Petition at 14 (internal citations omitted).

mitigate commercial risks."[40] Summarized herein, the Petition describes in detail the specific classes of entities it believes fall within its proposed NFP Electric Entity definition, and justifies inclusion of each specific class based upon a common public interest rationale.

1. FPA 201(f) Entities

"FPA 201(f) entities" is the first class of NFP Electric Entities defined by Petitioners. These entities include i) certain government and cooperatively-owned electric utilities (as described in FPA section 201(f)) and ii) federally-recognized Indian tribes that own or operate electric facilities (as determined by FERC case law).

a. Government and Cooperatively-Owned Electric Utilities Described by FPA Section 201(f)

Petitioners seek relief from the CEA and Commission regulations there under for those entities explicitly described by FPA section 201(f)[41] as being exempt from the plenary jurisdiction of FERC. Per the Petition, the first category of these entities includes certain government-owned electric utilities, including Federal electric utilities such as BPA and other Federal agencies that operate electric generating or transmission facilities,[42] and state-chartered

[40] Petition at 33. Petitioners explain that the term "nonfinancial end users" means an NFP Electric Entity that does not fall within the definition of a "financial entity" in CEA 2(h)(7)(C)(i) and that no NFP Electric Entity falls within that definition. See id. at 33-34.

[41] See supra note 19 and accompanying text.

[42] Per the Petition, there are nine Federal electric utilities in the United States, which are part of several agencies of the United States Government:

- the Army Corps of Engineers;
- the Bureau of Indian Affairs and the Bureau of Reclamation in the Department of the Interior,
- the International Boundary and Water Commission in the Department of State,
- the Power Marketing Administrations in the Department of Energy (BPA, Western Area Power Administration, Southwestern Area Power Administration, and Southeastern Area Power Administration), and
- the Tennessee Valley Authority (TVA).

In addition, three Federal agencies operate electric generating facilities:

- TVA, the largest Federal power producer;

electric utilities such as the New York Power Authority. Other examples of government-owned electric utilities include state or county utility boards or public utility districts formed under state or local law, joint action agencies or joint power agencies formed under state law to provide wholesale power supply and transmission services to member entities (each a Joint Action Agency), and other political subdivisions of a state.[43] Finally, municipal utilities ranging in size from LPPC members such as the Los Angeles Department of Water and Power and the Sacramento Municipal Utility District, to the smallest municipal electric utilities with fewer than 500 electric meters, are also contemplated as government electric utilities under FPA section 201(f).[44]

Per the Petition, the second category of entities described by FPA section 201(f) are electric cooperatives that either are financed by the U.S. Department of Agriculture's Rural Utilities Service ("RUS"), sell less than 4,000,000 megawatt hours of electricity per year, or meet the requirements of an "aggregated FPA 201(f) entity." These electric cooperatives generally consist of i) distribution cooperatives, which distribute electric energy service directly to their owner/member customers, and ii) G&T cooperatives, which are owned by distribution cooperatives and generate or purchase electricity and transmit it to their constituent distribution

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- the U.S. Army Corps of Engineers; and
- the U.S. Bureau of Reclamation.
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[43] Per the Petition, a public power district or public utility district may be owned and operated by a city, county, state or regional agency. See, e.g., Public Utility District No. 1 of Chelan County, Washington (http://www.chelanpud.org/your-PUD.html). An irrigation district is a utility organized under state law which generates electricity in the course of supplying water. For example, Imperial Irrigation District in California was formed in 1911 under the California Irrigation District Act, as described at http://www.iid.com/index.aspx?page=39. Government-owned utilities are accountable to elected and/or appointed officials and focus on providing reliable and safe electricity service, keeping costs low and predictable for its customers, while practicing good environmental stewardship.

[44] Per the Petition, a government owned or operated electric utility may be a department of the governmental entity, or may be organized as a separate agency, authority or instrumentality thereof.

cooperatives for delivery to the distribution cooperatives' owner/member customers. Aggregated entities most commonly consist of a G&T cooperative formed by its constituent distribution cooperative (NFP Electric Entity) members or, comparably, a Joint Action Agency which is formed by its constituent government-owned (NFP Electric Entity) utility members.

As background, Petitioners explain that the FPA originally was enacted "to remedy rampant abuses in the investor-owned electric utility industry"[45] but that cooperatively-owned electric utilities are easily distinguishable from investor-owned electric utilities because they are "effectively self-regulating."[46] More importantly, of the major abuses considered by Congress as the impetus for the FPA legislation, "virtually none could be associated with the [electric] cooperative structure where ownership and control is vested in the consumer-owners."[47] Based on this understanding of the legislative history, FERC's predecessor, the Federal Power Commission ("FPC"), concluded that electric cooperatives financed under the Rural Electrification Act of 1936 ("REA")[48] were intended by Congress to be FPA 201(f) entities and exempt from the FPC's jurisdiction over "public utilities."[49] The FPC made such a

[45] Salt River Project Agric. Improvement and Power District v. Fed. Power Comm'n, 391 F. 2d 470, 475 (D.C. Cir. 1968) (emphasis added by Petitioners).

[46] Id. at 473 (elaborating that electric cooperatives are "completely owned and controlled by their consumer-members and only consumers can become members. They are non-profit. Each member has a single vote in the affairs of the cooperative, and services are essentially limited to members. No officer receives a salary for his services[,] and officers and directors are prohibited from engaging in any transactions with the cooperative from which they can earn any profit.") (citation omitted).

[47] Id. at 475.

[48] 7 U.S.C. 901 et seq. The REA established the RUS as the body to administer financing to rural utilities.

[49] See Dairyland Power Coop. et al, v. Fed. Power Comm'n, 37 F.P.C. 12, 27 (1967).

determination in the 1960s notwithstanding the fact that, at that time, electric cooperatives were not expressly described in FPA section 201(f).[50]

b. Federally-Recognized Indian Tribes

Federally-recognized Indian tribes that own or operate electric facilities are not described by FPA section 201(f), and thus would be subject to regulation as public utilities under the FPA. The Petition notes, however, that FERC and its predecessor, the FPC, and at least one court have determined such federally-recognized Indian tribes are to be treated as entities described in FPA section 201(f).[51] To identify eligible Indian tribes, the Petition recommends that the Commission rely on determinations made by the Secretary of the Interior, periodically listed in the Federal Register, of Indian tribes to be recognized by the U.S. government pursuant to Section 104 of the Act of November 2, 1994.[52]

Petitioners note that FERC's determination that such Indian tribes should be treated as FPA 201(f) entities was based on the fact that, in operating such electric facilities, the Indian tribes perform government functions—the funds generated by such electric operations would be used for governmental purposes and would decrease the need for federal funding. Additionally,

[50] As part of the Energy Policy Act of 2005 ("EPAct 2005"), Congress codified the previous interpretation by FERC in Dairyland, id., (affirmed by the D.C. Circuit Court in Salt River, 391 F. 2d 470) that electric cooperatives that receive financing under the REA should be considered FPA 201(f) entities. At the same time, Congress also expanded the FPA 201(f) exemption to electric cooperatives that sell less than 4 million megawatt hours per year, even if those electric cooperatives do not receive any financing from the RUS. See Pub. L. 109-58, 1291, 119 Stat. 594, 985 (2005), amending FPA 201(f) "by striking ''political subdivision of a state,'' and inserting ''political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year.''

[51] Per the Petition, see City of Paris, KY vs. Fed. Power Comm'n, 399 F.2d 983 (DC Cir. 1968); Sovereign Power Inc., 84 FERC ¶ 61,014 (1998); Confederated Tribes of the Warm Springs Reservation of Or., a Federally Recognized Indian Tribe, and Warm Springs Power Enterprises, a Chartered Enter. of the Confederated Tribes of the Warm Springs Reservation of Or., 93 FERC ¶ 61,182 at 61,599 (2000) (concluding that "the Tribes are an instrumentality of the 'United States, a State or any political subdivision of a state'" and that Warm Springs Power Enterprises, a Chartered Enterprise of the Tribes, was entitled to Tribes' Section 201(f) exemption.).

[52] Pub. L. No. 103-454, 108 Stat. 4791, 4792 (codified at 25 U.S.C. 479a-1).

Indian tribes are subject to Interior Department oversight. Finally, like the other government or government-owned electric entities described in FPA section 201(f), the Indian tribes are tax exempt or "not-for-profit" entities.

2. Non-FPA 201(f) Electric Cooperatives

The Petition also requests relief for the very small number of cooperatively-owned electric utilities that do not meet the criteria of FPA section 201(f), either because they do not receive funding from RUS, sell more than 4,000,000 megawatt hours of electricity in a given year, or are not an "aggregated NFP Electric Entity."[53] FERC has estimated that there were approximately fifteen electric cooperatives (of more than 900) which do not meet the requirements set forth in FPA section 201(f).[54] Petitioners request that the Commission recognize such cooperatives as "appropriate persons," in accordance with CEA sections 4(c)(1), 4(c)(2)(B), and 4(c)(3)(K), for purposes of an exemption under CEA section 4(c)(6). Petitioners represent as a threshold matter that, regardless of whether an electric cooperative meets the specific criteria of FPA section 201(f), all cooperatively-owned electric utilities share certain

[53] See Petition at 23. The Petitioners note that under various state laws, cooperatively owned electric utilities, or electric cooperatives, are sometimes called "electric membership corporations" or "electric power associations." In addition, Petitioners note that under certain sections of tax laws, state public utility laws or regulations, the FPA or the FERC's regulations, electric cooperatives are sometimes called "rural electric cooperatives" or "cooperatives providing electric services to consumers and farmers," or by similar, but not identical, entity names. See Petition at 2, note 5. In this Notice, as the Petitioners did in their Petition, the Commission uses the term "electric cooperatives" to encompass all of these entities, which are formed for the primary purpose of providing electric energy service to their owners/member customers on a not-for-profit basis, and which are treated as cooperatives under Federal tax laws.

[54] Statement of Cynthia A. Marlette, General Counsel of FERC, before the Committee on Agriculture, Subcommittee on Conservation, Credit, Energy, and Research, United States House of Representatives (July 30, 2008) (available at http://www.ferc.gov/eventcalendar/Files/20080730104611-Marlette.pdf). NRECA believes that, of its current members, the following six entities are non-FPA 201(f) electric cooperatives: Pacific Northwest Generating Cooperative (PNGC Power), Golden Spread Electric Cooperative, Old Dominion Electric Cooperative, Wabash Valley Power Association, Wolverine Power Cooperative, and Deseret Power Electric Cooperative.

distinguishing features—a common not-for-profit public service mission and self-regulating governance model—that form the underlying rationale for the FPA section 201(f) exemption.[55]

In analyzing whether an entity qualifies as an appropriate person under CEA section 4(c)(3), Petitioners note that past Commission determinations have focused on the financial strength and sophistication of the persons for whom relief is being provided. Petitioners also posit that CEA section 4(c)(3)(K) allows the Commission to consider the operations management qualification of the person or class of persons in relation to the exempted transactions, as well as the person's or class of person's ability to execute the exempted transactions without additional regulatory protection by the Commission. When considered in light of these determinative factors, Petitioners argue that source of financing or total electric energy sales are not meaningful factors for purposes of differentiating between electric cooperatives that are appropriate for an exemption from the CEA and those that are not.[56]

[55] Similarly, to be treated as a "cooperative" under Federal tax law, regardless of 201(f) status, an electric cooperative must operate on a cooperative basis. See 26 U.S.C. 501(c)(12), 1381(a)(2)(C). As explained by the United States Tax Court in the seminal case of Puget Sound Plywood, Inc. v. Commissioner of Internal Revenue, operating on a cooperative basis means operating according to the cooperative principles of i) democratic member control, ii) operation at cost, and iii) subordination of capital. See 44 T.C. 305 (1965); see also Internal Revenue Manual § 4.76.20.4 (2006) (elaborating on the cooperative principles by explaining that each member of a cooperative has one vote, a cooperative must allocate any excess operating revenue to its members in proportion to the amount of business it did with each, and that members share their interest, risk, and burden to obtain services or benefits rather than invest as equity owners). Additionally, for any electric cooperative to be exempt from Federal income taxation pursuant to IRC 501(c)(12), it must collect annually "85 percent or more of [its] income . . . from members for the sole purpose of meeting losses and expenses." 26 U.S.C. 501(c)(12)(A). Accordingly, Petitioners argue that an electric cooperative, regardless of FPA section 201(f) status, lacks incentive or motivation to manipulate prices, disrupt market integrity, engage in fraudulent or abusive sales practices, or misuse customer assets because it: (1) is a consumer cooperative; (2) is controlled by its members; (3) must operate at cost and "not operate either for profit or below cost;" (4) may not benefit its individual members financially; and (5) if exempt from Federal income taxation, must collect at least 85 percent of its income from members.

[56] Petitioners argue that in promulgating CEA section 4(c)(6)(C), "Congress effectively makes the determination for the Commission that 'entities described in FPA 201(f)' are 'appropriate persons' entitled to the benefits of the exemptive order." Petition at 23. Thus, by extension, Petitioners argue that if non-FPA 201(f) electric cooperatives are at least as financially sound and operationally capable as those electric cooperatives described by FPA section 201(f), then they should also be considered appropriate persons.

First, the Petition argues that whether out of necessity due to insufficient Congressional appropriations, or by choice in order to find more appropriate or less expensive terms for certain needs, electric cooperatives may look to sources of financing beyond the RUS. Other nonprofit cooperative financing entities, such as the National Rural Utilities Cooperative Finance Corporation ("CFC") or Co-Bank,[57] exist to supplement RUS financing or provide additional financing resources and terms not available through the RUS. Petitioners note that electric cooperatives always can choose to borrow from private lenders or self-finance infrastructure investments and operations with ongoing revenues and reserves. Eligibility for RUS financing does not speak to an electric cooperative's operational soundness or financial strength.

Next, the Petition suggests that greater electric energy sales could result in greater financial strength. Petitioners note that while very few electric cooperatives historically have sold 4,000,000 megawatt hours or more in a particular year, the success of the electric cooperative model means that there may be a small number of cooperatives in any particular year whose annual sales exceed the threshold.[58] Furthermore, an electric cooperative's status under the FPA may fluctuate year-to-year depending on its annual megawatt sales, which always will fluctuate depending on usage trends, economic conditions, and weather patterns. Petitioners believe that Congress' policy decision to codify 4,000,000 megawatt hours per year as a

[57] Per the Petition, the CFC is a nonprofit cooperative entity formed in 1969 by NRECA's electric cooperative members. CFC provides access to financing to supplement the loan programs of the RUS. CFC is the largest non-governmental lender to America's rural electric systems, and nearly 200 electric cooperatives across the United States rely solely on CFC for financing. CFC has separately requested exemptive relief from the Commission for the swaps it enters into related to providing financing to its members electric cooperatives. CoBank is a cooperative bank owned by electric cooperatives and agricultural cooperatives, and is a part of the Farm Credit Administration system.

[58] Per the Petition's representation of data collected by NRECA, fewer than one percent of distribution cooperatives exceed the four million MWh annual sales threshold, as do approximately 24 of 66 G&T cooperatives. The Commission understands that of those G&T cooperatives that exceed the sales threshold in a given year, the majority are still FPA 201(f) entities because they receive financing from RUS.

threshold was based solely upon the fact that FERC, as well as other agencies, already used this level to identify "small utilities," "small entities," or "small businesses" that should be afforded protection from the costs and regulatory burdens imposed on larger entities.[59]

Thus, Petitioners argue that there is no implication under any of the FPA section 201(f) criteria for electric cooperatives that non-201(f) electric cooperatives are more or less creditworthy or financially sound, or more or less deserving of operational deference or regulatory preference, than electric cooperatives that meet one of the FPA section 201(f) criteria.[60]

III. Commission Determinations

A. Scope of the Proposed Order

In the exemptive order proposed herein (the "Proposed Order"),[61] the Commission is providing for a narrower scope of eligibility than requested by Petitioners. While the proposed exemptive relief is structured in a manner similar to the Petition's suggested approach and

[59] See Petition at 35-36. Counsel for Petitioners also represent that EPAct 2005 was largely a response to the electrical blackouts in the northeast United States during 2003 that later were found to be attributable to generation and transmission failures of the largest electric utility providers. Thus, Congress' chief concern in expanding the 201(f) exemption for electric cooperatives was ensuring that entities with substantial generation and transmission capacity remained subject to the plenary jurisdiction of FERC. Per the Petition, Congress did not make a policy decision that the electric cooperatives selling 4 million megawatt hours or more per year required regulation under FPA 201(f) and, where EPAct 2005 did give FERC additional discretionary jurisdiction over electric cooperatives, FERC has not chosen to exercise that discretionary authority to date. When FERC exercises its jurisdiction in certain instances, it allows non-FPA 201(f) electric cooperatives additional regulatory flexibility, subject to "self-regulation" by such cooperatives' member/owner boards, distinguishing the not-for-profit electric sector from investor-owned electric utilities. The very small number of electric cooperatives that do not meet the 4 million megawatts per year threshold at any point in time are, nonetheless, "self-regulating entities," share the same cooperative governance structure, operate on a cooperative basis and are not-for-profit entities.

[60] Petitioners note that non-FPA 201(f) electric cooperatives likely own more or larger generation and transmission assets, and therefore are arguably at least as financially sound and operationally qualified as electric cooperatives described in FPA section 201(f). Furthermore, these non-FPA 201(f) electric cooperatives may meet the financial criteria established in CEA section 4(c)(3)(F) for an "appropriate person" by having a net worth exceeding $1,000,000 or total assets exceeding $5,000,000.

[61] The text of the Proposed Order is set forth in section IV of this Notice.

incorporates many of the same parameters,[62] the Proposed Order uses different terminology to describe the pertinent categories of affected entities and transactions, and limits the exempted transactions to certain enumerated categories.[63] The Proposed Order identifies (i) the entities eligible to rely on the exemption for purpose of entering into an exempt transaction ("Exempt Entities"); (ii) the agreement, contract, or transaction for which the exemption may be relied upon ("Exempt Non-Financial Energy Transactions"); and (iii) the provisions of the CEA that will continue to apply to Exempt Entities engaging in Exempt Non-Financial Energy Transactions. Accordingly, relief from the requirements of the CEA and Commission regulations provided in the Proposed Order will be available for only an Exempt Entity entering into an Exempt Non-Financial Energy Transaction with another Exempt Entity, subject to certain conditions.

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[62] See Petition Exhibit 3.

[63] The Commission believes that the open-ended relief sought by the Petitioners makes it difficult to evaluate the full range of transactions that would be subject to exemption and, thus, to conduct legitimate public interest and CEA purpose determinations as required under CEA section 4(c). As the Commission is not providing the categorical relief requested by Petitioners at this time, it considered the Petition's secondary requests to provide i) an additional category for "trade options" and/or ii) delegated authority to Commission staff to review and approve new categories of exempted transactions for purposes of being eligible for the relief provided herein. See supra note 26. Given Congressional intent that the Commission need not determine the nature of a product when providing 4(c) relief, the Commission does not believe it would be appropriate to provide specific relief to trade options as a category of transactions in the context of this proposed relief. See supra note 7 and accompanying text. While it is possible that the scope of the transactions eligible for the relief proposed herein may include transactions that otherwise would qualify as trade options, the Commission need not make such a finding in the context of the proposed 4(c) exemption. Rather, the Commission has determined to limit the scope of the proposed exemption to Exempt Non-Financial Energy Transactions, as described in the Proposed Order, and the Commission is requesting comment on this description. As for the Petitioner's request regarding delegated authority to CFTC staff, the Commission has never in the past delegated authority to staff to make ad-hoc 4(c) determinations, and does not propose such a delegation herein. Additionally, the Commission is not providing relief retroactive to the enactment of Dodd-Frank, as requested by Petitioners. The Commission specifically requests comment as to whether it should provide such relief, and as to whether such relief would be necessary to provide any relief beyond that which has already been available via the Commission's Dodd-Frank implementation program, related exemptive orders, and staff no-action letters. The Commission also declines to propose, as was requested by Petitioners, that the transactions subject to the relief provided herein will not affect any entity's regulatory status under the CEA and Commission regulations. The Commission requests comment as to how the relief provided by the Proposed Order would be incomplete without such a provision and as to whether the Commission should include such a provision in the final exemptive order.

1. Exempt Entities

The Commission is proposing to include three general categories of electric utilities as Exempt Entities in the relief provided herein: i) government-owned electric utilities described by FPA section 201(f); ii) electric utilities owned by Federally-recognized Indian tribes, otherwise subject to regulation as public utilities under the FPA; and iii) cooperatively-owned electric utilities, regardless of whether such utilities are described by FPA section 201(f), so long as they are treated as cooperative organizations under the Internal Revenue Code ("IRC").[64] Given the unique public service mission and governance structure of government, Indian tribe, and cooperatively-owned electric utilities (as compared to investor-owned public utilities), the Commission believes that such Exempt Entities, when engaged in Exempt Non-Financial Energy Transactions, have less financial incentive to engage in market manipulation or other types of abusive trade practices that may implicate the public interest and/or purposes of the CEA and therefore are appropriate for section 4(c) relief.[65]

Generally, Exempt Entities are limited to nonfinancial commercial end users that operate on a not-for-profit basis. The Proposed Order defines Exempt Entities as those entities that do not meet the definition of a "financial entity" in CEA section 2(h)(7)(C). The purpose of this criterion is to prevent a cooperative that exists primarily in order to provide financing for its members, and thus enters into a significant number of derivative transactions to hedge financial

[64] The Proposed Order also includes as an Exempt Entity any not-for-profit entity that is wholly owned, directly or indirectly, by any one or more of the entities included within the three general categories above.

[65] The potential for manipulation described here differs from the situation in CFTC v. Dairy Farmers of America. In this case, a dairy cooperative was able to have a direct effect on a small illiquid spot cheese market that was a pricing component in the U.S. Department of Agriculture formula used to calculate milk prices under the Federal Milk Marketing Orders in an attempt to manipulate the price of Class III milk futures. The electric energy market situation is different because Exempt Entities do not report prices of Exempt Non-Financial Energy Transactions to indexes used to settle other derivative products that could benefit an Exempt Entity cooperative's members.

price risks, such as movements in interest rates, from benefiting from the relief provided in the Proposed Order.[66]

a. Electric utilities owned by Federal, state, or local government

Pursuant to the mandate in CEA section 4(c)(6)(C) and subject to the determinations described in Section III.B below, the Commission is proposing to include as Exempt Entities in its Proposed Order all government-owned electric utilities that are described by FPA section 201(f). FPA section 201(f) exempts from the plenary jurisdiction of FERC "any agency, authority, or instrumentality of" or "any corporation which is wholly owned, directly or indirectly, by" the federal government or a state or local government. These entities include, but are not limited to, all federal agency-owned electric generation and transmission facilities,[67] state-chartered electric utilities,[68] utility boards or public utility districts formed under state or local law,[69] and joint action or joint power agencies formed under state law to provide wholesale power supply and transmission services to member entities.[70]

b. Electric utilities owned by an Indian tribe

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[66] The Commission also is proposing, in a separate 4(c) order, to extend the end-user exception found in CEA section 2(h)(7) to cooperatives that are financial entities as defined in CEA section 2(h)(7)(C) ("Financial Cooperative 4(c) Order). The purpose of this 4(c) relief is to extend the benefits of the end-user exception to cooperatives that meet the definition of a financial entity, but whose members otherwise would qualify for the end-user exception but choose to take advantage of the cooperative's low-cost access to financing. See 77 FR 41940 (July 17, 2012). The Commission notes, however, that for the policy reasons described herein as well as in the Financial Cooperative 4(c) Order, the extension of the end-user exception to financial cooperatives still requires reporting of swap transactions, whereas the relief provided in this Proposed Order does not.

[67] See supra note 42.

[68] These utilities include, but are not limited to, entities such as the New York Power Authority.

[69] These utilities include, but are not limited to, municipal electric utilities, regardless of size.

[70] These utilities include government-owned public power and public utility districts such as an irrigation district organized under state law that generates electric energy during the course of supplying water.

Based on the determinations described in Section III.B below and pursuant to CEA section 4(c)(1), the Commission is proposing to include as Exempt Entities in its Proposed Order all electric facilities owned by federally-recognized Indian tribes that otherwise would be subject to FERC's plenary jurisdiction. For purposes of the Proposed Order, "federally-recognized" means that the Indian tribe has been documented by the Secretary of the Interior in the Federal Register as having been recognized by the U.S. government, pursuant to section 104 of the Act of November 2, 1994.[71]

The Commission has determined that electric utilities owned by federally-recognized Indian tribes are no different substantively than government-owned electric utilities described immediately above for purposes of benefiting from the relief provided in the Proposed Order. Like government-owned electric utilities, electric utilities owned by a federally-recognized Indian tribe use funds generated from electric energy sales for purposes of running a tribal government. That is, instead of accruing profits for the benefit of private investors or shareholders, any excess operating revenues related to the generation or transmission of electricity are used by the Indian tribe to support the tribal governing body and reduce dependence on federal funding. Additionally, Indian tribes are tax-exempt or not-for-profit entities. Finally, the Commission notes that for many of the same reasons just noted, FERC has interpreted "instrumentalities" of government to include federally-recognized Indian tribes, thus treating electric facilities owned by these Indian tribes as FPA section 201(f) entities.[72]

c. Electric utilities owned as cooperative organizations

[71] Pub. L. No. 103-454, 108 Stat. 4791, 4792, as codified at 25 U.S.C. 479a-1.

[72] See supra note 51.

Pursuant to CEA section 4(c)(6)(C), and subject to the determinations described in Section III.B below, the Commission is proposing to include as Exempt Entities in its Proposed Order all cooperatively-owned electric utilities that are described by FPA section 201(f).[73] Additionally, pursuant to the exemptive authority provided in CEA section 4(c)(1) and subject to the determination described in Section III.B below, the Commission is proposing to include as Exempt Entities all other electric cooperatives that are not described by FPA section 201(f).[74] By reference to the IRC in the Proposed Order, an "electric cooperative" means a non-profit or not-for-profit entity that is organized and continues to operate primarily to provide its members with electric energy services at the lowest cost possible and is taxed as an electric cooperative pursuant to IRC section 501(c)(12) or 1381(a)(2)(C).[75] In order for an electric utility to be taxed as a cooperative, the electric utility must demonstrate that it operates in accordance with three principles: i) democratic member control; ii) operation at cost (i.e., allocating any excess revenue, less cost of producing the revenue, among members in proportion to the amount of business done with each); and iii) subordination of capital (i.e., no single contributor of capital to

[73] FPA section 201(f) exempts from the plenary jurisdiction of FERC any electric cooperatives that either is funded by the RUS, sells less than 4,000,000 megawatt hours per year of electricity, or qualifies as an aggregated FPA 201(f) entity. An aggregated FPA 201(f) entity consists of "any corporation which is wholly owned, directly or indirectly, by any one or more [FPA 201(f) entity]." These entities include Joint Action Agencies that are formed by constituent government-owned electric utilities described by FPA section 201(f).

[74] See infra Section III.B.4 for the Commission's analysis of why non-201(f) electric cooperatives are deemed to be appropriate persons for purposes of CEA section 4(c)(1) relief.

[75] 26 U.S.C. 501(c)(12), 1381(a)(2)(C). For purposes of the definition, the term "electric cooperative" includes a "rural electric cooperative." The Commission understands that while not required for federal income tax status, many electric cooperatives are organized under state cooperative statutes as well. To the extent such laws impose requirement that conflict with those in IRC 501(c)(12), state law governs without jeopardizing 501(c)(12) status. See Internal Revenue Manual § 4.76.20.8 (2006).

the cooperative can control the operations or receive most of the pecuniary benefits of operations, setting a cooperative apart from an investor).[76]

Exempt Entity electric cooperatives generally conform to one of two structures. First, a G&T cooperative generates or purchases and transmits electric energy at wholesale prices to its constituent distribution cooperatives, which are members/owners.[77] Second, a distribution cooperative sells electric energy to member/owner retail customers.[78] Both structures are consumer cooperatives, meaning that they were formed by consumers for the "benefit of [such] members in their capacity as consumers."[79] As noted above, Exempt Entities do not include cooperatives that qualify as financial entities pursuant to CEA section 2(h)(7)(C), regardless of whether they are recognized as FPA section 201(f) entities.[80]

2. Exempt Non-Financial Energy Transactions

[76] The term "cooperative" is not defined in IRC 501(c)(12) or 1381(a)(2)(C). Rather, common law has interpreted operation on a cooperative basis to mean the organization demonstrates the three principles noted above. See Puget Sound Plywood v. Commissioner, 44 T.C. 305, 307-308 (1965). Electric cooperatives receive tax-exempt status if they meet the additional criteria of receiving at least 85 percent of revenue from their members for the sole purpose of meeting losses and expenses. See IRC 501(c)(12)(A). Otherwise, electric cooperatives are subject to federal income tax. See IRC 1381(a)(2)(C); Rev. Rul. 83-135.

[77] G&T cooperatives may also transmit electric energy to other G&T cooperatives that are members based on "generation capacity" agreements as described by Petitioners. See supra Section II.B.2.

[78] Retail customers, in turn, use the electric energy to power everyday activities, whether commercial or residential in nature.

[79] See Puget Sound Plywood, 44 T.C. at 306. Alternatively, producer cooperatives, such as large farming cooperatives, exist for the "benefit of the members in their capacity as producers." See id. The Commission notes that the public interest rationale for exempting consumer electric cooperatives articulated herein would not necessarily apply to other producer cooperatives, given differences in operational purposes and motivations behind forming such cooperatives.

[80] Additionally, financial cooperatives are not tax-exempt entities pursuant to IRC 501(c)(12). See Internal Revenue Manual § 4.76.20.5 (2006). The Commission intends for financial cooperatives that finance electric cooperatives, such as the CFC, to rely on the exemptive relief provided in the recently-proposed financial cooperative 4(c) order. See supra note 66.

The Proposed Order defines Exempt Non-Financial Energy Transactions as those agreements, contracts, or transactions entered into between Exempt Entities primarily in order "to satisfy existing or anticipated contractual obligations to facilitate the generation, transmission, and/or delivery of electric energy service to customers at the lowest cost possible, and the agreement, contract, or transaction is intended for making or taking physical delivery of the commodity upon which the agreement, contract, or transaction is based."[81] Exempt Non-Financial Energy Transactions are limited to six categories of agreements, contracts, or transactions, as described in further detail in the Proposed Order,[82] which facilitate: i) the generation of electric energy by an Exempt Entity, including fuel supply; ii) the purchase or sale and transmission of electric energy by/to an Exempt Entity; and iii) compliance with electric system reliability obligations applicable to the Exempt Entity and its facilities or operations.

[81] The Petition asserts that the purpose of all transactions for which relief is sought (as described therein) must be "'to hedge or mitigate commercial risks' (as such phrase is used in CEA Section 2(h)(7)(A)(ii))." See Petition at 4. The Commission believes, however, that based on the general descriptions and accompanying examples of Electric Operations-Related Transactions provided in Petition, some types of transactions may not be agreements, contracts, or transactions that the Commission traditionally has viewed to "hedge or mitigate commercial risk" as such phrase is used in CEA section 2(h)(7)(A)(ii). Due to the breadth and vagueness of some of the Petition's descriptions, it is unpractical for the Commission to identify every manifestation of an Electric Operations-Related Transaction that does not come within the Commission's jurisdiction, although it has attempted to do so to the extent that the Commission has already made an affirmative determination elsewhere as to the nature of a product described in the Petition. See infra notes 86-90 and accompanying text. In any case, in order to provide Exempt Entities with regulatory certainty pursuant to CEA section 4(c), the Commission is defining Exempt Non-Financial Energy Transactions to include all agreements, contracts, or transactions entered into for the primary purpose of satisfying existing or anticipated contractual obligations to fulfill an Exempt Entity's public service mission that are intended for making or taking physical delivery of the underlying commodity. The Commission is seeking comments on the merits to this approach in defining Exempt Non-Financial Energy Transactions.

[82] The descriptions of the categories of exempted transactions in the Proposed Order are based on the Commission's understanding of the transaction types as commonly known to the electric industry, as informed by the descriptions provided in the Petition and the Commission's past experience in these markets. While the categories are identified with the same terminology used in the Petition, the Commission notes that these categories are not described in identical terms and therefore do not necessarily describe the same scope of transactions as contemplated in the Petition for exemption. The Commission understands that many of the terms used to identify categories of transactions in the Petition are terms of art, commonly understood by the electric energy industry (including by Exempt Entities).

When combined with the requirements for Exempt Entities described above, the Commission believes that Exempt Non-Financial Energy Transactions, as defined under the Proposed Order, will not be used for speculative purposes. That is, Exempt Entity counterparties to an Exempt Non-Financial Energy Transactions must contemplate "delivery" of the underlying good or service at the time they enter into the agreement, contract, or transaction, whether that be for electric energy, generation capacity, access to transmission lines, fuel, or some combination of the foregoing.[83] Furthermore, these transactions generally are not used by Exempt Entities for the primary purpose of hedging fluctuations in the price of electric energy or any other commodity related to the generation, transmission, and/or delivery of electric energy to customers.[84] Finally, the majority of Exempt Non-Financial Energy Transactions are not suitable for trading on an exchange such as a registered DCM or SEF due to their highly bespoke nature, and cannot include transactions based on, derived from, or referencing any financial commodity or any metal, agricultural, crude oil or gasoline commodity that cannot be used as fuel to generate electric energy. For these reasons, and for the reasons discussed in the 4(c) analysis provided in Section III.B below, the Commission believes that these transactions are unlikely to have an impact on price discovery or the functioning of markets regulated by the Commission, and thus are appropriate for conditional relief from the requirements of the CEA and regulations there under, pursuant to CEA section 4(c).

The unique nature of the electric energy industry, including the unique nature of the not-for-profit utility structure, influenced the Commission's choice of the transactions within the

[83] Although some agreements may be settled through a book-out transaction, the transaction may never be entered into for speculative purposes.

[84] A key component of bona fide hedging, as defined in the Commission's regulations, is reducing the risk of fluctuations in price. In contrast, Exempt Non-Financial Energy Transactions primarily are used for making or taking delivery of electric energy in the physical marketing channel.

scope of the exemption in the Proposed Order. Supply of reliable, affordable electric energy has long been constrained by a limited amount of generation and transmission capacity, particularly in rural regions, that is capable of meeting peak demand. Unlike many physical commodities, electric energy is not capable of being purchased in large commercial quantities ahead of time, delivered, and stored for later consumption or use. That is, electric energy must be used or consumed on an as-needed basis.

Demand, on the other hand, can be subject to unpredictable fluctuations due to emergency situations and changes in weather patterns, usage trends, and larger macroeconomic conditions. Thus, electric utilities, including Exempt Entities, negotiate highly customized commercial arrangements in order to fulfill these constantly fluctuating retail electric energy needs while still complying with national and regional environmental and reliability standards. Each category of Exempt Non-Financial Energy Transactions described in the Proposed Order represents a component of these larger bespoke commercial transactions used to fulfill an Exempt Entity's public service mission.[85]

The Commission notes that not every transaction described by the Petition is being included in the Commission's definition of Exempt Non-Financial Energy Transaction. Due to the Commission's recent joint final rule and interpretation with the SEC in which it further defined what is (and is not) a swap ("Products Release"),[86] the Commission believes it would not

[85] Each category represents a factor in the ultimate price paid by retail customers for electric energy. For example, "generation capacity" transactions represent the cost component of acquiring and maintaining the generation assets used to produce the electric energy. "Electric energy delivered" represents the actual cost of using the generation assets to produce the electric energy.

[86] 77 FR 48208 (August 13, 2012).

be appropriate to provide 4(c) relief from the requirements of the CEA and Commission regulations there under for certain transactions that are not swaps.[87]

Specifically, the Commission notes that, consistent with an example provided in the Products Release, the example of a Fuel Delivered transaction provided in Exhibit B of the Petition would be covered by the forward exclusion from the swap definition.[88] Additionally, the Commission notes that, consistent with the general description provided in the Products Release, agreements, contracts, and transactions involving the category of Environmental Rights, Allowances or Attributes as specifically described by the Petition are covered by the forward exclusion from the swap definition.[89] Accordingly, while these agreements, contracts, and transactions are not covered by the relief in the Proposed Order, they nonetheless are not subject to the requirements of the CEA and Commission regulations there under otherwise applicable to swaps, such as clearing, trade execution, and reporting.[90]

Finally, the descriptions of the categories of Exempt Non-Financial Energy Transactions in the Proposed Order do not constitute official Commission determinations as to those transactions' legal status as a product subject to the jurisdiction of the CEA.[91] To the extent

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[87] The Commission has determined to interpret the forward exclusion from the swap definition consistently with the forward exclusion from the "future delivery" definition. Id. at 48227. Therefore, the forward exclusion from the swap definition applies equally to the forward exclusion from the "future delivery" definition. See id. at 48233, note 271.

[88] Compare Petition Exhibit 2 at 3 with 77 FR 48236.

[89] Compare Petition at 12 and Petition Exhibit 2 at 6 with 77 FR 48233-234

[90] However, any agreement, contract, or transaction that is a swap referencing one of these agreements, contracts, and transactions may be subject to the jurisdiction of the CEA (e.g., an option or other swap on or related to the price of an environmental allowance).

[91] As noted above, CEA section 4(c) does not compel the Commission to make such a determination prior to issuing 4(c) relief. See supra note 7 and accompanying text. In contrast, and in addition to providing per se determinations as to the product classification of certain transactions, the Products Release provides interpretive guidance as to how the Commission would analyze certain categories of transactions for purposes of determining whether a particular

overlap exists between transactions described as being subject to the forward exclusion from the swaps definition in the Products Release and transactions described by the categories of Exempt Non-Financial Energy Transactions in the Proposed Order, the Commission is requesting public comment as to whether the Proposed Order should provide relief for such transactions.

3. Conditions

Under the Proposed Order, Exempt Entities would remain subject to certain conditions. First, the Commission's general anti-fraud, anti-manipulation, and enforcement authority found in CEA sections 2(a)(1)(B), 4b, 4c(b), 4o, 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and Commission rules 32.4 and Part 180,which have application to both derivative and cash market transactions, will still apply. This condition will allow the Commission to initiate enforcement proceedings against Exempt Entities found to be engaged in manipulative, fraudulent, or otherwise abusive trading schemes when executing Exempt Non-Financial Energy Transactions with other Exempt Entities. Additionally, the Commission reserves its authority to inspect the books and records of Exempt Non-Financial Energy Transactions already kept in the normal course of business pursuant to the Commission's regulatory inspection authorities, in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities' overall market positions and to ensure compliance with the terms of the Proposed Order.

B. CEA Section 4(c) Considerations

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transaction is a swap. Accordingly, certain transactions covered by the categories of Exempt Non-Financial Energy Transactions in the Proposed Order may not be swaps. See, e.g., 77 FR 48238 (noting that the Commission will interpret a "full requirements" contract with embedded volumetric optionality as a forward and not an option if the contract exhibits the features described in the Products Release in section II.B.2.b)ii)).

The Commission is issuing the Proposed Order pursuant to authority found in CEA sections 4(c)(1) and 4(c)(6), among other reasons, because it believes that the proposed exemption will promote responsible economic or financial innovation and fair competition. In addition to criteria found in those provisions, both sources of exemptive relief require the Commission to make certain determinations based on criteria found in section 4(c)(2), as well.[92] Accordingly, the Commission considers and proposes to determine that: (i) CEA section 4(a) should not apply to the transactions eligible for the proposed exemption (as transacted by the entities eligible for the proposed exemption), (ii) providing section 4(c) relief from the CEA for Exempt Non-Financial Energy Transactions (as entered into between Exempt Entities) is consistent with the public interest and the purposes of the CEA, (iii) Exempt Entities are "appropriate persons" within the meaning of the term as defined in CEA section 4(c)(3), and (iv) the proposed exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA.

1. Responsible Economic or Financial Innovation and Fair Competition

The Commission believes that the exemption provided in the Proposed Order will promote financial innovation in electric energy markets facilitated by government and cooperatively-owned utilities. Government and cooperatively-owned electric utilities are not-for-profit entities whose sole purpose and mission is "to provide reliable electric energy to retail electric customers every hour of the day and every season of the year, keeping costs low and supply predictable, while practicing cost-effective environmental stewardship."[93] The consumer-

[92] The Commission interprets the phrase, "the Commission shall, in accordance with [CEA section 4(c)(1) and 4(c)(2)], exempt from the requirements of [the CEA] . . . ," to mean that the Commission must make the determinations required under CEA sections 4(c)(1) and 4(c)(2) prior to providing the mandated relief.

[93] Petition at 22.

as-owner cooperative model of electric utility, in partnership with municipal utilities and federal power agencies, has proven to be well-suited in developing innovative solutions to a complex array of issues related to extending electric energy generation and transmission resources into geographic areas of the United States where economies of scale do not exist, particularly those rural areas where traditional investor-owned utilities have chosen not to invest.[94] In order to meet these electric energy challenges, however, the Exempt Entity business model has depended on a flexible operating environment, facilitated over time by other regulatory relief such as the exemption from FERC's plenary jurisdiction provided by FPA section 201(f).

Due to factors largely beyond the control of Exempt Entities, the production, distribution, and usage needs of each Exempt Entity are constantly changing and have the potential to create the substantial commercial risk of not having enough generation, transmission, or distribution capacity for Exempt Entities to meet peak demand. Normally without the benefit of size and customer density, Petitioners contend that Exempt Entities have evolved to rely largely on each other in order to fulfill their public service mission of providing electric energy to their member-owners and retail customers at the lowest cost possible.[95] The transactions listed in the Proposed Order reflect this type of innovation. Going forward, due to the limitations of standardized derivative contracts in providing the same type of highly customized resources to unique energy needs, it is important that Exempt Entities continue to have the flexibility to negotiate innovative new arrangements bilaterally for the purpose of achieving their mission.

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[94] For instance, investor-owned, private utilities lacked a profit incentive early on to invest the vast sums of capital necessary to expand electric energy service into rural areas where the requisite infrastructure was not already in place. With support from the RUS, as established under the FPA, electric cooperatives were first established in order to serve these rural communities.

[95] For example, many G&T cooperatives are formed exclusively by distribution cooperatives for the purpose of providing each distribution cooperative with its full requirements.

Additionally, the Commission notes that, under current Commission regulations and guidance, it is unclear whether all Exempt Entities would qualify as eligible contract participants ("ECPs"), as such term is defined under CEA section 1a(18).[96] Therefore, absent relief such as that proposed herein, there is a risk that some Exempt Non-Financial Energy Transactions meeting the definition of a swap that involve non-ECP counterparties could not be traded away from a designated contract market.[97] As described elsewhere in this release, Exempt Entities engage in Exempt Non-Financial Energy Transactions with one another on only a bilateral basis because such transactions are not replicable on an exchange (whether due to transaction size, customized terms, or other reasons). Therefore, the Commission is proposing the exemption in the Proposed Order to ensure that Exempt Entities have the regulatory certainty necessary to continue negotiating highly customized, physically-settled agreements, contracts, and transactions that serve their unique public service mission of providing reliable, affordable electric energy to customers.

The Commission also believes that the relief provided in the Proposed Order will not distort the competitive landscape. First, the transactions covered by the Proposed Order relate, in many instances, to longstanding and exclusive agreements between Exempt Entities. As such, the Commission does not believe that granting an exemption from the requirements of the CEA either would change the nature of these transactions, or cause an Exempt Entity to enter into an

[96] 7 U.S.C. 1a(18). In a recent final interpretive rule further defining entities under the CEA, as amended by the Dodd-Frank Act ("Entities Release"), the Commission declined to recognize certain entities such as not-for-profit natural gas utilities as having per se ECP status. See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, 30657 (May 23, 2012). The Commission noted that it was, however, considering granting relief to FPA section 201(f) entities, pursuant to new authority under CEA section 4(c)(6), which "[might] address the concerns of some commenters" such as entities similarly situated to the utilities represented by Petitioners. See id. The relief provided in the Proposed Order is consistent with the Commission's Entities Release.

[97] See CEA section 2(e).

arrangement with another Exempt Entity instead of an investor owned utility or some other counterparty solely because the agreement would be covered by the exemption in the Proposed Order. The benefits of the relief provided in the Proposed Order to government utilities and electric cooperatives will maintain the current competitive landscape, thus permitting Exempt Entities to continue using Exempt Non-Financial Energy Transactions to fulfill their public service mission, as opposed to providing an unfair advantage to one group over another group.[98]

The CFTC is requesting comment on whether the Proposed Order may foster both financial or economic innovation and fair competition.

2. Applicability of CEA Section 4(a)

The Commission does not believe that CEA section 4(a), the exchange-trading requirement for futures contracts, should apply to Exempt Non-Financial Energy Transactions as defined in the Proposed Order. When transacted between Exempt Entities, these transactions are highly negotiated and bespoke in nature, cater specifically to the Exempt Entities' respective electricity, fuel, or other needs, and are intrinsically related to the Exempt Entities' public-service mission. Accordingly, the Commission does not view Exempt Non-Financial Energy Transactions as being suitable for on-exchange trading, in large part because, as noted above, these transactions and markets are unlikely to have an impact on price discovery or the functioning of markets regulated by the Commission. Thus, CEA section 4(a) should not apply.

3. Public Interest and the Purposes of the CEA

Exempting certain physical transactions between entities described in FPA section 201(f), and certain other electric cooperatives, from the provisions of the CEA and the regulations there

[98] The Commission notes that certain non-Exempt Entity electric utilities also may qualify for the end-user exception from the clearing and trade execution requirements for swaps under CEA section 2(h)(7) when engaged in bona fide hedging transactions. See 7 U.S.C. 2(h)(7)-(8).

under, subject to certain anti-fraud, anti-manipulation, and recordkeeping conditions, is consistent with public interest and the purposes of the CEA for the reasons discussed below.

a. Public Interest

CEA section 3(a) describes Congress' findings as to certain national public interests facilitated by transactions subject to the Act. These public interests include "providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities."[99]

Given the unique nature of each Exempt Non-Financial Energy Transaction conducted between Exempt Entities, such transactions are generally non-fungible and therefore cannot be traded as standardized products on an exchange. Accordingly, the universe of Exempt Non-Financial Energy Transactions generally occurs between Exempt Entities, thus constituting a mostly closed-loop of bilateral transactions. These bilateral transactions do not, by and large, face markets in which non-Exempt Entities such as investor-owned utilities engage in similar transactions, and therefore pose little (if any) threat of negatively affecting the liquidity, fairness, or financial security of trading derivative products on a registered designated contract market or swap execution facility in a material way.

Exempt Non-Financial Energy Transactions, as they are defined and conditioned in the Proposed Order, are not susceptible to being used as a means for "assuming price risk," or speculative activity. Rather, Exempt Entities may engage in these transactions for purposes of "managing" commercial risks that arise from electric operations in which the Exempt Entity engages to fulfill its public service mission of providing the most affordable and reliable electric energy possible to its members. Most of these commercial risks, however, are not directly

[99] CEA 3(a), 7 U.S.C. 5(a).

related to fluctuations in the price of a commodity. Rather, Exempt Entities' main concern is a possible inability to satisfy contractual obligations to supply electric energy service to customers, which may arise from somewhat unpredictable fluctuations in demand for electric energy. These fluctuations, in turn, make it difficult for Exempt Entities to forecast their exact needs for generation and transmission capacity, the exact amount of fuel to be used for the generation of electric energy, and related activities necessary to facilitate the Exempt Entity's public service mission. Exempt Non-Financial Energy Transactions generally use variable pricing, as opposed to fixed pricing, meaning that they are entered into primarily to ensure that Exempt Entities are able to meet their production, transmission, and/or distribution obligations, as opposed to serving a traditional hedging function against the risk of price fluctuations of electricity or some other commodity.

It is unlikely that an exchange could or would model a standardized derivative contract to duplicate the highly-customized economic terms of a bilaterally-negotiated Exempt Non-Financial Energy Transaction. Accordingly, such transactions between Exempt Entities are not susceptible to serving a price discovery function for any broader market or markets. A market participant seeking pricing information for a product or transaction involving the same underlying commodity would look to a standardized product or contract traded on a regulated exchange involving that commodity.[100]

[100] The Commission notes that FERC recently has proposed requiring entities described in FPA 201(f) to be subject to limited reporting requirements concerning the availability and prices of wholesale electric energy. In EPAct 2005, Congress added Section 220 to the FPA (16 U.S.C. 824t) directing FERC to "facilitate price transparency in markets for the sale and transmission of electric energy in interstate commerce" with "due regard for the public interest, the integrity of those markets, fair competition, and the protection of consumers." See Electricity Market Transparency Provisions of Section 220 of the Federal Power Act, 135 FERC ¶ 61,053 at PP 21-23 (Notice of Proposed Rulemaking) (2011) (collection of information from "any market participant" interpreted to include entities described in FPA 201(f)). The Commission specifically seeks comment on whether, in light of this proposal, the relief provided in the Proposed Order should be revised in the future to require reporting to an SDR for certain transactions.

The CFTC is requesting comment on whether the Proposed Order is consistent with the public interest.

b. Purposes of the CEA

Under section 3(b), in order to foster the public interests, it is the purpose of the CEA "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants."[101] The Commission believes that the exemptive relief provided in the Proposed Order is consistent with these purposes.[102]

Exempt Entities are either government or cooperatively-owned electric utilities organized under Federal tax laws as nonprofit or not-for-profit entities. All Exempt Entities share a public service mission of providing reliable electric energy to retail electric customers at all times, keeping costs low and supply predictable, while practicing cost-effective environmental stewardship. Elected or appointed government officials or citizens, or cooperative members or consumers, are directly involved in the day-to-day governance and management of an Exempt Entity's facilities and operations. There are no shareholders or outside investors to profit from the Exempt Non-Financial Energy Transactions, and any revenues accruing from operational risk management activities related to the electric facilities and operations are used to reduce the cost of electric service provided to cooperative members and retail customers.

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[101] CEA 3(b); 7 U.S.C. 5(b).

[102] As noted in section III(B)(1) above, the Commission believes that the exemption will promote financial innovation and fair competition.

Accordingly, the Commission believes that Exempt Non-Financial Energy Transactions between Exempt Entities are less vulnerable to fraudulent or manipulative trading activity. Congress affirmatively recognized this in the context of wholesale electric energy markets when it exempted government and cooperatively-owned electric utilities from FERC's plenary jurisdiction under FPA section 201(f).[103] Furthermore, the Proposed Order retains the Commission's general anti-fraud, anti-manipulation, and enforcement authority,[104] and all Exempt Entities, regardless of status under FPA section 201(f), remain subject to FERC's market manipulation authority.[105] Therefore, the relief provided in the Proposed Order does not interfere with the Commission's ability to police markets for manipulation and fraudulent trade practices.

Finally, the Commission does not view Exempt Non-Financial Energy Transactions between Exempt Entities as posing a systemic risk to the financial integrity or stability of markets. By definition, Exempt Entities do not consist of interconnected "financial institutions" subject to prudential regulation because they are "systemically important."[106] Exempt Non-Financial Energy Transactions do not involve financial market professionals, intermediaries, or any other entity registered with the Commission. Rather, Exempt Non-Financial Energy Transactions involve counterparty credit risk between only Exempt Entities, which share a common not-for-profit public service mission and are obligated to pursue operational, not

[103] See supra notes 45-50 and accompanying text for a discussion of the FPC's findings in its Dairyland decision, affirmed by the federal court in Salt River, explaining the underlying rationale for exempting non-investor owned public utilities from the plenary jurisdiction of the FPC.

[104] See CEA sections 2(a)(1)(B), 4b, 4c(b), 4o, 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and Commission rules 32.4 and Part 180.

[105] See FPA 222v; 16 U.S.C. 824v.

[106] Additionally, Exempt Entities do not consist of "financial entities" as the term is defined in CEA 2(h)(7)(C)(i).

financial, performance mandates. The Commission does not believe that imposing the requirements of the CEA on these transactions would reduce systemic risk or bolster the financial stability and soundness of the markets that the Commission does regulate. Accordingly, the Commission does not view the relief provided in the Proposed Order as being contrary to this purpose of the CEA.

The CFTC is requesting comment on whether the Proposed Order is consistent with the purposes of the CEA.

4. Appropriate Persons

Exempt Entities entering into Exempt Non-Financial Energy Transaction are "appropriate persons" for purposes of satisfying CEA section 4(c)(2) for different reasons, depending on the type of electric utility and the corresponding section of the CEA pursuant to which the relief in the Proposed Order is being granted. The Commission believes that Congress, in enacting CEA section 4(c)(6)(C), implicitly identified entities described by FPA section 201(f) as appropriate persons for purposes of qualifying for an exemption pursuant to CEA section 4(c)(6); otherwise, Congress would not have mandated that the Commission "shall . . . exempt" such entities upon making the required findings.[107]

Next, for the reasons just noted, the Commission believes that federally-recognized Indian tribes that own electric facilities are analogous to government entities that sponsor electric facilities, and therefore qualify as appropriate persons pursuant to CEA section 4(c)(3)(H).[108]

Finally, the Commission believes that non-FPA 201(f) electric cooperatives are

[107] Alternatively, the Commission notes that many FPA section 201(f) entities are government-owned or sponsored, and therefore would qualify as appropriate persons under CEA section 4(c)(3)(H): "Any governmental entity. . . or political subdivision thereof, . . . or any instrumentality, agency, or department of any of the foregoing."

[108] See id.

appropriate persons for the reasons articulated in the Petition with respect to such cooperatives. Under CEA section 4(c)(3)(K), the Commission may determine other persons not enumerated elsewhere in section 4(c)(3) to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections. As previously noted, the Commission believes that Congress implicitly deemed FPA 201(f) entities to be appropriate persons, thus indicating that FPA 201(f) entities have the requisite financial soundness and operational capabilities to execute transactions that are exempt from the requirements of the CEA.

For the purposes of a 4(c) exemption, the Commission believes that there is no material difference in an electric cooperative's financial soundness or operational capability based upon whether or not the electric cooperative meets the criteria of FPA section 201(f).[109] As Petitioners note, an electric cooperative that receives financing from a source other than the RUS or sells more than 4,000,000 megawatt hours of electricity per year is at least as financially sound and operationally qualified as electric cooperatives described in FPA section 201(f).[110] The Commission notes that non-201(f) electric cooperatives arguably are more financially sound and operationally capable, as they likely maintain greater generation and transmission assets capable of facilitating the excess electric energy sales.[111] Additionally, non-FPA 201(f) electric cooperatives that sell more than the threshold amount of electric energy per year often are in a position to benefit from better financing terms than those offered by the RUS based on having

[109] As previously noted, non-FPA 201(f) electric cooperatives are governed by the same public service mission as FPA 201(f) electric cooperatives (i.e., providing members with electric energy at the lowest cost possible).

[110] In expanding the FPA 201(f) exemption to include RUS-financed electric cooperatives, Congress went a step further in EPAct 2005 by also including electric cooperatives that sold less than 4,000,000 megawatt hours of electricity per year. According to counsel for Petitioners, this provision was meant to capture certain small, distribution-only cooperatives that did not receive financing from the RUS.

[111] Alternatively, certain non-FPA 201(f) electric cooperatives may qualify as appropriate persons based on their net worth exceeding $1,000,000 or total assets exceeding $5,000,000. See CEA section 4(c)(3)(F).

greater financial assets to post as collateral.

The CFTC is requesting comment as to whether the Exempt Entities identified in the Proposed Order are appropriate persons.

5. Ability to Discharge Regulatory or Self-Regulatory Duties

The exemptive relief contained in the Proposed Order will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA. Nothing in the Proposed Order will prevent the Commission or any contract market from carrying out regulatory or self-regulatory duties for markets in a commodity that may also be involved in an Exempt Non-Financial Energy Transaction. As previously discussed, given the bespoke nature of these transactions, they are not connected to the pricing and market characteristics of other related derivative products that trade on exchange. The Commission is less concerned about the regulatory oversight of Exempt Entities as they are "effectively self-regulating" bodies subject to government or cooperative-member management.

The CFTC is requesting comment as to whether the Proposed Order will have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the CEA.

IV. Proposed Order

The Commission has determined, pursuant to Commodity Exchange Act ("CEA") sections 4(c)(1) and 4(c)(6), to exempt from all requirements of the CEA and Commission regulations issued there under any Exempt Non-Financial Energy Transaction entered into solely between Exempt Entities, subject to the following definitions and conditions:

A. Exempt Entity shall mean i) any government-owned electric facility recognized under Federal Power Act ("FPA") section 201(f), 16 U.S.C. 824(f); ii) any electric facility

otherwise subject to regulation as a "public utility" under the FPA that is owned by an Indian tribe recognized by the U.S. government pursuant to section 104 of the Act of November 2, 1994, 25 U.S.C. 479a-1; iii) any cooperatively-owned electric utility, regardless of status pursuant to FPA section 201(f), so long as the utility is treated as a "cooperative" organization under Internal Revenue Code section 501(c)(12) or 1381(a)(2)(C), 26 U.S.C. 501(c)(12), 1381(a)(2)(C), and exists for the primary purpose of providing electric energy service to its member/owner customers at the lowest cost possible; or iv) any not-for-profit entity that is wholly owned, directly or indirectly, by any one or more of the foregoing. The term "Exempt Entity" does not include any "financial entity," as defined in CEA section 2(h)(7)(C).

B. Exempt Non-Financial Energy Transaction means any agreement, contract, or transaction based upon a "commodity," as such term is defined and interpreted by the CEA and regulations there under, so long as the primary purpose of the agreement, contract, or transaction is to satisfy existing or anticipated contractual obligations to facilitate the generation, transmission, and/or delivery of electric energy service to customers at the lowest cost possible, and the agreement, contract, or transaction is intended for making or taking physical delivery of the commodity upon which the agreement, contract, or transaction is based. The term "Exempt Non-Financial Energy Transaction" excludes agreements, contracts, and transactions based upon, derived from, or referencing any interest rate, credit, equity or currency asset class, or any grade of a metal, agricultural product, crude oil or gasoline that is not used as fuel for electric energy generation. Exempt Non-Financial Energy Transactions are limited to the following categories, which may exist as stand-alone agreements or as components of larger agreements that combine only the following categories of transactions:

1. Electric Energy Delivered transactions consist of arrangements in which a

provider Exempt Entity agrees to deliver a specified amount of electric energy to a recipient Exempt Entity within a defined geographic service territory, load, or electric system over the course of an agreed period of time. Such transactions include "full requirements" contracts, under which one Exempt Entity becomes obligated to provide, and the recipient Exempt Entity becomes obligated to take, all of the electric energy the recipient needs to provide reliable electric service to its fluctuating electric load over a specified delivery period at one or multiple delivery points or locations, net of any electric energy the recipient is able to produce through generation assets that it owns.

2. Generation Capacity transactions consist of agreements in which a recipient Exempt Entity purchases from a provider Exempt Entity the right to call upon a specified amount of the provider Exempt Entity's electric energy generation assets to supply electric energy within a defined geographic area, regardless of whether such right is ever exercised for the purposes of the recipient Exempt Entity meeting its location-specific reliability obligations. Such transactions also may specify certain conditions that must exist prior to exercising the right to use an Exempt Entity's generation assets, or establish an agreement between Exempt Entities to share pooled electric generation assets in order to satisfy regionally-imposed demand side management program requirements.

3. Transmission Services transactions consist of arrangements in which a provider Exempt Entity owning transmission lines sells to a recipient Exempt Entity the right to deliver a specified amount of the recipient Exempt Entity's electric energy from one designated point on the transmission lines to another, at a set price per wattage and over a certain time period, in order for the recipient Exempt Entity to provide electric energy to its customers. Such transactions may include ancillary services related to transmission such as congestion

management and system losses.

4. Fuel Delivered transactions include arrangements used to buy, sell, transport, deliver, or store fuel used in the generation of electric energy by an Exempt Entity. Additionally, Fuel Delivered transactions may include an agreement to manage the operational basis or exchange (i.e., location or time of delivery) risk of an Exempt Entity that arises from its location-specific, seasonal or otherwise variable operational need for fuel to be delivered.

5. Cross-Commodity Pricing transactions include arrangements such as heat rate transactions and tolling agreements in which the price of electric energy delivered is based upon the price of the fuel source used to generate the electric energy. Cross-Commodity transactions also include fuel delivered agreements in which the price paid for fuel used to generate electric energy is based upon the amount of electric energy produced.

6. Other Goods and Services

Other Goods and Services transactions consist of arrangements in which the Exempt Entities enter into an agreement to share the costs and economic benefits related to construction, operation, and maintenance of facilities for the purposes of generation, transmission, and delivery of electric energy to customers. In a full requirements contract between Exempt Entities that share ownership of generation assets, the provider Exempt Entity may determine how generation to meet the recipient Exempt Entity's full requirements will be allocated among the provider's independent generation assets, the jointly-owned generation assets, and the recipient's independent generation assets. Other Goods and Services transactions also may include agreements between Exempt Entities to operate each other's facilities, share equipment and employees, and interface on each other's behalf with third parties such as suppliers, regulators and reliability authorities, and customers, regardless of whether such agreements are triggered as

contingencies in emergency situations only or are applicable during the normal course of operations of an Exempt Entity.

C. Conditions. The relief provided herein is subject to the Commission's general anti-fraud, anti-manipulation and enforcement authority under the CEA, including but not limited to CEA sections 2(a)(1)(B), 4b, 4c(b), 4o, 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and Commission rules 32.4 and Part 180. Additionally, the Commission reserves its authority to inspect books and records kept in the normal course of business that relate to Exempt Non-Financial Energy Transactions between Exempt Entities pursuant to the Commission's regulatory inspection authorities. The relief provided herein does not affect the jurisdiction of FERC or any other government agency over the entities and transactions described herein. Furthermore, the Commission reserves the right to revisit any of the terms and conditions of the relief provided herein and alter or revoke such terms and conditions as necessary in order for the Commission to execute its duties and advance the public interests and purposes under the CEA, including a determination that certain entities and transactions described herein should be subject to the Commission's full jurisdiction.

V. Request for Comment

The Commission requests comment on all aspects of the issues presented by this proposed order. The Commission specifically requests comment on the scope of both the (a) transactions and (b) entities which would be eligible to rely upon the exemption provided in the proposed order. In addition, the Commission requests comment on the following questions:

1. Should the Commission limit the scope of Exempt Entities to only those electric utilities described by FPA section 201(f), given that Congress limited CEA section 4(c)(6)(C) thereto (or, is it an appropriate use of the Commission's general exemptive authority pursuant to

CEA section 4(c)(1) to exempt the non-FPA 201(f) electric cooperatives)? If it is appropriate to expand the scope beyond FPA 201(f) entities, should the Commission still limit the scope of electric cooperatives included as Exempt Entities to only those cooperatives with tax exempt status under the IRC (i.e., those that receive at least 85 percent of revenue from the cooperative membership)?

2. In light of other exemptive authority that was added to the CEA by the Dodd-Frank Act, such as the end-user exception in CEA section 2(h)(7)(A), is relief pursuant to CEA section 4(c) necessary and/or appropriate for Exempt Non-Financial Energy Transactions between Exempt Entities as described herein?

3. Should the Commission require that any Exempt Entity that is described by FPA section 201(f) relying on the relief provided herein notify the Commission of its change in status under FPA section 201(f) as a condition of such relief? If so, what purpose(s) would this serve?

4. For the purpose of issuing this Proposed Order, the Commission concluded that Exempt Non-Financial Energy Transactions do not serve a price discovery purpose. Please comment on the Commission's assessment. What facts and circumstances would require the Commission to revisit its analysis and alter the relief proposed herein such that reporting to an SDR should be required for certain transactions?[112]

5. The Commission believes that the Proposed Order's definition of "Exempt Non-Financial Energy Transaction," in combination with the definition of "Exempt Entity", should ensure that Exempt Non-Financial Energy Transactions cannot be used for speculative purposes. Please comment on whether the Proposed Order would so foreclose the possibility for

[112] Commenters should consider what impact, if any, it would have on the response to the question posed if FERC finalizes its recent proposal to require price transparency reporting in electric wholesale markets, even by FPA 201(f) entities. See supra note 100.

speculative trading and, if not, how the Proposed Order should be modified to achieve such a goal.

6. The Commission has proposed that electric facilities owned by only federally-recognized Indian tribes be included as Exempt Entities for purposes of the relief provided in the Proposed Order. The Commission specifically requests comment on every aspect of the Proposed Order as it relates to Indian tribes.

7. The Commission has limited its definition of Exempt Non-Financial Energy Transaction to six categories. Do any of the transactions described by or covered under these categories fail to come under the Commission's jurisdiction, such that relief pursuant to CEA section 4(c) is unnecessary and/or inappropriate, either due to an interpretation in the Products Release or otherwise?

8. Per the Petition's request, should the Commission stipulate that the relief provided in the Proposed Order i) applies retroactively to the enactment of the Dodd-Frank Act and ii) that transactions covered by the relief will not be considered by the Commission for any purpose which affects or may affect an Exempt Entity's regulatory status under the CEA (e.g., in determining status as a swap dealer or major swap participant)?

9. The Petition requested that the Commission provide categorical relief by including "any other agreement, contract, or transaction to which an Exempt Entity is a party." Should the Commission provide such categorical relief, so long as the primary purpose of the agreement, contract, or transaction is to satisfy existing or anticipated contractual obligations to facilitate the generation, transmission, and/or delivery of electric energy service to customers at the lowest cost possible, and the contract is intended to be settled through physical delivery of the underlying commodity?

10. Can any Exempt Non-Financial Energy Transaction, as defined in the Proposed Order, or any component of an Exempt Non-Financial Energy Transaction, be used to hedge price risk in an underlying commodity? If so, should the Commission explicitly exclude such price-hedging transactions from the definition of Exempt Non-Financial Energy Transaction?

VI. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that Federal agencies consider whether proposed rules will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis on the impact. The relief provided in the Proposed Order may be available to some small entities, because they may fall within standards established by the Small Business Administration ("SBA") defining entities with electric energy output of less than 4,000,000 megawatt hours per year as a "small entity."[113]

The Commission has considered carefully the potential effect of this Proposed Order on small entities and has determined that the proposed order will not have a significant economic impact on any Exempt Entity, including any entities that may be small. Rather, the Proposed Order relieves the economic impact that the Exempt Entities, including any small entities that may opt to take advantage of it, by exempting certain of their transactions from the application of substantive regulatory compliance requirements of the CEA and Commission regulations there under. Significantly, the Proposed Order prevents new requirements for swaps, such as clearing, trade execution and regulatory reporting, from affecting transactions that Exempt Entities traditionally have engaged in to serve their unique public service mission of providing reliable,

[113] U.S. Small Business Administration, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, footnote 1 (effective March 26, 2012), available at http://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf.

affordable electric energy service to customers. Absent such relief and to the extent Exempt Non-Financial Energy Transactions would qualify as swaps, small entities covered by the Proposed Order could be subject to compliance with all aspects of the CEA and its implementing regulations. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Proposed Order will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

Under the Paperwork Reduction Act ("PRA"), an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget ("OMB"). The Proposed Order does not contain any new information collection requirements that would require approval of OMB under the PRA.[114] While the Commission reserves its authority to inspect books and records kept in the normal course of business that relate to Exempt Non-Financial Energy Transactions between Exempt Entities pursuant to the Commission's regulatory inspection authorities, the Commission is not imposing a recordkeeping burden with respect to the books and records of Exempt Non-Financial Energy Transactions that already are kept in the normal course of business. Moreover, any inspection of books and records typically only will occur in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities' overall market positions and to ensure compliance with the terms of this Proposed Order. Accordingly, each inquiry would be specific to the facts triggering the inquiry, and thus will not involve "answers

[114] 44 U.S.C. 3501 et seq.

to identical questions posed to… ten or more persons," as the term "collection of information" is defined in the PRA in pertinent part.[115]

C. Consideration of Costs and Benefits

1. Introduction

Section 15(a) of the CEA[116] requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the Section 15(a) factors.

Prior to the passage of the Dodd-Frank Act, swap market activity was not regulated. In the wake of the financial crisis of 2008, Congress adopted the Dodd-Frank Act, in part, to address conditions with respect to swap market activities.[117] Among other things, the Dodd-

[115] 44 U.S.C. 3502(3)(a)(1). See also 44 U.S.C. 3518(c)(1)(B)(i) and (ii) (excluding collections of information related to administrative investigations against specific individuals or entities, and any subsequent civil actions).

[116] 7 U.S.C. 19(a).

[117] As the Financial Crisis Inquiry Commission explained:

> The scale and nature of the [OTC] derivatives market created significant systemic risk throughout the financial system and helped fuel the panic in the fall of 2008: millions of contracts in this opaque and deregulated market created interconnections among a vast web of financial institutions through counterparty credit risk, thus exposing the system to a contagion of spreading losses and defaults.

Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States," Jan. 2011, at 386, available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

Frank Act amends the CEA to establish a comprehensive regulatory framework for swaps.[118] In amending the CEA, however, the Dodd-Frank Act preserved the Commission's authority under CEA section 4(c)(1) to "promote responsible economic or financial innovation and fair competition" by exempting any transaction or class of transactions, including swaps, from select provisions of the CEA.[119] It also added new subparagraph 4(c)(6)(C) to the CEA specifically directing the Commission, in accordance with 4(c)(1) and (2), to exempt agreements, contracts, or transactions entered into between FPA 201(f) entities if doing so "is consistent with the public interest and the purposes of" the CEA.[120] For reasons explained above,[121] the Commission proposes to exercise its authority under CEA section 4(c)(1) and 4(c)(6) with regard to Exempt Non-Financial Energy Transactions[122] engaged in between Exempt Entities,[123] subject to the

[118] See discussion above at note [13]. Dodd-Frank Act section 721 (amending the CEA to add new section 1a(47)) defines the term "swap" to include "[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more … commodities…").

[119] Section 4(c)(1) of the CEA.

[120] As discussed above in section I.A., CEA sections 4(c)(2) and 4(c)(3) further articulate the conditions precedent to granting an exemption under 4(c)(1) and 4(c)(6)(C), including that the exempted agreements, contracts, or transactions be entered into between "appropriate persons," as that term is defined in 4(c)(6)(3).

[121] See section III.B. above.

[122] As discussed and further described above in section III.A.2., these consist of: any agreement, contract, or transaction based upon a "commodity," as such term is defined and interpreted by the CEA and regulations there under, so long as the primary purpose of the agreement, contract, or transaction is to satisfy existing or anticipated contractual obligations to facilitate the generation, transmission, and/or delivery of electric energy service to customers at the lowest cost possible. When entered into, Exempt Non-Financial Energy Transactions shall always be intended for making or taking physical delivery of the commodity upon which the transaction is based, and such commodity shall never be based upon, derived from, or reference any interest rate, credit, equity or currency asset class, or any grade of a metal, agricultural product, crude oil or gasoline that is not used as fuel for electric generation. Exempt Non-Financial Energy Transactions are limited to the following categories: electric energy delivered, generation capacity, transmission services, fuel delivered, cross-commodity pricing, and other goods and services.

[123] As discussed and further described above in section III.A.1, these are: i) any government-owned electric facility recognized under Federal Power Act ("FPA") section 201(f), 16 U.S.C. 824(f); ii) any electric facility otherwise subject to regulation as a "public utility" under the FPA that is owned by an Indian tribe recognized by the U.S. government pursuant to section 104 of the Act of November 2, 1994, 25 U.S.C. 479a-1; iii) any cooperatively-owned electric utility, regardless of status pursuant to FPA section 201(f), so long as the utility is treated as a

Commission's general anti-fraud, anti-manipulation, and enforcement authority pursuant to CEA sections 2(a)(1)(B), 4b, 4c(b), 4o, 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and Commission rules 32.4 and Part 180. Additionally, the Commission has reserved its authority to inspect the books and records of Exempt Non-Financial Energy Transactions already kept in the normal course of business pursuant to the Commission's regulatory inspection authorities, in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities' overall market positions and to ensure compliance with the terms of this Proposed Order.

In the discussion that follows, the Commission considers the costs and benefits of the exemptive order proposed herein (the "Proposed Order") to the public and market participants generally, and to Exempt Entities specifically. As earlier discussed in sections I.A. and III.A.2., to exempt transactions under CEA section 4(c), the Commission need not first determine—and is not determining—whether the transactions subject to the exemption fall within the CEA. However, to capture all potential costs and benefits, this consideration assumes that the transactions may now or in the future be swaps.[124] In the event the subject transactions would not be subject to the Commission's jurisdiction, the costs and benefits of this Proposed Order relative to the baseline scenario discussed below would be zero.

2. Baseline

The Commission considers the costs and benefits of this Proposed Order against a baseline scenario of non-action. In other words, the proposed baseline is the alternative situation

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"cooperative" organization under Internal Revenue Code section 501(c)(12) or 1381(a)(2)(C), 26 U.S.C. 501(c)(12), 1381(a)(2)(C), and exists for the primary purpose of providing electric energy service to its members at the lowest possible cost; or iv) any not-for-profit entity that is wholly owned, directly or indirectly, by any one or more of the foregoing.

[124] Accord note 81, supra.

that would result if the Commission declines to exercise its exemptive authority under CEA 4(c). This means that to the extent Exempt Non-Financial Energy Transactions engaged in between Exempt Entities qualify as a transaction subject to regulation under the CEA, they are subject to the regulatory regime that the CEA, as amended by the Dodd-Frank Act, and Commission regulations prescribes.

Under the post-Dodd-Frank Act regulatory regime for swaps, Exempt Entity swap counterparties that, as represented in the Petition, are "nonfinancial end-users of [Exempt Non-Financial Energy Transactions entered into] only to hedge or mitigate commercial risks"[125] are subject to the Commission's general anti-fraud, anti-manipulation, and enforcement authority,[126] as well as requirements for swap data reporting[127] and recordkeeping.[128] CEA section 2(h)(7) (the "end-user exception"), excepts a swap from swap clearing[129] and trade execution,[130]

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[125] Petition at 33.

[126] See CEA sections 2(a)(1)(B), 4b, 4c(b), 4o, 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and Commission rules 32.4 and Part 180.

[127] The CEA as amended by the Dodd-Frank Act contemplates two types of reporting to swap data repositories ("SDRs"). First, is real-time reporting: for every swap executed, certain transaction information, including price and volume, is to be reported to an SDR") "as soon as technologically practicable." CEA section 2(a)(13)(A) & (C); see also Real-Time Public Reporting of Swap Transaction Data, 77 F.R. 1182 (Jan. 9, 2012) (adopting 17 CFR part 43 regulations to implement real-time reporting). For swaps executed off of a DCM or SEF and for which neither counterparty is a swap dealer or major swap participant—as the Commission expects Exempt Non-Financial Energy Transactions engaged in between Exempt Entities would be—the real-time reporting obligation for the transaction falls to one of the counterparties, as agreed between themselves. 17 C.F.R. § 43.3(a)(3) Second, for each swap, additional information beyond that required in real-time reports must be reported to an SDR in a "timely manner as may be prescribed by the Commission." CEA section 2(a)(13)(G); see also Swap Data Recordkeeping and Reporting Requirements 77 F.R. 2136 (Jan. 13, 2012) (adopting 17 CFR part 45); Swap Data Recordkeeping and Reporting Requirements: Pre-enactment and Transition Swaps 77 F.R. 35200 (June 12, 2012) (adopting 17 CFR part 46).

[128] Swap Data Recordkeeping and Reporting Requirements 77 F.R. 2136 (Jan. 13, 2012) (adopting 17 CFR part 45); Swap Data Recordkeeping and Reporting Requirements: Pre-enactment and Transition Swaps 77 F.R. 35200 (June 12, 2012) (adopting 17 CFR part 46).

[129] CEA section 2(h)(1)(A)(it "shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing…if the swap is required to be cleared").

requirements if one counterparty is "not a financial entity; … is using swaps to hedge or mitigate commercial risk; and…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." However, unless both Exempt Entity counterparties are "eligible contract participants" ("ECPs"),[131] CEA section 2(e) prohibits them from executing a swap other than on a registered DCM, including directly transacting the swap bilaterally.[132] Against this baseline scenario, with respect to an Exempt Non-Financial Energy Transaction that is a swap, the public and market participants, including Exempt Entities, would experience the costs and benefits related to the regulations, noted above, for them as swaps. As considered below, the Proposed Order could alter these costs and benefits.

Also, the post-Dodd-Frank Act regulatory regime retains requirements applicable to "contract[s] of sale of a commodity for future delivery" within the meaning of CEA section 4(a) (commonly referred to as futures contracts), including that section's exchange-trading requirement for such contracts. Though the Commission need not first determine whether the transactions subject to exemption under CEA section 4(c) are futures or swaps, it has defined the boundaries for inclusion within the Exempt Non-Financial Energy Transaction category in a way that comports with the distinctions between futures contracts subject to CEA section 4(a) and

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[130] Transactions subject to the clearing requirement of CEA section 2(h)(1) must be executed on either a designated contract market ("DCM") or a swap execution facility ("SEF"). CEA section 2(h)(8).

[131] The term is defined in CEA section 1a(18). See also Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 F.R. 30596 (May 23, 2012).

[132] CEA section 2(e).

non-futures transactions.[133] For this reason, the Commission foresees no costs or benefits relative to the baseline attributable to exempting Exempt Non-Financial Energy Transactions as proposed from CEA section 4(a).

The Commission is also cognizant of the regulatory landscape as it existed before the Dodd-Frank Act's enactment. Any Exempt Non-Financial Energy Transactions engaged in between Exempt Entities that now would qualify as swaps (excluding options) were not regulated prior to Dodd-Frank. Thus, measured against a pre-Dodd-Frank Act reference point, Exempt Entities engaging in such swaps could experience costs attributable to the conditions placed upon the Proposed Order. For example, Exempt Entities were not subject to the Commission's regulatory inspection authorities with respect to swap transaction records prior to the enactment and effectiveness of the Dodd-Frank Act.

As a general matter, in its cost-benefit considerations, where reasonably feasible, the Commission endeavors to estimate quantifiable dollar costs. The costs and benefits of the Proposed Order, however, are not presently susceptible to meaningful quantification. Accordingly, the Commission discusses proposed costs and benefits in qualitative terms.

3. Costs

To Exempt Entities

The proposed rule is exemptive and would provide Exempt Entities with relief from regulatory requirements of the CEA for the narrow category of Exempt Non-Financial Energy Transactions engaged in between them. As with any exemptive rule or order, the proposed rule

[133] See, e.g., Statement of Policy Concerning Swap Transactions, 54 Fed. Reg. 30694 (CFTC July 21, 1989). For example, the transactions encompassed by this proposed exemption would be limited to those that are highly bespoke and thus not suitable for exchange trading, executed exclusively bilaterally, off-exchange between counterparties, and undertaken with the intent of making or taking physical delivery of the commodity upon which the transaction is based.

is permissive, meaning that potentially eligible affiliates are not required to elect it. Accordingly, the Commission assumes that an entity would rely on the Proposed Order only if the anticipated benefits warrant the costs. Here, the Proposed Order provides for the continued application of the anti-fraud, anti-manipulation, and enforcement provisions of the CEA and its implementing regulations, and additionally reserves the Commission inspection authority for books and records that the Exempt Entities currently prepare and retain[134]—all continuations of the baseline regulatory scheme established in the CEA. Accordingly, they generate no incremental costs.

To Market Participants and the Public

The Commission has considered whether an exemption from the CEA as proposed for Exempt Non-Financial Energy Transactions engaged in between Exempt Entities will expose market participants and the public to the risks that the CEA guards against—a potential cost. For a variety of reasons, the Commission believes that it does not. These reasons include the following:

- The highly bespoke nature of Exempt Non-Financial Energy Transactions, as well as the fact that they are used to manage unique electricity industry operational risks, rather than price risk of an underlying commodity, make them ill-suited for exchange trading and/or to serve a useful price discovery function.[135]

[134] For example, Exempt Entities that receive financing from the Rural Utilities Service ("RUS") are required to keep records of all master agreements and term contracts for the procurement of goods and services. See 18 CFR 125.3 (Schedule of records and periods of retention); RUS Bulletin 180-2. Under the books and records inspection authority contained in the Proposed Order, the Commission could request any of these procurement agreements that document an Exempt Non-Financial Energy Transaction for the purchase or sale of "electric energy delivered," as such term is defined in the Proposed Order.

[135] As explained in section III.B.3.d, above, the commercial risks that Exempt Non-Financial Energy Transactions face generally are not related to fluctuations in the price of a commodity, but are rather related to electricity retail demand fluctuations. Exempt Entities engage in Exempt Non-Financial Energy Transactions primarily to assure

- The incentive structure for Exempt Entities—as limited to not-for-profit governmental, tribal, and IRC section 501(c)(12) or section 1381(a)(2)(c) electric cooperative entities—is substantially different than that of investor-owned entities and poses a low risk for fraud, manipulation, or other abusive practices.[136]
- Exempt Non-Financial Energy Transactions are executed bilaterally within a closed-loop of non-financial, not-for-profit electric utility entities, are not market facing, and therefore have little, if any, ability to materially impact liquidity, fairness or financial security of derivative product trading on DCMs or SEFs.[137]
- This closed-loop trading characteristic, combined with the nonfinancial nature of the transacting parties, also limits the ability of Exempt Non-Financial Energy Transactions to create systemic risk.[138]

Moreover, besides carefully defining the boundaries for Exempt Non-Financial Energy Transactions between Exempt Entities, the Commission's Proposed Order incorporates conditions designed to protect the markets subject to the Commission's jurisdiction. Specifically, the Commission proposes to retain the general anti-fraud, anti-manipulation, and enforcement authority contained in the CEA and its implementing regulations. Additionally, the Commission is also retaining authority to inspect books and records, pursuant to its regulatory inspection authorities, in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities'

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their ability to meet production, transmission, and/or distribution obligations, not to hedge against the risk of electricity prices rising or falling.

[136] See section II.A.1. above.

[137] See section III.B.3.a. above.

[138] See section III.B.3.b. above.

overall market positions and compliance with this Proposed Order. Accordingly, based on the expectations that—for the narrow subset of electric industry transactions covered by this Proposed Order—the risk potential, at most, is remote and the prescribed conditions appropriate to contain them to the extent they may emerge, the Commission foresees no material costs attributable to risk associated with the Proposed Order.

The Commission has also considered the potential for the Proposed Order to exact a competitive cost by affording Exempt Entities an advantage vis-à-vis other market participants that may not be entitled to the exemption. As not-for-profit governmental, tribal, and cooperative entities as defined in the Proposed Order, the Commission understands that the mandate for Exempt Entities is to provide reliable, affordable electricity for their customers. While the Proposed Order will afford Exempt Entities flexibility and/or reduced compliance burden to manage their operational risks relative to non-Exempt Entities, the Commission has no basis to expect that in so doing the Proposed Order will impose a competitive cost on the markets subject to its jurisdiction.

4. Benefits

To Exempt Entities

Measured against the baseline scenario, the Proposed Order expectedly will benefit Exempt Entities by lessening the likelihood that CEA compliance would diminish their ability and/or incentive to continue to engage in Exempt Non-Financial Energy Transactions that, as described in the Petition and above,[139] are an operational tool relied upon by Exempt Entities to

[139] Petition at 12 (transactions for which exemption requested "are intrinsically related to the needs of . . . the [not-for-profit] Electric Entities . . . which arise from their respective electric facilities and ongoing electric operations and public service obligations" (citation omitted)); section III.A.2, above (the proposed order defines Exempt Non-Financial Energy Transactions as any agreement, contract, or transaction entered into primarily "to satisfy existing

effectively execute their public service mission. It will also benefit them by avoiding regulatory costs to comply with CEA swap requirements whether or not any Exempt Non-Financial Energy Transaction actually constitutes a swap.[140]

To the extent any Exempt Non-Financial Energy Transactions are swaps, as a threshold matter Exempt Entities could not execute them off of a registered DCM unless both Exempt-Entity counterparties qualify as ECPs.[141] The relevant criteria for determining ECP status varies for Exempt Entities that are governmental entities (or political subdivisions of governmental entities) and those that are not. For the former, governmental Exempt Entities must meet certain line of business requirements,[142] or "own… and invest… on a discretionary basis $50,000,000 or more in investments.[143] For the latter, non-governmental Exempt Entities either must have: (a) assets exceeding $10,000,000; (b) a guarantee for obligations; or, (c) greater than $1,000,000 net worth and "enter…into an agreement, contract, or transaction in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity's business."[144] While some of the larger Exempt Entities in particular may meet the definitional

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or anticipated contractual obligations to facilitate the generation, transmission, and/or delivery of electric energy service to customers at the lowest cost possible . . . .").

[140] As discussed below with respect to benefits to market participants and the public, Exempt Entities' members and other customers should be the indirect beneficiaries of these avoided costs.

[141] CEA section 2(e).

[142] That is, have "a demonstrable ability, directly or through separate contractual arrangements, to make or take delivery of the underlying commodity [or] incur…risks, in addition to price risk, related to the commodity." CEA section 1a(17)(A)(i) & (2) (as referenced in CEA section 1a(18)(A)(vii)(aa)). CEA section 1a(18)(A)(vii) specifies alternative criteria to qualify for governmental-entity ECP status that do not appear relevant given that Exempt Entities are not SDs, MSPs, or financial entities.

[143] CEA section 1a(18)(A)(vii)(bb).

[144] CEA section 1a(18)(A)(v).

requirements to be ECPs, the Petition does not provide information evidencing that all Exempt Entities for all types of Exempt Non-Financial Energy Transaction clearly would.[145]

If Exempt Entities are not ECPs, and given that Exempt Non-Financial Energy Transactions, as proposed, are bespoke to an extent that makes them incapable of exchange trading, absent Commission action non-ECP Exempt Entities would be unable to engage bilaterally in any Exempt Non-Financial Energy Transactions that are swaps. Relative to a circumstance that would preclude non-ECP Exempt Entities from continuing to engage in Exempt Non-Financial Energy Transactions that are swaps, the Proposed Order would afford the benefit of allowing the use of transactions that are closely related to Exempt Entities' public service mission to provide affordable, reliable electricity. The Proposed Order would also save Exempt Entities the time and expense that would be necessitated to determine if they were ECPs. For, with the Proposed Order, ECP status becomes largely irrelevant, while without it, Exempt Entities may have to concern themselves with ECP status determinations as a threshold for engaging in certain transactions.

The Proposed Order would also avoid potential costs that Exempt Entities might incur to comply with swap data reporting and recordkeeping requirements as articulated in Commission regulations for any Exempt Non-Financial Energy Transactions that were swaps. [146]

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[145] Furthermore, a comment letter submitted by two of the Petitioners in connection with the Commission rulemaking on the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," states that some not-for-profit consumer-owned electric utilities "may not meet the financial tests listed in the definition of ECP due to the relatively small size of their physical assets." Letter from NRECA, APPA and LPPC dated February 22, 2011, RIN 3235-AK65, at 12.

[146] See Real-Time Public Reporting of Swap Transaction Data, 77 F.R. 1182, 1232-40 (Jan. 9, 2012) (adopting 17 CFR part 43 regulations to implement real-time reporting). Swap Data Recordkeeping and Reporting Requirements 77 F.R. 2136, 2176-93 (Jan. 13, 2012) (adopting 17 CFR part 45); Swap Data Recordkeeping and Reporting Requirements: Pre-enactment and Transition Swaps 77 F.R. 35200, 35217-25 (June 12, 2012) (adopting 17 CFR part 46).

Even for Exempt Non-Financial Energy Transactions ultimately determined not to be swaps, if Exempt Entities perceived some potential that they could be swaps (now or as evolved in the future), Exempt Entities would likely need to expend resources to monitor contemplated transactions and make status determinations as to them. Moreover, the bespoke nature of these transactions could complicate the ability to generalize conclusions across transactions, potentially resulting in a need for more frequent, individualized assessments that could multiply determination costs. While the Commission lacks a basis to meaningfully project any such benefit in dollar terms, qualitatively it expects that the benefit would include the avoided costs of training staff to differentiate between swap and non-swap transactions and, in some cases at least, to obtain an expert legal opinion to support a determination. Additionally, uncertainty about whether a certain transaction would or would not be deemed a swap could prompt an Exempt Entity to forego a beneficial transaction or to substitute a transaction that served the operational needs less effectively. Avoiding a result that would diminish the use of operationally-efficient Exempt Non-Financial Energy Transactions is another benefit.

To Market Participants and the Public

For reasons similar to those discussed above in the Commission's analysis of the Proposed Order under CEA sections 4(c)(1) and (6), the Commission expects that this Proposed Order will benefit the public generally.[147]

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[146] Swap Data Recordkeeping and Reporting Requirements 77 F.R. 2136 (Jan. 13, 2012) (adopting 17 CFR part 45); Swap Data Recordkeeping and Reporting Requirements: Pre-enactment and Transition Swaps 77 F.R. 35200 (June 12, 2012) (adopting 17 CFR part 46).

[147] In that the impacted transactions are undertaken exclusively in a closed-loop environment from which financial participants are absent, the Commission does not foresee that derivative market participants beyond Exempt Entities will realize either a cost (as earlier discussed) or benefit impact.

First, the Commission believes that the Proposed Order aligns with the beneficial public interests served by the FPA, which—in addition to granting comprehensive jurisdiction over the electric industry to FERC—reflects, through FPA section 201(f)'s exemption, Congress' implicit view that, with respect to certain activities, a regulatory light-touch and avoidance of overlapping regulatory regimes for governmental and small cooperative electric utilities serves the public-interest objectives of the FPA.[148] The Commission interprets CEA section 4(c)(6)(C), directing the Commission to provide an exemption for FPA 201(f) entities to the extent consistent with the public interest and the CEA, as an extension of that view. Accordingly, by tailoring the Proposed Order for FPA section 201(f) entities (as well as others deemed equally suitable) in a careful manner intended to preserve the public interests protected under the CEA, the Proposed Order accommodates the public interests of both statutes.

Second, in that the proposed Exempt Entities share the same public-service mission of providing affordable, reliable electricity to their customers, those aspects of the Proposed Order that benefit Exempt Entities directly should indirectly benefit their customers as well. For example, the Proposed Order would enable non-ECP Exempt Entities to engage in swap Exempt Non-Financial Energy Transactions that would be barred to them under CEA section 2(e), or facilitate the likelihood that they would continue to engage in Exempt Non-Financial Energy

[148] See Salt River Project Agricultural Improvement and Power District v. Federal Power Commission, 391 F. 2d 470, 475 (D.C. Cir. 1968) ("But of the 19 major abuses summarized [in a Federal Trade Commission report to Congress on the electric utility industry], virtually none could be associated with the cooperative structure where ownership and control is vested in the consumer-owners… Consequently, the attention of the 74th Congress, in enacting the Federal Power Act, was focused on the sorts of evils associated exclusively with investor-owned utilities") In Salt River, the court considered whether the FPA 201(f) exemption, which at the time did not expressly encompass REA-financed cooperatives—entities subject to "extensive [REA] supervision over the planning, construction and operation of the facilities [REA] finances"—fell within the exemption, as the FPC had interpreted that it did. Id. at 473. The court found that, among other factors, the Congressional inaction in the face of 30 years of administrative practice extending FPA 201(f) exemptive treatment to REA-financed cooperatives reinforced the FPC's interpretation that REA-financed cooperatives were exempt from FPA coverage as instrumentalities of the Government under Section 201(f). Id. at 476.

Transactions that they might choose to forego for regulatory uncertainty or costs reasons absent the exemption. In these circumstances, Exempt Entity customers should be the ultimate beneficiaries (via supply reliability and affordability) of the operational risk-management and efficiencies that Exempt Non-Financial Energy Transactions afford. Similarly, to the extent that the Proposed Order enables Exempt Entities to avoid compliance and/or monitoring costs they would otherwise incur, the non-profit structure, compliance with requisite Internal Revenue Code conditions, and public service mission that Exempt Entities share means that the cost savings should be passed through to members and other customers proportionately in the form of lower electricity prices and/or higher revenue distributions to members.

And third, the public also benefits by the promotion of economic and financial innovation that, as explained above,[149] the Commission expects this Proposed Order will further. For, the unique environment in which these electric utilities must operate to reliably serve their customer load in the face of constantly fluctuating demand—compounded by the fact that many of these Exempt Entities do not enjoy the same scale economies as investor-owned utilities—places a premium on innovative solutions to operational issues. Exempt Non-Financial Energy Transactions represent one such innovation. The Commission envisions the Proposed Order, as contemplated by Congress,[150] will provide Exempt Entities regulatory certainty important to their ability to continue to utilize and develop innovative solutions through the use of highly bespoke, physically settled agreements, contracts, and transactions. Accordingly, the Commission expects the Proposed Order to benefit the public.

5. Costs and Benefits as Compared to Alternatives

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[150] See HOUSE CONF. REPORT NO. 102-978, 1992 U.S.C.C.A.N. 3179, 3213 ("4(c) Conf. Report"), noted in section I.A. above.

The chief alternatives to this Proposed Order are for the Commission to: (1) decline to exercise its exemptive authority, or (2) to exercise its exemptive authority more broadly and without conditions as requested in the Petition.

With respect to the first alternative—decline to exempt—the costs and benefit consideration is the mirror-image of that discussed above relative to the baseline scenario. A decision not to exercise exemptive authority in this circumstance would preserve the current post-Dodd-Frank regulatory environment.

Relative to the second alternative of exercising its exemptive authority more broadly and in a manner that would provide categorical relief from all of the requirements of the CEA as requested in the Petition, the Commission has purposefully proposed to define the categories of exempt entities and transactions more narrowly, and to preserve certain aspects of CEA jurisdiction for them. A potentially material difference between the entities that the Petition sought to exempt and how the Commission proposes to define the term Exempt Entities is the Commission's explicit requirement that an Exempt Entity not be a "financial entity" within the meaning of CEA section 2(h)(7)(C). Given, however, that the Petition expressly represents that the not-for-profit electric entities that would be encompassed by the requested exemption "are all nonfinancial end users,"[151] the Commission does not foresee a material cost of expressly stating this requirement relative to the Petitioned-for alternative. Conversely, the requirement delineates what the Commission considers an important gating principle for the exemption's appropriateness, and stating it explicitly reduces ambiguity that could fuel future disputes over the issue—a benefit.

[151] Petition at 33.

Also, compared to the Petition's description of transactions for which exemption was sought, the proposed definition of Exempt Non-Financial Energy Transactions incorporates limiting language[152] and articulates additional definitional elements (e.g., intent at execution to make or take physical delivery of the commodity upon which the transaction is based). The more open-ended, Petitioned-for transaction description theoretically could save Exempt Entities effort that they might otherwise need to expend to determine whether a transaction engaged in between them is or is not exempted compared to the more refined and limited definition of Exempt Non-Financial Energy Transactions that the Commission proposes. That said, an equally, if not more, persuasive case might be made that the greater certitude that the proposed definition's more bounded approach provides should mitigate determination costs. More importantly, given the inability to foresee how these transactions may develop, the Commission considers it prudent and in the public interest to ring-fence the definition within stated parameters to restrict the potential for the transactions to evolve in a manner incompatible with the purposes of the CEA.

Finally, as proposed, the exemption retains the Commission's general anti-fraud, anti-manipulation, and enforcement authority, as well as the Commission's authority to review books and records already kept in the ordinary course of business in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities' overall market positions and to ensure compliance with the terms of this Proposed Order, in contrast to the Petition's request for a wholesale exemption from the CEA. The Commission believes that the first two conditions

[152] It explicitly limits covered transactions to six articulated categories, while the Petition proposed a more open-ended approach that would have included all transactions relating to particular categories, but not others. See Petition at 4-5.

serve important beneficial ends to ensure the integrity of commodity and commodity derivatives markets within its jurisdiction. To the extent Exempt Entities incur some cost to remain compliant with the CEA's anti-fraud, anti-manipulation, and enforcement regime, the Commission considers such costs warranted by the importance of maintaining commodity market and price discovery integrity. The Commission also believes that authority to inspect books and records kept in the ordinary course of business, pursuant to its regulatory inspection authority, as they relate to Exempt Non-Financial Energy Transactions is important to assure visibility into activity in such transactions on an as-needed basis. Further, as a general matter, the Commission expects infrequently to exert its regulatory inspection authority with respect to Exempt Non-Financial Energy Transactions and, as proposed, such authority would involve only records that Exempt Entities keep in the ordinary course of business, only in the event that circumstances warrant the need to gain greater visibility with respect to Exempt Non-Financial Energy Transactions as they relate to Exempt Entities' overall market positions, and only to ensure compliance with the terms of this Proposed Order. The Commission anticipates that any costs occasioned by this condition are relatively insignificant.

6. Consideration of CEA Section 15(a) Factors

a. Protection of Market Participants and the Public

As explained above, the Commission does not foresee that the Proposed Order will have any effect on the protection of market participants and the public. More specifically, Exempt Non-Financial Energy Transactions as transacted bilaterally and in a closed loop between Exempt Entities in the highly specialized and unique electric-industry circumstances proposed for exemption do not appear to the Commission to generate risks of the nature addressed by the CEA. The Commission has attempted to delineate the definitional boundaries for Exempt

Entities and Exempt Non-Financial Energy Transactions in a manner that appropriately ring-fences against the possibility that they could generating such risks, either now or as they may evolve in the future. Moreover, the exemption incorporates conditions to counter residual risk that conceivably, though unexpectedly, might survive notwithstanding the Proposed Order's careful definitional crafting.

b. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The Commission foresees no negative impact from the Proposed Order on the efficiency, competitiveness, and financial integrity of markets regulated under the CEA. As narrowly limited to highly bespoke transactions, executed bilaterally between non-financial entities primarily in order to satisfy existing or expected operations-related contractual obligations, as opposed to speculating or hedging against the price risk of an underlying commodity, the Commission foresees little to no capability for Exempt Non-Financial Energy Transactions, to the extent any are swaps, to directly impact swap market efficiency, competitiveness, or financial integrity. Also, the Proposed Order incorporates definitional attributes that largely eliminate the potential for any futures market impact.

Further, as an exercise of the Commission's CEA section 4(c) authority to provide legal certain for novel instruments as Congress intended, the Proposed Order affords Exempt Entities transactional flexibility that the Commission understands to be valuable to their ability to efficiently deploy their limited resources.

c. Price Discovery

The Commission does not foresee that the Proposed Order will directly impact price discovery. As discussed above, the highly bespoke nature of Exempt Non-Financial Energy

Transactions, as well as the fact that they are used to manage unique electric industry operational risks rather than price risk of an underlying commodity, appears to make them ill-suited for exchange trading and/or to serve a useful price discovery function.

d. Sound Risk Management Practices

The Commission expects that the Proposed Order will promote the ability of Exempt Entities to manage the operational risks posed by unique electric market characteristics, including the non-storable nature of electricity and demand that can and frequently does fluctuate dramatically within a short time-span. As discussed above, the Commission understands that Exempt Non-Financial Energy Transactions are an important tool facilitating the ability of Exempt Entities to efficiently manage operational risk in fulfillment of their public service mission to provide affordable, reliable electricity.

Also, the Commission does not anticipate that the Proposed Order will compromise systemic risk management. The transactions proposed for exemption are not market facing, but are executed exclusively within closed-loops that do not include financial entities. These characteristics, among others, limit the ability of Exempt Non-Financial Energy Transactions to create systemic risk.

e. Other Public Interest Considerations

In utilizing its section 4(c)(1) and (6)(C) exemptive authority as proposed herein, the Commission believes it is acting to promote the broader public interest in an affordable, reliable electric supply as Congress contemplated.

7. Request for Public Comment on Costs and Benefits

The Commission invites public comment on its cost-benefit considerations, including the consideration of reasonable alternatives.

The Commission invites public comment on the magnitude of specific costs and benefits that would result from the Proposed Order, including data or other information to estimate the dollar value of such costs and benefits.

The Commission invites public comment on any cost or benefit impact, direct or indirect, that the Proposed Order may have with respect to the factors the Commission considers under CEA section 15(a), specifically: (a) protection of market participants and the public; (b) efficiency, competitiveness and financial integrity of the markets subject to the Commission's jurisdiction; (c) price discovery; (d) sound risk management; and (e) other public interest considerations.

Issued in Washington, DC, on August 16, 2012 by the Commission.

Sauntia S. Warfield
Assistant Secretary of the Commission

Appendices to Request for comment on a proposal to exempt, pursuant to authority in section 4(c) of the Commodity Exchange Act, certain transactions between entities described in section 201(f) of the Federal Power Act, and other electric cooperatives —Commission Voting Summary and Statements of Commissioners

NOTE: The following appendices will not appear in the Code of Federal Regulations

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O'Malia and Wetjen voted in the affirmative; no Commissioner voted in the negative.

Appendix 2- Statement of Chairman Gary Gensler

I support the proposed relief from the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) swaps provisions for certain electricity and electricity-related energy transactions between rural electric cooperatives; state, municipal, and tribal power authorities; and federal power authorities.

Congress directed the CFTC, when it is in the public interest, to provide relief from the Dodd-Frank Act's swaps market reform provisions for certain transactions between these entities.

For decades, these entities have been recognized as performing a public service mission, a fundamentally different function than investor-owned utilities. The purpose of these entities is to provide their customers or cooperative members with reliable electric energy at the lowest cost possible. They have been largely exempt from regulation by the Federal Energy Regulatory Commission because of their government entity status or their not-for-profit cooperative status.

The scope of the proposed relief extends only to non-financial electricity and electricity-related energy transactions for the generation, transmission and delivery of electric energy to customers. Such transactions must be intended for making or taking physical delivery of the underlying commodity.

I look forward to receiving public comment on the proposed relief.

[FR Doc. 2012-20589 Filed 08/22/2012 at 8:45 am; Publication Date: 08/23/2012]