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STATEMENT OF PAUL McELROY
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BEFORE THE

HOUSE COMMITTEE ON AGRICULTURE

HEARING ON OVERSIGHT OF THE SWAPS AND FUTURES MARKETS: RECENT EVENTS AND IMPENDING REGULATORY REFORMS

JULY 25, 2012

Mr. Chairman and Members of the Committee, I am Paul McElroy, Chief Financial Officer for JEA testifying today on behalf of the American Public Power Association (APPA). APPA is the national service organization representing the interests of over 2,000 municipal and other state- and locally-owned, not-for-profit electric utilities throughout the United States (all but Hawaii). Collectively, public power utilities deliver electricity to one of every seven electricity customers in the United States (approximately 46 million people), serving some of the nation's largest cities. However, the vast majority of APPA's members serve communities with populations of 10,000 people or less.

JEA is a member of APPA. We are located in Jacksonville, Florida, and proudly serve an estimated 420,000 electric, 305,000 water, and 230,000 sewer customers in Northeast Florida. JEA was created by the City of Jacksonville to serve those who live there and in the surrounding communities. The sole purpose of our business is to ensure that the electric, water and sewer demands of our customers are met, both today and for generations to come. Our goal is to provide reliable services at a good value to our customers while ensuring that our areas' precious natural resources are protected.

Public Power Utilities and Implementation of the Dodd-Frank Act

APPA supports the goals of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and has worked closely with the Commodity Futures Trading Commission (CFTC) and other interested parties hoping to improve its implementation, particularly related to regulations affecting "end users" of energy such as JEA and other APPA members. Even today,

now two years after enactment, the full effect of the Dodd-Frank Act on public power utilities is unclear as regulations implementing the statute continue to be promulgated. We strongly support the CFTC's efforts to issue these regulations in a timely fashion while also accommodating a necessary discussion among stakeholders to fully vet these rules for unintended or adverse consequences.

One such instance is the final swap-dealer rule,[1] which took effect on July 23, 2012. As written, the rule will substantially hinder public power and public gas utilities' ability to hedge against operational risks. Just like JEA, these utilities have no shareholders, so the costs imposed by this regulatory decision will be borne by only one group: our ratepayers.

As you know, the Dodd-Frank Act requires swap dealers and major swap participants to register with the CFTC and meet capital, margin, and reporting and recordkeeping requirements, as well as to comply with rigorous business conduct and documentation standards. The Dodd-Frank Act provides additional standards for swap dealers or major swap participants advising or entering into swaps with government-owned utilities and other government entities (referred to under the statute as "special entities"). For swap dealers advising or seeking to advise a special entity, the law states that it is "unlawful" to defraud that special entity.[2] For swap dealers or major swap participants entering into swaps with special entities, the law states that these dealers and swap participants must comply with rules set by the CFTC requiring special entities to have an independent representative before trading with a swap dealer or major swap participant.[3]

In December 2010, the CFTC (jointly with the Securities and Exchange Commission) issued a proposed rule to define the term "swap dealer," including (as required by the Dodd-Frank Act[4]) an exemption from the swap-dealer designation for those entities that engage in a *de minimis* quantity of swap dealing.

In the proposed rule, CFTC proposed two separate *de minimis* thresholds relating to the dollar quantity of swaps: $100 million annually for an entity's total swap-dealing activity; and, $25 million annually for an entity's swap-dealing activity with special entities, including, as noted above, public power, public gas, and federal utilities (government-owned utilities).

In February, 2011, the Not-For-Profit Electric End User Group (NFP EEU)—which includes APPA—filed comments on the proposed swap dealer rule. The comments recommended that the CFTC substantially increase the *de minimis* thresholds both for total swaps and for swaps with special entities.

A final rule was approved by the CFTC on April 18, 2012, and was published in the Federal Register on May 23, 2012. The final rule greatly increased the overall *de minimis* threshold from the proposed rule, raising it from $100 million to $3 billion. During an initial phase-in period, this threshold will be $8 billion. But, the final rule did not change the proposed rule's $25 million sub threshold for swap-dealing activities with special entities. Thus, the disparity

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[1] CFTC Regulation 1.3(ggg)(4); see 77 Fed. Reg. 30596, at 30744.
[2] 7 USCA § 6s(h)(4).
[3] 7 USCA § 6s(h)(5).
[4] 7 USCA § 1a(49)(D).

between the two thresholds is now substantially greater. This $25 million sub-threshold is smaller still when you consider that it is the aggregate of a swap partner's transactions with **all** special entities during any 12-month period.[5]

As a result, non-financial entities (such as natural gas producers, independent generators, and investor-owned utility companies) that do not want to be swap dealers will severely limit their swap-dealing activities with government-owned utilities to avoid exceeding the $25 million threshold.

Why Hedging Is Necessary

Government-owned utilities depend on nonfinancial commodity transactions, trade options and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Together, nonfinancial commodity markets play a central role in the ability of government-owned utilities to secure electric energy, fuel for generation, and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many government-owned utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially-settled nonfinancial commodity swaps with customized terms to hedge the unique operational risks to which many government-owned utilities are subject.

In hedging, mitigating or managing the commercial risks of their utility facilities' operations or public service obligations, government-owned utilities are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

Why Nonfinancial Counterparties Are Necessary

Electric power touches virtually every home and business in the United States. This near universality gives a false appearance of homogeneity. It is important to remember that what is being delivered is a physical commodity, e.g., electricity, coal, or natural gas. Ownership of a stock can be transferred coast to coast with a click of a button, but electricity must be delivered to the place it is to be used.

Each regional geographic market has a somewhat different set of demands driven by climate, weather, population, and the like. Each regional geographic market also has a somewhat different group of financial entity counterparties and nonfinancial entity counterparties available to meet these demands and thus able to enter into customized utility operations-related swaps needed for hedging price and supply risks. For example, a large merchant electric generation station in western Alabama might be available as a nonfinancial counterparty for a swap transaction to provide electricity to a specific site in Alabama. But that same entity would not necessarily be

[5] By way of reference a single, one-year 100 MW swap could have a roughly $25 million notional value. One-hundred MWs of power is enough to serve the average demand of approximately 75,000 residential customers.

able to offer the electricity in Oregon, and so would not be able to help an Oregon-based utility hedge its risks.

Because there are a limited number of counterparties for any particular operations-related swap sought by a utility, each financial or nonfinancial swap counterparty brings important market liquidity and diversity. The greater the number of counterparties, the greater the price competition. Conversely, reduced price competition necessarily increases prices.

JEA and the Special Entity Sub Threshold

I would like to illustrate these points with examples from my JEA's perspective.

As discussed above, the primary mission of JEA's electric system is to provide reliable and low cost electricity to our customers. I will say that again. While ensuring sufficient supply to serve our customers is primary, running a very close second is managing commodity fuel and purchased power costs. We accomplish this by efficiently and cost-effectively managing supply and price risks inherent in the procurement of fuel and power.

Take, for example, a capacity and energy swap between JEA and another municipal utility. This swap is intended to diversify our electric generation capability. By way of background, JEA has a large commitment solid fuel, while our swap partner in this example has a significant commitment to natural gas. And, history has taught us the importance of diversification time and time again.

This swap would be governed by Dodd-Frank: it would qualify for the end-user exception so would not have to be cleared, but one of the parties would have to report the transaction. However, the notional amount of the swap would exceed $25 million, and, if it were considered "dealing" activity under the rules' facts and circumstances guidelines, would invoke the sub-threshold provision.

This leaves us with the options of 1) having one party register as a dealer, 2) placing a registered dealer between the parties, or 3) affecting a physical exchange instead of a swap.[6] All of these solutions add complexity and cost, do nothing to reduce systemic financial risk, and will cause the transaction to be abandoned. That said, the same transaction, were it **not** to involve special entities, would impose none of the added cost and complexity. This seems neither appropriate, nor fair.

Likewise, JEA seeks to maximize flexibility regarding terms and conditions governing supply and price in all long-term fuel and purchased power contracts. This gives us the flexibility to efficiently and cost-effectively manage supply and price risks in fuel and power procurement. However, we have been told by several non-financial energy suppliers who currently serve as swap partners, none of whom are currently dealers, that they are looking closely at the "special entity sub-threshold" to determine the terms and conditions they may be willing to extend to us in the future.

[6] A physical exchange would be structured as two separate purchase power agreements, incorporating the costs of transmission and ancillary services.

When a major fuel supplier says they are "reevaluating" contractual terms and conditions, it almost certainly means that the level of flexibility we currently enjoy will be curtailed or eliminated and our costs and risk profile will increase. Again, however, this supplier can continue to extend to utilities that are not special entities contracts under the existing terms. And again, this seems neither appropriate, nor fair.

These are just two examples of how the sub threshold will affect JEA. As noted above there is a great deal of heterogeneity among APPA members, including in the use of hedging. Some make substantial use of hedging: others do not. Likewise, of APPA members who do make use of hedging, a recent informal survey of members showed great diversity in terms of the volume of hedging and the extent to which members relied on non-financial entities.

However, the rules could still affect all of our members. Members currently hedging will be affected, but so will smaller members who buy power from larger members who do. For example, while a small municipal electric distribution utility[7] in Oklahoma might not hedge its risks, it may buy its power from a larger public power provider—such as the Oklahoma Municipal Power Authority—which does. Also, those who do not currently hedge will be restricted in their ability to do so in the future.

The CFTC has said that it retained the $25 million threshold in light of the special protections that the Dodd-Frank Act affords to special entities. However, the statute does not require—even mention—special protections for special entities in regard to the swap dealer definition. As noted above, the law imposes requirements on swap dealers and major participants advising or entering into swaps with special entities. Nowhere does the law mention deeming a participant to be a swap dealer solely because they happen to be entering into swaps with a government-owned utility.

APPA thinks the distinction in the law is appropriate. Government-owned utilities understand the operations-related swap transactions they use to manage their commercial risks and do not need the special protections provided by the $25 million sub-threshold. **In fact, and ironically, these "protections" are likely to limit the ability of these utilities to hedge operational and price risks rather than to protect these utilities and their customers from risk.**

Government-Owned Utilities' Petition for Rulemaking

On July 12, 2012, APPA, the Large Public Power Council (LPPC), the American Public Gas Association (APGA), the Transmission Access Policy Study Group (TAPS), and the Bonneville Power Administration (BPA), filed with the CFTC a "Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)." The petition (see the attachment to this testimony) requests that the CFTC amend its swap-dealer rule to exclude utility special entities' operations-related swap transactions from counting towards the special-entity threshold. This amendment to the swap-dealer rule would allow producers, utility companies, and other non-financial entities to enter

[7] An electric distribution utility is one which solely distributes electricity, as distinguished from one which generates and distributes electricity.

into energy swaps with government-owned utilities without danger of being required to register as a "swap dealer" solely because of their dealings with government-owned utilities.

Specifically, the petition asks for a narrow exclusion:

- A government-owned utility's swaps related to utility operations would not count towards the special entity *de minimis* threshold, but would count towards the total *de minimis* threshold.

- Utility operations-related swaps are those entered into to hedge commercial risks intrinsically related to the utility's electric or natural gas facilities or operations or to the utility's supply of natural gas or electricity to other special entities. For example, these would include swap transactions related to the generation, production, purchase or sale, or the transportation of electric energy or natural gas, or related to fuel supply of electric generating facilities.

- Utility operations-related swaps do not include interest rate swaps. Those swaps would remain subject to the $25 million special entity sub-threshold.

We urge Committee members to support this petition.

Conclusion

In conclusion, the protections the CFTC is trying to afford through the $25 million special entity sub-threshold were not contemplated by the Dodd-Frank Act and are not needed for government-owned utility swaps related to utility operations. Government-owned utilities are well-versed in the markets in which they are hedging their risks and rely on these swaps solely to manage price and operational risks. More importantly, the assumption that financial firms will be able to replace all the swaps offered currently by our nonfinancial swap partners reflects a dangerous misunderstanding of how electricity is delivered and an indifference to the price Wall Street will impose in the absence of adequate competition and to the risk to supply if that price cannot be afforded. In sum, a failure to allow the narrow exclusion sought in our petition will limit our members' ability to hedge against risks and lead to increased risk and costs to the millions of ratepayers they serve.

Thank you again for this opportunity to testify, and I would be more than happy to answer any questions you might have.

ATTACHMENT:

July 12, 2012

Via Email and Messenger Delivery

Mr. David Stawick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulation 1.3(ggg)(4)

Dear Mr. Stawick:

The American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS") and the Bonneville Power Administration ("BPA")(collectively, the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend CFTC Regulation 1.3(ggg)(4),[8] which implements the *de minimis* exception to the definition of "swap dealer." The Petitioners specifically request that the rule amendment exclude from the "special entity sub-threshold," which appears in

[8] 77 Fed. Reg. 30596, at 30744.

Regulation 1.3(ggg)(4)(i), "Utility Operations-Related Swaps" to which the Petitioners and other "Utility Special Entities" are, or may in the future be, counterparties. The definitions of "Utility Operations-Related Swap" and "Utility Special Entity" are included directly in the text of the proposed rule amendment, and narrowly circumscribe the scope of the proposed rule amendment.

Such a rule amendment is permitted by Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[9] and is specifically contemplated by CFTC Regulation 1.3(ggg)(4)(v).[10] The rule amendment is necessary in order to preserve uninterrupted and cost-effective access to the customized, nonfinancial commodity swaps that Petitioners and other Utility Special Entities use to hedge or mitigate commercial risks arising from their utility facilities, operations and public service obligations.

The information required by CFTC Regulation 13.2 follows:

I. THE TEXT OF THE PROPOSED RULE AMENDMENT (Additional language is underlined and italicized)

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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Section 1.3 Definitions.

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(ggg) Swap Dealer.

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(4) *De minimis* exception. (i) Except as provided in paragraph (ggg)(4)(vi) of this section, a person that is not currently registered as a swap dealer shall be deemed not to be a swap dealer as a result of its swap dealing activity involving counterparties, so long as the swap positions connected with those dealing activities into which the person – or any other entity controlling, controlled by or under common control with the person – enters over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than $3 billion, subject to a phase in level of an aggregate gross notional amount of no more than $8 billion applied in accordance with paragraph (ggg)(4)(ii) of this section, and an aggregate gross notional amount of no more than $25 million *(the "special entity sub-threshold")* with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter)*; provided that such $25 million special entity sub-threshold shall* ***not*** *apply with regard to "utility operations related swaps" to which the counterparty is a "utility special entity." For purposes of this paragraph, (A) a "utility special entity" means a government "special entity" (as described in clause (i) or (ii) of*

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

10 77 Fed. Reg. 30744-30745.

Section 4s(h)(2)(C) of the Act or in clause (1) or (2) of §23.401(c) of this chapter) that owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. 796(19)), and (B) a "utility operations-related swap" shall mean any swap that a utility special entity enters into "to hedge or mitigate commercial risks" (as such phrase is used in Section 2(h)(7)(A)(ii) of the Act) intrinsically related to the electric or natural gas facilities that the utility special entity owns or operates or its electric or natural gas operations (or anticipated facilities or operations), or to the utility special entity's supply of natural gas and/or electric energy to other utility special entities or to its public service obligations (or anticipated public service obligations) to deliver electric energy or natural gas service to utility customers. For the avoidance of doubt, "intrinsically related" shall include all transactions related to (i) the generation or production, purchase or sale, and transmission or transportation of electric energy or natural gas, or the supply of natural gas and/or electric energy to other utility special entities, or delivery of electric energy or natural gas service to utility customers, (ii) all fuel supply for the utility special entity's electric facilities or operations, (iii) compliance with electric system reliability obligations applicable to the utility special entity, its electric facilities or operations, (iv) compliance with energy, energy efficiency, conservation or renewable energy or environmental statutes, regulations or government orders applicable to the utility special entity, its facilities or operations, or (v) any other electric or natural gas utility operations-related swap to which the utility special entity is a party. Utility operations-related swaps shall ***not*** *include a swap based or derived on, or referencing, commodities in the interest rates, credit, equity or currency asset classes, or 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*. For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

II. THE PETITIONERS

APPA is the national association that represents the interests of approximately 2000 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. Government-owned electric utilities provide over 15% of all KWh sales to retail electric customers.

LPPC is an organization representing 26 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% of the transmission investment owned by non-Federal government-owned electric utilities in the United States.

TAPS is an association of transmission dependent electric utilities located in more than 30 states. All of TAPS member electric utilities except one are government-owned electric utilities.

APGA is the national association that represents government-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Government-owned natural gas distribution systems are not-for-profit entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other government agencies that have natural gas distribution facilities.

Some government-owned utilities are both electric utilities and natural gas distribution utilities, and are therefore members of both APPA and APGA. The purpose of a government-owned electric utility or natural gas distribution system is to provide reliable, safe and affordable electric energy and/or natural gas service to the community it serves.

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 over one-third of the electricity used in the Pacific Northwest. BPA also owns and operates approximately 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."[11] BPA also funds one of the largest wildlife protection and restoration programs in the world.

III. NATURE OF THE PETITIONERS' INTEREST

APPA, LPPC, TAPS and APGA represent thousands of government-owned electric and natural gas utilities throughout the United States, all of which are "special entities" as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, and §23.401(c) of the Commission's regulations. BPA and the other Federal power agencies are "special entities" as well.[12] The Petitioners

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[11] BPA has 130 preference customers made up of electric utilities which are not subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"), including Indian tribes, electric cooperatives, state and municipally chartered electric utilities, and other Federal agencies located in the Pacific Northwest.

[12] According to the Energy Information Administration, there are nine Federal electric utilities in the United States, which are part of several agencies of the United States Government (see, http://www.eia.gov/cneaf/electricity/page/prim2/toc2.html): 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

respectfully seek the rule amendment for the benefit of all "Utility Special Entities" that currently, or may in the future, enter into Utility Operations-Related Swaps with counterparties that are not registered with the Commission as "swap dealers."

"Utility Special Entities," as defined in the proposed rule amendment, are a narrow category of special entities distinguishable by their electric energy and/or natural gas utility facilities, operations and public service obligations. None of the Utility Special Entities is a "financial entity;" all are nonfinancial entities and "commercial end users" as such term is used by Congress and regulatory policy makers. "Utility Operations-Related Swaps," as defined in the proposed rule amendment, are a narrow category of "swaps"[13] in the nonfinancial or "other commodity" asset class. Such swaps are, by definition, of product types intrinsically related to the commercial risks associated with utility facilities, operations and public service obligations, and are used to hedge or mitigate such commercial risks. Such customized nonfinancial commodity swaps are typically not available on exchanges or electronic trading platforms, due to the myriad non-numeric operational conditions, requirements and permutations embedded in such swaps.

The Petitioners commented on the Commission's proposed rules further defining "swap dealer" raising concerns that **both** the general *de minimis* threshold and the "special entity sub-threshold" needed to be raised significantly. *See* comments filed by NFP Electric End User Coalition, including APPA and LPPC with assistance from TAPS, in the Commission's "Entity Definitions" docket, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27917&SearchText=

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; the U.S. Army Corps of Engineers; and the U.S. Bureau of Reclamation.

[13] This term has not yet been defined by the Commission to the extent required to provide regulatory clarity to Petitioners and others in the utility industry. The Petitioners and others in the utility industry await publication in the Federal Register of rules further defining "swap," along with the Commission's response to public comments on any further questions asked by the Commission in the most recent statutory interpretations relevant to the definition of "swap," the Commission's response to comments solicited on the nonfinancial commodity "trade option" Interim Final Rule, the CFTC/FERC jurisdictional Memoranda of Understanding called for by Section 720 of the Dodd-Frank Act, the "tariffed transaction exemption(s)" and "between FPA 201(f) transaction exemption" called for in new CEA Sections 4(c)(6), and other final rules, interpretations and exemptions. *See* the comment letter filed by the Electric Trade Associations in the "Product Definitions" or "Definition of 'Swap'" docket at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47934&SearchText=Wasson, and other comment letters, applications and petitions filed by the Petitioners and others in the utility industry.

There is no need to wait to consider the proposed rule amendment for the effective date of the Commission's final rules further defining the term "swap." The proposed rule amendment, as drafted, will only be applicable to those utility operations-related transactions which are ultimately subject to the Commission's jurisdiction as "swaps," and would therefore be considered part of an entity's "swap dealing activity," and counted against either the general *de minimis* threshold or the special entity sub-threshold. In this manner, the proposed rule amendment is similar to all the Commission's regulations that include the term "swap," including the Entity Definition rules themselves. None of these regulations can be fully understood or applied to Petitioners' and other market participants' businesses until the Commission's final rules further defining "swap" and other foundational terms that include the term "swap" are effective for relevant asset classes and product types.

rural at 18-19, supporting the comments filed by the Edison Electric Institute and the Electric Power Supply Association in the same docket requesting significantly higher thresholds for ***both*** the general *de minimis* threshold and the special entity sub-threshold than were proposed by the Commission, a link to which appears at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27918&SearchText=

The Commission acknowledges the Petitioners' comments in numerous places in the Adopting Release for the Entity Definitions rules (the "Adopting Release"). *See*, for example, 77 Fed. Reg. 30627 and 30707. In the final rules, however, the Commission raised the general *de minimis* threshold by a factor of 80 during the phase in period (and by a factor of 30 thereafter) - from $100 million to $8 billion during the phase in period (and $3 billion thereafter). In contrast, the Commission left the special entity sub-threshold unchanged at $25 million. The Petitioners' concern about the competitive disadvantage represented by the discrepancy between the two thresholds in the final rules is the reason for this Petition.

A. Utility Special Entities Require Customized Utility Operations-Related Swaps.

Utility Special Entities depend on nonfinancial commodity transactions, trade options and "swaps," as well as the futures markets, to hedge commercial risks that arise from their utility facilities, operations and public service obligations. Together, these nonfinancial commodity markets play a central role in government-owned utilities securing electric energy, fuel for generation and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many government-owned utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially–settled nonfinancial commodity swaps with customized terms to hedge the unique operational risks to which each Utility Special Entity is subject.

The Utility Special Entities use Utility Operations-Related Swaps to ensure reliability of utility service and to reduce utility customers' exposure to future commodity price fluctuations and to stabilize utility rates. In hedging, mitigating or managing the commercial risks of its utility facilities operations or public service obligations, the Utility Special Entity are engaged in commercial risk management activities that are no different from the operations-related hedging of an investor-owned utility or an electric cooperative located in the same geographic region.

B. The "Market" for Each Particular Utility Operations-Related Swap is Illiquid.

Utility Special Entities enter into these bilateral customized swaps in illiquid regional or local "markets."[14] Some counterparties available to transact with Utility Special Entities

[14] The word "markets" is used in quotations in this context, as Utility Operations-Related Swaps do not occur with anywhere near the frequency or uniformity that financial "swaps" occur, or that agricultural, metals, global oil or other product types of "swaps" in the "other commodity" asset class occur. Utility

will be major financial institutions or other financial entities, such as hedge funds, that may or may not transact in other swap asset classes or product types. Other available counterparties will be nonfinancial counterparties, those which are not "financial entities" as such term is defined in CEA Section 2(h)(7)(C).

Each Utility Special Entity actively seeks out available swap counterparties in order to hedge its unique, ongoing and dynamically-changing commercial risks.[15] Commercial risk management policies in the energy industry typically require diversification of suppliers and swap counterparties, limited concentration of supplier/vendor/counterparty credit risk, and other commercial risk management metrics to prudently manage the commercial risks of bilateral contracting processes.

Each regional geographic market has a somewhat different group of financial entity and nonfinancial counterparties available to enter into customized Utility Operations-Related Swaps. An available counterparty may own or operate commercial businesses related to the particular nonfinancial commodity that underlies the Utility Operations-Related Swap. It may be a neighboring utility or electric cooperative, the owner of a merchant electric generation facility located in the area, or a natural gas or coal company with production assets in the region.

For example, a large natural gas utility or the owner of a large merchant electric generation station in western Alabama might be available as a nonfinancial counterparty for swaps referencing an Alabama delivery point. But that same entity would not necessarily offer the type of customized Utility Operations-Related Swap required by a Utility Special Entity located in Oregon. Or, a natural gas producer or coal producer with production assets in Wyoming might offer Utility Operations-Related Swaps required by a California-based or Oregon-based Utility Special Entity. But the same counterparty would not necessarily enter into a similar Utility Operations-Related Swap referencing a nonfinancial commodity delivered in the Southeast. Nor would it necessarily offer a Utility Operations-Related Swap referencing electric energy in any regional market.

C. Utility Special Entities Need All Available Utility Operations-Related Swap Counterparties.

Operations-Related Swaps are, in some cases, negotiated over a period of days, weeks or months. Some may be documented based on a master agreement template, with many pages of specialized operational, credit and other risk management provisions included by the bilateral counterparties as schedules. Transacting under standardized master agreement templates (with bilaterally negotiated schedules and transaction documents) should not be confused with a conclusion or an assumption that there is a trading "market" for Utility Operations-Related Swaps having, standardized or "market" terms.

[15] Utility Special Entities may also be called upon from time to time by other utilities located in the same geographic region, by or in coordination with electric reliability organizations, to act as counterparties in Utility Operations-Related Swaps for electric system reliability purposes. Such swaps should not be considered "swap dealing activity" by the utility counterparty or counterparties to such swaps. Otherwise, the Utility Special Entities may not be able to participate in such swaps for reliability purposes without causing the counterparty to exceed the Special Entity Sub-Threshold, which may compromise the reliability of the interconnected electric system.

Due to the limited number of counterparties for any particular Utility Operations-Related Swap in any particular region, each available financial or nonfinancial swap counterparty, whether or not a registered "swap dealer," brings important market liquidity or supplier/counterparty diversity for a Utility Special Entity. Multiple available counterparties create price competition for the customized swaps that a Utility Special Entity requires to cost-effectively hedge or mitigate unique commercial risks.[16]

Based on an informal survey of some of the larger Utility Special Entities, a substantial percentage of the counterparties that are currently available to enter into Utility Operations-Related Swaps with such Utility Special Entities are nonfinancial entities engaged in the electric, natural gas, coal or another aspect of the energy industry in the same geographic area as the specific Utility Special Entity.

Wall Street financial institutions and other financial entities tend to offer such swaps only where there is standardization of transaction terms and liquid trading markets: at trading hubs where the financial entity's swaps can be promptly and effectively hedged to maintain a "balanced book." Nonfinancial entities with assets or operations located in the geographic region may, as a result, face parallel commercial risks and can use the Utility Operations-Related Swap to manage some portion or aspect of the commercial risks inherent in its own physical assets, liabilities and commercial obligations.[17]

Because the Utility Special Entity is hedging a commercial risk, its focus is to align the Utility Operations-Related Swap as closely as possible with the underlying and unique commercial risk being hedged, rather than to settle for a more standardized, shorter-term, and therefore less "perfect" (and consequently less cost-effective) hedge for such commercial risk.[18]

D. Utility Operations-Related Swaps Often Have Large Notional Amounts.

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[16] In the Adopting Release, the Commission cites comments made by Petitioners' representatives and other energy industry market participants at the Commission Roundtable and meetings on these important points. See 77 Fed. Reg. at 30707-30708. Although a Utility Special Entity may be able to seek out a CFTC-registered Wall Street "swap dealer" or another financial entity, such as a hedge fund, to provide such a customized Utility Operations-Related Swap, if the "swap dealer" does not have assets in the region or is not otherwise active in the particular regional nonfinancial commodity swap market, the pricing and customization of the Utility Operations-Related Swap it offers are unlikely to be competitive.

[17] The nonfinancial counterparty may itself be entering into a Utility Operations-Related Swap "for the purpose of hedging physical positions," as that phrase appears in CFTC Regulation 1.3(ggg)(6)(iii) and about which the Commission is seeking further comment in the Adopting Release. That regulation is identified as an "interim final rule," and therefore presumably is still subject to further Commission rulemaking before the rules defining "swap dealer" are, indeed, final. See 77 Fed Reg. 30612. See also footnote 6 with reference to the Commission's anticipated further rulemakings on the definition of "swap" and nonfinancial commodity "trade options."

[18] We have discussed the Special Entity Sub-Threshold issue with energy trade associations and with large nonfinancial entities that currently act as regular counterparties to Utility Special Entities in these types of swaps. A number of these entities have indicated to Petitioners that they share our concern about the sub-threshold, and that they are prepared to file comments in support of this Petition. See footnote 16.

Many Utility Operations-Related Swaps have longer terms than may be typical in other swap asset classes or product types, as a result of the long-term commercial risks being hedged – risks arising from long-term utility service obligations, construction projects, generation outage or availability projections, or long term fuel needs. Consequently, the notional amount of such swaps can be quite large. In addition, due to the volatile nature of the market prices of these nonfinancial commodities, the notional amounts can fluctuate dramatically over the term of a Utility Operations-Related Swap. The prices of electric energy, fuel and natural gas are among the most volatile of traded commodities, especially prices for illiquid delivery points, subject to regional supply and demand factors such as weather, and with customized operational conditions and terms.

A single one-year 100 MW swap or a single three-year 10,000 mmBtu/day swap may have a notional value of $25 million.[19] A nonfinancial entity would, therefore, be available to enter into only one such swap with Utility Special Entity counterparties in any rolling twelve-month period. Otherwise, the nonfinancial entity risks exceeding the special entity sub-threshold, and would be required to register with the Commission as a "swap dealer."

E. Utility Special Entities are At a Competitive Disadvantage to Similarly-Situated Market Participants due to the Special Entity Sub-Threshold.

If the Commission denies the proposed rule amendment, Utility Special Entities could still look to CFTC-registered swap dealers for these types of swaps, or could use less customized, more expensive commercial risk management solutions that might be available on an exchange. Or Utility Special Entities could simply forego using nonfinancial commodity swaps for commercial risk management purposes entirely. At the same time, the available counterparties for Utility Operations-Related Swaps could enter into up to $8 Billion notional in swaps, or even $8 Billion in Utility Operations-Related Swaps, with counterparties ***other than*** Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. As a direct result of the Special Entity Sub-Threshold, Utility Special Entities are denied a level playing field in the competition for available counterparties for these commercial risk hedging swaps. Utility Special Entities are denied comparable, cost-effective access to such commercial risk management tools that will instead be offered to neighboring investor-owned utilities and electric cooperatives by otherwise available market participants.[20]

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[19] These examples are based on available quotes for 100 MWs of 7x24 electric energy for calendar year 2013 at Mid-C, PJM West and SP-15 for "Firm LD" power, and on Henry Hub calendar strip prices for natural gas. Each of these examples is for a relatively liquid delivery point, and for swaps that are not customized as are many Utility Operations-Related Swaps. To put these examples (and the $25 million Sub-Threshold) in context, the Los Angeles Department of Water and Power owns or operates 6000 MWs of electric generation, and the New York Power Authority owns or operates 7400 MWs of electric generation. JEA, formerly the Jacksonville Electric Authority, hedges approximately 13.8 million mmBtus of natural gas in an average year as part of its fuel procurement process for electric operations, based on the past 5 years actual hedging activity. If each of these Utility Special Entities was limited to one $25 million hedge per year with each non-"swap dealer" counterparty, it would dramatically limit the ability of these Utility Special Entities to hedge or mitigate commercial risks arising from everyday utility operations.

[20] An unintended consequence of the $25 million Special Entity Sub-Threshold applied to Utility Operations-Related Swaps will be to limit the Utility Special Entities' available counterparties and force

In today's regional markets, a Utility Special Entity is equally as likely as an investor-owned utility in the same region to be an attractive counterparty for an entity that chooses to "deal" in Utility Operations-Related Swaps, whether the entity is a nonfinancial company hedging its own commercial risks (or "hedging a physical position" as such phrase is more narrowly defined in the CFTC's definition of "swap dealer"), trading for profit (speculating), or engaging in a regular business of dealing in such swaps. The "playing field" between the Utility Special Entity and the investor-owned utility, electric cooperative or any other counterparty is currently "level."

Moreover, in today's regional markets, if a market participant (such as the Alabama merchant generator or the Wyoming natural gas or coal producer referenced above) is considering establishing a new entrant "swap dealing" business in specific regional product types of Utility Operations-Related Swaps, it will similarly consider the Utility Special Entity as a potential counterparty with the same ability to transact as any other potential counterparty. The Utility Special Entity benefits from any new or additional price competition.

Once the CFTC's Entity Definition rules are effective, as a result of the significant disparity between the general *de minimis* threshold and the special entity sub-threshold, the Alabama-based merchant generator or the Wyoming-based natural gas or coal producer, or any other market participant not intending to register as a "swap dealer," will substantially limit its swap dealing activity in Utility Operations-Related Swaps with Utility Special Entities. Indeed, in regions like California and the Southeast United States, where there are geographic concentrations of Utility Special Entities, a non-"swap dealer" counterparty may only be able to execute one such Utility Operations-Related Swap with one such Utility Special entity in a 12-month period without the risk of exceeding the $25 million sub-threshold. The entity will set up its swap dealing activity business, its business processes, its documentation and its compliance programs to transact with counterparties ***other than*** the Utility Special Entities, including neighboring investor-owned utilities and electric cooperatives. [21] The unworkably low, and comparatively disadvantageous, Special Entity Sub-Threshold

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Utility Special Entities to engage in Utility Operations-Related Swaps with financial institutions and other entities that are registered with the CFTC. This would concentrate, not disperse, risk to the United States financial system. For financial institutions, such activity may or may not be an activity in which such financial institutions or their "banking entity" affiliates are permitted to engage once the regulations implementing the Volcker Rule and other provisions of the Dodd-Frank Act rulemakings are finalized. Such Utility Operations-Related Swaps with "swap dealer" counterparties may also require the posting of margin by Utility Special Entities (depending on the applicable regulators' final rules on capital and margin).

[21] The Adopting Release notes that the statute's *de minimis* exception intended to increase competition within markets for swaps by encouraging new entrants, thereby decreasing costs for commercial end users and decreasing systemic risks by lessening concentration of dealing activity among a few major financial market participants. See 77 Fed. Reg. 30629. Ironically the special entity sub-threshold acts directly contrary to this stated statutory and regulatory objective. For Utility Special Entities hedging commercial risks, the sub-threshold will serve to discourage new entrants and concentrate the Utility Special Entity's counterparty credit risk. The proposed rule amendment would restore this competitive, and less risky, market structure.

threatens the Utility Special Entities' uninterrupted access to these important and cost-effective commercial risk management tools.

IV. SUPPORTING ARGUMENTS

For the following reasons, the Commission should approve the proposed rule amendment as soon as possible:

A. The Commission has the Authority to Approve the Rule Amendment.

Section 1a(49)(D) of the Commodity Exchange Act ("CEA") as amended by the Dodd-Frank Act, and new CFTC Regulation 1.3(ggg)(4)(v) authorize the Commission to change or modify the requirements of the *de minimis* exception to the "swap dealer" definition by rule or regulation, without engaging in further joint rulemaking or joint interpretative guidance with the Securities and Exchange Commission. The Adopting Release acknowledges this. See footnote 464 at 77 Fed. Reg. 30634, and related text.

Section 1a(49)(D) provides as follows:

...(D) *DE MINIMIS* EXCEPTION – The Commission shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to making of this determination to exempt."

As the Commission notes on page 30702 of the Adopting Release, "... CEA Section 1a(49)(D) directs the CFTC to promulgate regulations to establish factors with respect to the making of the determination to apply the *de minimis* exceptions to the definition of the term "swap dealer."

New CFTC Regulation 1.3(ggg)(4)(v) provides as follows:

"...(v) Future adjustments to scope of the de minimum exception. The Commission may by rule or regulation change the requirements of the *de minimis* exception described in paragraphs (ggg)(4)(i) through (iv) of this section.

Clearly the Commission has the authority to approve the proposed rule amendment.

B. The Factors Set Forth the Proposed Rule Amendment are Distinctly and Uniquely Applicable to Utility Operations-Related Swaps and to Utility Special Entities.

The proposed rule amendment will have no affect on the *de minimis* exception to the "security-based swap dealer" definition. Nor will the proposed rule amendment have any affect on the *de minimis* exception to the Commission's "swap dealer" definition as it applies in general to special entities (including Utility Special Entities) engaging in

financial swaps or nonfinancial" other commodity" swaps, other than those product types critical to hedging or mitigating commercial risks in the utility industry.

The factors set forth in the proposed rule amendment are not applicable to security-based swap dealers or to their counterparties. Counterparties to security-based swaps do not need such security-based swaps to "hedge or mitigate commercial risks", as is the case with commercial end users' need for nonfinancial commodity swaps to hedge or mitigate commercial risks. Congress specifically recognized the importance of protecting "commercial end users" access to nonfinancial commodity swaps when it emphasized that the Dodd-Frank Act's focus on financial market stability and price and market transparency should not be achieved without also preserving commercial end users' access to swaps used to hedge or mitigate commercial risks.[22]

The factors that argue in favor of the Commission approving the proposed rule amendment are also inapplicable to entities involved in agricultural or metal commodities transactions and swaps. Such entities are simply not subject to public service obligation comparable to those that apply to utilities that require Utility Operations-Related Swaps to hedge commercial risks associated with utility facilities, operations and public service obligations. Utilities (including Utility Special Entities) have public service obligations under Federal, state and local laws and regulations, and utility reliability obligations, that other industries simply do not share. Congress recognized these important obligations throughout the Dodd-Frank Act as deserving of the Commission's regulatory deference. See Section 720 of the Dodd-Frank Act calling for FERC/CFTC memoranda of understanding, new CEA Section 2(a)(1)(I) regarding jurisdiction of the various energy regulatory agencies, and new CEA Section 4(c)(6) directing the Commission to consider public interest waivers of its jurisdiction.

The Commission clearly has the authority to approve the proposed rule amendment. The factors that argue in favor of the proposed rule amendment, and limit its affect, reflect the unique and the different characteristics of these types of "swaps" and these market participants, and recognize the differing applicable laws and regulations, and statutory and regulatory policies The Commission should approve the proposed rule amendment and do so as soon as possible.

C. Nothing in the Dodd-Frank Act or the CEA Requires the Special Entity Sub-Threshold.

The proposed rule amendment is narrowly tailored to achieve both the statutory goals and Congressional intent underlying the Dodd-Frank Act, and to leave in place the supplemental investor protection objectives of the Commission in including the Special Entity Sub-Threshold in the "swap dealer" definition.

In the Dodd-Frank Act, Congress imposed on registered "swap dealers" heightened business conduct standards when advising, offering or entering into swaps with "special entities." Nothing in the Dodd-Frank Act imposes or requires the Commission to impose

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[22] *See* 156 Cong Rec. H5238 (the "Dodd-Lincoln letter").

business conduct standards on entities that are not required to register as "swap dealers." Nothing in the Dodd-Frank Act requires the Commission to impose an exponentially smaller *de minimis* sub-threshold for counterparties that are not registered "swap dealers" and that enter into swaps to which "special entities" are counterparties. The Adopting Release acknowledges as much, characterizing the lower threshold as "*consistent with* the fact that Title VII's requirements applicable to swap dealers . . . provide heightened protection to these types of entities." 77 Fed. Reg. at 30630 (*emphasis added*).

The Adopting Release cites the Dodd-Frank Act provisions that impose on *registered* swap dealers and major swap participants (those market professionals whose activities are directly regulated by the Commission) heightened business conduct standards and documentation requirements for interacting with "special entities." The Adopting Release then extrapolates without explanation as to why it is consistent for the Commission to extend its regulatory reach beyond the market professionals registered as "swap dealers," whose conduct the statute intends it to regulate, to impose restrictions on the activities of entities that are not swap dealers, and whose *de minimis* "swap dealing activities" do not require such registration. The Special Entity Sub-Threshold is a clear regulatory overreach by the Commission, and should be modified where such regulatory overreach negatively affects the ability of yet another group of entities that are not "swap dealing" – the "Utility Special Entities" – to hedge or mitigate the commercial risks of their nonfinancial, public service enterprises.

The Adopting Release gives examples of situations where the special entity "lacked the requisite sophistication and experience to independently evaluate *the risks of the investment* and exposed the [special entity] to a heightened risk of catastrophic loss ultimately led to a complete loss of their investments." See footnote 425 and text accompanying at 77 Fed. Reg. 30630 (*emphasis added).* In the examples, the special entities were acting outside the scope of their core operations as investors in financial derivatives, interacting with financial institution or "financial entity" market professionals, using cash reserves or other cash assets of the special entity to invest (for profit or loss) in financial derivatives instruments. By contrast, the Utility Special Entities use Utility Operations-Related Swaps to hedge the commercial risks of their core utility operations, not to invest for profit.

D. The Proposed Rule Amendment is Consistent with Both Congressional Intent of the Dodd-Frank Act and Will have No Affect on the Commission's Investor Protection Policy Objectives.

The investor protection objectives of the Dodd-Frank Act, and the Commission's own "consistent" and supplemental investor protection objectives as expressed in the Adopting Release, would not be affected or compromised by the proposed rule amendment. As is clear from the proposed definition of "Utility Operations-Related Swap," the Utility Special Entity enters into such a nonfinancial commodity swap to hedge commercial risks that arise from its utility facilities, operations and public service obligations.

The proposed rule amendment is drafted narrowly to respect the Commission's investor protection policies but to achieve the distinct, but equally important, Congressional intent of the Dodd-Frank Act: to preserve cost-effective (and comparative, competitively equal) access to nonfinancial commodity swaps that Utility Special Entities use "to hedge or mitigate commercial risks."

The proposed rule amendment does not amend either the general *de minimis* threshold for swap dealing activity. The general *de minimis* threshold would continue to apply to Utility Operations-Related Swaps to which Utility Special Entities are counterparties. Nor does the proposed rule amendment change the "special entity sub-threshold" for swaps in asset classes or product types other than Utility Operations-Related Swaps to which Utility Special Entities are counterparties.

In defining the term "Special Entity" in Section 4s(h)(2)(C) of the Dodd-Frank Act and establishing the heightened business conduct standards for registered "swap dealers," Congress did not intend for the Commission expand its regulatory oversight beyond oversight of regulated "swap dealers" to place restrictions on entities that are not required to register as "swap dealers." In establishing the Special Entity Sub-Threshold and then not substantially raising it when it raised the general de minimis threshold, Ihte Commission restricted Utility Special Entities' competitive abilities, and severely restricted Utility Special Entities' access to the nonfinancial commodity swaps needed to cost-effectively hedge or mitigate commercial risks.

V. PROCESS AND TIMELINE FOR PETITION

The Petitioners respectfully request the Commission to act as soon as possible on the proposed rule amendment -- to remove continuing regulatory uncertainty for the Utility Special Entities and counterparties that would, but for the Special Entity Sub-Threshold, be available to enter into Utility Operations-Related Transactions with Utility Special Entities. As the Commission's new "swap" regulations are proposed, become final and implementation begins, market participants are evaluating whether and how to participate in the new market structure for "swaps." At the same time, Utility Special Entities have continuing utility public service obligations to provide affordable, reliable utility service to their customers, and consequently have both short-term and long-term commercial risks to hedge.

As the effective dates and compliance dates approach for the new "swap" regulatory regime, market participants are beginning to turn their attention away from current activities in nonfinancial commodities and commodity swaps in general. The challenges of the new regulatory requirements applicable to "swaps," including challenges for systems, staffing, compliance, documentation and reporting are overwhelming, even for

the largest financial institutions and financial markets professionals, especially given the tight and interrelated compliance timelines.

The added challenge of determining whether to register as a "swap dealer" for one or more asset classes or product types of "swaps" are even more daunting for a nonfinancial entity, whose primary and ongoing business is not trading or investing or dealing in the financial markets, but drilling for natural gas, mining coal, or generating, transmitting and/or delivering electric energy or natural gas to consumers.[23]

If a market participant decides to continue some amount of "swap dealing activity" in Utility Operations-Related Swaps, it will carefully evaluate and then establish compliance procedures to monitor the two *de minimis* thesholds. In doing so, it will certainly hesitate or delay incurring the expense of setting up specially calibrated systems, compliance processes and staff training in order to engage in one or two such swaps with Utility Special Entities within a 12-month period. A nonfinancial counterparty that does not choose to register as a "swap dealer" will instead understandably focus on modifying its business processes and documents to engage in swaps with counterparties other than Utility Special Entities, under the general *de minimis* exception threshold.

We request that the Commission promptly publish the proposed rule amendment for comment in the Federal Register, without waiting for the effective date of the Entity Definitions rules. We recommend a public comment period of no longer than 20 days, and respectfully request publication of the Commission's final approval or grounds for

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[23] A number of the nonfinancial entities with whom the Petitioners (or the trade association Petitioners' members) transact in Utility Operations-Related Swaps have told us that they are currently evaluating their nonfinancial commodity "swap" activities in light of the final Entity Definitions rules, the Interim Final Rule in Section 1.3(ggg)(6)(iii), and the statutory guidance provided in the Adopting Release and elsewhere in the CFTC's regulations, interpretations and precedents. Such nonfinancial entities are also awaiting the CFTC's final rules defining the term "swap," which is the foundational rulemaking which will enable the energy industry to understand the scope of the CFTC's jurisdiction over our industry's transactions. As of July 10, 2012, for the electric and natural gas utility industry, the challenges are compounded by the continuing uncertainty as to what is and isn't a "swap," a "nonfinancial commodity forward" transaction, a nonfinancial commodity forward with embedded optionality, or a "trade option." See footnote 6 above. Once the rules defining "swap" are final with respect to our industry's transactions, each nonfinancial entity will then (and can only then) analyze which of its activities will fall within the definition of "swap," and therefore would or could be "swap dealing," which of its activities will be excluded as "hedging a physical position" (depending on the outcome of that final rulemaking), or fit within other safe harbors under the interpretive guidance provided by the Commission. Then and only then can the nonfinancial entity decide, as a business matter, whether to continue all or any of its swap dealing activities, and whether to register as a "swap dealer" or to register for a limited designation as a "swap dealer" for certain asset classes and product types (that may or may not include particular Utility Operations-Related Swaps). Alternatively, only then can such a nonfinancial entity alternatively decide to wind down any swap activities which the Commission might consider to be "swap dealing activities." Nothing requires a nonfinancial entity (whose primary business is not to engage in financial markets transactions like "swaps") to continue its past or current business strategies. If a particular nonfinancial entity decides to continue some level of swap dealing activity, it may decide not to continue such activity as a registered "swap dealer." At last decision point, once the new Dodd-Frank Act rules are effective and as compliance dates approach, these entities will restrict their swap dealing activity to stay well below the two very different *de minimis* exception thresholds in the CFTC's swap dealer definition.

denying the rule amendment within 10 days thereafter.[24] The Petitioners request that the amended rule be retroactive and prospective for all Utility Operations-Related Swaps to which a Utility Special Entity is a counterparty entered into after the effective date of the Entity Definition rules.

VI. CONCLUSION

The Petitioners respectfully petition the Commission under CFTC Regulation 13.2 to amend CFTC Regulation 1(ggg)(4), which implements the *de minimis* exception to the definition of "swap dealer," as described above.

[24] The proposed rule amendment relieves a competitive restriction on Utility Special Entities, and modifies the special entity sub-threshold to the *de minimis* exception to the definition of "swap dealer." The Commission and interested persons in the electric and natural gas industry have been on notice of the Utility Special Entities' concerns since early May 2012. As a result, the proposed rule amendment is entitled to the earlier effective date permitted by CFTC Regulation 13.6.

SIGNATURE PAGE – SPECIAL ENTITY SUB-THRESHOLD PETITION

Please contact any of the individuals below or Patricia Dondanville, Reed Smith LLP, 10 South Wacker Drive, 40th Floor, Chicago Illinois 60606, telephone (312) 207-3911, or e-mail pdondanville@reedsmith.com, if you have questions regarding this Petition.

Respectfully submitted,

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EXECUTIVE PROFILE

Senior executive with extensive experience in private and public, for-profit and not-for-profit enterprises, currently serving as CFO of the country's seventh largest public utility. Career profile includes diversified C-level and General Manager experience in leading multi-national and multi-location, customer service oriented businesses. Proven track record of successful executive leadership in start-up and turnaround situations, as well as refocusing mature organizations to achieve higher growth rates, better customer satisfaction ratings, and increased financial returns. Demonstrated expertise includes strong, balanced leadership, as well as developing and implementing organization-wide strategic initiatives.
Exceptional strengths include:

- Strategic Planning
- Market Positioning and Pricing
- Relationship Management
- Customer Service
- Executive Team Leadership
- Human Resource Planning
- Communication Skills
- Cultural Competency
- Financial Management
- Investor Relations
- Risk Management
- Change Management

SELECTED ACCOMPLISHMENTS

Executive leadership role in rebalancing JEA business strategies and priorities, resulting in fundamentally stronger policies and practices in risk management, finance, rates, power generation planning, water resource planning, and capital investment.

Led the development and implementation of a best practice, enterprise risk management program. This program is the primary framework for managing and anticipating risks, and serves as the corporate incubator for most strategic initiatives.

Led strategic alliances and partnerships, executing agreements in nuclear, biomass and solar power generation, while managing inter-local government utility agreements.

Developed and executed strategy for JEA's $6.0 billion municipal debt portfolio, including maintaining a unique position in variable rate debt that accrues annual hard dollar savings of more than $25 million.

Restructured Bombardier's mature inventory finance business into a more competitive, market-focused, customer satisfaction oriented organization. This included changing marketing strategy and pricing, improving customer satisfaction, and applying technology to lower operating costs. Portfolio increased from $700 million to $1.4 billion, operating expenses were reduced from 4% to 2.5% of average assets, and return on equity increased from 18% to 30%.

Led the design and implementation of an e-commerce and marketing strategy, which included on-line application, approval and document delivery.

Grew the market share of Pitney Bowes' North American captive lease subsidiary from 48% to 72%. Growth was achieved by transforming the organization's culture to one with a competitive market and customer service focus, applying technology for operational improvement, and leveraging this new platform to develop an open market, competitive business. Reduced delinquency from 12% to 6% while simultaneously reducing writeoffs by 50%.

Testified in Federal court as a leasing expert on behalf of Pitney Bowes in a $400 million class action lawsuit. This testimony resulted in dismissal of the action.

Led, within a major international enterprise, the first divisional adaptation and implementation of Six Sigma methodology.

Crafted the communications strategy for investor and rating agency relationships. Success requires the knowledge and skill to assimilate business strategy and performance into a compelling message, capable of supporting corporate objectives and credit ratings.

Directed the development, acquisition and installation of numerous customer oriented information and operations systems. These included automatic credit approval and credit scoring, predictive dialer, inventory finance, risk management, loan origination, loan servicing, collection management, general ledger, and payroll systems.

Led the development and implementation of a best practice internal audit function.

CURRENT AND PAST FUNCTIONAL COMMITTEE MEMBERSHIPS

Fuels and Purchase Power Committee – Chair of the JEA committee, which facilitates economic decision making regarding fuels and purchase power, including unit commitment, dispatch, fleet operations, fuel procurement, environmental impacts, and finance.

Debt and Investment Management Committee – Committee members meet quarterly to review financial performance and policy compliance, and establish strategies and objectives for the next twelve months.

Human Resource Committee – As a member of the board of directors for a small business, chaired the Human Resources Committee, directing policies and practices for compensation and benefits.

Corporate Compensation Committee – Established and maintained market-based compensation programs tied to business results, which appropriately rewarded and recognized individual performance.

Corporate Credit Committee – Evaluated and approved transactions valued from $5 to $50 million, covering a wide range of collateral, including aircraft and real estate, as well as communication, transportation and industrial production equipment.

Risk Management Committee – Evaluated and approved new lines of business activity, as well as credit lines up to $20 million.

Futures Group – Worked directly with the CEO of Pitney Bowes and subject matter experts from Harvard, MIT, University of Pennsylvania, and the Futures Institute to analyze the potential risks and opportunities that technology and market changes posed for this global corporation. Conclusions and recommendations led to significant changes in supply chain strategy as well as a number of divestitures and acquisitions.

CURRENT AND PAST INDUSTRY BOARD AND COMMITTEE MEMBERSHIPS

The Energy Authority (TEA) – Past board member, current Finance and Audit Committee member. TEA is a $1.5 billion energy trading and risk management company, jointly owned by JEA and six other public power entities, operated for the mutual benefit of its owners and other public power systems.

Large Public Power Council, Tax and Finance Committee – Co-chair of this committee, which is responsible for monitoring, evaluating and formulating positions regarding emerging or proposed federal legislation and rules affecting the industry.

Large Public Power Council, CEO Roundtable – Three times a year, the CEOs from the largest 25 public power systems meet to formulate lobbying strategy and to share current common experiences. Participate as co-chair of the Tax and Finance Committee.

Black & Veatch, Management Consulting Business (MCB), Advisory Board – Black & Veatch's MCB Advisory Board consisted of eight to ten executive-level members from academia, utilities and suppliers, as well as retired management consultants. The Board met semi-annually to review strategy, market and operational plans, and performance, as well as to advise the CEO and senior management.

PROFESSIONAL EXPERIENCE

JEA – Jacksonville, FL **2002 - PRESENT**
Chief Financial Officer

Responsibilities include Corporate Planning, Strategic Alliances and Partnerships, Demand-Side Management, Treasury, Accounting and Financial Reporting, Internal Audit, Enterprise Risk Management, Budgets, Financial Planning and Rates.

Select Accomplishments

- Developed and executed significant changes in strategy, financial and capital planning, and pricing. These changes drove substantial improvement in financial metrics; led to continued availability of low-cost capital and operating funding; provided financial flexibility; and improved credit ratings.
- Led the development and implementation of the premier enterprise risk management and internal audit programs within the public power sector.
- Led the development, design and public hearing process for the following creative rate and pricing structures:
    - Electric System
        - Variable Fuel Rate Policy and Recovery Charge
        - Conservation Charge and Revenue Allocation for Demand-Side Management
        - Environmental Charge
        - Incremental Economic Development Plan
    - Water and Sewer System
        - Base Rate Increase and Rate Structure Changes
        - Environmental Charge
- Leveraged skills, knowledge and experience to design and deliver numerous successful investor and rating agency presentations.
- Led the municipal markets' most significant treasury team in developing and executing strategies, which resulted in hundreds of millions of dollars of debt service savings. Specifically, $98.4 million of debt service savings in the last eighteen months, with an additional $25 million anticipated over the next twelve months.
- During the most challenging economic and capital market environment in the last fifty years, led the strategy development and execution for successfully managing a $2.0 billion variable rate debt program. The ongoing annual debt service savings is approximately $25 million.
- Represented JEA as the official corporate spokesperson and/or presenter to the following entities:
    - Security and Exchange Commission (SEC)
    - U.S. House of Representatives, Staff Briefing
    - Jacksonville City Council and Committees
    - Corporate Spokesman in FPL Litigation
    - American Public Power Association
    - Moody's Investor Services for LPPC
    - Rating Agencies and Investors

BOMBARDIER CAPITAL CORPORATION **1995 -2001**
Vice President and General Manager
Mortgage Finance Division – Jacksonville, FL
Consumer Finance Division – Jacksonville, FL
Inventory Finance Division – Colchester, VT

Responsible for business units' return on equity and functional leadership of strategic planning, risk management, marketing, sales, customer service, finance, technology services and operations for North American and U.S. Divisions. Direct reports included six to eight functional Vice Presidents. Asset levels reached $2.0 billion; 500 employees served over 50,000 customers and 4,000 retailers. Mortgage and Consumer Finance Division were turnaround assignments. Recruited by Bombardier through a national search conducted by Egon Zehnder.

PITNEY BOWES CREDIT CORPORATION **1977 - 1994**
Vice President and Division Manager
Internal Finance Division – Norwalk, CT

Responsible for the Division's return on equity and functional leadership of strategic planning, marketing, sales, customer service, training and operations. This North American Division employed over 300 people, located in three regional and two national business centers, in addition to a headquarters location. The Division managed assets totaling $1.4 billion and served over 335,000 customers. Direct reports included seven regional Vice Presidents and three functional director level positions.

Director of Marketing

Responsible for product and service development and implementation, pricing, market share, sales and customer satisfaction.

Controller

EDUCATION

University of Pennsylvania – Wharton School
Philadelphia, PA
Advanced Management Program

St. Joseph's College
Rensselaer, IN
B.S. Degree in Accounting

OTHER AFFILIATIONS

Leadership Florida – Executive class of 2012

Leadership Jacksonville – Executive class of 2007

Mountain Top Institute, Jacksonville, FL – Past Director

City of Jacksonville's Dialogue on Race Relations – Participant

Jacksonville Community Council Inc. (JCCI) – Member and Participant

First Coast Manufacturers Association – CFO Council Participant

Committee on Agriculture
U.S. House of Representatives
Information Required From Nongovernmental Witnesses

House rules require nongovernmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. Name: Paul E. McElroy

2. Organization you represent: JEA, 21 Church Street, Jacksonville, Florida 32202

3. Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee: Employed as JEA's Chief Financial Officer for the last seven years

4. Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:

5. If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold: Appearing on behalf of the American Public Power Association (APPA)

PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF TESTIMONY.