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In this issue:

CLIENT ALERT: CFTC PROPOSED GUIDANCE THAT CERTAIN COMMERCIAL TRANSACTIONS ARE NOT SWAPS

On April 4, 2016, the Commodity Futures Trading Commission (“CFTC”) issued proposed guidance¹ that may be useful for some of you who enter electric power capacity contracts or gas peaking supply contracts. The proposed guidance would clarify that certain such contracts should not be considered “swaps” because they are examples of “customary commercial arrangements” as described in the rule defining “swap.”² Comments on the proposed guidance are due May 9, 2016.

Background

In 2012, the CFTC identified several types of commercial agreements, contracts, and transactions that involve customary commercial arrangements³ that would not generally be considered swaps.⁴ It also listed factors it would consider in determining whether similar types of agreements, contracts, and transactions should not be considered swaps, including:

- They do not contain payment obligations, whether or not contingent, that are severable from the agreement, contract, or transaction;
- They are not traded on an organized market or over-the-counter; and
- In the case of commercial arrangements, they are entered into:
 - By commercial or non-profit entities as principals (or by their agents) to serve an independent commercial, business, or non-profit purpose, and
 - Other than for speculative, hedging, or investment purposes.

The Proposed Guidance

Based on the comments submitted on electric capacity contracts and gas peaking supply contracts, the CFTC states that it preliminarily believes that such contracts, as described in the Proposed Guidance, meet the factors it listed in 2012, and thus should not be considered swaps. They are “entered into by commercial or non-profit entities to assure availability of a commodity, not to hedge

¹ Certain Natural Gas and Electric Power Contracts, 81 Fed. Reg. 20,583 (Apr. 8, 2016) (“Proposed Guidance”).

² Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,208 (Aug. 13, 2012) (the “Products Release”).

³ Proposed Guidance at 20,586.

⁴ Products Release at 48,246.

against risks arising from a future change in price for the commodity or to serve a speculative or investment purpose.”⁵ They may still be considered forward contracts; the Proposed Guidance would not affect the CFTC’s rules on that score.⁶

The new guidance may have minimal impact for typical public power clients. In many cases, we believe that where clients have determined that such contracts might be considered swaps (usually due to “volumetric optionality” in the delivery term), they are structured as trade options. With the elimination of the Form TO annual reporting obligation for trade options, the classification of these types of contracts thus has less practical consequence for many utilities.

While welcome, the Proposed Guidance does appear somewhat confused about the nature of the transactions to which it claims to apply. For example, the CFTC appears to assume that all LSEs purchase capacity in order to comply with state PUC orders or to meet state- and/or federally-required objectives,⁷ and that all LSEs operate in organized markets.⁸ While we regard this text as illustrative rather than as identifying requirements to qualify for the relief, the examples could be better. Similarly, the discussion of natural gas peaking supply contracts uses as its example a cogen plant buying gas from an LDC, which is not the most representative situation the CFTC could have chosen to illustrate peaking gas contracts for traditional power plants.

Notwithstanding these examples, we are not certain that many clients would find enough value to undertake the cost of commenting. Please contact us if you have specific concerns.

We note that the information contained in this memorandum is highly simplified for general reading and is not intended as legal advice for any specific situation. Please do not hesitate to contact one of the attorneys listed below if you would like advice or additional information.

FOR ADDITIONAL INFORMATION, PLEASE CONTACT THE FOLLOWING SPIEGEL ATTORNEYS:

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⁵ Proposed Guidance at 20,586.

⁶ The CFTC notes that several aspects of its 2012 definition of “swap” and related issuances remain unchanged by this guidance, including “the interpretation of when an agreement, contract, or transaction with embedded volumetric optionality would be considered a forward contract,” including the treatment of demand response programs under that interpretation; its “interpretations regarding full requirements and output contracts,” and the CFTC’s Office of General Counsel’s “Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy.” *Id.* at 20,586 & n.34.

⁷ Proposed Guidance at 20,584.

⁸ *Id.* at 20,584 n.5 (“The CFTC understands that this type of contract enables [an RTO or ISO] to call on resource adequacy capacity to ensure the reliability of electric service to end users or consumers. The LSE . . . , which is required to purchase capacity contracts, cannot itself call on the supplier to deliver electricity—only the RTO or ISO can.”).