

Client Alert

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CFTC Excludes Certain Swaps with Utility Special Entities from the Special Entity De Minimis Calculation for Purposes of Swap Dealer Registration

By Julian Hammar and Michael Sorrell

On September 26, 2014, the Commodity Futures Trading Commission (“CFTC”) published a final rule in the *Federal Register* permitting a person to exclude “utility operations-related swaps” entered into with “utility special entities” in calculating the aggregate gross notional amount of the person’s swaps positions for purposes of the *de minimis* exception from swap dealer registration applicable to swaps with special entities (“Final Rule”).¹ The Final Rule codifies previously granted no-action relief, with certain modifications.

The Final Rule will become effective October 27, 2014, and is available [here](#).

BACKGROUND

CFTC Regulation 1.3(ggg)(4)(i), 17 C.F.R. 1.3(ggg)(4)(i), provides for a *de minimis* exception from swap dealer registration for any person that enters into swaps connected with swap dealing activities, the aggregate gross notional amount of which does not exceed during the preceding 12 months one of two thresholds:

- \$3 billion, subject to an initial phase-in level of \$8 billion (the “General De Minimis Threshold”); and
- \$25 million, with respect to swaps with “special entities,” as defined in section 4s(h)(2)(C) of the Commodity Exchange Act (“CEA”) and CFTC Regulation 23.401(c) (the “Special Entity De Minimis Threshold”).²

The CFTC received a petition requesting that Regulation 1.3(ggg)(4)(i) be amended to exclude from the Special Entity De Minimis Threshold the notional amount of swaps to which “utility special entities” were counterparties and that were related to their utility operations.³ The petition contended that such relief was necessary to increase the number of counterparties available to utility special entities. In response, CFTC staff issued a no-action letter, CFTC Staff Letter No. 12-18,⁴ pursuant to which the notional amounts of utility commodity swaps to

¹ Exclusion of Utility Operations-Related Swaps with Utility Special Entities from De Minimis Threshold for Swaps with Special Entities, 79 Fed. Reg. 57,767 (Sept. 26, 2014).

² Section 4s(h)(2)(C), 7 U.S.C. 6s(h)(2)(C) defines a special entity as: a federal agency; a State, State agency, city, county, municipality, or other political subdivision of a State; any employee benefit plan, as defined in the Employee Retirement Income Security Act of 1976 (“ERISA”); any government plan as defined in ERISA; and any endowment. CFTC Regulation 23.401(c), 17 C.F.R. 23.401(c), adds to the definition “any instrumentality, department, or a corporation of or established by a State or subdivision of a State.”

³ The Petition was filed by the American Public Power Association, the Large Public Power Council, the American Public Gas Association, the Transmission Access Policy Study Group, and the Bonneville Power Administration.

⁴ CFTC Staff Letter No. 12-18 (Oct. 12, 2012).

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which certain utility special entities were counterparties and which were related to their utility operations could be excluded from the Special Entity De Minimis Threshold, subject to certain conditions.

CFTC Staff Letter No. 14-34 subsequently superseded and expanded the original no-action letter, which had required the utility special entity to be using the swap to hedge a physical position in an exempt commodity and that the counterparty not be a financial entity. These conditions were deemed to be too restrictive such that potential counterparties were not entering into relevant swaps with special entities.⁵

Following the issuance of these no-action letters, on June 2, 2014, the CFTC published for comment a proposal to amend CFTC Regulation 1.3(ggg)(4) to permit a person to exclude “utility operations related swaps” with “utility special entities” in calculating the aggregate gross notional amount of the person’s swaps solely for purposes of the Special Entity De Minimis Threshold.⁶

FINAL RULE

Under the Final Rule, a person may exclude “utility operations-related swaps” where the counterparty is a “utility special entity,” solely for purposes of determining whether its swap dealing activity has exceeded the Special Entity De Minimis Threshold. However, such swaps would still have to be counted toward the determination of whether a person has exceeded the higher General De Minimis Threshold.

The Final Rule defines a “utility special entity” as any special entity that:

- Owns or operates electric or natural gas facilities or 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 or natural gas service to utility customers; or
- Is a federal power marketing agency under Section 3 of the Federal Power Act (16 U.S.C. 796(19)).

This definition is the same as proposed and set forth in CFTC Staff Letter No. 14-34.

For purposes of the Final Rule, a “utility operations-related swap” is a swap that meets the following conditions:

- A party to the swap is a utility special entity;
- A utility special entity is using the swap to hedge or mitigate commercial risk as defined in CFTC Regulation 50.50(c), 17 C.F.R. 50.50(c);

⁵ CFTC Staff Letter No. 14-34 (Mar. 21, 2012).

⁶ Exclusion of Utility Operations-Related Swaps with Utility Special Entities from De Minimis Threshold for Swaps with Special Entities, 79 Fed. Reg. 31,238 (June 2, 2014).

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- The swap is related to an exempt commodity (as defined in Section 1a(20) of the CEA) or to an agricultural commodity insofar as such agricultural commodity is used for fuel for generation of electricity or is otherwise used in the normal operation of the utility special entity; and
- The swap is (1) an electric energy or natural gas swap or (2) is associated with:
 - The generation, production, purchase or sale of natural gas or electric energy, the supply of natural gas or electric energy to a utility, or the delivery of natural gas or electric energy service to utility customers;
 - Fuel supply for the facilities or operations of a utility special entity;
 - Compliance with an electric system reliability obligation; or
 - Compliance with an energy, energy efficiency, conservation, or renewable energy or environmental statute, regulation or government order applicable to a utility.

A person seeking to rely on the exclusion in the Final Rule may rely on the written representations of the utility special entity that it is a utility special entity and that the swap is a utility operations-related swap, unless it has information that would cause a reasonable person to question the accuracy of the representation. The Final Rule requires a person relying on such written representations to maintain such representations in accordance with the recordkeeping requirements in CFTC Regulation 1.31, 17 C.F.R. 1.31.

The Final Rule supersedes the relief granted by CFTC Staff Letter No. 14-34, except that parties may continue to rely upon that relief with respect to swaps entered into in reliance on that letter prior to the effective date of the Final Rule.

The Final Rule does not include a requirement that a person relying on the exclusion must not be a financial entity, which was included in CFTC No-Action Letter No. 12-18, but was eliminated by CFTC No-Action Letter No.14-34 and the proposed rule. The CFTC stated that barring financial entities from taking advantage of the exclusion would thwart the purpose of the rulemaking while providing minimal additional regulatory protections.

Unlike under the proposed rule, the Final Rule does not contain a notice filing requirement to rely on the exclusion. However, the CFTC has directed its staff to assess possible amendments to CFTC regulations that would provide the CFTC with information regarding whether counterparties to utility special entities are relying on the exclusion in the Final Rule to avoid swap dealer registration (such as amending the reporting rules to add a data reporting field identifying utility operations-related swaps) and generally how the exclusion is affecting the markets for utility operations-related swaps.

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