



# Michigan Municipal Electric Association

809 Centennial Way • Lansing, Michigan • 48917-9277  
Phone: (517) 323-8346 • Fax (517) 323-8373 • [www.mmeanet.org](http://www.mmeanet.org)

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May 7, 2013

The Honorable Debbie Stabenow, Chair  
Committee on Agr., Nutrition & Forestry  
United States Senate  
328A Russell Senate Office Building  
Washington, DC 20510

The Honorable Thad Cochran, Ranking Member  
Committee on Agriculture, Nutrition & Forestry  
United States Senate  
328A Russell Senate Office Building  
Washington, DC 20510

Dear Chair Stabenow and Ranking Member Cochran:

Thank you for the opportunity to provide comments as the Senate Agriculture Committee begins considering reauthorization of the Commodities Exchange Act.

The Michigan Municipal Electric Association (MMEA) is the trade group for 41 municipally-owned, public power utilities in the state of Michigan. Over the past three years, MMEA has worked closely with the Commodity Futures Trading Commission (CFTC) to inform the new derivatives regime put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). With the rules largely finalized, MMEA has begun compliance efforts.

We write to bring to your attention, and request relief from, an unintended consequence of the Act that hampers our risk management efforts and those of other municipally-owned utilities. Namely, the swap dealer definition finalized by the CFTC last April has substantially hindered government-owned utilities' ability to hedge against operational risks.

## **MMEA Hedges to Mitigate Commercial Risk**

Public power utilities are sophisticated market participants that engage in swaps activity to hedge legitimate commercial risks. Municipal utilities like MMEA 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. Nonfinancial commodity markets play a central role in our ability to secure electric energy, fuel for generation, and natural gas supplies for delivery to consumers at reasonable and stable prices.

In hedging, mitigating or managing operational risks, we 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.

## **Non-financial Firms Are Necessary Counterparties**

Electric energy is unique among commodities because it cannot be stored; it must be used at the time it is produced. Each regional geographic market has a somewhat different set of demands (driven by weather and other factors) and a different group of financial and nonfinancial counterparties available to meet these demands by entering into utility operations-related swaps needed for hedging price and supply risks.

Owners of electrical generation and distribution facilities – whether investor-owned utilities, municipal or cooperative utilities, or merchant generation companies – operate in their geographical proximity. As they balance their generation to meet changing demands on an hour-to-hour basis, their most likely trading counterparties are other regional market participants. These regional market participants, unlike financial entities, have a vested interest in maintaining the reliability of the electric grid and ensuring that sufficient liquidity exists to manage their operations.

Because there are a limited number of counterparties for any particular operations-related swap, having a variety of counterparties brings important market liquidity and diversity.

## **The Special Entity “Sub-Threshold” Threatens to Subject End Users to Increased Regulation**

Dodd-Frank directed the CFTC to require swap dealers and major swap participants to register and meet strict capital, margin, and reporting and recordkeeping requirements, as well as comply with rigorous business conduct and documentation standards. Congress was concerned that there be a distinction between these market-making entities and end-users that use swaps to hedge commercial risk.

To address those concerns, the Dodd-Frank Act included a “*de minimis* exception” to the definition of a swap dealer, to ensure that the definition captured only those entities engaged in a significant amount of dealing activity. In the proposed rule to define these entities, the CFTC set 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, which include government owned utilities.

The Not-For-Profit Electric End User Group (NFP EEU) filed comments recommending that the CFTC substantially increase both thresholds. Nevertheless, the final rule greatly increased the overall *de minimis* threshold from the proposed rule, raising it from \$100 million to \$3 billion, while leaving unchanged the \$25 million sub-threshold for swap-dealing activities with special entities.

As a result, nonfinancial entities (such as natural gas producers, independent generators, and investor-owned utility companies) that do not want to be swap dealers, and would otherwise not be captured by the definition, have decided to stop engaging in transactions with government-owned utilities to avoid exceeding the \$25 million threshold.

## **Efforts to Obtain Regulatory Relief Have Been Exhausted**

On July 12, 2012, 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) filed a petition requesting that the CFTC

amend its swap-dealer rule to exclude utility operations-related swap transactions from counting towards the special entity threshold.

Instead, the CFTC released a “no-action” letter allowing a counterparty to deal in up to \$800 million in swaps with government-owned utilities without being required to register as a swap dealer. The no-action letter, however, also included a number of additional limitations.

The no-action letter has failed to provide nonfinancial counterparties with the assurances they need to enter into swap transactions with municipal utilities. Our traditional counterparties are unwilling to spend the time and money to create a separate compliance process, and adjust their policies and procedures, to facilitate transactions with the small segment of any particular regional market that utility special entities represent.

Several CFTC commissioners have indicated that they believe that relief is appropriate and, absent action by the CFTC, legislation to address this issue directly would be appropriate.

### **The Public Power Risk Management Act is a Targeted, Technical Correction**

On March 11, 2013, Rep. Doug LaMalfa introduced the “*Public Power Risk Management Act of 2013*” (H.R. 1038). The legislation largely mirrors the intent and effect of the NFP EEU petition, providing narrowly targeted relief for operations-related swaps for government-owned utilities. Specifically, the legislation would provide that the CFTC, in making a determination to exempt a swap dealer under the *de minimis* exception, shall treat a utility operations-related swap with a utility special entity the same as a utility operations-related swaps with any entity that is not a special entity.

The legislation carefully defines which entities would qualify as a “utility special entity.” It also specifically defines the types of swaps that could and could not be considered a “utility operations-related swap.” For example, the legislation specifically prohibits interest, credit, equity, and currency swaps from being considered as a utility operations-related swap. Likewise, except in relation to their use as a fuel, commodity swaps in metal, agricultural, crude oil, or gasoline would not qualify either. Finally, the legislation also confirms that utility operations-related swaps are fully subject to swap reporting requirements.

When implemented, this legislation should provide certainty to nonfinancial entities that they can enter into swap transactions with government-owned utilities without fear of being deemed a swap dealer.

We strongly request that you support inclusion of this legislation as part of a CFTC reauthorization.

Regards,

A handwritten signature in blue ink that reads "Jim Weeks". The signature is written in a cursive, flowing style.

Executive Director