



November 20, 2009

The Honorable Christopher J. Dodd
Chairman
Banking, Housing & Urban Affairs Committee
534 Senate Dirksen Office Building
Washington, DC 20510

The Honorable Richard C. Shelby
Ranking Member
Banking, Housing & Urban Affairs Committee
534 Senate Dirksen Office Building
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The Honorable Blanche L. Lincoln
Chairman
Agriculture, Nutrition and Forestry Committee
328-A Senate Russell Office Building
Washington, DC 20510

The Honorable Saxby Chambliss
Ranking Member
Agriculture, Nutrition and Forestry Committee
328-A Senate Russell Office Building
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The Edison Electric Institute (EEI), the Electric Power Supply Association (EPSA), the American Gas Association (AGA) and our undersigned members are writing to express our concern with certain aspects of proposals to address oversight and transparency of over-the-counter (OTC) energy derivatives markets. EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate consumers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. EPSA is the national trade association representing competitive power suppliers, including generators and marketers. The competitive power sector operates a diverse portfolio that represents 40 percent of the installed generating capacity in the United States. EPSA members use a variety of fuels and technologies to generate electricity, including coal, geothermal steam, hydropower, natural gas, nuclear, oil, solar, and wind. AGA represents 202 local energy utility companies that deliver natural gas to more than 65 million homes, small businesses and industries throughout the U.S., serving 170 million American in 50 states.

While we support the goals of the Administration and the Congress to improve transparency and stability in OTC derivatives markets, it is essential that policy makers preserve the ability of companies to access critical OTC energy derivatives products and markets. Our members rely on these products and markets to manage price risk and help keep rates stable and affordable for retail consumers.

When discussing any increased regulation of exchange and OTC derivatives markets, it is important to note that these transactions are not the source of systemic risk in the broader economy. In fact, the entire commodity market is less than 1% of the global OTC derivative market, and the energy commodity portion is yet a fraction of that one percent. Therefore, Congress should maintain an appropriate balance between establishing market oversight rules

that allow for prudent use of market-based risk management tools and providing regulators with the ability to establish a high level of transparency and the tools needed to protect consumers against market manipulation and systemic risk.

Our members believe that effective OTC derivatives reform should:

- **Provide a clear exemption for end-users of OTC derivatives products**, such as electric and gas utilities that use OTC derivatives markets to hedge against commodity price risk for natural gas and wholesale electric power. The hedging transactions of derivatives end-users do not contribute to systemic risk, and, therefore, should be exempted from the definitions of swap dealer and major swap participant.
- **Promote clearing of standardized derivatives between large financial dealers**, where appropriate, through regulated central counterparties to reduce systemic risk and bring additional transparency through information regarding pricing, volume and risk. However, **our members are opposed to mandates that would require all or most OTC derivatives transactions to be centrally cleared or executed on exchanges**. The available evidence shows that clearing would **not** bring pricing benefits that would offset the cost of margining for gas and power derivatives, as some have suggested. In fact, the high cash margin requirements of clearing would significantly increase transaction costs for our members and, ultimately, their retail customers. In addition, it would tie up needed cash at a time when the cost of capital is high, access to capital markets is uncertain, and our industry needs to invest billions in renewable energy sources and new energy infrastructure. As a result, our more capital-constrained members may choose to hedge fewer of their transactions, thereby increasing their risks and passing potentially volatile pricing onto retail customers.
- **Promote greater regulatory oversight and transparency of OTC derivatives through increased financial reporting** and authority to the Commodity Futures Trading Commission (CFTC) to prevent manipulation of the derivatives markets. We believe that this transparency can be achieved in a much more cost-effective way through mechanisms such as a central data repository, as opposed to mandatory clearing.
- **Promote the harmonization and clear delineation of regulatory authorities** and functions among the Securities and Exchange Commission (SEC), the CFTC, the Federal Energy Regulatory Commission (FERC) and other Federal agencies to ensure similar products are governed by similar standards. Accordingly, such harmonization should also work to minimize the burden and cost of compliance with regulatory oversight. As an example, we believe that **all regional transmission organization (RTO) products and services provided under a FERC-approved tariff and subject to regulatory oversight by the FERC should be exempt from duplicative regulation by the CFTC**.
- **Amend the proposed definition of a swap to ensure that financially-settled physical transactions are excluded from the definition of swap**. Amend the proposed exclusion from the definition of swap that currently reads “a non-financial commodity or security for deferred shipment or delivery, so long as the transaction is

physically settled” to “a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction contains an enforceable delivery obligation.” In order to avoid unnecessary costs (e.g., where a party sits in a chain between the producer and ultimate user of a commodity) and for administrative convenience, many physical transactions are settled through a book-out, which is an agreement between two parties to a forward contract to settle their respective obligations with a cash payment, as opposed to making and taking physical delivery. Book-outs have been exempted under CFTC rules since 1993.

Simply put, electricity and gas utilities engage in risk management transactions in the OTC derivatives markets to help ensure stable and affordable rates for our customers by helping to hedge against price volatility in natural gas and wholesale electric power - two of the most volatile commodities. We stand ready to work with you to craft OTC derivatives reforms that enhance transparency and improve overall market functions without creating adverse unintended consequences and increased costs for us and the consumers we serve.

CC: Members of Senate Committee on Banking, Housing, and Urban Affairs
Members of Senate Committee on Agriculture, Nutrition and Forestry

List of Supporting Organizations:

Allegheny Energy, Inc.
Allete/Minnesota Power
Alliant Energy Corp.
Ameren Corp.
American Electric Power, Inc.
Arizona Public Service Co.
Atlantic City Electric
Atmos Energy
Avista Corp.
Black Hills Corp.
BP America, Inc.
Calpine Corp.
CenterPoint Energy, Inc.
Central Vermont Public Service Corp.
Cleco Corp.
Conectiv Energy
Consolidated Edison, Inc.
Constellation Energy Group, Inc.
CMS Energy Corp.
Delmarva Power & Light Co.
Dominion
DPL Inc.
DTE Energy Co.
Duke Energy Corp.
Dynegy, Inc.
Edison International
Empire District Electric Co.
Energy Future Holdings
Entergy Corp.
Exelon Corp.
FirstEnergy Corp.
FPL Group, Inc.

GDF Suez Energy North America
Great Plains Energy, Inc.
Independent Power Producers of New York
New England Power Generators Association, Inc.
Indianapolis Power & Light Co.
Integrus Energy Group, Inc.
International Power America
LS Power
Madison Gas & Electric Co.
MidAmerican Energy
Mirant Corporation
MDU Resources Group, Inc.
Mt. Carmel Public Utility Co.
National Fuel Gas Co.
National Grid
NorthWestern Energy
NRG Energy, Inc.
NV Energy, Inc.
OGE Energy Corp.
Otter Tail Power Co.
Pacific Gas & Electric Co.
Pepco Holdings, Inc.
Portland General Electric
Progress Energy, Inc.
PPL Corp.
Public Service Enterprise Group, Inc.
Puget Sound Energy
RRI Energy
Sempra Energy
Shell Energy North America
Southern Company

TECO Energy, Inc.
Tenaska, Inc.
US Power Generating Co.
Wisconsin Energy Corp.
Vectren Corp.
Xcel Energy Inc.