

CFTC Provides Relief Excluding Utility Swaps from Swap Dealer Calculations

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The CFTC has issued a no-action letter that permits the exclusion of utility operations-related swaps from de minimis swap dealer threshold calculations, and has since proposed a rule to make this relief permanent.

On March 21, 2014, the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) issued [No-action Letter 14-34](#) (No-action 14-34), which permits the exclusion of utility operations-related swaps from *de minimis* [swap dealer](#) (SD) threshold calculations under CFTC Regulation 1.3(ggg). Public utilities are "special entities" under Dodd-Frank Title VII rules, and a much lower [notional](#) threshold applies for designation as an SD for parties that enter into swaps with special entities (see [Practice Note, Is Your Client a Swap Dealer or Major Swap Participant?: Swaps Entered into with "Special Entities"](#)).

No-action 14-34 provides that DSIO will not recommend enforcement action against any person, or any other entity controlling, controlled by or under common control with that person, that fails to include [utility operations-related swaps](#) when determining whether it has entered into swaps as a result of its swap dealing activities (qualifying swaps) in excess of the special entity *de minimis* threshold, as long as it has not otherwise entered into qualifying swaps in excess of either:

- The general *de minimis* SD notional threshold (currently \$8 billion), including utility operations-related swaps.
- The special entity *de minimis* notional threshold (originally \$25 million; \$800 million under No-action Letter 12-18, discussed below), excluding utility operations-related swaps.

No-action 14-34 was issued in response to a petition by several electric power industry representative groups which:

- Identified key conditions that they believe have inhibited counterparties' willingness to enter into swap transactions with utility entities, thereby limiting available swap counterparties for utility special entities.
- Requested that the CFTC provide relief for certain swaps that utility special entities rely upon to hedge risks arising from their electric or natural gas operations or obligations.

No-action 14-34 supersedes [No-action Letter 12-18](#) (No-action 12-18), which provided relief from SD registration requirements if utility commodity swaps connected with a person's qualifying swap activities with utility special entities over the course of the immediately preceding 12 months had an aggregate gross notional amount of no more than \$800 million (see [Legal Updates, Making Sense of All the No-action Swaps Action: CFTC No-action and Other Relief on Threshold Swap Dealer and MSP Calculation Exclusions](#) and [No-action Guidance on SD, MSP and CPO Rules under Dodd-Frank Issued by CFTC](#)). The relief provided under No-action 14-34 will remain in effect until the effective date of any final CFTC action regarding the petition, which ultimately seeks an amendment of CFTC Regulation 1.3(ggg)(4).

Utility Operations-related Swap

In order to qualify as a "utility operations-related swap," a swap must meet all of the following conditions:

- A party to the swap is a utility special entity.

- The utility special entity has represented to its counterparty that it is using the swap in the manner described in the exceptions to the clearing requirement under [17 C.F.R. 50.50\(c\)](#).
- Either the swap is an electric energy or natural gas swap or the utility special entity has represented to the other party that the swap 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;
 - compliance with electric system reliability obligations; or
 - compliance with an energy, energy efficiency, conservation, or renewable energy or environmental statute, regulation or government order applicable to a utility.

Utility Special Entity

A "utility special entity" is defined as a special entity that either:

- Owns or operates electric or natural gas facilities or electric or natural gas operations.
- Supplies natural gas and/or electric energy to other utility special entities.
- Has public service obligations under federal, state or local law or regulation to deliver electric energy and/or natural gas services to utility customers.
- Is a federal power marketing agency as defined in Section 3 of the Federal Power Act ([16 U.S.C. § 796\(19\)](#)).

Practical Impact

This exemption is welcome in the marketplace by both dealers and utilities because it facilitates liquidity and reduces costs in the energy swaps markets. This liquidity had been threatened because market participants were fearful of being designated as swap dealers as a result of entering into swaps with utility special entities. This is because SDs are subject to an extensive framework of Dodd-Frank rules on both external and internal business conduct for SDs that is costly and cumbersome to adhere to (see [The Dodd-Frank Act: Requirements for Swap Dealers and MSPs Checklist](#)), including special external business conduct standards for swaps entered into with special entities (see [Swap Dealers and MSPs: Final Dodd-Frank External Business Conduct \(EBC\) Rules: Swaps with Special Entities](#)). Those rules will not apply to these swaps, which reduces cost for the end-user utility, and therefore for the public. However, depriving end-user public entities of certain Title VII protections that they may have benefitted from somewhat reduces this public benefit.

Update: The CFTC has issued a [proposed rule](#), which would transform this temporary no-action relief into a permanent CFTC Rule. To be eligible for this relief under the proposal, the entity that wishes to exclude its utility swaps from its calculation of its aggregate notional amount of swaps with Special Entities for purposes of determining whether it is an SD would be required to file a one-time electronic notice with the National Futures Association (NFA). This rule proposal is not intended to have any effect on the relief provided by No-action 14-34 and this proposal's interaction with No-action 14-34 will be addressed if and when the proposal becomes a final rule. The proposal was announced on May 30, 2014, and will be open for comments for 30 days after its publication in the *Federal Register*.

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