

E-ALERT | Dodd-Frank Act

April 5, 2013

CFTC EXEMPTS CERTAIN ENERGY TRANSACTIONS FROM DODD-FRANK REGULATION

On March 28, 2013, the U.S. Commodity Futures Trading Commission (“CFTC”) issued two final orders exempting certain energy transactions from regulation under the Commodity Exchange Act (“CEA”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).¹ The first order, in response to a petition from certain independent system operators (“ISOs”) and regional transmission organizations (“RTOs”) regulated by the Federal Energy Regulatory Commission (“FERC”) or the Public Utility Commission of Texas (“PUCT”), exempts specified transactions of these RTOs and ISOs. The second order exempts certain non-financial energy transactions between and amongst government-owned electric utilities and cooperatively-owned electric utilities. This alert summarizes the key provisions of these orders.

BACKGROUND

In amending the CEA, the Dodd-Frank Act brought “swaps,” as broadly defined in the statute, under federal regulation. The Dodd-Frank Act also added section 4(c)(6) to the CEA,² which provides that the CFTC shall exempt from the requirements of the CEA an agreement, contract or transaction that is entered into pursuant to a tariff or rate schedule approved or permitted to take effect by FERC or a State or municipal regulatory authority, or between government or cooperatively-owned entities described in Section 201(f) of the Federal Power Act (“FPA”),³ if the CFTC determines that exemption would be consistent with the public interest and the purposes of the CEA.

Certain RTOs and ISOs⁴ on February 7, 2012 filed a joint petition requesting that the CFTC exercise its exemptive authority under section 4(c)(6) to exempt certain agreements, contracts, and transactions for the purchase or sale of specified electric energy products that could be deemed to be swaps. A similar petition requesting exemptive relief was filed on June 8, 2012, by a group of trade associations and other organizations representing the interests of government and/or cooperatively owned electric utilities to exempt certain “electric operations-related transactions” between such utilities that might be considered swaps from the CEA’s requirements.⁵

¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

² 7 U.S.C. § 6(c)(6).

³ 16 U.S.C. § 824(f).

⁴ The petitioners included three RTOs (Midwest Independent Transmission System Operator, Inc., ISO New England, Inc., and PJM Interconnection, L.L.C.) and two ISOs (California Independent System Operator Corporation and New York Independent System Operator, Inc.), whose central role as transmission utilities is subject to FERC regulation. In addition, the petitioners included the Electric Reliability Council of Texas, Inc. (“ERCOT”), an entity that performs the role of an ISO, but whose central role as a transmission utility in the electric energy market is subject to PUCT regulation, which regulates electricity rates in Texas.

⁵ This petition was submitted by the National Rural Electric Cooperative Association, American Public Power Association, Large Public Power Council, Transmission Access Policy Study Group, and Bonneville Power Administration.

In response to these petitions, the CFTC published proposed exemptive orders in the *Federal Register* on August 28, 2012 and August 23, 2012, respectively, and requested comment. After evaluating the comments received, the CFTC published final exemptive orders on April 2, 2012.

RTO/ISO EXEMPTIVE ORDER

The CFTC's RTO/ISO final order exempts certain "financial transmission rights," "energy transactions," "forward capacity transactions," and "reserve or regulation transactions" that are offered or sold in a market administered by one of the petitioning RTOs or ISOs pursuant to a tariff or protocol that has been approved or permitted to take effect by FERC or PUCT (collectively, "covered transactions"). The final order defines each of the covered transactions in detail.

In this regard, the final order specifies that the forward capacity transaction category includes certain generation capacity, demand response, and energy efficiency transactions. The final order also clarifies that virtual and convergence bids and offers are included in the energy transactions category. However, the CFTC rejected commenters requests that "logical outgrowths" of the covered transactions be included within the exemption. The CFTC further stated that the covered transactions must be tied to the allocation of the physical capabilities of an electric energy transmission grid because such activity would be inextricably linked to the physical delivery of electric energy. The final order also exempts persons offering, entering into, rendering advice, or rendering other services with respect to the covered transactions.

To be eligible for exemption, transactions must be entered into by persons who are "appropriate persons,"⁶ or "eligible contract participants" ("ECPs").⁷ In general, these persons are financially sophisticated or meet certain minimum financial requirements. In addition, transactions may be entered into by persons who are in the business of (i) generating, transmitting, or distributing electric energy, or (ii) providing electric energy services that are necessary to support the reliable operation of the transmission system.

The final order includes several conditions precedent regarding information-sharing and confidentiality of CFTC requests for information from an RTO, ISO, or its members.

Before the exemptions are effective, each petitioning RTO or ISO must (i) submit a legal opinion or memorandum of outside counsel that provides the CFTC with assurance that applicable netting arrangements provide the petitioner with enforceable rights of set off against any of its market participants under the Bankruptcy Code and (ii) demonstrate full compliance with FERC's credit practice requirements.⁸ Similar requirements are provided for ERCOT subject to similar PUCT regulations.⁹

It is important to note that under the final order, the CFTC's anti-fraud and anti-manipulation authority, and scienter-based prohibitions will continue to apply, and that the CFTC reserved its authority under section 4(d) of the CEA to conduct investigations to determine compliance with the exemption's conditions and to take enforcement action for violations caused by non-compliance with such conditions.

⁶ As defined in section 4(c) of the CEA, 7 U.S.C. § 6(c).

⁷ As defined in section 1a(18) of the CEA, 7 U.S.C. § 1a(18) and CFTC regulations.

⁸ 18 C.F.R. § 35.47.

⁹ The CFTC staff issued a no-action letter to give the RTOs and ISOs time to take steps to satisfy the conditions and requirements specified in the final order. See CFTC Letter No. 13-05 (Mar. 29, 2013).

The order was published in the *Federal Register* and became effective on **April 2, 2013**. A copy of the order is available [here](#).

GOVERNMENT AND/OR COOPERATIVELY-OWNED ELECTRIC UTILITIES EXEMPTIVE ORDER

The government and/or cooperatively-owned electric utilities final order exempts certain non-financial energy transactions between and amongst government-owned electric utilities and cooperatively-owned electric utilities from most CEA requirements. The entities eligible for the relief include:

- Government and cooperatively-owned entities specified in section 201(f) of the FPA.¹⁰
- Electric facilities or utilities wholly owned by an Indian tribe recognized by the U.S. government or wholly owned by a cooperative that does not qualify under section 201(f), so long as the cooperative is treated as such under the Internal Revenue Code and exists for the primary purposes of providing electric energy service to its member/owner customers at cost, or any other entity that is wholly owned, directly or indirectly, by any one or more of the foregoing.

As justification for the relief, the CFTC noted that transactions between these entities are within a “closed loop,” and therefore do not materially impair price discovery in CFTC-regulated markets, and that the entities have a unique public service mission and non-profit structure.

The transactions covered by the final order must be entered into for the primary purpose of managing supply or price risks arising from current or anticipated public service obligations to physically generate, transmit, and deliver electric energy service to customers. In this regard, transactions used to manage price risks must relate to an obligation to make or take physical delivery and not speculation. They are limited to six categories, each as described in the order: electric energy delivered, generation capacity, transmission services, fuel delivered, cross-commodity pricing, and other goods and services.

Expressly excluded from the exemption are agreements, contracts, and transactions based upon, derived from, or referencing any interest rate, credit, equity or currency asset class, or any grade of a metal, or any agricultural product, or any grade of crude oil or gasoline that is not used as fuel for electric energy generation.

Again, the CFTC retained its general anti-fraud and anti-manipulation authority, as well as certain scienter-based prohibitions under the CEA, with respect to the transactions covered by the order, and can investigate entities to determine compliance with the exemption’s conditions.

The order was published in the *Federal Register* and became effective on **April 2, 2013**. The order is available [here](#).

¹⁰ FPA section 201(f) provides in relevant part that certain provisions of the FPA neither apply to nor include: the United States, a State or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

16 U.S.C. § 824(f).

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