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Energy Regulatory Alert

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Congress Considering Amendments to Dodd-Frank to Soften the Impact on Utility Companies

On Thursday, March 14, 2013, the U.S. House of Representatives Committee on Agriculture heard testimony relating to a suite of bills to amend the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Act") in an effort to soften the impact of the Act on utility companies.

H.R. 1038, the Public Power Risk Management Act of 2013, would revise current rules that make it difficult for public power entities to find counterparties for their hedging activities. The bill would require that all swaps related to utility operations be subject to the same rules, regardless of whether the utility is investor-owned or a public power entity. Currently, an entity engaging in swaps in connection with transactions with or on behalf of its customers can avoid being subject to regulation as a "swap dealer" if it engages in no more than a de minimis quantity of swap dealing. De minimis is currently defined as less than $3 billion annually for total swap dealing activity, but less than $25 million annually in swaps with public power companies.

Terry Naulty, general manager and CEO of Owensboro Municipal Utilities (OMU), offered testimony in support of the bill on behalf of the American Public Power Association. Mr. Naulty claimed that the de minimis limitation has harmed OMU's hedging activities because there are a limited number of counterparties for any given swap.

By way of background, the Commodity Futures Trading Commission (CFTC) issued a "no-action" letter in 2012, allowing a counterparty to engage in up to $800 million in swaps with government-owned utilities without being required to register as a swap dealer. However, Mr. Naulty explained that the "no-action" letter had failed to provide enough assurances to OMU's counterparties. The $800 million de minimis threshold applied under only certain circumstances, including that the swap be used to hedge a "physical position" and that the swap involve a commodity that the parties transact in the ordinary course of their "physical energy business." In addition, a counterparty taking advantage of the increased threshold would have to report to the CFTC with information about the specific swaps it had executed with public power entities.

H.R. 677, the Inter-Affiliate Swap Clarification Act, which passed the House last year but was not taken up by the Senate, has been reintroduced. **H.R. 677** would exempt inter-affiliate swaps from margin requirements and ensure that end users that clear their swaps through an affiliate do not lose the benefits of the end-user exemption from the Act's centralized clearing requirements. Most utilities are considered end users. The bill would make it easier for companies that clear their swaps through a central service company or single affiliate that trades on the open market to continue to hedge their risks in this way. Marie N. Hollein, president and chief executive officer of Financial Executives International, offered

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testimony in support of the bill on behalf of the Coalition for Derivatives End-Users. Ms. Hollein explained that inter-affiliate swaps do not pose the sort of systemic risk that the Act was created to prevent and that centralized clearing requirements should apply to only transactions with external counterparties.

H.R. 634, the Business Risk Mitigation and Price Stabilization Act of 2013, would exempt commercial end users from having to post margins for their swap transactions. Jim Colby, assistant treasurer at Honeywell International, Inc., testified in support of the bill. Mr. Colby testified that it had not been the intent of Congress to impose a margin requirement on end users, but that banking regulators had interpreted the statute as requiring the posting of margins. He asked that Congress make the exemption for end users explicit to end the confusion.

H.R. 1003 would require the CFTC to conduct a cost-benefit analysis when drafting regulations. The bill would require not only that the costs and benefits of a regulation be quantified, but also that the impact on market liquidity be calculated and taken into account.

Also under consideration is **H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2013**, which would eliminate indemnification requirements for the sharing of data relating to cleared swaps. In addition, **H.R. 992, the Swaps Regulatory Improvement Act**, would remove the “push-out” requirement that forces banks to move swap trading to separately capitalized affiliates that are not federally insured.

All of the bills are sponsored by Republicans, the majority party in the House. While some Democratic House members have signed on as cosponsors, Rep. Collin Peterson (D-MN), the Committee’s senior Democrat, stated that he believes the bills are unlikely to be taken up by the democratically controlled Senate any time soon. To date, Senate Democrats have been reluctant to “reopen” Dodd-Frank, even for technical corrections, because they believe that Republicans might try to “gut” the Act as part of that process. Rep. Peterson also observed that the CFTC has not yet finished drafting regulations and that much of the proposed legislation might not be needed once the CFTC has completed its implementation of the Act.

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