Resolution 22-09
Sponsor: JEA

Derivatives and Risk Management for Public Power Utilities

Many public power utilities 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. Together, these nonfinancial commodity markets play a central role in securing electric energy, fuel for generation, and natural gas supplies for delivery to consumers at reasonable and stable prices. Specifically, many public power utilities purchase firm electric energy, fuel and gas supplies in the physical delivery markets (in the "cash" or "spot" or "forward" markets) at prevailing and fluctuating market prices, and enter into bilateral, financially settled nonfinancial commodity swaps with customized terms to hedge their unique operational risks.

Public power utilities enter such transactions with both swap dealers and non-financial entities (including investor-owned utilities, independent power producers, and natural gas suppliers) to hedge their commercial operations risks. Non-financial entities provide needed market competition and highly customized products that Wall Street firms are unable or unwilling to provide.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) imposed new requirements on "swap dealers and major market participants" that transact with "special entities." Special entities include governmental entities, including government-owned, public power utilities. In debating the legislation before its enactment, lawmakers acknowledged the importance of hedging commercial operations-related risks to government-owned utilities and the ability of such utilities to manage and assess such transactions.

In initial regulations implementing Dodd-Frank, the Commodity Futures Trading Commission (CFTC) required that only entities registered as a swap dealer may enter into more than a *de minimis* amount of swap dealing ($25 million) with special entities. The effect of this rule was to prevent non-financial entities from entering swaps with public power utilities, putting public power utilities at a serious disadvantage in hedging their operational risks. After substantial efforts by the American Public Power Association, the CFTC amended those regulations on September 23, 2014, to clarify that swaps entered by a public power utility to hedge utility operations risks would be exempt from this $25 million threshold. As a result, public power utilities have access to a broader array of potential swap partners, including banks and other swap dealers and non-financial entities, including investor-owned utilities, independent power producers, and natural gas suppliers.

In addition, the Federal Energy Regulatory Commission and the CFTC issued on January 2, 2014, a memorandum of understanding that provides parameters for how the two agencies will deal with jurisdictional issues over commodity and commodity derivatives markets, services, and products.

NOW, THEREFORE, BE IT RESOLVED: That the American Public Power (APPA) believes that public power utilities have an ongoing and legitimate interest in accessing commodity and commodity derivatives markets to hedge utility operations risks, that the Commodity Futures Trading Commission (CFTC) should not take steps that will unnecessarily burden this ability, and at the very least, that public power utilities should have the same ability to hedge commercial operations related risks as other utilities; and

BE IT FURTHER RESOLVED: That in the case of market manipulation in regional transmission organization markets, APPA recognizes that the CFTC's expertise in investigating manipulation is invaluable, and encourages the CFTC and Federal Energy Regulatory Commission to continue to work together to prevent manipulation in the energy markets.

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