Testimony of Joseph T. Kelliher
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FPL Group, Inc.
On Behalf of the Edison Electric Institute and the Electric Power Supply Association
Before the Committee on Energy and Natural Resources
United States Senate
March 9, 2010

Mr. Chairman, Ranking Member Murkowski, and Members of the Committee:

My name is Joseph T. Kelliher, and I am Executive Vice President – Federal Regulatory Affairs for FPL Group, Inc. I appreciate the opportunity to appear before you today to testify about how financial transmission rights and other electricity market mechanisms may be impacted by the financial regulatory reform legislation which has passed the House of Representatives and is before the Senate.

FPL Group is a public utility holding company headquartered in Juno Beach, Florida. FPL Group is one of the Nation's largest electricity companies, a premier clean energy company with two principal electric subsidiaries, NextEra Energy Resources, LLC, a competitive generation company that operates in 26 states and is the largest wind developer in the United States, and Florida Power & Light Company, a vertically integrated utility in Florida. These two FPL Group companies own, operate or control nearly 43,000 megawatts of electric generation facilities. The issues the Committee is examining today are equally important to both NextEra Energy Resources and Florida Power and Light Company. They are as important to the ability of a vertically integrated utility to deliver reasonably priced electricity as they are to the ability of a wind developer and independent power producer to sell their electricity output.

At FPL Group, I am responsible for federal regulatory policy for both NextEra Energy Resources and Florida Power and Light Company. I have spent my entire professional career working on energy policy matters, serving in a variety of roles in both the public and private sectors. Previously, I served as Chairman of the Federal Energy Regulatory Commission (FERC), a FERC Commissioner, a senior policy advisor to the Secretary of Energy, and Majority Counsel to the House Energy and Commerce Committee. I also have had a variety of private sector roles.

While FERC Commissioner, I asked Congress during development of the Energy Policy Act of 2005 to grant FERC authority to prevent and penalize market manipulation. I did so because I believed there was a regulatory gap in FERC's authority to prevent market manipulation that needed to be filled. During my chairmanship FERC implemented its anti-manipulation rules and began to conduct market manipulation investigations. Many of these investigations were conducted jointly with the Commodity Futures Trading Commission (CFTC). Some FERC enforcement actions have resulted in jurisdictional disputes between FERC and CFTC.

I am testifying today on behalf of the Edison Electric Institute (EEI) and the Electric Power Supply Association (EPSA). EEI is the trade association of U.S. shareholder-owned electric companies, with international affiliates and industry associate members worldwide. The U.S. members of EEI serve 95 percent of the ultimate electricity customers in the shareholder-owned segment of the industry and represent about 70 percent of the total U.S. electric power industry. EPSA is the national trade association for competitive wholesale power suppliers, including generators and marketers. EPSA members include both independent power producers and the competitive wholesale generation arms of certain utility holding companies. The competitive sector operates a diverse portfolio that represents 40 percent of the installed generating capacity in the United States. EPSA members do business nationwide, both in the two-thirds of the country served by Regional Transmission Organizations (RTOs) or Independent System Operators (ISOs) and the remaining one-third of the country dominated by traditional vertically-integrated utilities. My examples and context are from FPL Group's perspective but are representative of EEI and EPSA member concerns and requests.

My testimony today:

- Details the importance of over-the-counter (OTC) derivatives to well-functioning electric markets and explains the need for a specific energy end-user exemption from any mandate that OTC transactions clear or trade on CFTC-regulated exchanges; and

- Requests that the Committee support legislation to clarify that electricity products and services provided under a FERC-approved tariff and subject to regulatory oversight by FERC, such as financial transmission rights (FTRs), should be exempt from duplicative regulation by the CFTC.

EEI and EPSA support the goals of the Administration and Congress to improve transparency, stability, and oversight of financial markets, including OTC derivatives markets. However, when crafting legislation for that purpose, it is essential that policymakers preserve the ability of electric and natural gas companies to use OTC energy derivatives and similar financial products and FTRs for prudent, legitimate business purposes. A large group of end-users has communicated this message to Congress on numerous occasions.[1] Further, a group of energy end-users that includes virtually the entire utility, electric power and natural gas industries has also emphasized the importance of these products to the energy sector.[2] Utilities, independent electricity generators, renewable energy providers, and other market participants rely on these products and markets to manage wholesale electricity and natural gas price risk. By prudently managing our risk we are better able to keep rates stable and affordable for our consumers.

I recognize that this Committee does not have jurisdiction over the financial market reform legislation. However, you do have a very important jurisdictional issue at stake: Unless it is properly crafted, the financial market reform legislation will encroach upon this Committee's jurisdiction over electricity and natural gas markets regulated by FERC under the Federal Power Act and the Natural Gas Act. Specifically, it could interfere with wholesale electricity markets under FERC's jurisdiction that are managed and overseen by RTOs and ISOs and the market under the Public Utility Commission of Texas' jurisdiction in the case of the Electric Reliability Council of Texas (ERCOT). It could create a duplicative, overlapping and potentially conflicting regulatory regime with both FERC and the CFTC imposing regulatory requirements and overseeing transactions. It could shift regulatory jurisdiction from a consumer protection and reliability agency with expertise in electricity markets—an agency dedicated to assuring just and reasonable prices—to a financial regulatory agency with no such background or duty. The legislation will create tremendous regulatory uncertainty and introduce regulatory and business risk in an area where there is now repose. As a result, consumers would see higher prices for electricity and natural gas and greater price volatility.

As I will explain, RTOs and ISOs efficiently dispatch generation resources to minimize fuel costs and enable the RTO/ISO customers (utilities, generators, marketers) to manage the cost of congestion on the transmission system by the use of FTRs. In our parlance, customers use FTRs to "hedge" their congestion costs. Some may argue that FTRs resemble a derivative product or swap that should be subject to the CFTC's jurisdiction. Indeed the RTOs and ISOs themselves could be subject to the CFTC's jurisdiction unless the reform legislation is properly crafted. However, in contrast to derivatives, FTRs are integrally tied to the physical delivery of electricity and must be physically feasible. Moreover, they provide a uniquely important hedging tool to electricity suppliers and consumers who produce, transport, and consume electricity on a continuous basis and do so in a fully transparent market. In addition, FTRs already are comprehensively regulated by FERC and the RTOs and ISOs themselves. There simply is no need to subject these transactions and organizations

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[1] *See* October 2, 2009 letter to Members of the U.S. House of Representatives and February 3, 2010 letter to Members of the U.S. Senate from the Coalition for Derivatives End-Users (attached).

[2] *See* January 21, 2010 letter to Members of the U.S. Senate from the Energy End-Users Coalition (attached).

to costly, duplicative and potentially conflicting oversight by two agencies. This Committee clearly has a strong interest in making sure the legislation does not encroach on FERC's oversight authority over electric and natural gas markets.

The Administration has called upon Congress to enact major financial reform legislation because of the dramatic failures we have experienced in financial markets and failed government oversight of those markets. Those failures simply are not present in electricity and natural gas markets regulated by FERC. In short, there is no regulatory gap that needs to be filled by expanded CFTC authority over markets currently effectively regulated by FERC.

When considering any increased regulation and requirements for OTC derivatives markets, it is important to note that end-user commodity derivatives transactions do not pose the type of "systemic risk" – i.e., "too big to fail" – that Congress is seeking to eliminate through the proposed legislation. In fact, from a quantitative perspective, the entire commodities market is less than one percent of the global OTC derivatives market, and the energy commodity portion is only a fraction of that one percent. Therefore, we believe that Congress should strike the proper balance in its regulatory reform efforts by establishing energy market oversight rules that allow for prudent use of OTC risk management products while also providing regulators with the tools needed to protect consumers against market manipulation and systemic risk.

With its competitive power company, renewable energy provider, and vertically integrated utility, FPL Group looks at the impact of financial reform legislation from the perspective of our customers, who are wholesale and retail electric consumers. We certainly support the goal of financial regulatory reform, but the ability of electric and natural gas companies to use OTC energy derivatives for legitimate business purposes should be preserved. In addition, the CFTC should not have the authority to regulate wholesale electricity markets and transactions that are already subject to a FERC-approved tariff. This would result in costly, duplicative and overlapping regulation over our sector. The balance of my testimony focuses on that problem.

I will briefly describe and explain: (i) why utilities and electricity generators use FTRs and OTC derivatives products; (ii) the cost to consumers of unnecessary over-regulation of these OTC derivatives transactions; and (iii) why FERC has and should retain exclusive jurisdiction over wholesale electricity markets.

To understand the role of FTRs and OTC derivatives in wholesale electricity markets, I will begin with a short explanation of how those markets are currently structured and regulated. Most of NextEra Energy Resource's generation assets operate within RTOs or ISOs. In fact, over 65% of Americans, or 134 million customers, live in regions served by RTOs and ISOs. These organizations administer formal, "organized" wholesale electricity markets; these markets are subject to detailed rules and oversight by FERC. Utilities are required to file tariffs to comply with FERC's requirements. These organizations also operate the electric grid in their areas and independently administer transmission assets to ensure access to transmission on a nondiscriminatory basis. RTOs and ISOs also have independent market monitors who certify that these markets are operated fairly and without unmitigated market power. All RTOs and ISOs and the transactions that occur in them currently are regulated exclusively by FERC (except ERCOT, which is regulated by the Public Utility Commission of Texas).

When RTOs and ISOs were first organized, the utility members retained their rights to move electricity from their generators to their customers by using physical transmission "paths." Administering a physically-based system of transmission rights proved to be both cumbersome and inflexible over time. And it was not very good at managing congestion. The problem with these physically-based systems is that the demand for electricity varies by a factor of two every day, and so the economic pattern of transmission flows varies from hour-to-hour and day-to-day. A fixed set of physical transmission rights does not fit this reality.

As RTOs and ISOs evolved, and their markets became more efficient – which means less expensive for consumers – the system of physical transmission rights evolved to a system of financial transmission rights or FTRs. FTRs are also an integral part of markets that are based on locational marginal pricing with security constrained economic dispatch (also known as LMP pricing), which I will discuss briefly below. All RTOs and ISOs have adopted, or are moving to adopt, a form of LMP, though some of the details vary from region to region. LMP has proven to be the most efficient way within an RTO to take maximum advantage of the physical capability of the transmission system while maintaining reliability. LMP provides the mechanism to dispatch generation according to which generators are the least expensive to run at the time they are needed to serve the load.

FTRs are integral to the proper functioning of competitive electric markets. FTRs allow electric market participants to manage their electricity and transmission price risk when delivering power on the grid.

However, in order to better understand FTRs, one must understand LMP. In RTO/ISO electricity markets, generators receive the "locational" price for the electricity they put on the grid at what is known as the "point of injection." The utilities, known as local distribution companies (or LDCs), pay the locational price at the point where they withdraw power from the grid. Differences in these two locational prices typically arise as a result of congestion on the transmission system. Congestion is like a kink in a hose. The transmission system is too clogged to allow lower cost generation on one side of the kink to flow to the other side. That means a higher cost generator runs even though a lower cost generator is available elsewhere on the transmission system – that is behind the kink. Consequently, where there is a difference between these two prices, the generator or LDC will be subject to congestion fees that are paid to the RTO/ISO.

In order to give market participants the ability to manage the differences in the locational prices, RTOs and ISOs sell, or auction, FTRs on a long-term, year-ahead and short-term basis. Ownership of an FTR thereby allows the entity to recoup some of the congestion fees. But these FTR markets are already heavily regulated by the FERC:

- RTOs sell a quantity of FTRs that corresponds to the capacity of the transmission system—neither more nor less. So the "supply" of FTRs is based on the physical characteristics of the transmission system and regulated consistent with that;
- The auctions are designed to sell FTRs in combinations that are most highly valued by market participants—and the auctions themselves are governed by tariff rules established by FERC;
- Auction proceeds go to transmission owners and LDCs;
- Ownership of an FTR does not allow a market participant to change the value of that FTR; FTR transactions are fully transparent—the ownership of each FTR is available for all to see on RTO/ISO web sites;
- Settlement or payouts of FTRs are based on bidding by generators and load-serving entities for power sales and purchases, consistent with anticipated power production and consumption by market participants and reflecting congestion on the transmission system; and
- FTR markets are subject to FERC's anti-manipulation rule.

The auctions have detailed rules about how FTRs can be purchased. As a general rule, the FTRs auctioned by the RTOs are those that have not already been claimed by the LDCs, who have preferential access to FTRs. In addition, FTR holders are subject to credit requirements. The RTOs and ISOs administer the FTR markets, subject to FERC's extensive oversight. There is no regulatory gap and there is no basis to introduce duplicative regulation of this market.

Generators and LDCs buy FTRs to manage, or hedge, the amount they will have to pay for congestion. Without the ability to hedge this risk, costs would go up, and customers would be subject to the volatility that results from the all-too-regular occurrence of transmission congestion. Some have criticized the fact that non-utility players are involved in the market for FTRs. But it is essential to have a variety of players and the liquidity they bring to the market. The market monitors also review all of the above.

Another way that generation companies manage risk is by entering into transactions to sell some of the electricity that they will generate in advance. They do those transactions with credit-worthy counterparties. For example, a generator might sell an amount of electricity for one agreed price for all hours in the summer months of June through September. The generator will then know that it will always get that price for that amount of electricity during those four months. The generator foregoes the prospect of getting higher prices absent the sale but, more importantly, it avoids the risk that prices will fall below the fixed price it is paid by the buyer of the electricity. A generator also can do the same thing with respect to the fuel it buys to run the plants. The generator might transact in the OTC market for natural gas or lock in fuel costs for its gas power plants.

Risk management is also important to clean energy companies. NextEra Energy Resources is the leading wind energy company in the United States. While most of the output from our wind projects is sold under power purchase agreements, we do operate some merchant wind projects that sell into the market on a daily basis. Many other wind energy companies in the U.S. rely heavily on merchant sales. Wind energy companies hedge the power output of merchant wind projects to provide necessary certainty to support project financings and corporate earnings projections. As an example, a company can sell the physical output from its wind projects into the daily market and receive the daily market floating price for power. To hedge the risk of price volatility in the daily markets, the company could enter into a "fixed for floating power swap". A typical power swap transaction would involve the wind energy company receiving a fixed price for power from a counterparty (typically a bank) and paying the daily market floating price for power to that counterparty.

Another way to manage risk is through put options that provide downside price protection for merchant wind project financings. A put option provides a company with the right to sell power to a counterparty (typically a bank) at a strike price and in return the company pays the bank an upfront premium for this option. As an example, assume the current power market was $50/MWh, but a power price of only $40/MWh was required to provide sufficient cash flows to support the debt payments in a project financing. The company could enter into a power put option; pay a counterparty an upfront premium for the right to sell power to them with a strike price of $40/MWh. If the price of power dropped below $40/MWh, the company would have the right to sell power to the counterparty for $40/MWh to protect project cash flows. If the price of power went up to $60/MWh, the company would continue to sell power into the daily market and would not exercise the put option.

The growth of clean energy could result in new products to manage risk, such as a weather derivative for wind resources. The concept would be for a counterparty to take on the variability of the wind resource as measured against a long-term historical wind index. The wind energy company would receive a payment from the counterparty if the wind resource came in lower than the historical average wind index and pay the counterparty if the wind resource came in higher than the historical average wind index.

It would be difficult to support a merchant wind business without having OTC derivatives available to hedge market price risk. Banks would be unwilling to lend money without the ability for projects to lock in prices and provide certainty on project cash flows. These types of nonstandard, or customized, products are important to the wind business.

Our customers benefit from this hedging and trading activity. We are in a position to agree to longer-term power sales contracts with wholesale customers; the price terms under those contracts are in large part possible because of the relative price stability that hedging provides to our portfolio. It is our experience that retail customers in particular want prices for power sales to be stable rather than subject to the fluctuations and uncertainties of the spot market. Without hedging and trading, we simply would not be able to do that.

These types of hedging transactions are not always done on an exchange because we tailor the product we sell to the needs of the purchaser; in other words, these are not necessarily standardized products. Even certain products that could be considered standardized are often contracted for under specific, customized delivery, credit or capital terms.

In RTO/ISO markets, electric utilities that have divested their power plants must buy power to serve their customers. In the Northeast and Mid-Atlantic states, utilities periodically enter the market to purchase full requirements service to meet their load obligations. These transactions are highly customized. The products sold include energy in quantities that match the utilities' load in each hour of the day delivered to the utilities' service territory. The utility also passes system balancing costs and transmission costs to the seller as part of the transaction. These transactions are highly customized and cannot be executed on an exchange. Energy companies that make these customized sales often hedge their positions with standardized products.

Some would argue that advance sales of power, where the price is based upon an average of other sales or an index, are futures transactions and would subject them to the CFTC's exclusive jurisdiction. We disagree. These are wholesale and retail power sales already regulated by FERC and state utility commissions, respectively, and should not be regulated by the CFTC.

NextEra Energy Resources would not be able to offer customized products greatly valued by customers if it could not hedge its future price risk. Requiring NextEra Energy Resources to conduct all of its transactions on exchanges, with standard rather than customized contracts to meet its customers' needs, and subjecting those transactions to costly central clearing requirements, would undoubtedly result in significant price increases for its customers. These examples illustrate why we support an end-user exemption for both wholesale and retail market participants.

In addition to concerns about FTRs and other hedging activities, I want to mention a concern that the RTOs and ISOs themselves could arguably become subject to the CFTC's jurisdiction as "derivatives clearing organizations" under some versions of the financial reform legislation. RTOs and ISOs routinely settle hundreds of millions of dollars of financial transactions entered into by their markets' participants. If any of those transactions are classified as derivatives transactions, the RTOs and ISOs could be classified as derivatives clearing organizations to the extent that they provide "clearing" services for the transactions. That, in turn, could mean that these organizations themselves would be subject to the CFTC's jurisdiction, in addition to the FERC's jurisdiction. This would add untold complexity and expense, and drive up the costs of these organizations, which would be passed on to electricity consumers.

The Senate Banking and Agriculture Committees are considering financial reform legislation that may subject all of the types of transactions I have described above to the CFTC's jurisdiction. Some versions of the proposed legislation would require transactions that are now done "over the counter" to be cleared and/or traded on CFTC-regulated exchanges. The requirement to clear and/or trade such transactions on an exchange would materially increase both wholesale and retail electricity prices. Transactions conducted on an exchange are subject to substantial margin requirements, while transactions that are not conducted on an exchange do not have the same margin requirements. The consequences of the margin requirement are significant.

Today, credit-worthy companies like NextEra Energy Resources and Florida Power & Light routinely engage in OTC derivative transactions with other credit-worthy counterparties. These transactions are often not subject to a margin requirement due to the creditworthy nature of the parties. Rather we typically rely on each other's balance sheets, or the value of other assets, as security for the trade. However, margin is typically required only when exposure has reached a mutually agreed upon limit. Exposures above such limit are then subject to margining requirements. Thus parties to off-exchange transactions pay less overhead, which benefits our customers.

Analysis by members of the large end-user energy group previously mentioned has found that the increased costs of forced trading on exchanges would be hundreds of millions of dollars for the average utility or generation company. The margin requirement would tie up large amounts of cash, creating "dead" capital at a time when the power sector faces the need to invest hundreds of billions of dollars in clean energy technologies, energy efficiency, the smart grid, and additional transmission capacity.

It is critical that these companies continue to have access to the OTC market for these hedges. Requiring suppliers to hedge on an exchange would expose them to significant liquidity risk for cash margining. The cost of this risk would ultimately be borne by the utilities' customers via higher prices charged for the full requirements service. For example, in February utilities in New Jersey purchased approximately 2,500 MW for a three-year term. If this entire volume were hedged on an exchange, suppliers would have had to post about $1 billion in cash to cover initial margin and variation margin. This $1 billion would have been added to bids accepted for the auction and ultimately would have been borne by consumers in New Jersey. There are a number of other states that conduct similar auctions. They would face a similar cost premium to reflect the additional working capital costs that suppliers would have to bear if the OTC markets are not available for the hedging needed to provide these types of products. Competition would also decline as the liquidity risk would simply be unacceptable to many suppliers. It is a basic tenet of markets that fewer participants would result in higher prices to customers.

Therefore, if financial reform legislation requiring clearing for these transactions were enacted, consumers would see their prices increase because an additional and unnecessary layer of cost would be added to the marketplace – without a commensurate reduction in risk.

Initial reform proposals have included a number of vague or ambiguous terms that will need to be clarified prior to passage of a final measure. The aim of all of the financial reform proposals has always been to focus on the large financial players whose transactions can pose systemic risk. Without a specific exemption, it will not be clear whether electricity end-users are also intended to be covered and subject to the various new requirements. Something this important and costly needs to be clear and should unambiguously exempt end-users managing commercial risk from the clearing and exchange-trading requirements. Unless the terms of the legislation are precise, determining which parties and transactions are subject to a clearing requirement will be left to the broad discretion of the CFTC. CFTC Chairman Gensler and his staff have stated on numerous occasions the position that virtually all OTC transactions, including FTRs, should be cleared or traded on exchanges; we respectfully disagree.

As a result, we believe that the legislation should clarify that FERC is the sole regulatory authority governing electricity products and services provided under a FERC-approved tariff and subject to regulatory oversight by the FERC, with the same true for the Public Utility Commission of Texas for ERCOT.

It is important for Congress to make clear that FERC retains exclusive authority under the Federal Power Act over all wholesale electric markets and transactions subject to a FERC tariff. As indicated in the discussion of FTRs, financially settled transactions are an integral component of RTO/ISO markets. Consistent with the purposes of the Federal Power Act, they ensure the efficient and reliable physical generation, transmission and wholesale delivery of electricity at just and reasonable rates. In addition to the Federal Power Act authority, FERC has a duty under the Energy Policy Act of 2005 to ensure these markets are not subject to manipulation or abuse.

Wholesale electricity markets are already pervasively regulated by FERC, and the introduction of CFTC regulation either creates duplicative regulation or transfers FERC jurisdiction to the CFTC. It does not fill a regulatory gap, since there is no gap in this area. If there are two regulators, the rules will inevitably be different depending upon which agency imposes them. Gamesmanship, abuse and market manipulation all thrive under this kind of overlapping and confusing regulation. In my view, bifurcated jurisdiction of these markets will invite market manipulation. Clear and unambiguous authority for FERC to regulate these transactions is essential. There is already litigation over which agency has authority to police manipulation by futures market participants that affects FERC jurisdictional markets. We cannot afford further confusion over regulatory jurisdiction.

Some have suggested that the problems created by duplicative oversight over these markets by both FERC and the CFTC could be worked out by directing the two agencies to enter into a Memorandum of Understanding delineating who will do what. I believe that approach will be ineffective. As I indicated earlier, the Commodity Exchange Act confers upon the CFTC "exclusive" jurisdiction over certain aspects of futures transactions, namely futures trading on exchanges Other CFTC authority is non-exclusive. FERC and CFTC disagree on their respective authority under current law, reflected in litigation over FERC's efforts to police alleged market manipulation by futures participants that affected FERC-jurisdictional markets. This is an honest disagreement, but one that is fundamental and has persisted for years. There is no reason to believe this disagreement will disappear, especially if Congress enacts legislation that grants CFTC additional discretionary authority in any legislation with significant ambiguity and replete with undefined terms. The House bill appears to leave it up to CFTC to determine where FERC jurisdiction ends. The plain fact of the matter is that FERC and CFTC disagree on their respective legal authority under current law. The enactment of legislation such as the House bill would only sharpen that disagreement. To the extent there is disagreement between two federal agencies on how to interpret their legal authority, that disagreement can only be resolved by the courts or Congress, not by a Memorandum of Understanding between agencies with a good-faith disagreement. That is why a simple memorandum of understanding between FERC and the CFTC would be fundamentally inequitable and unworkable. Any such deliberation would seem to inevitably result in the CFTC's assertion of exclusive jurisdiction over matters which have historically been the legitimate purview of FERC.

To address the concerns I have outlined, we respectfully request the members of the Committee to support legislation that: (1) clarifies FERC's plenary and exclusive jurisdiction over products and services provided under a FERC-approved tariff and subject to regulatory oversight by the FERC (except for ERCOT, which the legislation should recognize is subject to the Public Utility Commission of Texas's jurisdiction), and (2) confirms that RTOs and ISOs, and ERCOT, would not be subject to CFTC regulation as if they were NYMEX-like futures exchanges or derivatives clearing organizations. We would welcome the opportunity to work with the Committee to develop legislation to address our concerns.

As you have heard from New York Public Service Commission Chairman Garry Brown, the National Association of Regulatory Utility Commissioners (NARUC) shares our industry's position on these critical issues. At its meeting in February, NARUC expressed its strong support for exclusive FERC jurisdiction over any agreement, contract, transaction, product, market mechanism or service offered or provided pursuant to a tariff or rate schedule filed and accepted by the FERC, or the Public Utility Commission of Texas for Texas/ERCOT.[3]

We believe that Congress should recognize and preserve FERC's exclusive jurisdiction. Electric and gas utilities, electricity generators, and renewable energy providers utilize FTRs and OTC derivatives to manage risk with the ultimate aim of helping to ensure stable and affordable rates for our customers. We do this by using derivatives transactions to hedge against price volatility in natural gas and wholesale electric power—two of the most volatile commodities—that already are substantially regulated. Adding CFTC regulation and costly new requirements to this mix will not resolve the issues that Congress wants to address in the wake of the financial crisis, but will serve only to increase energy costs that will ultimately be passed on to our customers. CFTC regulation should be left to areas where their expertise carries benefits, such as by focusing on the transactions and market participants that could yield a systemic risk that would jeopardize our economy or financial system.

I appreciate the Committee's invitation to testify today and your willingness to examine these issues. I hope that I have provided you with a sense of the impact of duplicative regulation of energy transactions and how it would result in higher costs for companies like FPL Group, which in turn would result in higher costs for our customers. I would be pleased to answer any questions you may have.

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[3] CS-1 Resolution on Financial Reform Legislation Affecting Over-the-Counter Risk Management Products and Its Impacts on Consumers, adopted by the NARUC Board of Directors, February 17, 2010 (attached).

Coalition for Derivatives End-Users

Identical Letter Sent To Each Member Of House

October 2, 2009

The Honorable Nancy Pelosi
U.S. House of Representatives
235 Cannon House Office Building
Washington, DC 20515

Dear Representative Pelosi:

The undersigned companies and trade associations—representing diverse segments of American industry and serving virtually all U.S. consumers—support efforts by Congress to improve transparency, accountability and stability in the nation's financial markets. As you develop a regulatory framework, we strongly urge policymakers to preserve the ability of companies to manage their individual risk exposures by ensuring access to reasonably priced and customized over-the-counter (OTC) derivative products.

Business end-users rely on OTC derivatives to manage risks including fluctuating currency exchange, interest rates, and commodity prices. By insulating companies from risk, customized OTC derivatives provide businesses with access to lower cost capital—enabling them to grow, make new investments and retain and create new jobs.

In contrast, some reform proposals would place an extraordinary burden on end-users of derivatives in every sector of the economy—including manufacturers, energy companies, utilities, healthcare companies and commercial real estate owners and developers. Specifically, proposals that would require all OTC derivatives used by business end-users to be centrally cleared, executed on exchanges or cash collateralized or subject end-users to capital charges, would inhibit companies from using these important risk management tools in the course of everyday business operations. These proposals, which would increase business risk and raise costs, are at cross purposes with the goals of lowering systemic risk and promoting economic recovery.

In order to promote U.S. competitiveness and economic growth, policymakers must ensure that any financial services reform effort allows U.S. business to manage the risks inherent to their businesses. In today's challenging economy, access to customized derivatives helps businesses maintain operations, invest in new technologies, build new plants and retain and expand workforces.

Thank you for your thoughtful consideration of our request. We look forward to working with you to promote stability and transparency as part of the ongoing economic recovery.

Sincerely,

3M
Acadia Realty Trust
Air Products and Chemicals, Inc.
Allegheny Technologies Incorporated
Alpha Natural Resources
AMB Property Corporation
AMC Entertainment Inc.
Ameren Services
American Chemistry Council
American Electric Power
American Forest & Paper Association
American Gas Association
American Residential Communities LLC
Anadarko Petroleum Corporation

Coalition for Derivatives End-Users

Identical Letter Sent To Each Member Of House

API - American Petroleum Institute
Apple Inc.
ARAMARK Corporation
Associated Estates Realty Corporation
Association for Financial Professionals
Bayer Corporation
Behringer Harvard
Boston Scientific Corporation
BP America
Brady Corporation
Brookdale Senior Living Inc.
Bunge
Business Roundtable
Cabot Corporation
Cargill, Incorporated
Caterpillar Inc.
CDW Corporation
Chesapeake Energy Corporation
CNL Financial Group
Coca-Cola Bottling Company United, Inc.
Cohen Brothers Realty Corporation
Commercial Developments International, Inc.
Commodity Markets Council
Community Health Systems
Compass Minerals
Constellation Energy
Cooper Tire & Rubber Company
Corning Incorporated
Corporate Properties of the Americas, LLC
Covidien
Cummins Inc.
Deere & Company
Devon Energy
Digital Realty Trust
Direct Energy
Dominion
Donaldson Company, Inc.
DTE Energy
Duke Energy Corporation
Dynegy
Eastman Chemical Company
Eaton Corporation
Ecolab
Edens & Avant
Edison Electric Institute
EFCO Corp.
El Paso Corporation
Electric Power Supply Association (EPSA)
Eli Lilly and Company
Emdeon Inc.
Enbridge Energy Partners and Subsidiaries
EnCana Oil & Gas (USA) Inc.
Energy Future Holdings
Entergy Corporation
Exelon Corporation
Financial Executives International
First Energy
FMC Corporation
Ford Motor Company
Forest City Enterprises, Inc.
FPL Group
GDF SUEZ Energy North America
General Electric Company
GID Investment Advisers LLC
Goodrich Corporation
Grove Property Fund LLC
Harley-Davidson, Inc.
HCA Inc.
HCR ManorCare
Health Care REIT, Inc.
Helix Funds
Hersha Hospitality Trust
Hobbico, Inc.
Host Hotels & Resorts, Inc.
IBM
Independent Petroleum Association of America
Industrial Energy Consumers of America
Information Technology Industry Council
Intel Corporation
International Housewares Association
Invenergy LLC
Johnson & Johnson
KBS Capital Advisors
KBS Real Estate Investment Trust
KBS Real Estate Investment Trust II
Kinder Morgan
Lefrak Organization Inc
Legacy Reserves LP
Lexmark
Loews Corporation
MarkWest Energy Partners, L.P.
MeadWestvaco

Coalition for Derivatives End-Users

Identical Letter Sent To Each Member Of House

Medtronic, Inc.
Meredith Corporation
Mid-America Apartment Communities, Inc.
MillerCoors
Millipore Corporation
Mississippi Manufacturers Association
Monday Properties
National Association of Manufacturers
National Association of Real Estate Investment Trusts
Natural Gas Supply Association
National Grid
National Gypsum Company
Newfield Exploration
Northwestern Energy
Novation Capital
Novelis Inc.
NRG Energy
Owens-Illinois, Inc.
PPL Corporation
Praxair, Inc.
Procter & Gamble
Progress Energy
PSEG
Questar Energy
Regency Centers Corporation
Retail Energy Supply Association
Ryder System, Inc.
ScanSource Inc.
Sempra Energy
Shell Oil Company
Simon Property Group, Inc.
Simons Petroleum, Inc.
Southern Company
Stellar Industries, Inc.
Strategic Hotels & Resorts, Inc.
Superior Graphite Co.
Superior Woodcraft, Inc.
Tenaska Marketing Ventures
Tenaska Power Services
Targa Resources
Tennant Company
Teradata Corporation
The Boeing Company
The Commonwealth Group, LLC
The Durst Organization
The JBG Companies
The John Buck Company
The Pinnacle Companies
The Process Gas Consumers Group
The Real Estate Roundtable
The Williams Companies
Thomas Properties Group, Inc.
TRW Automotive
United Launch Alliance
U.S. Chamber of Commerce
Vanguard Natural Resources, LLC
Vermeer Corporation
Volvo Group North America
Washington Gas
Weather Risk Management Association
Weingarten Realty Investors
Weyerhaeuser Company
Whirlpool Corporation
Xcel Energy
Yocum Oil Company
Zimmer, Inc.

Coalition for Derivatives End-Users

Similar letter sent to all Senate offices.

February 3, 2010

The Honorable Harry Reid
United States Senate
522 Hart Office Building
Washington, DC 20510

Dear Senator Reid:

The undersigned companies and trade associations—which represent American companies that use over-the-counter (OTC) derivatives to manage business risks including fluctuating currency rates, interest rates and commodity prices—support efforts by Congress to improve transparency, accountability and stability in the nation's financial markets. We remain concerned however, that certain proposals for reform of the OTC derivatives market would place an extraordinary burden on and competitively disadvantage end-users in diverse sectors of the economy – including manufacturing, energy, healthcare, technology, commercial real estate and other industrial sectors.

OTC derivatives provide companies with access to lower cost capital and protect against risk—enabling businesses to grow, make new investments and retain and create jobs. In promoting market stability, central clearing, transparency and oversight, it is critical that policymakers preserve the ability of companies to manage their individual risk exposures by ensuring access to reasonably-priced OTC derivative products.

Some reform proposals would require OTC derivatives used by business end-users to be executed on exchanges, centrally cleared, or subject to daily mark-to-market collateral or onerous capital charges. Such requirements could prevent companies from using these important risk management tools in the course of their everyday business operations.

We applaud the efforts of many House Members to improve the derivatives title of H.R. 4173, the Wall Street Reform and Consumer Protection Act, and recognize the need to treat businesses that use derivatives to manage risk differently than other derivatives users. We encourage the Senate to strengthen these provisions to fully protect end-users from clearing, margining, and exchange-trading requirements that could discourage them from pursuing responsible risk-mitigation strategies. The loss of these important risk management tools would be detrimental to businesses, the economy, and job creation.

In order to promote U.S. competitiveness and economic growth, policymakers should ensure that any financial services reform effort allows U.S. business to manage their risks effectively. To that end, we request that any derivatives reform package considered by the Senate should include:

- A definition of "major swap participant" that excludes businesses whose derivatives use does not pose a threat to financial stability and that use OTC derivatives to hedge business risk;

- Explicit exemptions from central clearing, bilateral margining and exchange-trading requirements for business end-users;

- Clarification that any increases to capital charges should be based on actual risk of loss and aimed at promoting the safety and soundness of the financial system, and should not be assessed to penalize the use of OTC derivatives or otherwise create an incentive to centrally clear transactions; and

- Legislative certainty that any new requirements are applied prospectively, recognizing that market participants negotiated existing trades based on the laws and market practices in effect at the time of these transactions.

In today's challenging economy, access to customized derivatives helps businesses maintain operations, invest in new technologies, build new plants and retain and expand workforces.

Thank you for your thoughtful consideration of our request. We look forward to working with you and your staff to promote stability and transparency as part of the ongoing economic recovery.

Sincerely,

3M
A&D Insight, LLC
Acadia Realty Trust
Aerospace Industries Association of America, Inc.
Air Products and Chemicals, Inc.
Alcoa
Allegheny Energy
Allegheny Technologies Incorporated
Alliant Energy Corp.
Allstate Insurance Company
AMB Property Corporation
AMC Entertainment Inc.
Ameren Services
American Adhesive Coatings Company
American Electric Power
American Forest & Paper Association
American Gas Association
American Petroleum Institute
American Residential Communities
Anadarko Petroleum Corporation
Applied Materials, Inc.
ARAMARK Corporation
Arch Coal Inc.
Ashford Hospitality Trust
Associated Estates
Associated Industries of Massachusetts
Association for Financial Professionals (AFP)
Atmos Energy
Avista
Bayer Corporation
Black Diamond Minerals, LLC
Black Hills Corporation
Blyth, Inc.
Bobrick Washroom Equipment, Inc.
Bolton Emerson Americas
Boston Scientific Corporation
Business Roundtable
BP America
Cabot Corporation
Caribbean Property Group
Caterpillar Inc.
Chatham Financial
Chesapeake Energy Corporation
CIP Real Estate
CMS Energy
CNL Financial Group
Columbia Sussex Corporation
Community Health Systems

Compass Minerals
ConAgra Foods, Inc.
ConGlobal Industries
Constellation Energy
Cordillera Energy Partners III, LLC
Craton Capital Management, LLC
Cummins Inc.
Cybex International Inc
Dean Foods Company
Deere & Company
Devon Energy Corportation
Dominion
Donahue Schriber Realty Group L.P.
Douglas Emmett
Duke Energy
Dynegy Inc.
Eagle Rock Energy Partners, L.P.
Eaton Corporation
Ecolab Inc.
Edison Electric Institute
Edison International
El Paso Corporation
Emdeon
Enbridge Energy Company, Inc.
EnCana Oil & Gas (USA) Inc.
Energy Future Holdings Corp.
Entertainment Properties Trust
EOG Resources, Inc.
Exelon Corporation
Financial Executives International
First Capitol Ag
FMC Corporation
Ford Motor Company
Forest City Enterprises, Inc.
Formation Capital
FPL Group
GID Investment Advisers LLC
Glimcher Realty Trust
Golden Living
Goodrich Corporation
Hampshire Real Estate
HCA Inc.
HCR ManorCare
Health Care REIT, Inc.
Heritage Feeders, L.P.
Hersha Hospitality Trust
Hess Corporation
Host Hotels & Resorts, Inc.
Hyundai Capital America / Hyundai Motor
Finance Company
IBM
Independent Petroleum Association of America
Independent Petroleum Association
of Mountain States (IPAMS)
Jungs Station Associates
Kansas City Power & Light Company
KBS Real Estate Investment Trust, Inc.
Kelly-Moore Paint Co.,Inc.
Kerzner Istithmar Limited
Kilroy Realty Corporation
Legacy Partners Residential, Inc.
Lexmark International, Inc.
LINN Energy
Loews Corporation
Marlin Steel Wire Products, LLC
Medtronic, Inc.
Mid-America Apartment Communities, Inc.
MidAmerican Energy Holdings Company
MillerCoors
Mississippi Manufacturers Association
MVP Management Corporation
National Association of Corporate Treasurers
National Association of Manufacturers
National Association of Real Estate
Investment Trusts
National Grid
National Gypsum Company
National Mining Association
National Retail Properties, Inc.
Newfield Exploration Company
Nissan North America, Inc.
Novation Partners
Novelis Inc.
Ocean Properties LTD.
ONEOK, Inc.
Portland General Electric
Public Service Enterprise Group
Puget Sound Energy
Quadrangle Development Corporation
Questar Corporation
Regency Centers Corporation
Rolls-Royce North America
Ryder System, Inc.
Sealed Air Corporation
Simon Property Group
Simons Petroleum, Inc.
Southern Union Gas Services, Ltd.
Southwestern Energy Company
Sprinkle Financial Consultants LLC
St. Mary Land & Exploration Co.
Strategic Hotels & Resorts, Inc
Superior Graphite Co.
Superior Woodcraft, Inc.
Swift Energy Company
Targa Resources, Inc.
Teradata Corporation
Texas Independent Producers and
Royalty Owners Association
Texas Oil & Gas Association
Texas Pipeline Association
The AES Corporation
The Boeing Company

The Commonwealth Group
The Durst Organization
The Procter & Gamble Company
The Real Estate Roundtable
The Timken Company
The Walt Disney Company
Thomas Properties Group, Inc.
Timberlane Village associates
UM Holdings Ltd
U.S. Chamber of Commerce
United Technologies Corporation
Vectra Management Group
Vermeer
W. R. Grace
Walker Center Associates, LLC
Weingarten Realty Investors
Whiting Petroleum Corporation
Xcel Energy
Zilber Ltd
Zimmer, Inc

AMERICA'S NATURAL GAS ALLIANCE AXPC AGA American Gas Association APPA American Public Power Association

American Public Gas Association AWEA COMPETE EEI EDISON ELECTRIC INSTITUTE

EPSA IPAA NGSA National Rural Electric Cooperative Association US Oil & Gas Association ADVOCATE FOR THE OIL & GAS INDUSTRY

Joint Association Letter Regarding the OTC Derivatives Issue

January 21, 2010

Dear Senator:

The undersigned associations represent all the major segments of the electric power and natural gas industries serving every consumer in the United States. We are writing to express our recommendations to address oversight and transparency of over-the-counter (OTC) derivatives markets. 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 energy-related OTC derivatives products and markets. Our members rely on these products and markets to manage price risk and help keep costs stable and affordable for consumers.

When discussing any increased regulation of 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 one percent of the global OTC derivative market, and the energy commodity portion is yet a fraction of that one percent. Congress should therefore maintain an appropriate balance between establishing a market oversight rule that allows 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 commodity market end-users of OTC derivatives products,** such as electric and gas utilities that use OTC derivatives markets to primarily hedge against commodity price risk associated with their business. End-user transactions in commodity derivatives do not contribute to systemic risk, and, therefore, these end-users should be exempted from any 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 energy 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 energy 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 mandatory reporting requirements and a central data repository, as opposed to mandatory clearing for energy.

- **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 electricity 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 physical transactions with enforceable delivery obligations 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 companies 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.

List of supporting associations:

America's Natural Gas Alliance, American Exploration and Production Council, American Gas Association, American Public Power Association, American Public Gas Association, American Wind Energy Association, COMPETE Coalition, Edison Electric Institute, Electric Power Supply Association, Independent Petroleum Association of America, Interstate Natural Gas Association of America, Large Public Power Council, Natural Gas Supply Association, National Rural Electric Cooperative Association, and US Oil & Gas Association.

GS-1 Resolution on Financial Reform Legislation Affecting Over-the-Counter Risk Management Products and Its Impacts on Consumers

WHEREAS, There is a diverse group of end-users, consisting of electric and natural gas utilities, suppliers, customers, and other commercial entities who rely on over-the-counter ("OTC") derivative products and markets to manage electricity and natural gas price risks for legitimate business purposes, thereby helping to keep rates stable and affordable for retail consumers; *and*

WHEREAS, The United States Congress is considering financial reform legislation with the goal of ensuring that gaps in regulation, oversight of markets and systemic risk do not lead to economic instability; *and*

WHEREAS, Previous NARUC resolutions support federal legislative and regulatory actions that fully accommodate legitimate hedging activities by electric and natural gas utilities; *and*

WHEREAS, The proposed legislation would, among other things, provide the Commodity Futures Trading Commission (CFTC) with oversight of OTC risk management products, including mandatory centralized clearing and exchange trading of all OTC products; *and*

WHEREAS, Mandatory centralized clearing of all OTC contracts will increase expenses associated with hedging activity, and ultimately end-user prices, due to increased margin requirements; *and*

WHEREAS, A report by the Joint Association of Energy End-Users stated that the effect of margin requirements resulting from mandatory clearing for electric utilities would have the unintended effect of reducing or eliminating legitimate hedging practices and could jeopardize or reduce investments in Smart Grid technology; and for natural gas utilities and production companies could reduce capital devoted to infrastructure and natural gas exploration; *and*

WHEREAS, The laudable goals of reform that ensure market transparency and adequate regulatory oversight can be accomplished by means other than mandatory clearing of OTC risk management contracts and the anticipated extra expense. For example, a requirement that natural gas and electric market participants engaging in legitimate hedging report all OTC derivative transactions to a centralized data repository, like the CFTC, provides sufficient market transparency without the costs associated with mandatory clearing; *and*

WHEREAS, Proposed reforms would cause regulatory uncertainty with regard to the oversight of Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs), where such uncertainty and/or overlapping jurisdiction can lead to negative impacts on liquidity, market confidence and reliability; *and*

WHEREAS, The Federal Energy Regulatory Commission (FERC), and the Public Utility Commission of Texas (PUCT) for Texas/ERCOT, as the regulators with the necessary expertise and statutory mandates to oversee electricity and natural gas markets to protect the public interest and consumers, should not be preempted by the financial reform legislation from being able to continue exercising their authority to ensure reliable, just and reasonable service and protect consumers; *and*

WHEREAS, Energy markets currently regulated by FERC or the PUCT (for Texas/ERCOT) under accepted tariffs or rate schedules should continue to be subject to FERC's and the PUCT's (for Texas/ERCOT) exclusive Federal jurisdiction, including jurisdiction over physical and financial transmission rights, and market oversight; and should themselves not be subject to CFTC jurisdiction as a clearinghouse due to the financial and other settlement services they provide those transacting in regional electricity markets; *now, therefore be it*

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners, convened at its 2010 Winter Committee Meetings in Washington, D.C., supports passage of financial reform legislation ensuring that electric and natural gas market participants continue to have access to OTC risk management products as tools in their legitimate hedging practices to provide more predictable and less volatile energy costs to consumers; *and be it further*

RESOLVED, That new financial legislation being considered by Congress should weigh the costs of potential end-user utility rate increases versus the benefits of new standards for the clearing of OTC risk management contracts used by natural gas and electric utilities for legitimate hedging purposes; *and be it further*

RESOLVED, That any federal legislation addressing OTC risk management products should provide for an exemption from mandatory clearing requirements for legitimate hedging activity in natural gas and electricity markets; *and be it further*

RESOLVED, That any exemption to the mandatory clearing requirement for OTC derivatives be narrowly tailored as to not allow excessive speculation in natural gas and electricity markets; *and be it further*

RESOLVED, That the FERC, and the PUCT for Texas/ERCOT, charged with the statutory obligation to protect the public interest and consumers, should continue to be the exclusive Federal regulators with authority to oversee any agreement, contract, transaction, product, market mechanism or service offered or provided pursuant to a tariff or rate schedule filed and accepted by the FERC, or the PUCT for Texas/ERCOT; *and be it further*

RESOLVED, That NARUC authorizes and directs the staff and General Counsel to promote with the Congress, the Commodity Futures Trading Commission and other policymakers at the federal level, policies consistent with this statement.

Sponsored by the Committee on Gas, Consumer Affairs, and Electricity
Adopted by the NARUC Board of Directors February 17, 2010