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February 22, 2011

By Electronic Submission

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: End-User Exception to Mandatory Clearing of Swaps
(RIN 3038-AD10)

Dear Mr. Stawick:

San Diego Gas & Electric Co. ("SDG&E") appreciates the opportunity to provide comments on the end-user clearing exception rule proposed by the Commodity Futures Trading Commission ("CFTC" or "Commission") to implement Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1]

SDG&E is a regulated public utility that provides safe and reliable energy service to 3.4 million consumers through 1.4 million electric meters and 840,000 natural gas meters in San Diego and southern Orange counties. As an end user, SDG&E relies on derivatives to hedge or mitigate commodity market and interest rate risks that arise in the normal course of business. To protect our customers from price volatility, SDG&E's procurement function uses energy derivatives to hedge or mitigate risks primarily related to natural gas and electricity prices and the specific physical locations where we transact. These derivatives include fixed-price natural gas positions, options, and basis risk instruments. We rely on over-the-counter products, in part, because they allow us to hedge natural gas and electricity delivery at locations for which no standard futures contract is available. All of these derivatives are governed by risk management and transacting activity plans supporting electricity and generation fuel procurement that have been filed with and approved by the California Public Utilities Commission. We also use

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010). The proposed rule is set forth in End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747 (proposed Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 39) ("NOPR").

interest rate derivatives to moderate our exposure to interest rates primarily as a result of our current and expected use of financing.[2]

Introduction

Congress designed the end-user exception so that businesses could continue to hedge commercial risk without incurring new clearing-related costs.[3] SDG&E is not a financial entity, and it only uses swaps to hedge or mitigate commercial risk. Accordingly, SDG&E qualifies for the end-user exception, so long as it "notifies the Commission . . . how it generally meets its financial obligations associated with entering into noncleared swaps."[4] Because we believe the notification requirements should not make the clearing exception excessively burdensome for end users to elect, and because failure to comply with the end-user exception rules could result in severe criminal penalties,[5] it is critically important that the final notification requirements are clear to end users and not overly complex. With these goals in mind, SDG&E offers the following suggestions:

- Instead of a real-time, swap-by-swap notification requirement, the Commission should adopt an annual, general notification requirement for all uncleared swaps.

- Instead of swap-by-swap approval by an appropriate committee of the board of directors, the Commission should permit the board committee either generally to approve uncleared swaps or, alternatively, to delegate its approval authority to an official subject to its supervision.

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[2] These comments are based on, and on behalf of, SDG&E's trading to support its electricity and power plant fuel procurement. Note that SDG&E's core natural gas portfolio (to serve its retail natural customers) is combined with that of its affiliate, Southern California Gas Company, which manages this combined portfolio through a separate trading operation. All hedges supporting this combined portfolio are done with SoCalGas as the counterparty to the transaction, although a certain portion of the costs and benefits from SoCalGas' hedging are flowed through to SDG&E's core customers.

[3] *See* Letter from Sens. Dodd and Lincoln to Reps. Frank and Peterson (June 30, 2010), *in* 156 Cong. Rec. S6192 (daily ed. July 22, 2010) ("Whether swaps are used by an airline hedging its fuel costs or a global manufacturing company hedging interest rate risk, derivatives are an important tool businesses use to manage costs and market volatility. This legislation will preserve that tool. Regulators . . . must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk.").

[4] Dodd-Frank § 723(a)(3) (to be codified at 7 U.S.C. § 2(h)(7)(A)(iii)).

[5] *See id.* § 741(b)(7) (to be codified at 7 U.S.C. § 13(a)(6)) (making it a felony punishable by a fine of not more than $1,000,000 or imprisonment for not more than ten years, or both for "[a]ny person to abuse the end user clearing exemption").

- The Commission should generally avoid imposing unnecessary new requirements on entities, such as SDG&E, that are already subject to extensive, and effective, regulation.

Notification

The Commission asked whether it would be "difficult or prohibitively expensive for persons to report the information required under the proposed § 39.6."[6] The Commission further invited comment on whether there is "a more feasible and cost effective way for the Commission to receive notification regarding the use of the end-user clearing exception."[7] SDG&E commends the Commission for its sensitivity to the potential burdens of complying with the end-user exception's notification requirement. SDG&E respectfully submits that an omnibus, annual notification of how the end user generally meets its financial obligations associated with entering into uncleared swaps would be more consistent with Dodd-Frank and more feasible for end users such as SDG&E.

The Commission's proposed rule is significantly more expansive than Dodd-Frank's notification requirement. Dodd-Frank requires an end user choosing not to clear swaps to "notif[y] the Commission . . . how it *generally* meets its financial obligations associated with entering into noncleared *swaps*."[8] Dodd-Frank therefore contemplates a general requirement relating to all uncleared swaps. Dodd-Frank does not suggest, much less require, notification of how the end user meets its financial obligations with respect to each individual swap.

By contrast, the Commission's proposed rule requires disclosure with respect to each particular swap that is not being cleared. This disclosure must occur "each time the end-user clearing exception is elected."[9] And this disclosure must contain twelve specific items of information related to the swap.[10] Particularly in light of the many other new requirements Dodd-Frank imposes on end users of derivatives, these twelve additional certifications required each and every time we enter into an uncleared swap seem unnecessarily difficult and burdensome.

The Commission's proposed, extensive notice obligation will result in additional expense for end users. Specifically, end users will incur compliance costs related to each of the

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[6] NOPR, 75 Fed. Reg. at 80,750.

[7] *Id.* at 80,752.

[8] Dodd-Frank § 723(a)(3) (to be codified at 7 U.S.C. § 2(h)(7)(A)(iii)) (emphasis added).

[9] NOPR, 75 Fed. Reg. at 80,748, 80,756.

[10] *See id.* at 80,749, 80,757.

twelve specific disclosures for each swap, each time it enters into an uncleared swap. Detailed and potentially frequent disclosures pose the further risk that an end user will be forced to reveal sensitive commercial information that might, in turn, harm its business. An omnibus, annual notification of how the end user generally meets its financial obligations associated with entering into uncleared swaps would solve these problems.

A general notification would also serve the Commission's objectives of (1) collecting information about how the end-user clearing exception is being used; (2) encouraging deliberation by electing counterparties; and (3) efficiently monitoring potential abuses of the end-user clearing exception.[11] Under our proposed alternative approach, end users would still provide information regularly to the Commission about how the exception is being used, and this information would still enable the Commission to identify and investigate potential abuses of the clearing exception. Additionally, the end user choosing not to clear a swap would still be forced to engage in appropriate deliberation. In fact, general deliberation might be more effective in encouraging end users to look holistically at the risk and benefits of an entire swap portfolio. By contrast, real-time, swap-by-swap notification would have minimal, if any, additional benefit to the Commission or to end-user counterparties.

Finally, applying an onerous, swap-by-swap notification requirement to SDG&E would serve no purpose. SDG&E is a regulated utility, and all of our energy swaps are traded pursuant to plans filed with and approved by the California Public Utilities Commission. Accordingly, SDG&E already engages in appropriate deliberation related to its derivatives activity, and already discloses this activity to appropriate regulators.

Board Approval

SDG&E is an issuer of securities under Section 12 of the Securities Exchange Act of 1934, and it is required to file reports pursuant to Section 15(d) of that Act. Accordingly, Dodd-Frank permits SDG&E to elect the clearing exception "only if an appropriate committee of the issuer's board or governing body has reviewed and approved its decision to enter into *swaps*" subject to the exception.[12] As with the notification requirement, Dodd-Frank's use of the plural form "swaps" contemplates that the appropriate committee of the board may give general, rather than swap-by-swap, approval.

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[11] *See id.* at 80,751-52 ("The Commission anticipates that empirical data collected in this manner will aid its ability to evaluate how the end-user clearing exception is being used and encourage appropriate deliberation by counterparties prior to its use. The Commission also preliminarily believes receiving notification and other information in connection with CEA Sections 2(h)(7)(A)(iii) and 2(h)(7)(F) through SDRs should allow monitoring for potentially abusive practices, and timely action to address abusive practices if they were to develop.").

[12] Dodd-Frank § 723(b) (to be codified at 7 U.S.C. § 2(j)) (emphasis added).

Again, however, the proposed rule would require end users to certify that "an appropriate committee of the board of directors (or equivalent body) has reviewed and approved the decision not to clear *the swap*."[13] Because SDG&E may enter into numerous small swaps each quarter, swap-by-swap approval will impose excessive burdens on the governance of our business. SDG&E therefore urges the Commission to clarify that an end user complies with Dodd-Frank's board approval requirement when an appropriate committee of its board of directors approves all uncleared swaps or a policy generally governing uncleared swaps. As we have proposed above, an annual, general certification to the Commission should satisfy Dodd-Frank's requirements. Alternatively, SDG&E believes that a committee of the board should be permitted to delegate swap-by-swap approval authority to an appropriate official subject to board supervision.

FERC-Regulated Markets

Finally, in implementing Dodd-Frank, the Commission should remain sensitive to the fact that the utilities market and market participants are already subject to extensive regulation by the Federal Energy Regulatory Commission ("FERC"). Transactions by utilities such as SDG&E in FERC-regulated markets, especially in the context of real-time scheduling, are already transparent and are thus consistent with a major goal of Dodd-Frank. Further, as Congress recognized in requiring the CFTC to enter into a memorandum of understanding with FERC, the overlapping interests of the two Commissions give rise to many potential jurisdictional or regulatory conflicts.[14] Accordingly, SDG&E urges the CFTC to exercise caution before imposing additional, duplicative, and potentially inconsistent regulatory requirements on market participants in FERC-regulated markets.

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SDG&E appreciates the opportunity to comment on the proposed end-user exception rule. For the foregoing reasons, we think these suggested changes to the proposed rule would lessen the compliance burden on end users and, as Congress intended, preserve our ability to hedge risk without compromising the Commission's important oversight role.

Sincerely,

/s/ E. Gregory Barnes
E. Gregory Barnes

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[13] NOPR, 75 Fed. Reg. at 80,757 (proposed 17 C.F.R. § 39.6(b)(6)(ii)) (emphasis added).

[14] *See* Dodd-Frank § 720.

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner