

# EVO & TO

## Where are we now?

CFTC Energy and Environmental Markets Advisory Committee Meeting

July 29, 2015

Paul Hughes, Manager, Risk Control, Southern Company Services

Arushi Sharma Frank, Director of Regulatory Affairs and Counsel, Electric Power Supply Association

# Disclaimer

Materials and statements expressed in this presentation do not necessarily reflect the views of any particular company or Association with respect to any issue discussed herein, and are not attributable to any party other than the presenters. Anyone viewing or listening to the presentation or using this document should note that the document is for discussion purposes only in the context of the proceeding in which it has been presented. Neither the presenters nor any third party make any warranties, expressed or implied, nor representations about the accuracy of the information or its appropriateness for any given purpose or situation. The statements and publication shall not be construed as including advice, guidance, or recommendations to take, or not to take, any actions or decisions in relation to any matter, including without limitation relating to investments or the purchase or sale of any securities, shares or other assets of any kind. Should you take any such action or decision, you do so at your own risk. Information on the topics covered may be available from other sources, which you may wish to consult for additional views or information not covered.

# Since we last spoke about EVO & TO...

- Proposed TO rule welcomed
  - Continuing to track and are very supportive of the proposed TO relief.
  - Hope for some additional rule revisions and clarifications in preamble guidance.
  - Disappointed with no mention of Position Limits exclusion for TO. Comment docket shows energy stakeholder support (especially from end-users) for clarity on PL Exclusion to be included in the final TO rule.
- Southern is in the process of re-evaluating its previous agreements based on the revised EVO language.
- General “sigh of relief” across the industry for EVO clarity, but...
- Spent a lot of time discussing preamble language and concurrences...
  - Treatment of Capacity Contracts
  - Contracts that allow for zero or nominal delivery
- Will discuss today how the TO docket can be a forum for clear direction on EVO vs. TO analysis.

# Bridging the Gap Between Forwards and Swaps

**Forward Contracts** with  
“embedded optionality”  
(intended to be *physically*  
settled)

**Stand-alone Commodity  
Trade Options**  
(intended to be *physically*  
settled)

**Commodity Options**  
(*financially* settled)

Facts and Circumstances Bridge



**Forward Contracts**

A

B



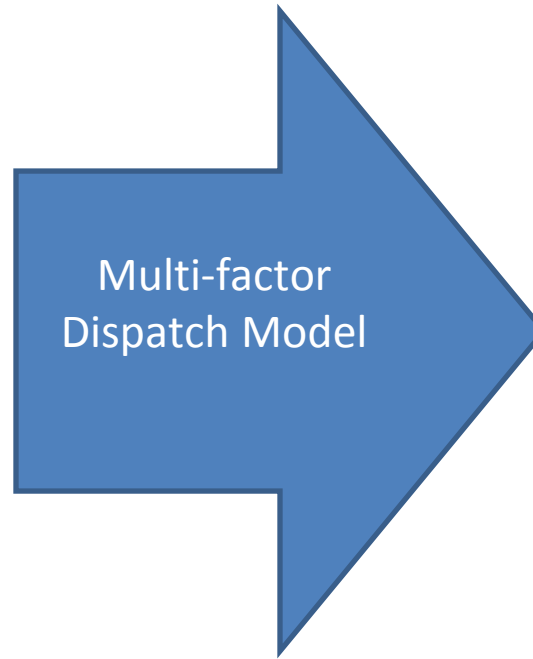
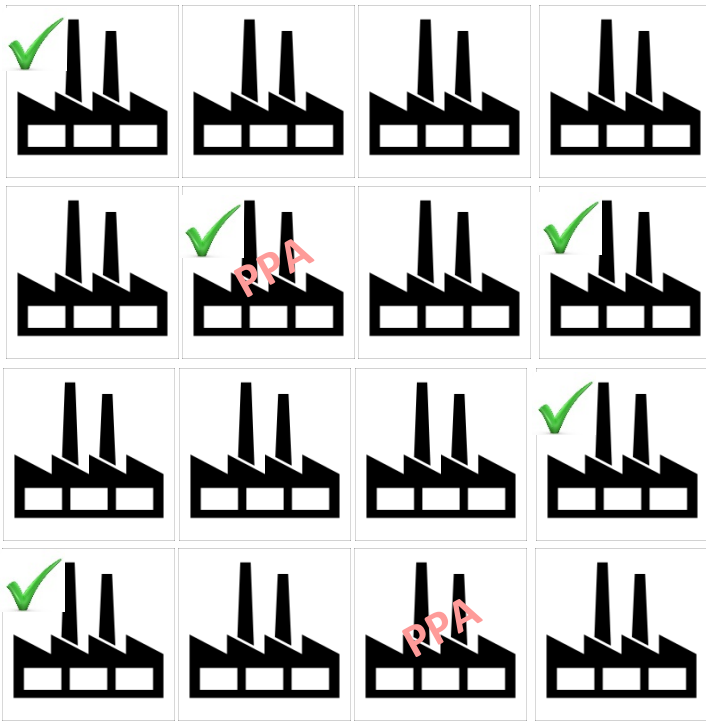
**Swaps**

The term “swap” does not include any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.  
- CEA 1a(47)(B)(ii)

The term “swap” means any agreement, contract, or transaction that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind.  
- CEA 1a(47)(A)(i)

# Example

## Generation Fleet, including PPAs



## Power

- Regional Physical Markets
- Real-time nature of business requires ability to take zero, *but does not change the settlement intent* (no storage / real-time business)
- Capacity contracts
- Accounting Rules provide exception for capacity type transactions
- *Facts & Circumstances support physical settlement*

## Gas

- Regional Physical Markets
- Real-time nature of business requires ability to take zero, *but does not change the settlement intent*
- Storage is not always available
- *Facts & Circumstances support physical settlement*

# Issues That Need... **CLARITY**

- Swap Definition / CEA Exclusion Interpretation
  - How do “facts & circumstances” apply to:
    - (i) Contracts with the intent to physically settle that allow zero or nominal delivery (including, but not limited to “peaking” or “swing” contracts).
  - Affirmation of Treatment of Capacity Contracts

Separately...

- Exclusion of Trade Options from Position Limits

# “Facts and Circumstances” - Physical Gas Contracting

**A. A natural gas utility enters into a Master Physical Gas/Base Supply Agreement with a natural gas producer in 1998.**

Characteristics of the 1998 Physical Gas Master Agreement (“Base Contract”):

- (i) No obligation on *either party to do anything, e.g. enter into any specific deal for physical gas*
- (ii) Dictates on a going-forward basis the business relationship *if the parties choose* to enter into a physical delivery agreement
- (iii) Contemplates *only* physical delivery based on to-be-determined pricing, quantity and service terms
- (iv) Any financial options tied to physical delivery must be reflected in *amendment* to physical master/base or separately reflected in financial documentation, e.g. ISDA

**B. The natural gas utility and gas producer choose to undertake three different deals pursuant to the same underlying Physical Gas Master Agreement. executed on separate transaction confirms:**

B1 - Interruptible Delivery (fully interruptible by buyer or seller)

B2 - Firm Variable (baseload/minimum take + swing as percentage thereof)

B3 - Firm (no baseload/minimum take + peaking or swing of up to fixed qty.)

***Given what we know about the agreement, how would these contracts be classified?***

# Industry Report: Classification Approaches Differ

- Clarity achieved on “Firm Variable” and “Interruptible”
- Treatment of “Firm” by market participants is inconsistent
  - Views may not be shared between physical counterparties as to contract characterization... “agree to disagree”
  - Smaller suppliers (independent producers, marketers, storage providers) are not responding to solicitations or Requests for Proposals for peaking/firm end-user to end-user deals



# Proposed Solutions

## TO Proposal is an Important Starting Point

- Could get small EUs back in the game if Form TO no longer required
- Careful review of comments on the TO “tracking” issue
- Some comments discuss the quantification challenges for valuation of TOs for reporting and/or tracking

## TO Final Rule is an Opportunity for Further Clarity

- Final rule should clarify and affirm that physical contracts which allow for zero or nominal delivery may satisfy the CFTC’s interpretations and guidance on forward contracts, in light of a Facts and Circumstance Analysis demonstrating that such contracts exclusively intend physical settlement

*This is consistent with the Seven-Part Test, which itself contemplates that actual delivery may or may not occur*

- Clarify capacity contracts status
- Clarify that TOs are excluded from future Position Limits rule

# In closing, a bit of perspective...

Federal Power Act – 80 years (1935)



Natural Gas Act – 77 years (1938)



Dodd-Frank Act – 5 years (2010)





Electric Power Supply Association  
*Advocating the power of competition*



**Arushi Sharma Frank**  
**Director of Regulatory Affairs, and Counsel**  
**Electric Power Supply Association**  
**1401 New York Ave., NW**  
**Suite 1230**  
**Washington, DC 20005**  
**(202) 628-8200 | [asharmafrank@epsa.org](mailto:asharmafrank@epsa.org)**

**Paul Hughes, CPA**  
**Manager, Risk Control**  
**Southern Company Services**  
**600 18<sup>th</sup> Street North**  
**GS-8164**  
**Birmingham, AL 35203**  
**(205) 257-3035 | [phughes@southernco.com](mailto:phughes@southernco.com)**