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Kathleen L. Barrón, Esq.  
Vice President  
Federal Regulatory Affairs and Policy

Telephone 202.347.7500  
Fax 202.347.7501  
www.exeloncorp.com

Exelon Corporation  
101 Constitution Avenue, NW  
Suite 400 East  
Washington, DC 20001

September 20, 2010

**Via E-Mail**

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

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: COMMENTS OF EXELON CORPORATION  
Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and  
Consumer Protection Act (RIN 3235-AK65; 3038-AD06)

Dear Mr. Stawick and Ms. Murphy:

On August 20, 2010, the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (together the "Agencies") issued a joint Advance Notice of Proposed Rulemaking ("ANOPR").<sup>1</sup> The Agencies sought public comment on "key definitions" for terms the Agencies must further define and implement under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").<sup>2</sup> Exelon Corporation ("Exelon") appreciates the opportunity to provide such comments.

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<sup>1</sup> Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (Aug. 20, 2010).

<sup>2</sup> Public Law No. 111-203, 124 Stat. 1376 (2010). Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010," according to Section 701 of the Act.

## **Introduction**

Exelon's operations and assets are in the generation, transmission and distribution sectors of the electric utility industry and the distribution sector of the natural gas industry. Exelon owns two distribution utilities, Commonwealth Edison Company ("ComEd") and PECO Energy Company ("PECO"), which together provide electric distribution service to over five million retail electric customers in northern Illinois and in southeastern Pennsylvania.<sup>3</sup> ComEd and PECO also own transmission assets, which are operated by the PJM Interconnection, L.L.C. ("PJM"). Exelon's third principal business unit is Exelon Generation Company, LLC ("ExGen"), which owns and operates all of Exelon's power plants.

Accordingly, Exelon is not a traditional, vertically-integrated utility that owns and operates all three facets of the electricity business, and that therefore charges bundled, regulated rates to all of the retail customers in the traditional service territories of the utilities it owns. Rather, ComEd and PECO charge regulated distribution service rates and receive FERC-regulated rates that reflect their share of the transmission assets PJM operates. ExGen sells its generation at market-based rates primarily in PJM and in the geographic footprints in which other regional transmission organizations ("RTOs") operate transmission systems.

With respect to the electricity generation component of its business, at the retail level in both Illinois and Pennsylvania, retail customers can choose alternative competitive energy suppliers. Those that do not do so receive provider-of-last-resort ("POLR") service from ComEd or PECO. To serve this load, both utilities procure power competitively through state-mandated programs in which ExGen participates.<sup>4</sup> ExGen, therefore, does not provide supply for all of its affiliated utilities' POLR customers.<sup>5</sup>

Therefore, ExGen has a significant amount of generation supply exposed to the volatile spot market prices for energy that prevail in RTOs like PJM, where most of ExGen's assets are located. Rather than take the substantial commercial risk which that exposure entails, ExGen chooses to hedge, or "lock-in," to a significant extent, the price it receives for the generation that would otherwise be exposed to volatile spot market prices. It does so to a material extent by participating in the competitive, mature, over-the-counter ("OTC") bilateral market for swaps. Given the foregoing, Exelon has a significant interest in the Agencies' implementation of this important new legislation.

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<sup>3</sup> PECO Energy Company also provides natural gas service to about 500,000 retail customers in the suburban counties surrounding the City of Philadelphia.

<sup>4</sup> Through the end of 2010, ExGen is PECO's full requirements supplier. Starting January 1, 2011, winners in PECO's procurement process for service as of that date will begin to supply PECO's POLR requirements.

<sup>5</sup> In fact, ExGen is limited to certain percentages of the power procured by ComEd and PECO in accordance with the rules and regulations applicable to procurement for POLR load in Illinois and Pennsylvania. Additional information concerning Exelon can be found in a presentation attached hereto entitled "A Power Producer's Perspective on Dodd-Frank (Hedging Physical Power)," which Exelon shared with CFTC staff on September 2, 2010 (the "Exelon Hedging Presentation").

## **Substantive Comments**

At the outset, Exelon states that it fully supports the policy objectives underlying the Act, and believes that increased oversight and transparency of the OTC market to prevent systemic risk is appropriate and necessary. Regulatory oversight of a market ensures that its participants follow the rules, and significantly deters manipulation that can distort prices. A market that is not at risk of collapse is good for Exelon and all market participants.

Exelon also believes that use of OTC swaps to hedge commercial risk by businesses like ExGen, whose core business is the production and sale of a real product in physical wholesale markets for that product, does not create systemic risk. Accordingly, Exelon suggests that the key definitions that will dictate which entities are regulated more substantially than others should be carefully tailored to ensure that entities like Exelon are not subject to the requirements imposed on swap dealers and major swap participants. Accordingly, Exelon offers the following comments on the key definitions contained in the ANOPR.

### **I. Swap**

Exelon believes that Congress did not intend to expand or change the common understanding of the term "swap," which is an agreement that is structured to settle financially, most often taking the form of a fixed for floating swap (a transaction wherein one party pays the other a fixed price times a notional quantity and the other party pays a floating price that is usually linked to an index – *i.e.*, the parties "swap" a fixed price stream for a floating price stream).<sup>6</sup> Such an agreement does not have any physical delivery obligation. In contrast, physical agreements expressly require the delivery of a real product in exchange for payment.

One question the Agencies face is whether the fact that contracts with physical delivery obligations can be and are on occasion "booked out" renders such contracts financial rather than physical, and therefore potentially within the ambit of the Act. The answer is no.

Counterparties in the energy markets may book out one or more contractual obligation to deliver, for all or a portion of contractually contemplated delivery terms, if the product they have bought and sold with each other, at different times and therefore almost always at different prices, is the same.<sup>7</sup> For example if A has a sale to B of 100 MW of firm energy around-the-clock ("ATC") for the month of August, 2010 for a fixed price of \$50/MWh, and B has a sale to A of 50 MW for the same month and also of firm energy ATC but at \$60/MWh, for convenience A and B may choose to fulfill some of their delivery and receipt obligations by booking out 50 MW before the beginning of the delivery term. As a

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<sup>6</sup> Examples of energy fixed for floating swaps are set forth on pages 9 and 11-12 of the Exelon Hedging Presentation.

<sup>7</sup> As explained in the next section of this letter, companies like Exelon are always rebalancing their hedge positions as circumstances warrant. Therefore, it is not unusual for a company like Exelon to buy and sell with the same counterparty for the same product and delivery term.

result of the book out, neither 50 MW of A's sale to B nor B's 50 MW sale to A are scheduled, but the parties still owe each other the prices they agreed to pay. As most parties have underlying agreements that allow them to net payment obligations, a book out may also result in a net payment. In this example, as A owes B \$60 and B only owes A \$50, to effect payment A pays B \$10 if A and B have a payment netting provision in their underlying enabling agreements. Note also that in this example, A still has to schedule/deliver 50 MW to B, and B must confirm the schedule for 50 MW and pay the \$50 fixed price for it, because A and B have only booked out half of A's 100 MW sale to B.

As this example makes clear, a book out simply enables parties to forego the obligation to schedule amounts which, at the time of delivery under both contracts, are not needed by the other party. In addition, the mutual desire to book out only arises as the delivery term approaches, and only if both parties decide that it would be more convenient to book out than to deliver the same amount to each other. Neither party has a unilateral right to book out; they must agree to do so and thereby contractually remove the prior delivery and receipt obligations they had to each other.

As Senators Dodd and Lincoln observed in their public letter to Representatives Frank and Peterson:

[I]n implementing the derivatives title, Congress encourages the CFTC to clarify through rulemaking that the exclusion from the definition of swap for "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled" is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and the CFTC's established policy and orders on this subject, including situations where commercial parties agree to "book-out" their physical delivery obligations under a forward contract.<sup>8</sup>

Accordingly, Exelon suggests that the Agencies include the following elements as part of the definitions needed to fully define the term "swap:"

**A "swap" shall mean "an agreement, contract or transaction which requires financial settlement."**

**A sale that is "intended to be physically settled" shall mean a sale "made pursuant to an agreement or contract containing a legally enforceable delivery obligation."**

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<sup>8</sup> Letter from Senators Christopher Dodd and Blanche Lincoln to Representatives Barney Frank and Collin Peterson, June 30, 2010, at 3 ("This letter seeks to provide some additional background on legislative intent on . . . various sections of Title VII of . . . the Dodd-Frank Act.") (the "Dodd-Lincoln Letter").

## II. Swap Dealer

As understood by the marketplace, a swap dealer is an entity that performs the intermediary function of facilitating a market for swaps, and this understanding is reflected in the governing statutory language in the Act. A swap dealer is in the business of offering to buy and sell swaps, because it sits in the center of the market in which it actively promotes and facilitates transactional activity. It earns profits primarily by executing transactions at different prices within the spread between market bids to buy and offers to sell. It is not hedging the risk of its commercial activities; it is making markets in swaps with the aim of making profits in so doing.

A swap dealer has the opportunity to successfully make markets because there is a wide variety of potential customers with business objectives that are satisfied with swaps. Some, like Exelon, are customers because they need the swaps to hedge the commercial risk that is inherent in their core business of generating electricity. Others are attempting to earn trading profits. A physical electricity firm such as Exelon is not in the swaps business, but rather is a customer of swap dealers. The ordinary course of business for Exelon is the generation of electricity; that is its primary business. That Exelon is in the market for OTC swaps does not change this fundamental fact.

In addition, Exelon has a sizeable portfolio of swaps, but that does not mean that Exelon is a swap dealer. That is because the conditions under which Exelon hedges are not static. Its anticipated unit availability, transmission conditions, the weather, and many other factors can change. These changes require Exelon to continually rebalance its portfolio of swaps and other agreements used to hedge price risk. For example, Exelon could lose a unit due to an outage caused by a significant mechanical failure rendering the unit unavailable for a period of months. All other things being equal, this will mean that Exelon has become "over-hedged" – it has some swaps and other agreements on its books that it does not need to hedge price risk, and that therefore present price risk. Exelon is paying a fixed price, but it is not being paid by PJM the floating price stream that it is exchanging with its swap counterparty, and therefore Exelon is exposed to the price risk associated with that floating price. Exelon can rebalance by entering into a new swap under which it is on the other side of the same kind of swap used to hedge originally (*i.e.*, when Exelon assumed that the unit would be available), where the amount swapped is a function of the amount of generation associated with the lost unit.

Exelon's portfolio of swaps is therefore significant, given that it owns or controls over 30,000 MW of generation over a very broad geographic footprint. The main mission of ExGen's power marketing division is to hedge this substantial generation portfolio as the conditions that affect it change. It must, of necessity, enter into multiple transactions to adjust its portfolio due to constantly changing circumstances. It does not do so because it is "dealing" in swaps.

In this context, the Dodd-Lincoln Letter is also instructive; it supports Exelon's view that the ambiguity in the statutory language that could suggest a broad definition of swap dealer should be interpreted more narrowly:

Congress does not intend to regulate end-users as Major Swap Participants or Swap Dealers just because they use swaps to hedge or manage the commercial risks associated with their business. For example, the Major Swap Participant and Swap Dealer definitions are not intended to include an electric or gas utility that purchases commodities that are used either as a source of fuel to produce electricity or to supply gas to retail customers and that uses swaps to hedge or manage the commercial risks associated with its business.<sup>9</sup>

In light of the foregoing, Exelon suggests that the Agencies include the following elements as part of the definitions needed to fully define the term "swap dealer," as contemplated by the statute:

**"Dealer" means "a person that makes a market in swaps."**

**"Makes a Market" means "makes bids to buy and offers to sell swaps or a type of swap at all times."**

**"Ordinary course of business for its own account" means "engaging in a business that is principally comprised of buying and selling swaps as a service to its customers, the principal objective of which is to earn profits by entering into transactions at different prices within the spread between bids to buy and offers to sell."**

**"De Minimis Swap Dealer" means an "entity otherwise meeting the requirements of Section [of appropriate regulation defining swap dealer] whose position in uncleared swaps or a type of swap, excluding swaps held for hedging or mitigating commercial risk, does not rise to a level requiring oversight to ensure the protection of the financial system of the United States."**

### **III. Major Swap Participant**

As provided in the Act, a Major Swap Participant is an entity "whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets," holds a "substantial position" in swaps not used to hedge or mitigate commercial risk or for certain

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<sup>9</sup> Dodd-Lincoln Letter at 3.

pension plan purposes, or is a highly leveraged financial entity relative to the capital it holds that is not subject to federal banking agency capital requirements.<sup>10</sup>

A "substantial position" is the threshold that "the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States."<sup>11</sup> In setting the definition of "substantial position," the Commission must consider the person's relative position in uncleared swaps and may consider the value and quality of collateral held against counterparty exposures.<sup>12</sup>

Exelon is not the kind of entity capable of creating systemic risk due to its participation in the market for OTC swaps, or otherwise. The vast majority of its OTC swaps are hedges of the price risk associated with its generation portfolio. In addition, that portfolio has real, inherent value – people and businesses will need electricity generated by power plants that are part of a large interconnected grid for the foreseeable future. Accordingly, even a hypothetical significant default by Exelon under its OTC swaps would not pose the risk of "serious adverse effects on the financial stability of the United States banking system or financial markets." Its assets will still have substantial value, which would be available to satisfy, in large part, its obligations to counterparties.

As in the case of the definition of swap dealer, the Dodd-Lincoln Letter supports this view of the intent of the statutory language:

Congress expects the regulators to maintain through rulemaking that the definition of Major Swap Participant does not capture companies simply because they use swaps to hedge risk in their ordinary course of business.<sup>13</sup>

In addition, Exelon does not hold a "substantial position" of uncleared swaps not used to hedge or mitigate commercial risk. Although Exelon is a large corporation, the definition of substantial position should not be set such that the amount of its net uncleared swaps would be at or above the level associated with prudent monitoring, as required by the statute to constitute a "substantial" position. Exelon suspects that the same is true of many similarly-situated entities in the markets in which it participates.

Finally, the Agencies should define the term "commercial risk" because the term is in the applicable statutory language and is pivotal to any definition that can conform to that language. That definition should include the risks faced by a firm like Exelon in the conduct of its physical electricity operations that can be mitigated using swaps.

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<sup>10</sup> The Act, § 721(a)(16) (to be codified at 7 U.S.C. § 1 et seq, § 1a(33)).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Dodd-Lincoln Letter at 3.

Mr. David A. Stawick  
Ms. Elizabeth M. Murphy  
September 20, 2010  
Page 8

Accordingly, Exelon suggests that the Agencies include the following elements as part of the definitions needed to fully define the term "major swap participant," as contemplated by the statute:

**"Substantial Position" shall mean "the net, unhedged minimum quantity of uncleared swaps, excluding swaps held for hedging or mitigating commercial risk, held by a Financial Entity or other category of entity designated by the Commission that is systemically important to the stability of the financial system of the United States or can significantly impact the financial system of the United States, above which a default of such entity would cause adverse systemic financial impacts to the financial system of the United States."**

**"Commercial Risk" shall mean "any economic risk arising from financial, physical or any other attribute of a commercial enterprise including, but not limited to, commodity price volatility risk, commodity price basis risk, commodity supply volatility risk, commodity demand volatility risk, risk of failure of production, risk of loss of markets, weather risk, balance sheet risk, credit risk and currency exchange rate risk."**

### **Conclusion**

Exelon appreciates this opportunity to provide these comments on the ANOPR and recommends that the Agencies adopt the proposed definitions included here in any Notice of Proposed Rulemaking concerning them. Exelon looks forward to participating in the formal rulemakings that will be issued to implement the Act.



Mr. David A. Stawick  
Ms. Elizabeth M. Murphy  
September 20, 2010  
Page 9

Respectfully submitted,

/s/ Kathleen L. Barrón  
Kathleen L. Barrón, Esq.  
Vice President, Federal Regulatory Affairs  
and Policy  
Exelon Corporation  
101 Constitution Avenue, NW  
Suite 400 East  
Washington, D.C. 20001  
T: (202) 347-7500

/s/ Noel Trask  
Noel Trask, Esq.  
Lead Counsel, Exelon Power Team  
Exelon Corporation  
300 Exelon Way  
Kennett Square, PA 19348-2473  
T: (610) 765-6649

/s/ David M. Perlman  
David M. Perlman  
Bracewell & Giuliani LLP  
2000 K Street, NW, Suite 500  
Washington, DC 20006  
T: (202) 828-5804  
*Counsel to Exelon Corporation*

cc: Dan Berkovitz, General Counsel, CFTC

Eric Juzenas, Senior Counsel to the Chairman, CFTC

Attachment

Attachment to Comments of Exelon Corporation

A Power Producer's Perspective  
on Dodd-Frank (Hedging Physical Power)



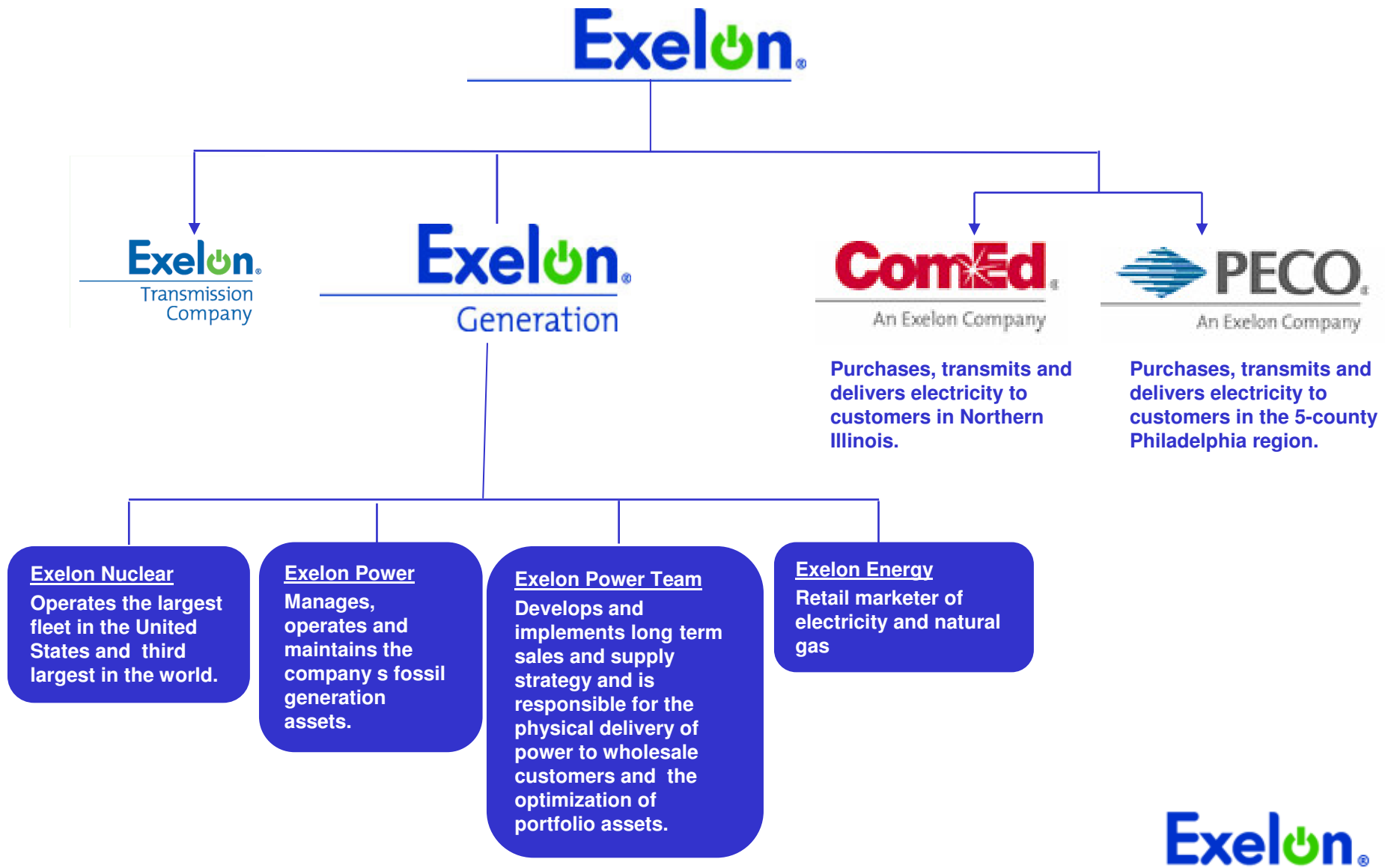
# A Power Producer's Perspective on Dodd-Frank (Hedging Physical Power)

September 2, 2010



- **Company overview**
- **Power markets, energy prices and cash flow/earnings risk**
- **Hedging**

# The Exelon Companies



# Multi-Regional, Asset-Based Company

**Exelon**  
Generation

<u>Total Capacity</u>	
Owned:	24,850 MW
Contracted:	6,153 MW
<b>Total:</b>	<b>31,003 MW</b>

<u>Midwest Capacity</u>	
Owned:	11,412 MW
Contracted:	2,900 MW
<b>Total:</b>	<b>14,312 MW</b>

<u>ERCOT/South Capacity</u>	
Owned:	2,222 MW
Contracted:	2,917 MW
<b>Total:</b>	<b>5,139 MW</b>

**ComEd**  
An Exelon Company

Electricity Customers: 3.8M

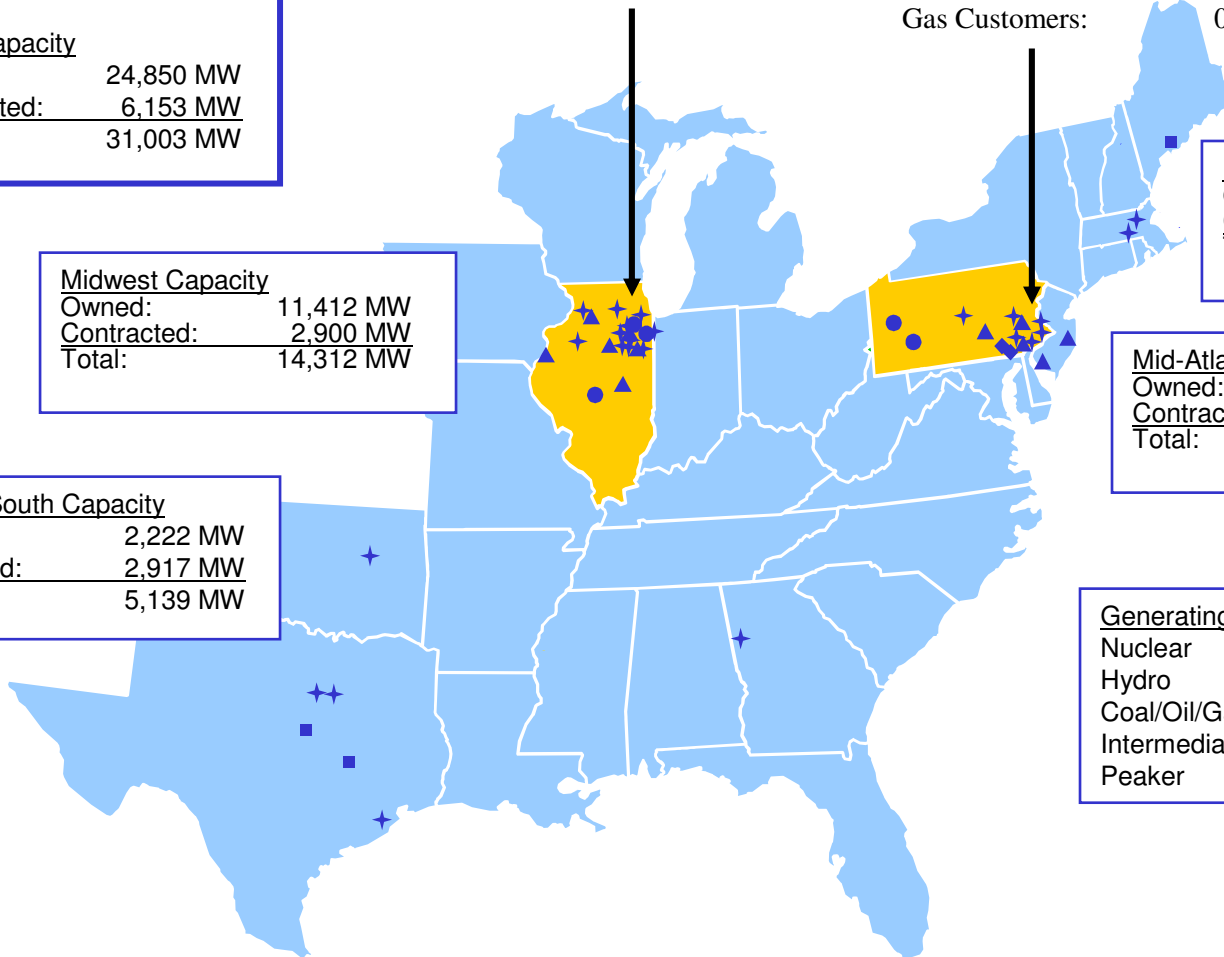
**PECO**  
An Exelon Company

Electricity Customers: 1.6M  
Gas Customers: 0.5M

<u>New England Capacity</u>	
Owned:	182 MW
Contracted:	0 MW
<b>Total:</b>	<b>182 MW</b>

<u>Mid-Atlantic Capacity</u>	
Owned:	11,034 MW
Contracted:	336 MW
<b>Total:</b>	<b>11,370 MW</b>

<u>Generating Plants</u>	
Nuclear	▲
Hydro	◆
Coal/Oil/Gas Base-load	●
Intermediate	■
Peaker	✦



- **Is ...**
  - Owning and operating a fleet of generating units and selling the electricity to wholesale customers in spot and forward markets (Exelon Generation)
  - Owning and maintaining electric transmission facilities that deliver bulk power to local distribution systems (ComEd and PECO)
  - Owning and operating electric distribution systems that deliver electricity to over five million retail customers (ComEd and PECO)
  - Hedging the price risk associated with its generation portfolio (Exelon Generation – Power Team)
- **And is not ...**
  - Engaging in financial or derivatives trading or dealing

# Organized Power Markets - Price Volatility

- These physical markets yield the volatile spot prices that Exelon hedges using different types of transactions
  - Examples are PJM, MISO, ISO-NE, and ERCOT
- Primary mission is to match supply (generation) and demand (load) based on market offers for supply
  - Determine spot market prices at generator nodes (pay generators) and load buses (charge loads a zonal price based on aggregation of load bus prices)
  - Create and publish prices for combinations of nodes called “hubs” to facilitate power markets
- Spot market prices are a function of the spot fuel price for the type of fuel used by the marginal generating unit needed to match demand
  - Fuel on the margin is usually coal or natural gas
  - Demand is largely a function of the weather



# Forward Power Prices and Cash Flow Volatility

## Forward Power Prices

## Revenue Implications

2012 Power Price on  
On Jan 1 2009

2012 Power Price on  
On Jan 1 2012

\$ 60 / Megawatt-hour  
(MWh)

\$ 80 / MWh

\$ 60 / MWh

\$ 40 / MWh

### Increase in expected revenues

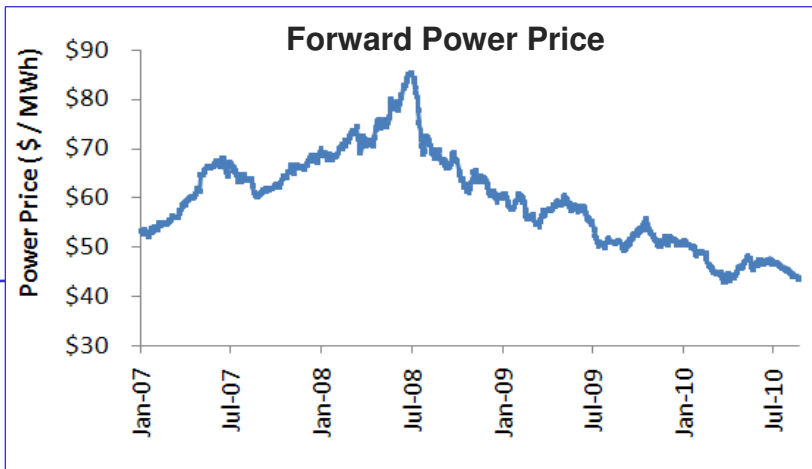
- Cash surplus
- Meet operating expenses and interest payments
- Pay dividends and invest in new infrastructure.

### No change in expected revenues

- Cash to meet operational expenses, interest payments, dividends etc.

### Decline in expected revenues

- Cash shortfall
- Cannot fully meet operating expenses, interest payments
- Unable to pay dividends and invest in new infrastructure.
- Increased credit risk and associated margin requirements



Forward prices can fluctuate substantially

**If left unhedged, cash flows are subject to substantial fluctuations due to changes in power prices**

- Exelon hedges price volatility that exists in the markets in which most of Exelon's generating units are located
- Objectives
  - Maintain desired credit rating
  - Ensure cash flow certainty to enable capital expenditures and cover O&M
  - Maintain shareholder value return policy
- Longer term hedging – portfolio management (mitigate forward power market price risk)
  - Transactions that typically start six months to three years after the trade date and have terms of a year or longer
- Shorter term hedging – portfolio optimization (adjust hedging due to changes in unit availability and the weather)
  - Transactions that start from as soon as the next hour and have terms ranging from the next hour up to six months

# Types of Hedging Transactions

- Physical transactions
  - Standard megawatt blocks of energy
  - Products to match load (electricity demand) of customer
  - Sales to distribution utilities like PECO, ComEd, PPL, Allegheny, under state auctions/RFPs, to serve customers not receiving service from competitive retail suppliers
- Financial transactions
  - Standard over-the-counter (OTC) swaps: agreements to exchange floating price stream (e.g., PJM spot market price x MW amount) for fixed price stream (agreed fixed price x same MW amount)
  - Exchanged-traded swaps
  - Standard put options: seller provides to buyer the right, but not the obligation, to sell at a fixed price (meaning in effect the right to exchange a floating price stream for a fixed price stream )
    - Fixed strike price is part of agreement, premium paid for the option
  - Proxy hedges of forward power prices using commodities the prices for which are closely correlated with forward power prices (e.g., buy natural gas puts)

- Exelon produces power, and seeks to hedge in markets where liquidity exists
- Market for physical hedges in out years can be relatively thin
- Market for financially-settled hedges in out years is typically more liquid
- A substantial percentage of Exelon's longer term hedges are OTC swaps

# Example - OTC Swap To Hedge Long-Term Price Risk

- Assume 100 MW of expected generation in PJM in Calendar Year 2013
- Assume further that a market exists for OTC swaps for 2013 and that the price today to buy a swap for the entire year is \$60/MWh
- Revenue possibilities without hedge, and assuming an average spot price in 2013 could be \$40, \$60, or \$80 per MWh:

$$\text{Revenues} = 100 \times \text{PJM Western HUB Price (\$/MWh)} \times 8760$$

↑  
Expected  
Generation  
(MW)

↑  
Variable  
Market Price

↑  
Hours per  
year

PJM WHUB Price (\$/MWh)	40	60	80
Revenues	\$35M	\$52.5M	\$70M

## OTC Swap Example (cont'd)

### Revenues assuming entry into OTC swap for \$60/MWh:

Revenues (fixed for float swap) =  $100 \times \$60 \times 8760 - 100 \times \text{PJM WHUB Price} \times 8760$

Revenues (net : generation and swap) :  $100 \times \$60 \times 8760 = \$52.5 \text{ M}$



Seller still paid by PJM for generating, but effectively transfers that revenue to swap counterparty in exchange for fixed price revenue stream

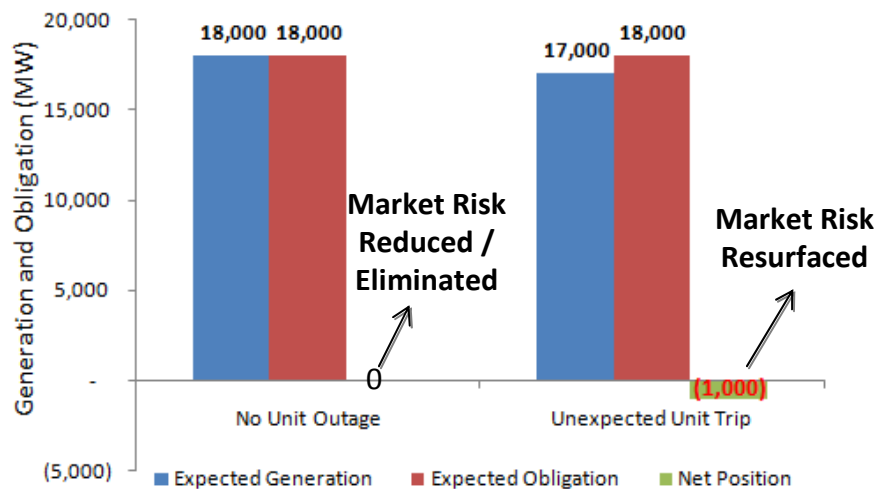
PJM WHUB Price (\$/MWh)	40	60	80
Revenues	\$52.5M	\$52.5M	\$52.5M

# Unit Failure Example – Shorter Term Hedging

13

- Unexpected loss of supply (generation unit failures) :
  - An outage or partial outage of a unit, such as an unexpected boiler leak at a coal plant can cause the unit to be out of service for days, weeks or even months
- Implications :
  - As most of the generation has been sold forward/hedged via swaps, a unit failure causes the power producer to be short power (oversold) because the generation is no longer available (some forward sales become unnecessary as hedges, and themselves create market risk, because power producer is no longer being paid the floating price stream it is transferring to its swap counterparty)
- Required hedging action :
  - Enter into an opposite fixed-for-floating swap (pay a fixed price in return for the floating price) or buy physical power at a fixed price to bring position back into balance

## Net Position : Generation and Obligation

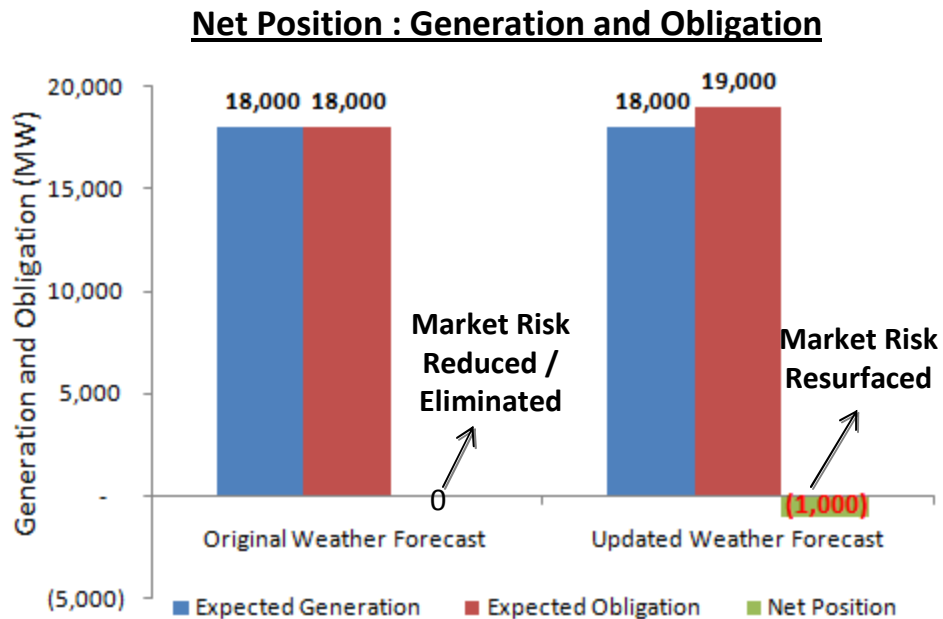


Example reflects loss of 1,000 MW in expected generation due to an unexpected unit outage. The way to hedge as a result of this would be to enter a fixed for float swap, effectively buying back the lost 1,000 MW in the market for a known, fixed price

# Weather Risk Example – Very Short Term Hedging

14

- Weather Risk (impact on quantity of sales obligation):
  - Weather is one of the primary factors influencing electricity demand - and it is hard to predict
- Implications:
  - If expected temperatures increase in the short-run (typically anywhere from the next hour up to 10-15 days out), expected need for generation increases (and vice versa).
- Required Hedging Action:
  - In the situation where a revised weather forecast and corresponding load obligation exceeds the original expected load obligation (more demand than expected), a power producer may choose to buy physical power at a fixed price, or enter into a swap where it pays the fixed price and receives the floating price, both of which would reduce price exposure from being short the power.



As a result of increased demand of a 1,000 MW caused by unexpected weather, producer would once again be exposed to market prices. A way to hedge against this would be to enter a new fixed for float swap, effectively buying the previously unanticipated 1,000 MW at a known, fixed price.



- Demand exists for the “real” product – electricity
  - Demand for power is the basis of the long-run value of generators
  - Physical generators hedge to mitigate price risk
  - Through hedging, a generator is “locking in” its sales revenues
  - When the buyer is a load-serving entity it is locking in its purchase costs
- Ownership of real assets ensures stability in either rising or falling markets
  - Locked in revenue stream creates cash flow certainty and therefore the ability to meet financial obligations
  - In rising market, a net seller’s collateral requirements increase, but so too does the value of its assets (right-way risk)
  - In falling market, a net seller’s collateral requirements decrease and its hedges protect value

**Hedging by power generators, or by others with tangible assets with inherent economic value, does not contribute to systemic risk**

- A physical generator is in the business of producing and selling power
- A physical generation business must hedge its risk
- Efficient hedging requires transactions in both physical and financially-settled products
- OTC swaps are key tool for hedging
- Although a swap customer, a physical power generator is not a "dealer" or otherwise in the "swap business"
- A physical generator that uses financial transactions as part of its hedging program will not thereby create systemic risk