Capital Power Corporation
401 – 9th Ave SW
Calgary, Alberta T2P3C5
T 403.717-8989 F 403.717.8194
www.capitalpower.com

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DELIVERED VIA ELECTRONIC MAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission

(Collectively called the "**Authorities**")

c/o: Mr. Michael Brady
Senior Legal Counsel, Capital Markets
British Columbia Securities Commission
P.O. Box 10142 Pacific Centre
701 West Georgia Street
Vancouver, B.C. V7Y 1L2
e-mail: mbrady@bcsc.bc.ca

Dear Sirs/Mesdames:

RE: Multilateral Staff Notice and Request for Comment dated January 21, 2015, pertaining to Proposed Multilateral Instruments 91-101 – *Derivatives Product Determination* and 96-101 - *Trade Repositories and Derivatives Data Reporting*

Capital Power Corporation, together with its affiliates and subsidiaries (collectively "**Capital Power**"), makes this submission to comment on Multilateral Notice and Request for Comments published by the Authorities on January 21, 2015 (the "**Multilateral Notice**"), pertaining to proposed Multilateral Instrument 91-101 – *Derivatives Product Determination* (the "**Proposed Scope Rule**"), its proposed companion policy ("**Proposed Scope CP**"), proposed Multilateral Instrument 96-101 -*Trade Repositories and Derivatives Data Reporting* (the "**Proposed TR Rule**") and its proposed companion policy ("**Proposed TR CP**"). This letter will refer collectively to the Proposed Scope Rule, the Proposed TR Rule and their respective proposed companion policies as the "Proposed Rules".

Capital Power appreciates the opportunity to comment, and commends the Authorities for seeking public input, on the Proposed Rules. Capital Power generally supports the efforts of the Authorities, working in conjunction with the Canadian Securities Administrators ("**CSA**"), to establish a regulatory regime for the Canadian over-the-counter ("**OTC**") derivatives market, in order to address Canada's G-20 commitments. To that end, Capital Power respectfully urges the Authorities to develop regulations that strike a balance between not unduly burdening derivatives market participants while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities. Capital Power is

a member of the International Energy Credit Association ("**IECA**") and fully supports the comments submitted by the IECA, in their March 19, 2015 letter, in response to the Multilateral Notice.

Capital Power is a growth-oriented North America power producer headquartered in Edmonton, Alberta. Capital Power develops, acquires, operates and optimizes power generation from a variety of energy sources, including coal, natural gas, biomass and wind. Capital Power owns more than 2700 megawatts of power generation capacity across 15 facilities in Canada and the United States, and owns 371 megawatts of capacity through power purchase arrangements. An additional 1020 megawatts of owned generation capacity is under construction or in advanced stages of development in Alberta and Ontario.

Capital Power optimizes and hedges its commodity portfolio using physical forward contracts for electricity, natural gas, environmental commodities (e.g. carbon offsets and credits), USD/CDN currency exchange, and financial derivative transactions based on those same commodities. Capital Power's trading counterparties include other power producers, utility companies, banks, hedge funds and other energy industry market participants. Trading activities take place primarily through electronic exchanges, such as ICE (Intercontinental Exchange) and NGX (Natural Gas Exchange), but also through brokered transactions and directly with counterparties. Capital Power is a registered "market participant" in the Alberta wholesale electricity market constituted as the Alberta "Power Pool" under the *Electric Utilities Act* of Alberta (the "**EUA**") and is also a licensed "retailer" (as defined in the EUA) of retail electricity services to large commercial and industrial customers in the retail electricity market in the Province of Alberta.

Before providing comments to some of the specific questions that the Authorities posed in the Multilateral Notice, Capital Power would like to draw the Authorities' attentions to the structure of, and some transactions associated with, the Alberta wholesale and retail electricity markets. We would also like to point out some interpretative challenges and nuances those transactions and markets create in the context of the Proposed Rules, particularly the concept of "*settlement by delivery of a commodity*" in section 2(1)(d)(i) of the Proposed Scope Rule. We thank the Authorities for recognizing, in the Proposed Scope CP, that electricity is a commodity capable of being physically delivered.

ALBERTA ELECTRICITY MARKETS:

The wholesale electricity market in Alberta (and Ontario) is unique in Canada because it is "deregulated", which means that the wholesale price of electricity is determined by market forces of supply and demand in an open and competitive market place between independent market participants that include generators, transmission and distribution companies, marketers, retailers, municipal utilities and large consumers. This is contrasted to "regulated" markets in the other provinces in which large government-owned integrated public utilities own and control all aspects of the electricity value-chain from generation to sale and delivery to the ultimate consumer. The term "deregulated" is a misnomer however because Alberta's electricity market is extensively regulated through the EUA, and other statutes, by the Alberta Utilities Commission ("**AUC**"), the Independent System Operator, operating as the Alberta Independent System Operator ("**AESO**") and the Market Surveillance Administrator ("**MSA**"), among others.

As stated above, the Alberta electricity market is constituted as a Power Pool under the EUA. The AESO operates the Power Pool to ensure fair, efficient, open and competitive market access. The MSA and AUC monitor and enforce market participant behaviour and market rule compliance.

Power Pool and "Delivery" of Wholesale Electricity:

The EUA requires that all electricity imported into Alberta, or generated in Alberta and not consumed on site, be exchanged through the Power Pool. The physical characteristics of electricity are such that: (i)

production (generation) and consumption (load) must match each other nearly perfectly and in real-time to maintain system reliability, because large volumes of electricity cannot yet be economically stored; and (ii) once generated, one unit of electricity (MW) is indistinguishable from another, so the use of a common trading pool (the Power Pool) obviates the need to try to track individual MWs of consumption back to a particular source of generation[1].

The Power Pool therefore functions as a real-time spot market for the physical exchange of bulk wholesale electricity, matching demand with the lowest priced supply to establish an hourly pool price for all electricity exchanged through the pool during that hour. "Delivery" of electricity through the Power Pool is accomplished by generators supplying electricity to the pool and loads consuming that electricity from the pool at essentially the same instant it is generated. Settlement of electricity exchanged through the Power Pool occurs after the fact, typically on a monthly basis, and is facilitated by the AESO, which credits generators for electricity they deliver to the pool at the applicable hourly pool prices and debits loads for electricity that they draw from the pool at the applicable hourly pool prices.

In addition to the real-time spot market for electricity that the Power Pool represents, the EUA allows parties to enter into forward physical contracts for the purchase and sale of electricity. These are called "direct sales agreements" under the EUA[2], or "Net Settlement Instructions" or "NSIs" under the AESO's rules[3].

Net Settlement Instructions and "Delivery" of Electricity:

NSIs provide electricity market participants with an alternative to buying and selling at the hourly Power Pool price and can therefore act as a hedge against price volatility. They allow buyers and sellers to enter directly into contracts with other pool participants for an agreed amount of power, at a negotiated price, over a specified period of time in the future. The AESO has no visibility into the contracted price; however the AESO must have visibility into the MW volumes sold for each NSI in order to net those volumes against actual metered volumes that the NSI parties exchange through the pool. This visibility allows the AESO to determine the amount of MWs settled by the parties through the AESO for actual metered volumes[4]. The NSI parties settle directly between themselves the contracted volumes at the contracted prices.

NSIs replicate what, absent the Power Pool structure, would be a direct sale and delivery of physical electricity between a generator and a load. Because of the pool structure however, the "delivery" of physical electricity under an NSI still occurs by the real-time exchange of electricity through the Power Pool, as it does in any other wholesale electricity transaction exchanged through the pool.

Retail Transactions and "Delivery" of Electricity:

A third aspect of the Alberta electricity market in which the Power Pool is relevant and the concept of "delivery" is nuanced is the retail electricity market. Electricity consumers in Alberta can purchase

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[1] Market Surveillance Administrator, Alberta Wholesale Electricity Market, Sept. 29, 2010, pg. 7, http://albertamsa.ca/uploads/pdf/Reports/Reports/Alberta%20Wholesale%20Electricity%20Market%20Report%20092910.pdf

[2] *Electric Utilities Act*, Statutes of Alberta 2003, Ch. E-5.1, Sec. 19(1). See also Sec. 19(2) for requirements that electricity exchanged through direct sales agreements, or "forward contracts" (i.e. exchange traded forward electricity contracts), must be undertaken in accordance with AESO rules.

[3] AESO Rules 103.5, see also : http://www.aeso.ca/downloads/Pool_Participant_Manual_-_Net_Settlement_Instructions_-_Sept_2011.pdf.

[4] *Ibid.*

electricity directly through the Power Pool at the hourly spot price, or they may arrange for electricity supply from Retailers[5] by appointing such Retailers as their agent and retailer of record. Electricity supply arranged by Retailers may be at prices other than the hourly spot price, including at fixed, capped or collared prices, all as may be negotiated between the Retailer and the consumer. In addition to arranging for the supply of electricity from the pool, Retailers provide consumers with various load settlement and account management services in connection with the customer's consumed electricity.

Within the retail electricity market in Alberta, "delivery" of electricity to an end-use customer (like a home-owner or small business) by an electricity Retailer involves the Retailer arranging for the delivery of electricity from the Power Pool to the customer's electricity meter through the inter-connected electric transmission and distribution system. Within Alberta's deregulated electricity market Retailers do not own their own power generation, transmission or distribution assets, so all that a Retailer is able to do is act as a customer's agent to arrange for electricity purchase from the pool, arrange for delivery of that electricity by transmission and distribution utilities to the customer and then settle, on behalf of the customer, for the procured and delivered electricity with the relevant third parties.

Ancillary Services and "Delivery" of Electricity:

A fourth aspect of the Alberta electricity market that is relevant to the issue of "delivery" of electricity are transactions referred to as "Ancillary Services". A full discussion of Ancillary Services is beyond the scope of this letter but examples of them include "operating reserves", "transmission must run service", "black start services" and "load shed scheme services"[6]. The EUA defines them as follows:

> *"ancillary services" means those services required to ensure that the interconnected electric system is operated in a manner that provides a satisfactory level of service with acceptable levels of voltage and frequency*;[7]

The AESO procures ancillary services from generators and loads either directly or through openly competitive procurement processes, including the online exchange known as WattEx, which is operated by NGX[8]. AESO uses ancillary services to maintain the stability and integrity of the Alberta interconnected electricity system.

With respect to the concept of "delivery of electricity" in the context of ancillary services, depending on the particular type of ancillary service (for example "operating reserves"), the party providing the service to AESO may be required to either deliver, or refrain from delivering, certain volumes and/or voltages and/or frequencies of electricity to the Power Pool at particular times. Any electricity delivered to the pool as a result of ancillary service transactions is exchanged through the Power Pool as any other electricity delivered to the pool.

Applicability to the Proposed Scope Rule:

Applying the foregoing discussion about Alberta electricity markets to the Proposed Scope Rule, and to comment in part specifically to Question 1 posed in the Multilateral Notice (i.e. whether the Proposed Scope Rule provides sufficient clarity as to the contracts and instruments that are subject to trade reporting), Capital Power submits that the Proposed Scope Rule, particularly the concept of "intended to be settled by delivery of a commodity" in section 2(1)(d)(i), does not clearly address the nuances of

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[5] *Electric Utilities Act*, Statutes of Alberta 2003, Ch. E-5.1, Sec. 1(1)(uu).
[6] http://www.aeso.ca/market/5093.html
[7] *Electric Utilities Act*, Statutes of Alberta 2003, Ch. E-5.1, Sec. 1(1)(b).
[8] http://www.ngx.com/?page_id=88

exchange of physical electricity through the Alberta Power Pool. As a result, it is unclear whether the types of transactions described above would be subject to trade reporting or not?

Capital Power submits that such transactions would not be subject to trade reporting. Capital Power submits that such transactions are, despite the nuances of the Power Pool structure, either: (i) "*excluded derivatives*" within the meaning of section 2(1)(d)(i) and (g) (i.e. "*exchange traded*" in the case of ancillary services traded on WattEx) of the Proposed Scope Rule; or (ii) "*additional contracts not considered to be derivatives*" as described in the Proposed Scope CP.

With respect to bulk wholesale electricity transactions, NSIs, non-WattEx traded ancillary services and the language in section 2(1)(d)(i), Capital Power submits that the intention to settle such transactions by actual delivery of electricity is both evidenced, and satisfied, by market participants complying with the requirement, under the EUA, that all electricity in Alberta be exchanged through the Power Pool. In other words, although electricity in Alberta generally cannot be delivered (except in cases of on-site production and consumption) directly by generators to loads, the exchange of electricity through the Power Pool satisfies the "delivery" requirement for the purposes of the Proposed Scope Rule. Settlement of electricity exchanged through the pool is typically cash settlement with the AESO, but such cash settlement is not allowed in place of the statutory requirement to actually exchange electricity through the pool.

With respect to retail electricity contracts, Capital Power submits that such contracts are either: (i) "*excluded derivatives*" under section 2(1)(d)(i); or (ii) "*additional contracts not considered to be derivatives*", in particular, that they are "*consumer contracts to purchase non-financial products or services at a fixed, capped or collared price*" as described in the Proposed Scope CP. With respect to romanette (i) in the preceding sentence, Capital Power submits that the "intent to deliver" requirement is satisfied by (A) the contractual obligation of a Retailer to arrange for both the supply of electricity to the consumer from the Power Pool and the delivery of that electricity to the customer's meter through the inter-connected electric system, and (B) the contractual obligation of the customer to accept and pay for the electricity arranged for by the Retailer. Additionally, Retailers and their customers do in fact regularly arrange for and take delivery of contracted quantities of electricity at contracted prices in their ordinary course of dealings and cash settlement in place of arranging for and taking the electricity is typically not allowed under such contracts. With respect to romanette (ii) in the sentence above, as mentioned earlier, Retailers provide load settlement, account management and related services to their customers in conjunction with arranging for electricity supply, the prices in such contracts are negotiated between Retailer and customer and they are often based on fixed, capped or collared prices in relation to the hourly Alberta Power Pool spot price.

Capital Power respectfully requests that the Authorities please clarify, either in the Proposed Scope Rule or Proposed Scope CP, that the kinds of Alberta Power Pool transactions described above are not subject to trade reporting, or at least please state if the Authorities disagree with Capital Power's conclusions in this regard? Alternatively, because the Alberta Power Pool market structure is unique to Alberta, Capital Power respectfully requests that the Alberta Securities Commission issue an order, under Sec. 10 of the *Alberta Securities Act* ("**ASA**"), designating physical electricity transactions associated with the Power Pool not to be derivatives under the ASA.

We note that the ASC issued an order to the Alberta Power Pool Council on December 21, 1995 (the "**1995 Order**"), upon enactment of the EUA and with respect to OTC derivatives arising out of the operation of the Alberta Power Pool[9]. The 1995 Order exempted Power Pool participants and other

[9] http://albertasecurities.com/Notices%20Decisions%20Orders%20%20Rulings/Issuers/ALBERTA%20POWER%20POOL%20COUNCIL%20-%20ORDER%20-%20%201995-12-21%20-%202350035.pdf

qualified parties from the prospectus and registration requirements of the ASA at that time. The 1995 Order expired according to its terms on December 21, 1997.

Capital Power respectfully submits that a new order clarifying the status of Power Pool transactions as derivatives, or not, under the ASA would provide much needed clarity to Alberta Power Pool participants as they struggle to understand, and prepare to comply with, the derivatives regulatory regime being developed by the CSA. Capital Power further submits that a designation that Power Pool transactions are not derivatives under the ASA, and thus exempt from derivatives regulation, is justified and appropriate because of the fulsome regulatory regime, including financial qualifications for market participants, which already governs such transactions under the EUA and AESO Rules.

Furthermore, such an exemption would be consistent with the approach adopted by the U.S. Commodity Futures and Trading Commission ("**CFTC**"), in their Final Order dated April 2, 2013, which exempted specified electricity related transactions, in markets regulated by several U.S. independent system operators and regional transmission organizations, from almost all of the provisions of the U.S. Commodity Exchange Act and the CFTC's regulations, including trade reporting requirements (the "**ISO/RTO Order**")[10]. Many of the exempted transactions in the ISO/RTO Order are very similar to transactions in the Alberta Power Pool and subject to similar existing regulatory frameworks. Accordingly, Capital Power respectfully submits that a similar exemption for Alberta Power Pool transactions and market participants from the CSA's proposed derivatives regulatory framework would be both logical and justified.

SPECIFIC COMMENTS TO QUESTIONS:

Capital Power has the following specific comments in reply to the specific questions posed by the Authorities in the Multilateral Notice. The numbered paragraphs below correspond to the numbering of the questions, as set out in the Multilateral Notice, to which Capital Power has comments (i.e. we have not commented on every question posed).

(a) The Proposed Scope Rule and Proposed Scope CP:

2. Embedded Optionality

Capital Power supports the approach proposed by the Authorities, that certain optionality embedded in an agreement to change volume, quantity, timing or manner of delivery of a commodity (and potentially other forms of optionality such as with respect to price) will not, in itself, result in the agreement being a derivative. Capital Power submits the approach is appropriate because such optionality should not, in itself, negate the intent of the parties to deliver and receive a commodity if the optionality is exercised. Capital Power agrees with the Authorities' comments that such intent must be determined by reviewing the contract and the conduct of the parties as a whole, including whether the contract allows, from the outset, for cash settlement in place of delivery of the commodity upon exercise of the option.

Optionality with respect to volume, time, manner, price, etc., is common in commercial agreements for purchases and sales of commodities and is typically included for practical and efficiency reasons, including hedging risks associated with the production or consumption of a commodity. For example, at the time of entering into an agreement to purchase and sell carbon offsets at a future date, the seller may be unsure of the exact number of offsets he may be able to deliver, or the exact date of delivery, because production of the offsets may be contingent on variable factors associated with the underlying carbon reduction project. The buyer may be unsure of the exact number of offsets that she may need for her business'

[10] http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-07634a.pdf

carbon reductions compliance purposes. Optionality in such circumstances allows parties the flexibility to tailor their agreement to suit their respective commercial needs for the relevant commodity and should not simply because of that flexibility, in itself, negate the intent to deliver or take the commodity, as determined based on a holistic review of the contract and the conduct of the parties.

Zero or nominal optionality requires clarification

One point in connection with the embedded optionality concept that Capital Power submits the Authorities should clarify however, is in cases where the optionality allows the parties to deliver or receive zero, or nominal, volumes of a commodity. Capital Power submits that such zero or nominal volume optionality should not, in itself, negate the intent to deliver and make the contract a reportable derivative. Capital Power submits that the same holistic analysis described above should apply to such optionality.

Applied to the example of the carbon offset transaction above, the underlying carbon reduction project may not generate any carbon offsets in a particular year (for reasons that may be both within and outside the control of the seller), so he would want the option to deliver zero or nominal volumes. On the other hand, in any given year, buyer's business may not have any carbon reduction compliance obligations, so she would want the option to take zero or nominal volumes of offsets in such year. In such circumstances the zero or nominal optionality again simply provides commercial flexibility to the parties and should not absent other indicators, in particular cash settlement from the outset in lieu of delivery, make the contract a reportable derivative for the purposes of the Proposed Rules.

Viewed from a risk-based analysis perspective, Capital Power does not believe that contracts for delivery of a physical commodity that contains optionality of the kinds described above, and in the Proposed Scope CP, pose systemic risk to Canada's financial system. Accordingly, such contracts and options should not need to be regulated, including reported, in the same manner as derivatives and options on financial commodities.

(b) The Proposed TR Rule and Proposed TR CP:

4. Exclusion of registered derivatives dealers from local counterparty definition

Capital Power appreciates the oral explanation that representatives for the Authorities provided, during their February 26th webinar on the Proposed Rules, about why the local counterparty definition in the Proposed TR Rule excludes entities that are registered as derivatives dealers, or in another category, under securities legislation of a Canadian province or territory. Capital Power agrees that there is little value in requiring "foreign" dealers (i.e. those not registered in the home jurisdiction of any one of the Authorities) to report their derivatives trades to the Authorities, by capturing such dealers within the definition of "local counterparty", unless those trades otherwise involve a local counterparty within one of the Authorities' home jurisdictions. For example, there would be little value to the ASC in having a derivatives dealer registered in Quebec deemed a "local counterparty" in Alberta, and therefore have to report all of its derivatives trades to the ASC, even those trades not otherwise involving Alberta local counterparties. Accordingly, Capital Power submits that the exclusion of such foreign registrants from the definition of local counterparty is appropriate.

6. Reporting Counterparty Waterfall and Derivatives Dealer Definition

Capital Power supports the proposed hierarchy in the reporting counterparty waterfall in Section 25 of the Proposed TR Rule. Capital Power believes that the hierarchy properly allocates reporting responsibility, as

among various categories of derivatives market participants, to those best suited to fulfil the reporting responsibilities.

Capital Power submits however, that to avoid any confusion under the reporting counterparty waterfall, the definition of "derivatives dealer" should be clarified to indicate in which jurisdiction an entity must be "…*engaging in the business of trading in derivatives*…" (the CSA has previously described that phrase as the "business trigger for dealing in derivatives") in order to be caught by the definition and thereby, *prima facie,* be deemed as the reporting counterparty in most instances. This clarification is particularly important since, as discussed above, the definition of local counterparty excludes foreign registrants.

Capital Power notes that the derivatives dealer definitions, in each of the respective TR Rules (or TR Regulation) already in place in Manitoba, Ontario and Quebec, specify that the business trigger for dealing in derivatives activity take place in Manitoba, Ontario or Quebec respectively. The definition of derivatives dealer in the Proposed TR Rule is silent on the jurisdictional point. Capital Power is unsure whether this silence was intentional or unintentional on the part of the Authorities but believes that the point should be clarified to pre-empt any confusion.

To illustrate the potential for confusion, please consider a situation in which one party to a derivatives trade is a non-dealer local counterparty in one of the Authorities' jurisdiction, say Alberta, but the other party to the trade was a "foreign" party, say a New York based swap dealer. Assume that the trade with the Alberta local counterparty was the only trade with an Alberta nexus for the New York swap dealer. The business trigger for dealing in derivatives concept does not exist under the regulations provided by the CFTC with respect to swap dealer determination or swap data reporting and could, therefore, be unfamiliar concepts for the New York swap dealer.

Because the TR Rule will only apply in the respective provinces of the Authorities' jurisdiction, and the derivatives dealer definition lacks jurisdictional specificity, the New York swap dealer might reasonably conclude that it is not a derivatives dealer in Alberta. As a result, the non-dealer Alberta local counterparty would have to report the trade under the reporting counterparty waterfall set forth in section 25, even though it might not otherwise be the reporting counterparty for any other trades and the New York swap dealer may be reporting many trades in jurisdictions outside of Canada. Capital Power submits that such an outcome should be avoided because it could place unreasonable and unnecessary compliance burdens on non-dealer local counterparties in the provinces where the Authorities have jurisdiction.

Additionally, confusion as to reporting counterparty status on the part of foreign dealers may result in such dealers being reluctant to enter into trades with local counterparties in the Authorities' jurisdiction. That could result in market contraction, a decrease in liquidity, and a focusing of risk in derivatives markets as fewer and fewer participants are willing, or able, to transact in those markets. To avoid such potentially negative outcomes, Capital Power asks the Authorities to clarify the jurisdictional nexus in the derivatives dealer definition.

To that end, Capital Power submits that the derivatives dealer definition should specify that a person is a derivatives dealer if they either: (i) engage in the business of trading in derivatives anywhere in the world; or (ii) are registered as a "dealer", "swap dealer", or any similar classification, under the derivatives laws of any jurisdiction in the world. Capital Power submits that being registered as a dealer anywhere in the world should be determinative, not for the local counterparty definition (as is the case in Manitoba, Ontario and Quebec), but for both the derivatives dealer definition and by extension the reporting counterparty waterfall under Section 25 of the Proposed TR Rule.

In addition to clarifying the jurisdictional nexus issue discussed above, Capital Power requests that the Authorities please clarify whether, in determining if a party is a derivatives dealer for the purposes of the Proposed TR Rule, the word "derivatives" as used in the derivatives dealer definition includes or excludes the "excluded derivatives" identified in Section 2(1) of the Proposed Scope Rule? In other words, in determining whether a party is a derivatives dealer or not, should a party consider its activities with respect to either, or both, reportable and/or excluded derivatives, or just reportable derivatives? Capital Power submits that, logically, only reportable derivatives should be considered given that the core purposes of the Proposed Rules apparently include (i) determining what should be reportable and (ii) who should report that which has been determined to be reportable. Anything not reportable should be irrelevant to determining who has to report.

On a more fundamental level, though beyond the scope of the Proposed Rules and this letter, Capital Power submits that the entire concept of being "in the business of trading in derivatives", that was borrowed from securities markets and lies at the heart of the derivatives dealer definition in the Proposed TR Rule, requires significant modification and clarification in the context of derivatives markets. Derivatives markets are fundamentally different from securities markets in many key respects. Therefore, concepts applicable to securities markets, such as elements determinative of a securities dealer, when applied with only nominal changes to elements determinative of a derivatives dealer, are poorly suited to derivatives markets. Capital Power looks forward to being able to comment to the CSA more substantively on these issues in the future.

9. End-user Commodity Transaction Exemption

Capital Power commends the Authorities for proposing, in Section 40 of the Proposed TR Rule, the $250 million (CAD) aggregate notional value exclusion for reporting trades of commodity derivatives, other than cash or currency, among counterparties who are neither derivatives dealers nor Canadian financial institutions. Capital Power is concerned however, that the $250 million (CAD) threshold is too low, will require trade reporting by small derivatives market end-users who pose no systemic risk, and who will therefore be unnecessarily and unreasonably burdened by trade reporting. Capital Power respectfully requests that the Authorities increase the proposed threshold from $250 million (CAD) to at least $1.0 billion (CAD). Capital Power also respectfully requests that the Authorities provide the analysis conducted by their staffs, in establishing the $250 million (CAD) threshold, so that a more comprehensive review of the threshold can be made by Capital Power and other derivatives market participants.

In addition, Capital Power requests that the Authorities please clarify certain practical-application aspect of the $250 million (CAD) threshold as follows:

- Is the $250 million (CAD) threshold to be calculated over a particular period of time, such as a rolling 12 month period, or is it a "snap-shot in time"?

- Capital Power understands that exceeding the threshold will trigger a reporting requirement but is unclear whether the reporting requirement is only prospective or retrospective? In other words, does Sec. 40 mean to say that once one trade puts a party over the threshold, all of that party's then outstanding derivatives trades become reportable, or only the one trade that put the party over the threshold and subsequent trades that keep the party over the threshold?

- Assuming the threshold has been exceeded and all or some of a party's trades are reportable, what happens if at some point in the future the aggregate notional values of the party's trades fall below the threshold, does that party then cease reporting?

- At page 24 of the Proposed TR CP, the Authorities state that "*the exclusion applies only to a transaction where each counterparty is neither a derivatives dealer nor a Canadian financial institution.*". Is that to say therefore, that in calculating aggregate notional value of outstanding trades, for the purposes of Sec. 40, an end-user counterparty should not count any trades between itself and a derivatives dealer or Canadian Financial Institution? In other words, the end-user counterparty only need consider if its trades with other end-user counterparties exceed the $250 million (CAD) threshold?

- Sec. 40 states that the $250 million (CAD) threshold is to be determined "*without netting*". Capital Power respectfully submits that netting should be allowed in determining the threshold because standard industry practice among commodity derivatives market participants, in determining both counterparty and overall commodity portfolio risk exposure values, is to net positions. Evidence of the industry standard practice to net exposures can be seen in the provisions of several common standard-form physical and financial derivative master trading agreements, such as the ISDA Master Agreement, GasEDI Base Contract, NAESB Base Contract and EEI Master Power Purchase & Sale Agreement. All of these agreements provide for netting of payments between the parties, not only netting of periodic payments required under specific transactions, but also in the event of default and termination.

- In addition to netting being standard commodity derivative industry practice to determine risk exposures, another standard practice is to determine such exposures based on marked-to-market calculations of specific transactions, rather than to consider gross notional value (i.e. product x volume) as set forth in the Proposed TR Rule and TR CP. Capital Power submits that determining the $250 million (CAD) threshold should be based on standard industry practices, to the extent reasonable possible, to facilitate easier compliance by the industry. Accordingly, Capital Power submits that the $250 million (CAD) threshold should be calculated based on market-to-market positions and not gross notional values.

- How is the $250 million (CAD) threshold to be calculated in the context of trades denominated in currencies other than the Canadian dollar and fluctuations in the values of those currencies relative to the Canadian dollar? Must a party convert the gross notional values of all its derivative trades into Canadian dollars? Assuming the answer to the preceding question is "yes", and as a result of such conversion a party falls above (or below) the $250 million (CAD) threshold, but then at some point in the future, again because of currency exchange fluctuations, it falls below (or above) the threshold, would that party then cease (in the case of falling below the threshold) or commence (in the case of falling above the threshold) reporting as a result of the currency exchange fluctuations?

10. & 11. Implementation, Transition Period and Staged Implementation

During the February 26th webinar on the Proposed Rules, representatives for the Authorities orally stated that, subject to review of comments received on the Proposed Rules, they expected that the Proposed Rules would become effective sometime during the first half of 2016. Capital Power believes that time-frame is appropriate.

Capital Power also believes that it is essential that there be a transition period between the Proposed Rules becoming effective and the date that the first reporting obligations will begin, so that parties can adequately prepare to be the reporting counterparty. Such preparations may include developing new business processes and procedures, determining the reporting hierarchy status of counterparties, amending contracts, putting reporting counterparty agreements in place with equivalent hierarchy

counterparties, implementing new, or modifying existing, derivatives trade data capture systems, and on-boarding with trade repositories. Many counterparties may become reporting counterparties for the first time and for them these preparations will require dedication of significant financial, technical and human resources.

For example, in terms of trade data capture system vendors and on-boarding with trade repositories, "new" reporting counterparties in the Authorities' jurisdictions may be quite small customers compared to the types of international entities with which such vendors and trade repositories usually do business. In addition, Canada's derivatives markets are only a very small part of global derivatives markets and therefore system vendors and trade repositories may not give Canadian reporting counterparties a very high priority in terms of developing appropriate reporting tools and facilitating on-boarding.

For these reasons, Capital Power submits that staged implementation of the reporting obligation under the Proposed TR Rule is not only appropriate but absolutely essential, particularly for end-user counterparties who may be becoming the reporting counterparty for the first time. Capital Power submits that for such new reporting counterparties a one year transition period between effective date of the Proposed TR Rule and reporting start date would be appropriate. Shorter transition periods may be appropriate for parties already reporting under Manitoba, Ontario and Quebec TR rules at the date the Proposed TR Rule comes into effect. In any event however, Capital Power submits that at least a six month transition period would be appropriate for all reporting counterparties.

OTHER COMMENTS TO PROPOSED TR RULE & TR CP:

Paragraph (b) of local counterparty definition, "…responsible for the liabilities of the counterparty."

Capital Power requests that the Authorities please clarify their comments, in the Proposed TR CP, with respect to the language quoted above from paragraph (b) of the local counterparty definition. These words express the "guaranteed affiliate" concept under that definition. At page 3 of the Proposed TR CP the Authorities state that in their view: "*this responsibility must be for all or substantially all of the affiliated entity's liabilities.*". Would the Authorities please clarify if by "*all or substantially all*", they meant: (i) all of such affiliated entity's liabilities of any kind whatsoever; (ii) just with respect to derivatives trades; (iii) on a trade by trade, or counterparty by counterparty basis; or (iv) some other meaning?

Section 37(3)

Capital Power finds the words "*best efforts"* in Section 37(3) of the Proposed TR Rule, and the associated guidance in the Proposed TR CP, to be too broad and confusing. At page 23 in the Proposed TR CP, the Authorities state that they interpret best efforts to mean "***at a minimum,*** *instructing the recognized trade repository to release derivatives data to the securities regulatory authority.*" (emphasis added). Capital Power asks the Authorities to clarify what else they would expect a reporting party to do to satisfy Section 37(3), if instructing a trade repository to release derivatives data only minimally meets the requirements? Capital Power submits that such instruction is essentially all that a reporting counterparty could reasonably do, or should be expected to do, and that the language in Section 37(3) and the Proposed TR CP should be revised accordingly.

Reporting of inter-affiliate trades

Capital Power respectfully submits that inter-affiliate derivative trades should be reportable in cases in which the trade is between affiliates who are wholly or majority controlled by the same ultimate parent entity and the financial results of the affiliates are reported on a consolidated basis with the parent. Capital

Power submits that a reporting exemption for such inter-affiliate derivatives trades is appropriate because such trades do not pose systemic risk to Canada's financial system.

Firstly, an exemption from reporting such trades would be consistent with the approach taken by the CFTC.[11] Secondly, it would also be consistent with the CSA's proposal that inter-affiliate trades would be exempt from mandatory clearing under CSA Staff Notices 91-303 – *Proposed Model Provincial Rule on Mandatory Central Clearing of Derivatives*. Thirdly, Capital Power notes (and supports the fact) that under the Proposed TR Rule inter-affiliate derivative trade data would not be publicly disseminated. That being the case however, Capital Power respectfully submits that the compliance burden that will be placed on derivatives market participants, by requiring them to report inter-affiliate derivative trade data only to the Authorities and not to the public, is not justified by the very limited additional market transparency that such reporting would provide **only** to the Authorities, particularly since such inter-affiliate trades are not systemically risky in the first place.

To illustrate our view that such inter-affiliate trades are not systemically risky, please consider the following example corporate structure, which Capital Power submits is a common one in the energy industry:

> A group of four affiliated entities each individually owns a factory for the manufacture of widgets ("**ProductionCos**"). The ProductionCos are all wholly or majority owned by the same "**ParentCo**" and their financial results are reported on a consolidated basis with ParentCo. ParentCo also provides credit support (parental guarantees and/or letters of credit) for the ProductionCos as and when needed.
>
> The four factories require electricity and natural gas to operate. To procure electricity and natural gas, and to hedge against commodity price volatility, the ProductionCos desire to enter into forward contracts for the physical supply of electricity and natural gas and financial derivatives contracts related to those commodities. Each ProductionCo could transact in the market directly with other derivatives market participants to obtain such commodity derivative transactions.
>
> Rather than having each ProductionCo transact on its own behalf, their corporate family has another affiliate, "**TradeCo**", whose function is to transact derivatives on behalf of the entire corporate family, either as a disclosed or undisclosed agent. TradeCo is also wholly or majority owned by ParentCo, its financial results are reported on a consolidated basis with ParentCo and ParentCo provides credit support as and when needed.
>
> TradeCo was established to make negotiating, entering into and administering the corporate family's derivatives activities more efficient. It is more efficient and cost effective for one member of the corporate family to negotiate, execute and administer derivatives trades with external parties than to have four ProductionCos each have to negotiate, enter into and administer such agreements. TradeCo may also trade derivatives with external parties for its own account.
>
> After TradeCo has entered into an "outward facing derivative trade" with an external party as disclosed or undisclosed agent for a ProductionCo, any profits or losses associated with such trade are recorded in the financial ledgers of the relevant ProductionCo on a monthly, quarterly or annual basis simply by means of accounting entries, rather than by the actual exchange of funds. There may or may not be written agreements in place, including trade confirmations, between ProductionCos and TradeCo and each outward facing derivatives trade may or may not have an exactly corresponding inter-affiliate trade. On a monthly, quarterly or annual basis the financial

[11] http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-09.pdf

results of the ProductionCos and TradeCo are rolled up into ParentCo and reported on a consolidated basis.

In the above scenario, Capital Power respectfully submits that, to the extent that any of the above trades might be systemically risky, it is only the outward facing trades with unaffiliated entities that could pose such risk. The inter-affiliate trades are not risky because of the consolidated financial position of the entire corporate family, including the fact that ParentCo is the common credit support provider and common control point for all of its subsidiaries. Accordingly, Capital Power submits that only the outward facing trades should be reportable (assuming they would otherwise be reportable under the Proposed TR Rule).

Additionally, Capital Power notes that in the Proposed TR CP, the Authorities have stated a desire to avoid dual reporting of derivatives trade data. Capital Power submits that requiring reporting of inter-affiliate derivative trade data, particularly on a "one-to-one" or "back-to-back" basis, is in essence requiring dual reporting of such trade data, to the extent that the outward facing trade would be reportable under the Proposed TR Rule in the first instance. The only difference between the outward facing trade and the inter-affiliate trade in such instances would be the identity of the parties and their respective roles as "buyer" or "seller" under the back-to-back trades. That is, if TradeCo was the "buyer" in the outward facing trade with a third party it would be the "seller" in the inter-affiliate trade with ProductionCo.

Based on considerations of systemic risk Capital Power sees no rational for requiring reporting of inter-affiliate trades. Additionally, requiring such reporting by Canadian derivatives market participants when similar reporting is not required in the U.S. under the CFTC's reporting regulations will put additional compliance burdens on Canadian derivatives market participants and may put them at a competitive disadvantage to U.S. derivatives market participants. For the foregoing reasons Capital Power respectfully submits that inter-affiliate derivatives trades should be exempted from reporting under the Proposed TR Rule in situations in which the affiliates are wholly or majority owned subsidiaries of a common parent, the subsidiaries' and parent's financial results are reported on a consolidated basis and the parent provides credit support for the derivatives trading related liabilities of its subsidiaries.

Capital Power respectfully requests that the Authorities consider its comments and again expresses its gratitude for the opportunity to provide comments. If you have any questions, or if we may be of further assistance, please contact Mr. Zoltan Nagy-Kovacs, Senior Counsel, at 403-717-4622 (znagy-kovacs@capitalpower.com)

Yours Truly,

"***CAPITAL POWER***"

Per: *"Zoltan Nagy-Kovacs"*

Zoltan Nagy-Kovacs
Senior Counsel

cc. Alberta Electric System Operator, attention Mr. Tom Sloan

Market Surveillance Administrator, attention Mr. Michael Nozdryn-Plotnicki