



DELIVERED VIA ELECTRONIC MAIL

Mar 31, 2015

British Columbia Securities Commission  
701 West Georgia Street  
Vancouver, BC  
V7Y 1L2

Attention: Mr. Michael Brady, Senior Legal Counsel

Dear Mr. Brady:

**Re: FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC), (together, FortisBC)  
Comments re MI 91-101 Derivatives: Product Determination and MI 96-101 Trade  
Repositories and Derivatives Data Reporting**

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#### 1. Introduction

The Alberta Securities Commission, the British Columbia Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the New Brunswick Financial and Consumer Services Commission and the Nova Scotia Securities Commission (the Authorities) published proposed Multilateral Instrument 91-101 Derivatives: Product Determination (the Scope Rule) and proposed Multilateral Instrument 96-101 Trade Repositories and Derivatives Data Reporting (the TR Rule) for comment. Previously, the Canadian Securities Administrators (CSA) OTC Derivatives Committee (the Committee) had published the CSA Staff Consultation Paper 91-301 regarding Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting (the Model Rules, subsequently Updated Model Rules). These have been drafted based on existing provisions of Ontario securities law. The CSA had requested comments from affected users on the Updated Model Rules so that it may make appropriate changes and enable each jurisdiction to develop its own rules. FortisBC provided comments on Feb 4, 2013.

The driving force behind these rules is the Committee's requirement to implement G-20 commitments. These include requirements that all standardized over-the-counter (OTC) derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties. They also require that OTC derivatives contracts be reported to trade repositories (TR) and non-centrally cleared contracts should be subject to higher capital requirements.

In developing the rules, the Committee seeks to implement effective regulatory oversight of derivatives markets without unduly burdening market participants. Where possible, rules will be harmonization with international standards and consistent across Canadian jurisdictions.

This letter includes FortisBC's previous comments and any concerns related to the Updated Model Rules, Scope Rule and TR Rule. FortisBC's primary interest in the proposed Rules is to ensure that it is able to continue to effectively manage costs for its customers without additional material administrative requirements or costs. Once the Rules are established for the individual jurisdictions, FortisBC would like the opportunity to review, understand and potentially comment on them.

## 2. FortisBC Use of Derivatives

In order to mitigate the risk of market price movements on its natural gas rates for customers, FEI has actively engaged in OTC natural gas commodity hedging in the past. FEI has undertaken hedging to protect customers and not for speculative purposes.

FortisBC has also engaged in physical gas commodity trading and enters into forward electricity contracts for the purposes of managing costs for customers. As will be discussed in this letter, FortisBC believes that these types of transactions should not be classified as derivatives per the Scope Rules definitions and therefore not subject to the pending derivatives legislation.

FortisBC's financial hedging and physical commodity purchases and trading strategies and plans have been subject to approval by the British Columbia Utilities Commission on a regular basis before their implementation.

Because FortisBC performs financial hedging and physical trading to mitigate risks and reduce costs for customers, FortisBC believes it should be classified as a derivatives end user, rather than a derivatives dealer, derivatives adviser or large derivatives participant. As such, FortisBC expects to be exempt from much of the reporting and capital and margin requirements.

## 3. Comments Regarding Scope Rule – Derivatives: Product Determination

The purpose of the Scope Rule is to establish the types of derivatives that will be subject to the requirements of the Trade Repositories and Derivatives Data Reporting (TR Rule). As previously stated, FortisBC's primary concern regarding the Model Rule relating to Product Determination relates to the definition of a derivative. In particular, FortisBC believes there should be greater clarity relating to physically delivered commodity contracts or instruments that are excluded from being derivatives. According to the Model Rule, an instrument is not a derivative if it is for immediate or deferred delivery of a physical commodity other than cash or a currency and:

- Requires counterparties make or take physical delivery;
- Does not allow for cash settlement in place of physical delivery;
- Is intended by the counterparties to be physically settled.

FortisBC would like to point out that there are often circumstances in physical commodities markets where physical delivery is intended but instead does not take place and cash settlement occurs. These are often referred to as net-offs or book-outs in the natural gas and

electricity markets. In these arrangements, an end user, such as FortisBC, may purchase physical commodity supply for a period (such as a month or season) in the future, with the intent to physically take the supply from the counterparty. However, once into that period, FortisBC may wish to sell off that physical supply on a particular day, perhaps due to lower customer requirements caused by reduced weather demand. Therefore, FortisBC may sell some or all of this supply back to the same counterparty. In the case where it is all sold back, because the purchase and sell volumes are the same, the parties may choose to not physically flow any of the supply and opt for cash settlement. This helps reduce operational requirements, time and costs for the parties.

These types of arrangements may occur repeatedly as they provide flexibility for utility end users in managing customer load variability and costs. In fact, FortisBC may enter into these arrangements knowing that its actual customer load can vary significantly from its forecasted requirements at the time the arrangement is put in place, and therefore that a net-off or book-out and a cash settlement may occur later – however, FortisBC does not know exactly when, or if, it will happen. Therefore, FortisBC has concerns with the wording in the Model Rules under Section 2: Excluded Derivatives (end of paragraph five) which states:

*“Additionally, in situations where a market participant settles contracts in cash on a repeated basis, we take the position that irrespective of contractual requirements for physical settlement, this may be evidence of a party’s intention not to physically settle”.*

FortisBC believes that its arrangements that are originally entered into with the original intent of physical delivery, but may result in a net-off or book-out, should be excluded from being a derivative even if cash settlement in place of physical delivery occurs on a repeated basis. This is because these arrangements are intended to help manage physical supply and costs for customers, rather than for the purposes of speculating on market prices for financial gain or market manipulation. Additionally, the electric contract book-outs are occurring after entering into the original arrangement due to decreases in service load requirements (which could be caused by factor such as decreased customer electricity demand and/or weather) or transmission outages, both which are not within control of the FortisBC and as such differ from traditional derivative contracts that carry the characteristics of incremental financial risk.

FortisBC also seeks clarification whether these book-outs, which are caused by factors beyond the control of the utility, are scoped into excluded derivatives, as defined under section 2(1)(d)(ii) of Proposed Multilateral Instrument 91-101 which requires that “delivery is rendered impossible or commercially unreasonable by an intervening event or occurrence not reasonably within the control of the counterparties”. If the book-outs caused by reduced service load requirements from customers or transmission outages do not fall within the scope of excluded derivatives, then FortisBC argues that the definition is unreasonable and requires further clarity.

Another arrangement frequently used by FEI to manage customer load variability and gas costs relates to peaking supply. FEI will often enter into peaking supply arrangements with a counterparty wherein FEI has the right to call on physical supply for a limited number of days

during the peak winter season. Again, this type of arrangement helps FEI manage load variability and costs for customers. Whether FEI calls on this supply or not, a fee is paid by FEI to the counterparty for this optionality. FEI's intent is to physically take delivery if customer load requirements dictate, however it may not require the supply in the end. In this case, there is not a cash settlement in place of physical delivery but rather cash is paid to have the option of physical delivery. FEI also believes that this type of arrangement should be excluded from being a derivative.

Within the Model Rules, the Committee does discuss cash settlements related to contract termination, breach or frustration provisions and force majeure events that are outside the control of the parties. These do not make an otherwise firm obligation for physical delivery merely an option for physical delivery with cash settlement and so are excluded from being derivatives.

FortisBC believes that the Updated Model Rules and the proposed Scope Rule addresses these types of arrangements it enters into, as described herein, are also excluded from being derivatives and therefore the derivatives regulation but seeks further clarity regarding events not reasonably within the control of the counterparties:

*Updated Model Rules Section 2(d) (i) of the Explanatory Guidance - Paragraph 7 - Situations may exist where, after entering into the contract for delivery of the commodity, the counterparties enter into an agreement that terminates their obligation to deliver or accept delivery of the commodity (often referred to as a "book-out" agreement)...We will generally not consider a book-out to be "derivative" product provided that, at the time of execution of the original contract, the counterparties intended that the commodity would be delivered.*

*Proposed Scope Rule under Section 2(d) (ii) of the Companion Policy - does not allow for cash settlement in place of delivery except where all or part of the delivery is rendered impossible or commercially unreasonable by an intervening event or occurrence not reasonably within the control of the counterparties, their affiliated entities, or their agents;*

*Subparagraph 2(d) (ii) Explanatory Guidance Updated Model Rules – In general, we consider examples of events not reasonably within the control of the counterparties would include:*

- *Events to which typical force majeure clauses would apply,*
- *Problems in delivery systems such as the unavailability of transmission lines for electricity or a pipeline for oil or gas where an alternate method of delivery is not reasonably available, and*
- *Problems incurred by a counterparty in producing the commodity that they are obliged to deliver such as a fire at an oil refinery or a drought preventing crops from growing where an alternative source for the commodity is not reasonably available.*

#### 4. Comments Regarding MI 96-101 – Trade Repositories and Derivatives Data Reporting

As previously stated FortisBC also had concerns regarding the Model Provincial Rule – Trade Repositories and Derivatives Data Reporting and so provided comments on Feb 4, 2013 and restated here within.

The Model Rule requires that all derivatives transactions be reported to a central Trade Repository. The Model Rule also determines the parties responsible for reporting to a TR. In some cases, this may include end users. At a minimum, it is expected that end users be able to access TRs to confirm their transactions reported by other parties. TRs will be established by the marketplace, as companies interested in being TRs will make an application to do so.

FortisBC understands that fees may be charged by TRs to cover costs relating to data reporting and access. The Model Rule states that fees imposed by TRs should be fair and publicly disclosed for each service offering. FortisBC would like to emphasize its view that these fees should not be material in amount or change significantly from year to year as they will be costs that our utility customers will have to pay. We believe that the issues regarding fees have been addressed adequately in Section 12 of the proposed TR Rule.

*Section 12 – all fees and other material cost imposed by a designated trade repository on its participants must be*

- (a) Fairly and equitably allocated among participants, and*
- (b) Publicly disclosed for each service it offers with respect to the collection and maintenance of derivatives data*

FortisBC would like to vehemently express its concerns regarding data transparency and the TR making transaction data available to the public. FEI purchases natural gas at a number of market hubs in B.C. and uses financial hedges to manage price risk at these hubs. While some market hubs are very liquid, such as the AECO/NIT market hub proxy for Alberta gas, others are not so liquid. In particular, the Sumas market hub is relatively illiquid, with a small number of buyers and sellers. As part of its previous price risk management strategy, in the past FEI typically hedged its Sumas price exposure for each winter period. FEI is concerned that, given the small amount of trading at this hub, making the derivatives data available to the public for this hub could compromise FEI's hedging position or strategy if it needed to hedge the Sumas price in the future. FEI would prefer that this data is made public in such a manner that protects FEI's positions and strategies to manage price risk and costs for its customers. FortisBC is also concerned with the public availability of any pricing data associated with its forward electricity contracts as these are usually negotiated in confidence with the counterparty. If this pricing is made available to competing counterparties, it could compromise FortisBC's ability to competitively enter into pricing power supply that assists in managing costs for its customers.

FortisBC has some comments regarding data reporting to a TR. FortisBC understands that the Committee is interested in harmonizing derivatives reporting rules with other jurisdictions. However, greater clarity is needed regarding the ability for reporting to a TR in one jurisdiction to satisfy the reporting requirements to a TR under another jurisdiction. For example, if FortisBC, as an end user subject to the B.C. reporting requirements, transacts with a derivatives dealer subject to the U.S. reporting requirements per Dodd-Frank regulations, does the derivatives dealer report under both jurisdictions or just in accordance with the U.S. Dodd-Frank regime? And if it reports only under Dodd-Frank rules and to a U.S. TR, does the Committee recognize

this as substitute reporting under the B.C. TR? Also, is there a situation where FortisBC may have to report derivatives transactions, other than where its counterparty is not a derivatives dealer, adviser or large derivatives participant? FEI believes there needs to be greater clarity regarding the degree of similarity between two jurisdictions that will be required for the administrators in either jurisdiction to grant permission for substituted compliance. FortisBC believes that these questions have been remedied in the TR rule under Section 25 and 26 and it focuses on the issues regarding reporting local counterparty and substituted compliance.

While FortisBC may not be subject to reporting requirements under the Model Rules for the most part due to its assumed end user status, FortisBC would like to know more about the penalties for non-compliance with regard to reporting. Specifically, what are the types of non-compliance and penalties for each type of violation? FortisBC believes a grace period once implementation of the legislation begins is appropriate until parties are more familiar with the requirements.

While FortisBC's counterparties may do most of the required TR reporting, FortisBC would still be required to keep records of the derivatives data for each transaction for a minimum of seven years after the transaction has expired. The Updated Model Rules Section 17 confirm that the requirement to maintain records for seven years after the expiration or termination of a transaction, rather than from the date the transaction was entered into, which reflects the fact that transactions create on-going obligations and information is subject to change throughout the life of a transaction.

Section 35 of the Updated Model Rule describes the reporting regarding valuation data. It states that valuation data must be reported to the TR at the end of each business day by derivatives dealers and also at the end of each quarter for all reporting counterparties that are not derivatives dealers. This quarterly valuation data reporting would only be performed by FortisBC as an end user if it were a reporting counterparty and therefore dealing with a party who is not a derivatives dealer, adviser or large derivatives participant. FortisBC had requested to know the specific data requirements which are now available in Appendix A of Model Provincial Rule – Trade Repositories and Derivatives Data Reporting Minimum Data Fields Required to be Reported to a Designated Trade Repository.

FortisBC also believes that a listing of which companies are derivatives dealers, advisers, large derivatives participants and end users should be updated as participants register. This would help participants in determining their roles in terms of reporting and other obligations under the regulation.

The Committee had requested specific feedback on subsection 40(2) of the TR rule that provides an exemption for reporting requirements for derivatives transactions in the physical commodity market involving market participants with small derivatives exposures. The exemption rule releases a party from reporting if it is not a dealer or adviser and has less than \$500,000 aggregate notional value under all its outstanding transactions. FortisBC believes that this exemption is to remove any administrative reporting burden for small volume end users who

are unlikely to pose any threat to financial markets. FortisBC believes that the \$500,000 amount is so minimal that it is almost equivalent to having no minimum threshold at all, given that parties often enter into transactions up to a year or longer and market prices can fluctuate significantly. FortisBC suggests that a more meaningful threshold in the order of \$10 million might be more appropriate. For example, a small volume end user hedging 5,000 GJ per day (about half a standard gas contract) for 365 days at about \$5.50/GJ would result in a notional value of about \$10 million. As FortisBC's past notional values have far exceeded this threshold, FortisBC does not believe it would qualify for this exemption. Therefore, while FortisBC has suggested increasing the threshold amount, the Committee should place more weight on comments received by small volume end users when determining the threshold as these users will be directly impacted. FortisBC acknowledges that under Part 5: Exclusions subsection 40 Option #1, the proposed exemption for commodity-based transactions between two end-users below threshold of \$250,000,000 aggregate notional value, without netting, under all outstanding commodity based derivatives will help reduce the reporting burden on end-users that may not be systemically important.

#### 5. Conclusion

FortisBC appreciates the Committee's consideration of comments in developing the derivatives regulation. FortisBC has submitted its concerns and comments in the interests of managing its gas and electricity supply and costs for its customers. FortisBC welcomes further discussion of these comments and concerns if it is required and would like to have the opportunity to review and comment on future papers and provincial rules.

Please direct any further questions to Nina Virdee at (604) 592-7859.

Yours very truly,



Cynthia Des Brisay

VP, Energy Supply and Resource Development

**FortisBC Energy Inc.**