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INDUSTRY CURRENT •

Corporate Renewable Energy Purchases Can Trigger Dodd-Frank Swap Reporting Requirements - Part I

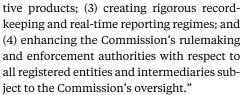
This week's Industry Comment is written by **Paul Forrester**, a partner in the Chicago office of **Mayer Brown**. Forrester's corporate finance and securities practice is especially focused on structured credit, including collateralized loan obligations, energy financings and project development and financing. Here, he examines the swap reporting requirements that result from the recent rise of non-utility renewables offtakers.

Corporate purchases of renewable energy are on the rise in the U.S. According to the American Wind Energy Association, almost 25 percent of all wind power purchase contracts signed in 2014 were with corporate buyers and other non-utility companies. These buyers include brand-name companies such as Amazon, Dow, Google, Facebook, Ikea, Mars, Microsoft and Yahoo, as well as the U.S. General Services Administration and public and private universities.

Corporations are often attracted by wind energy's unique ability to hedge against rising prices for other fuels—just as utilities buy fixed price wind energy to protect their consumers against volatility in the price of other fuels. Purchasing clean, renewable wind power also helps many companies and nonutility purchasers achieve internal environmental and clean power targets. Corporate investment in renewable energy is occurring both on- and off-site, and through both direct ownership and long-term purchase or similar agreements. Off-site long term agreements, however, can raise an unexpected reporting issue under related Dodd-Frank Act requirements.

SOME DODD-FRANK CONTEXT

Title VII of the Dodd-Frank Act is called the Over-the-Counter Derivatives Reform and Transparency Act. It covers "swaps" and is intended to establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system by, among other things (and in the words of the **Commodity Futures Trading Commission**): "(1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized deriva-



The CFTC and the Securities and Exchange Commission have primary rulemaking authority over the provisions in Title VII of Dodd-Frank. They are required to make certain rulemakings jointly and generally to consult with each other and with the U.S. Treasury and others in their individual rulemakings. The jurisdictional boundaries between the CFTC and the SEC are based on whether a transaction is a "swap" or a "security-based swap." The SEC has authority over security-based swaps, which are based on a security, loan or a "narrow" security index. The CFTC has authority over all other "swaps," except "mixed swaps" for which the CFTC and the SEC share joint authority.

How Does a Corporate Buyer's Desire to Hedge Its Price for Power Raise these Reporting Requirements?

The Dodd-Frank Act includes special treatment for certain hedging transactions by so-called end-users (specifically, exemptions from clearing and possibly margin for noncleared swaps). However, despite requests that it do so, the Act does not categorically exclude such hedging from other regula-



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tion. In fact, in the joint Product Definition final rule that defines a swap, the CFTC and SEC generally followed the language of the Dodd-Frank Act in crafting a broad definition (contained, in the case of the CFTC, in the CFTC's regulation 1.3(xxx)) with several reasonably broad exceptions described in the final rule's preamble. These exceptions deal with various categories of contracts (e.g., insurance), including an exclusion for

forward contracts that are intended to be physically settled. Accordingly, a traditional power purchase agreement that provides for physical settlement will not likely be a swap and, as a result, will not need to be reported, cleared or margined. In addition, a typical "book-out" (subsequently agreeing to a financial settlement instead of required physical settlement) is not likely to cause a physically settled PPA to become a swap, even though the contract is not in fact physically settled.

However, if there is no intention to physically settle such sales and purchases (as is the case with the so-called "contracts for differences" often used by corporate buyers of renewable energy), and, as a result, the transaction represents a financial hedge, the CFD will be a swap, which will trigger the related Dodd-Frank reporting requirements.

Notably, the CFTC's definition of a swap includes an anti-evasion provision (set forth in CFTC regulation 1.6) to the effect that a transaction that is willfully structured to evade any amendments made to the Commodity Exchange Act by the Dodd-Frank Act shall be deemed a swap for purposes of such amendments and the rules, regulations, and orders of the Commission promulgated thereunder.

Check back next week for the second installment of this Industry Current.