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

Corporate purchases of renewable energy are on the rise in the United States. 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 US 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 non-utility 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 (CFTC)): "(1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight."

The CFTC and the Securities and Exchange Commission (SEC) 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 US 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 margin for non-cleared swaps).[1] However, despite requests that it do so, the Act does not categorically exclude such hedging from other regulation.[2] In fact, in the joint Product Definition final rule[3] 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 (PPA) that provides for physical settlement will not likely[4] 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" (CfDs) 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.

What are the Dodd-Frank Reporting Requirements for CfDs?

The Dodd-Frank Act added new section 2(a)(13(G) to the Commodity Exchange Act (CEA) and required all swaps, whether cleared or not, to be reported to swap data repositories (SDRs), which are new registered entities created by Section 728 of the Dodd-Frank Act. Pursuant to its applicable authority under CEA section 21, the CFTC in its Swap Data Recordkeeping and Reporting Requirements final rule[5] has adopted rules regarding the reporting requirements for swaps. These rules often distinguish swaps to which swap dealers (SDs) or major swap participants (MSPs) are counterparties and swaps that are cleared (and generally impose more stringent reporting requirements therefor).

The relevant reporting requirements are set forth in the CFTC's regulations and include part 45[6] (real-time reporting)—both for "creation" data (CFTC regulation 45.3) as well as for "continuation," including "life-cycle" and "state" data, (CFTC regulation 45.4). Additionally, if applicable,[7] the related reporting requirements for the related end-user exception under part 50.50(b).[8]

The real-time reporting requirements include the provision of specified information to an SDR (e.g., DTCC) that is currently accepting such data at the inception of the swap. The requirements are set forth in the related regulation, including the minimum primary economic terms (PETs) set forth in Exhibit D (Other Commodity Swaps) in Appendix I to part 45.[9]

The PETs required to be reported at inception include the applicable parties and the specified primary economic terms for the related swap.

They are generally required to be reported "as soon as technologically practicable" to do so, but, in any event, not later than 48 business hours in the first year following the rule's compliance date; 36 business hours in the second year; and 24 in the third year.

Notably, while certain of the specified real-time reporting data is anonymized (e.g., the applicable swap counterparties' unique legal entity identifiers), the pricing and other PET data for the reported swap are intended to be publicly available to provide transparency. As a result, however, it may be possible to determine the parties to the CfD due to the relatively specific data that is available.

The required real-time swap inception reporting is triggered by "execution" of the related swap. The CFTC's regulation 45.1 defines this as follows:

> *Executed* means the completion of the execution process.
>
> *Execution* means an agreement by the parties (whether orally, in writing, electronically, or otherwise) to the terms of a swap that legally binds the parties to such swap terms under applicable law. Execution occurs simultaneous with or immediately following the affirmation of the swap.

Since an agreement will often be "legally binding" even though performance by the swap counterparties of their obligations may be subject to required satisfaction of specified conditions precedent, the prudent view is to file the required information immediately following signing of the agreement and, as a practical matter, coordinate that signing with the ability and readiness to make the required reporting.

CFTC regulation 45.1 also defines the following:

> *Life cycle event* means any event that would result in either a change to a primary economic term of a swap or to any primary economic terms data previously reported to a swap data repository in connection with a swap. Examples of such events include, without limitation, a counterparty change resulting from an assignment or novation; a partial or full termination of the swap; a change to the end date for the swap; a change in the cash flows or rates originally reported; availability of a legal entity identifier for a swap counterparty previously identified by name or by some other identifier; or a corporate action affecting a security or securities on which the swap is based (e.g., a merger, dividend, stock split, or bankruptcy).
>
> *State data* means all of the data elements necessary to provide a snapshot view, on a daily basis, of all of the primary economic terms of a swap in the swap asset class of the swap in question, including any change to any primary economic term or to any previously-reported primary economic terms data since the last snapshot. At a minimum, state data must include each of the terms included in the most recent *Federal Register* release by the Commission listing minimum primary economic terms for swaps in the swap asset class in question. The Commission's current lists of minimum primary economic terms for swaps in each swap asset class are found in Appendix 1 to Part 45.

Swap continuation data reporting requirements include any change to the previously reported PETs as well as life cycle events. Information about non-cleared swaps with only non-SD/MSP counterparties generally must be reported by the second business day following the date of a life cycle event during the first year following the rule's compliance date, and the date immediately following the life cycle event thereafter. There is a sole exception for life cycle event data relating to a corporate event affecting the non-reporting counterparty that must be reported not later than the third business day after the date on which such event occurs during the first year following the rule's compliance date and the

second business day thereafter. Meanwhile, state data must be reported on a daily basis.

Who Must Undertake the Required Dodd-Frank Reporting for CfDs?

CFTC regulation 45.8 determines which swap counterparty must be the reporting counterparty for a swap. Generally, the regulation requires reporting by the swap counterparty that is a SD or, if none, the MSP or, if none, that the swap must specify which counterparty is to be the reporting counterparty.

Corporate buyers (even ones with significant experience with other swaps) are usually reluctant to assume the responsibility for this required Dodd-Frank swap reporting and will probably lack first-hand and immediate access to some of the data required to be reported (e.g., actual swap volumes for variable or "as generated" CfDs and the related fixed and floating financial payments due). As a result, it will likely fall on the renewable energy project owner (or an affiliate) to agree to be the reporting counterparty for the swap and to undertake the required swap reporting, even though this may be the only type of swap for which such an owner will be required to do so.

These requirements have caught many project owners by surprise and, as a result, they were sometimes unprepared for the required reporting obligations and especially the relatively tight timing therefor. While the CFTC's regulations acknowledge the use of third-party service providers to provide assistance with the required reporting, the regulations (see, e.g., CFTC regulation 45.9) also make clear that the required reporting obligations remain with the applicable reporting counterparty.

For more information about the topics raised in this Legal Update, please consult the author or your regular Mayer Brown lawyer.

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Endnotes

[1] Initial confusion regarding whether the end-user exemption extended to margin was clarified and eliminated by Congress in January 2015 by amendments added to CEA section 4s(e) by the Terrorism Risk Insurance Program Reauthorization Act of 2015 and the exemption extended to margin for certain non-financial end-users.

[2] Those making these requests argued that hedging by end-users did not contribute to the financial crisis and, as a result, should not require or trigger regulation.

[3] Available at http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2012-18003a.

[4] The implied note of caution relates to the controversy regarding the relatively confusing and, at least among affected market participants, controversial treatment under the swap definition of certain forward contracts with embedded optionality, which has required an additional final interpretation, which can be found at http://www.cftc.gov/PressRoom/PressReleases/pr7174-15.

[5] Available at http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2011-33199a.

[6] Available at http://www.ecfr.gov/cgi-bin/text-idx?SID=7e900ed689c831a5a614e457e580391f&mc=true&node=pt17.2.45&rgn=div5.

[7] Although probably not, since these types of swaps will likely have sufficiently idiosyncratic terms and, as a result, not be subject to otherwise required mandatory clearing.

[8] Available at http://www.ecfr.gov/cgi-bin/text-idx?SID=7e900ed689c831a5a614e457e580391f&mc=true&node=se17.2.50_150&rgn=div8.

[9] Available at http://www.ecfr.gov/cgi-bin/text-idx?SID=7e900ed689c831a5a614e457e580391f&mc=true&node=pt17.2.45&rgn=div5#ap17.2.45_114.1.

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