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Our File: S927

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Dear Sirs/Mesdames:

**RE: Multilateral CSA Staff Notice 91-302 –Updated Model Rules: Product
Determination and Trade Repositories and Derivatives Data Reporting**

SaskEnergy Incorporated (“SaskEnergy”) and TransGas Limited (“TransGas”) welcome the opportunity to comment on Multilateral CSA Staff Notice 91-302 –Updated Model Rules: Product Determination and Trade Repositories and Derivatives Data Reporting.

The current Staff Notice revisits the Model Rules first outlined in CSA Staff Consultation Paper 91-301, published in Saskatchewan on January 15, 2013.

SaskEnergy notes that its 91-301 submissions are not accounted for in the appendices to Staff Notice 91-302. We hope those comments have been considered, or will be considered by the Committee at this time. SaskEnergy encloses its original reply to Staff Paper 91-301. Please see Appendix A.

About SaskEnergy and TransGas

SaskEnergy is a Saskatchewan Crown Corporation and operates as a natural gas distribution utility. TransGas is a wholly owned subsidiary of SaskEnergy and operates

primarily as a natural gas transmission utility. Additional information on SaskEnergy, its subsidiaries, and our use of derivatives is included in Appendix "A".

Comments on Staff Notice 91-302 – Product Determination

Gas Supply

The Model Rules appear to contemplate a very broad definition of derivatives, such as that reflected in the proposed amendment to clause 2(1)(o) of *The Securities Act, 1988* (Saskatchewan). The Model Rules then exclude specific contracts and instruments from trade repository and derivatives data reporting requirements.

The updated Model Rules preserve most of the substance of the original. In particular, exemptions are maintained for certain types of foreign exchange transactions, commodity contracts where there is an intent to deliver, and small physical commodity transactions generally when the party's aggregate outstanding notional amount of derivatives is less than \$500,000.00.

As a supplier of natural gas, SaskEnergy maintains its support for a physical delivery exemption. However, in order for a delivery exemption to have any benefit in terms of cost and administration, the application of that exemption must be clear. The clarifications with respect to netting, offsets, options as to volume or timing, force majeure, cash settlement on termination, and book-outs are therefore welcome.

The decision to both preclude and allow forms of optionality, with intent to physically deliver, will create some difficulties in interpretation.

The explanatory guidance states that a provision that creates "an option to change the volume or quantity, or the timing or manner of delivery, of the commodity to be delivered" "may" fall within the exemption. However, the explanatory guidance also "take[s] the position that the contract must create an obligation on the counterparties to make or take delivery of the commodity and not merely an option to make or take delivery."

The problem with catching everything in the definition of derivative, and then exempting only specific things, is that any errors occur on the side of over regulation. It may also create a chilling effect on certain types of contracts, beyond those which are actually caught by the regulation, as companies seek to avoid uncertainty or complex analysis.

For example, contracts with small producers of gas are very common in Saskatchewan. Contracts with small consumers of gas are also very common. Those contracts are typically meter and location specific, may provide for fixed or indexed pricing, and do not require a minimum delivery or receipt. What SaskEnergy is gaining on these contracts is exclusivity, in that any gas purchased by the customer must be from SaskEnergy, or any gas sold by the producer at that metering point must be to SaskEnergy. The small

producer or consumer is gaining flexibility to periodically shut-in wells or to suspend operations. SaskEnergy is facilitating gas production, commerce and industry within the province.

The intent of the rule is likely not to regulate natural gas speculation at a stranded meter proximate to a hamlet in Saskatchewan. Any further clarification that can be provided in that regard would be helpful. A meaningful *de minimis* exemption would also help.

SaskEnergy repeats its concerns with respect to the small physical commodity transaction thresholds.

Gas Transportation

The gas transportation and storage issue raised in our original submissions on March 15, 2013 has not been expressly addressed. These would seem to be contracts entered into for business purposes, which relate to provision of a service, and which do not involve investment, speculation or hedging. Despite this they seem to have become an issue in the United States, unless a very particular test is met.

There is a tendency to view this regulation through the perspective of our professions, our training, or our type of business. However, any characterization of transport and storage contracts as an option or derivative is arguably an application of form over substance and we would like further clarification on this matter

Comments on Staff Notice 91-302 – Trade Repositories

With respect to trade repositories and derivatives data reporting, the Rule arguably does not go far enough in terms of inter-provincial cooperation, and inter-provincial designation of trade repositories.

SaskEnergy remains concerned that trade repositories will not promptly seek Saskatchewan designation. The original clarification that reporting would then be made directly to the regulator helps, but this may or may not be of benefit to the local counterparty.

Similarly, SaskEnergy is pleased that the reporting obligation will reside first with the derivatives dealer, and not the end user, and that the reporting party can be agreed upon. However, where a non-local reporting counterparty does not report or does not properly fulfill its duties, it ultimately falls to the local counterparty, and in some provinces the availability of other local counterparties is limited.

SaskEnergy repeats its concerns with respect to affiliate reporting.

Conclusion

SaskEnergy and TransGas are thankful for the opportunity to provide these comments.

Where any doubt exists that the benefits of the new regulatory regime will not warrant its cost, direct and indirect, SaskEnergy would argue for some caution, some care, and potentially a narrower scope.

Respectfully submitted,

SASKENERGY INCORPORATED



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APPENDIX "A"

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March 15, 2013

Our File: S9279

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British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

Dear Sirs/Mesdames:

**RE: CSA STAFF CONSULTATION PAPER 91-301 - MODEL PROVINCIAL RULES
– DERIVATIVES: PRODUCT DETERMINATION AND TRADE REPOSITORIES
AND DERIVATIVES DATA REPORTING**

SaskEnergy Incorporated ("SaskEnergy") and TransGas Limited ("TransGas") welcome the opportunity to comment on the proposed model provincial rules, as set out in CSA Staff Consultation Paper 91-301 - Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting, published in Saskatchewan on January 15, 2013.

The potential economic and administrative burden on natural gas market participants associated with trade repositories and derivatives data reporting make product determination, or regulatory scope, of particular interest to SaskEnergy and its subsidiaries, including TransGas.

without applying any margin or additional costs. No profit or loss should be incurred by the utility on the sale of natural gas.

The difference between SaskEnergy's cost of gas and the revenue generated from commodity rates is tracked in the Gas Cost Variance Account (GCVA). The outstanding balance in the GCVA is refunded to or collected from customers in the next commodity rate application. This process supports the principle that no profit or loss is made by SaskEnergy on the sale of natural gas. The corporation's independent auditors on behalf of the Provincial Auditor, as well as the Saskatchewan Rate Review Panel, monitor the GCVA to ensure this principle is followed.

Natural gas utilities across Canada have different rate setting processes. SaskEnergy's process is to recommend a rate based on the forward natural gas market and reduction of the GCVA balance to zero over that same 12 month time period. The rate is established for November 1 of each year and then reviewed for a potential change on April 1 if the GCVA continues to be too large or if market conditions change materially. Rate applications are reviewed by the Saskatchewan Rate Review Panel, which makes a recommendation to the Provincial Cabinet.

SaskEnergy purchases its customers' gas on the open market. The primary pricing point of natural gas in North America is Henry Hub in Louisiana. Because of its pipeline connections to high consuming regions in the United States, a futures contract based on Henry Hub trades on the New York Mercantile Exchange (NYMEX). AECO is the largest natural gas hub in Canada and is located in Alberta. AECO is priced as a basis (differential) to NYMEX which typically represents regional differences in supply and demand and usually considers the cost to transport gas from western Canada to the high consuming regions in the east. When a large volume of transactions occur at a hub, such as AECO, it becomes a pricing reference point for smaller hubs such as in Saskatchewan. SaskEnergy purchases its natural gas supply from producers and suppliers in Saskatchewan and Alberta. In Saskatchewan, this gas is exchanged at the TransGas Energy Pool (TEP) and the price is quoted as a basis (differential) to AECO prices in Alberta. The Alberta purchases are made primarily at AECO and the natural gas is shipped to Saskatchewan. Therefore factors affecting the price of gas in North America, reflected in the NYMEX natural gas price, affect the price of gas in Saskatchewan, and the price of gas paid by SaskEnergy's customers.

Natural Gas prices are extremely volatile, even relative to other commodities. They are influenced by a number of variables including demand, production, storage levels, and economic conditions. These variables are affected by other variables such as weather. To aid in mitigating this volatility, to provide our customers with greater price certainty and to enable annual or twice annual rate changes, SaskEnergy uses a number of mechanisms which include the physical storage of gas, physically settled gas forwards or options, or the purchase of financially settled derivatives to hedge risk.

rather contract for storage service and TransGas manages the flow of gas based on system requirements. All TransGas storage customers benefit from the flexibility and reliability that these diversified facilities provide.

Storage and transport rates are tariff based on a cost of service model, with approved rates of return. This differs from the model typically used for storage, which is market based. Rates are approved by the Saskatchewan Cabinet, with prior input from a customer dialogue process.

Comments

1. Physical Gas Exemption

Natural gas is sold on a forward basis for practical reasons inherent in the natural gas sector. It will continue to be sold on a forward basis, even if every financial institution were to retreat from the energy sector. Almost all sales are going to be “derivatives”, as defined, and the financially versus physically settled distinction is really an artificial one from a price risk perspective. Our price “risk” and price “speculation” is occurring largely in circumstances where physical delivery must occur.

A contract or instrument prescribed under the definition of “derivative” is deemed not to be a derivative under the Model Provincial Rule if it is:

- 2(d) a contract or instrument for immediate or deferred delivery of a physical commodity other than cash or a currency
 - (i) that requires the counterparties to make or take physical delivery,
 - (ii) that does not allow for cash settlement in place of physical delivery, and
 - (iii) that is intended by the counterparties to be physically settled,

Under a model where gas is effectively sold at cost, administrative costs, such as the cost of interpreting complex regulations and of reporting gas transactions, must be included in the cost of gas. SaskEnergy supports a model that exempts contracts with an intent to physically deliver from the scope of this legislation, so as to best avoid a level of administrative expense from reporting granular details of a gas purchase strategy that is already available to the Saskatchewan Rate Review Panel, and therefore relatively transparent.

Similarly, the proposed physical exemption model is preferred as it will allow SaskEnergy to continue to trade in physical gas with its affiliates without the administrative, reporting and other burdens of regulation. These intra-affiliate trades, it

If the instances of legitimate, commercially necessary exemptions start to outnumber the rule, and we start to see exemptions that are multiple paragraphs or pages in length as is occurring elsewhere, then some fresh thought has to be given as to the harm we are trying to prevent in this particular context, and if this regulation is the best way of achieving it.

We would frankly prefer a short list of things we cannot do without regulation to a list of things we can.

With respect to options or embedded options, SaskEnergy would also like to see a general exception for options, where there is an intent to physically take delivery of the commodity.

SaskEnergy strongly supports a model that exempts from the scope of this legislation contracts with an intent to physically deliver, so as to avoid a level of administrative expense from reporting transaction level details of a gas purchase strategy. If that cannot ultimately be achieved, or cannot be achieved without a great deal of complexity, then a public interest exemption specific to the utility might be considered.

2. Financially Settled Commodity Transactions

By internal policy, SaskEnergy's financially settled transactions are limited to hedging with counterparties with the very highest credit ratings. SaskEnergy itself is a Crown Corporation, and an agency of the Government of Saskatchewan. We are buying physical gas at index because of a number of credit and contextual factors, including the particular constitution of the Saskatchewan market, with a lot of supply from producers and small producers. The whole purpose of the true (rather than commercially incidental) "financially settled" transaction is to mitigate SaskEnergy's risk, and the price risk faced by SaskEnergy's customers, in a volatile natural gas market. Anything that affects cost of this service, liquidity generally or the availability of counterparties, is directly harmful to SaskEnergy's customers.

Any mischief to be addressed by regulation should be weighed against the effect of that regulation in determining appropriate scope.

If reporting requirements are to be imposed, it is submitted that they be tiered as they are in the United States with financial institutions effectively having the first obligation to report in most instances. Anything that can be done to limit SaskEnergy's trading, reporting, report verification and record keeping obligations is welcome.

SaskEnergy likely opposes any initiative that, intentionally or unintentionally, directly or as an end result, imposes what is effectively a securities dealer between SaskEnergy and its counterparty.

These contracts or instruments include, but are not limited to ... a consumer or commercial contract or instrument to acquire, or lease real or personal property ... a commercial sale, servicing, or distribution arrangement ... a contract or instrument for the purpose of effecting a business purchase and sale or combination transaction . . .

Depending on the type of service required, both SaskEnergy delivery and TransGas transportation or storage contracts may contain either single or tiered pricing.

Under a single pricing model, customers pay for capacity whether or not they actually flow, receive or store gas, and this capacity has value and may or may not be assignable, depending on the contract. The customer pays exactly the same amount whether or not they use the capacity, and there is no additional usage fee.

Under a tiered pricing model, a basic monthly charge is paid to preserve the right to use facilities, and for administrative costs, and the SaskEnergy "delivery" or TransGas "commodity" fee is based on the volumetric usage of the facility.

These fees are completely separate and apart from the cost of the gas commodity and relate only to transport or distribution of that commodity.

If natural gas pipeline services or storage transactions are derivatives as defined (and we do not agree that they are), or are treated as derivatives, a new layer of regulatory oversight and regulatory reporting would require investment in staff and resources not traditionally associated with pipeline or storage operations. It seems to have the potential to be extremely complex. We do not want to be in a position of hiring people and buying systems, solely to interpret and administer this additional regulatory obligation. Nor do we wish to reorganize our entire way of doing business, simply to achieve some regulatory test or exemption.

In the United States there has been a great deal of confusion on this point, as guidance from the CFTC initially seems to suggest that the two-tiered transport or storage contracts prevalent in the United States may be "commodity options", by default, and that transport and storage capacity is a commodity. The original test provided an exemption for "exclusive" use of a specified facility, "or portion thereof", but had a restrictive "however" clause. The later clarification with respect to the "however" clause reads, in part:

In OGC's view, if (1) a facility usage agreement, contract or transaction discussed herein includes a two-part fee structure, (2) the right to use the specified portion of the facility for the term of the agreement, contract or transaction is legally established upon entering into the agreement, contract or transaction, (3) the party who has legally established the right to use the specified portion of the facility for the term of the agreement, contract or transaction pays the Demand Charge/Reservation Fee in a commercially

beneficial, rather than something more complex. The Corporation again asks that the application of these provisions be targeted to circumstances where the mischief to be addressed outweighs the cost, and clarification be given where appropriate.

Conclusion

SaskEnergy and TransGas are thankful for the opportunity to provide these comments. SaskEnergy recognizes that there are considerations in play which are much broader than the energy sector, SaskEnergy's interests, or the cost consumers pay for natural gas or gas transport and storage.

At SaskEnergy's level and from SaskEnergy's perspective, the existing energy sector practices have worked well. They have allowed us to successfully meet our corporate and customer objectives in an efficient way.

Increased regulatory burden ultimately increases costs for our customers. Even the prospect of new regulation in Canada is drawing on staff resources, and affecting the way we do business, as are the new regulations elsewhere. The Committee must make sure the benefit of any mischief to be avoided justifies the cost.

Where any doubt exists that the benefits of the new regulatory regime will not warrant its cost, direct and indirect, SaskEnergy would argue for some caution, some care, and potentially a narrower scope. A public interest exemption or exemptions specific to the utility might also be considered.

Respectfully submitted,

SASKENERGY INCORPORATED



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