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Nunavut Securities Commission
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Dear Sirs/Mesdames:

RE: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP (collectively the "Proposed Instrument")

Capital Power Corporation, together with its affiliates and subsidiaries (collectively, "**Capital Power**"), makes this submission in response to the Canadian Securities Administrators' April 4, 2017 requests for comments on the Proposed Instrument. Capital Power appreciates the opportunity to comment and commends the Canadian Securities Administrators ("**CSA**") for seeking public input on the Proposed Instrument.

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, solar and wind. Capital Power owns approximately 4500 megawatts of power generation capacity across 24 facilities in Canada and the United States and pursues contracted generation capacity throughout North America.

Capital Power hedges and optimizes its commodity portfolio using physical forward contracts for electricity, natural gas, environmental commodities (e.g. renewable energy certificates, carbon offsets and carbon 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 third-party 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 electricity services to large commercial and industrial customers in the Alberta retail electricity market.

Capital Power generally supports the efforts of the 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 CSA 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 supports and recommends all of the comments and proposed revisions to the Business Conduct Rule submitted by the IECA in its September 1, 2017 letter (the "**IECA Letter**"). In addition, Capital Power is aware of the comments submitted by Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, in a letter dated August 15, 2017 (the "**Sutherland Letter**"). Although Capital Power is not associated with The Canadian Commercial Energy Working Group, Capital Power supports the comments in the Sutherland Letter and respectfully urges the CSA to adopt the proposed revisions to the Business Conduct Rule set forth in the Sutherland Letter.

COMMENTS:

Capital Power has the following general and specific comments regarding the Proposed Instrument:

General Comments:

Timing of comment and implementation periods:

When the CSA published the Proposed Instrument for comments on April 4, 2017, the CSA indicated that it was also developing a proposed registration regime for derivatives dealers, derivatives advisers and potentially other derivative market participants. The CSA stated, in the Notice and Request for Comment document that published the Proposed Instrument, that it expected to publish Proposed National Instrument 93-102 *Derivatives: Registration* and a related companion policy ("**Proposed Registration Instrument**") for comment during the same consultation period as for the Proposed Instrument. The CSA

extended the comment period for the Proposed Instrument for an additional 150 days to allow market participants and other stakeholders an opportunity to consider both proposed instruments before the comment period expired.

On June 15, 2017, the CSA published CSA Staff Notice 93-301 which stated that the comment periods for the Proposed Instrument and the Proposed Registration Instrument would not overlap. Capital Power believes that this is unfortunate because the concept of "derivatives dealer" is key to whether a party is subject to the Proposed Instrument.

Capital Power expects that the "derivatives dealer" concept will be fully vetted in the Proposed Registration Instrument. Capital Power hopes that the Proposed Registration Instrument will clarify that any exemptions to derivatives dealer registration can be relied upon not only for the purposes of the Proposed Instrument, but also for all other derivatives rules and instruments that the CSA has already enacted (like derivatives trade reporting), or may yet enact. Therefore, Capital Power respectfully requests that the CSA further extend the comment period for the Proposed Instrument so that there is overlap with the comment period for the Proposed Registration Rule. Capital Power strongly believes that the Proposed Instrument and the Proposed Registration Instrument should be moved forward and implemented together.

Alternatively, Capital Power respectfully requests that market participants be given the opportunity to submit supplementary comments on the Proposed Instrument (including comments on specific questions not addressed in this letter) during the comment period for the Proposed Registration Rule.

Specific Comments:

1. **Definition of "Eligible Derivatives Party" (CSA Question 1)**

In the Notice and Request for Comment document that published the Proposed Instrument, the CSA stated that the proposed definition of "eligible derivatives party" was generally like the definition of "permitted client" in NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Requirements*. The CSA has asked whether this proposed definition is appropriate, including whether any additional categories should be included or categories removed.

In response to this question, Capital Power would respectfully draw the CSA's attention to the fact that there are already defined terms for certain categories of sophisticated derivatives market participants contained in various provincial blanket orders (such as Alberta Securities Commission Blanket Order 91-507, "**BO 91-507**") and in the Quebec Derivatives Act; namely, the definitions of "qualified party" (provincial blanket orders) and "accredited counterparty" (in Quebec). Rather than being based on the definition of permitted client in NI 31-103, Capital Power respectfully submits that it would be more logical for the proposed definition of eligible derivatives party to be aligned with the existing qualified party and accredited counterparty definitions. In fact, Capital Power questions the need for the new proposed eligible derivatives party definition at all. The CSA could simply have adopted either, or both, the qualified party and/or accredited counterparty definition(s) in the Proposed Instrument.

With respect to aligning the proposed eligible derivatives party definition with the qualified party and accredited counterparty definitions, Capital Power specifically submits that the proposed eligible

derivatives party definition be expanded to include the categories of entities described in clauses (p)(q)(s)(t)(u)(v)(w) and (x) of the definition of "qualified party" found in BO 91-507[1].

Without detracting from the importance of including all the categories described in those clauses of BO 91-507, Capital Power considers the following concepts to be essential inclusions to the definition of eligible derivatives party:

- An eligible derivatives party should include an entity that wholly directly or indirectly: owns; is owned by; or is under common ownership with, one or more eligible derivatives party(ies) (see clauses (t) through (v) of qualified party definition in BO 91-507);

- An eligible derivatives party should include an entity whose obligations under a derivatives transaction are fully guaranteed by an eligible derivatives party (see clause (x) of the qualified party definition in BO 91-507); and

- An eligible derivatives party should include an entity that uses derivatives to manage physical commodity risk (see clause (p) of the qualified party definition in BO 91-507).

Concerning the first two bullets above, Capital Power considers them to be essential additions to the eligible derivatives party definition because, in Capital Power's experience, many commercial energy companies that participate in derivatives markets are organized on the basis of project level entities that own specific assets (like a natural gas processing plant or a wind farm), a trading entity that engages in derivatives hedging transactions with third parties on behalf of the project level entities, and a ultimate parent entity that guarantees the obligations (derivative and otherwise) of its project level and trading entity subsidiaries. Within this corporate structure neither the project level entities nor the trading entity might individually have sufficient assets to meet any asset thresholds of the eligible derivatives party definition, but the parent-guarantor likely does have sufficient assets.

Concerning the third bullet above, Capital Power respectfully refers the CSA to the extensive comments about this concept in the Sutherland Letter (pgs. 4-7). Capital Power fully agrees with those comments and the letter's proposed amendments to the eligible derivatives party definition.

2. Knowledge and experience requirements in clause (m) of the definition of "Eligible Derivatives Party" (CSA Question 3)

The CSA has posed several specific questions about clause (m) of the definition of eligible derivatives party. Capital Power respectfully offers the following comments for the CSA's consideration.

Concerning the question of an entity representing in writing that it has requisite knowledge and experience to be an eligible derivatives party, the CSA has asked whether such representation should be limited to specific types of derivatives based on that entity's specific knowledge and experience with specific types of derivatives. Capital Power respectfully submits that requiring representations on the granular level of specific types of derivatives would be impractical and too onerous both for entities giving such representations and for those relying on them.

[1] http://www.albertasecurities.com/Regulatory%20Instruments/5330057%20_%2091-507_OTC_Trades_in_Derivatives.pdf. See clauses (p)(q)(s)(t)(u)(v)(w) and (x) in the definition of "qualified party".

From the perspective of the entity giving such representation, every time the entity's "knowledge and experience" (which are very broad and subjective concepts) with respect to a particular type of derivative changed, that entity would likely have to give new, or revised, representations. This would create an onerous administrative burden on such entity and provide little practical benefit to the entity relying on the representation. It could require, for example, regularly re-issuing written representations to dozens, if not hundreds, of trading counterparties.

It could also potentially trigger default events, followed by transaction terminations, under derivatives trading agreements, to the extent that previously given, overly granular, representations were no longer true or reliable about a party's "knowledge and experience" with particular types of derivatives. The OTC derivatives market is often characterized by inter-related transactions among different market participants and across different commodities. Thus, a default and subsequent termination, under one derivatives transaction among two parties could spread to other derivatives transactions among different parties and adversely affect the entire market. Capital Power respectfully submits that such an unintended consequence should be avoided.

Similarly, the party relying on representations given to it concerning knowledge and experience of a derivatives trading counterparty, which in the case of the Proposed Instrument would be derivatives dealers, could conceivably be put in a position of frequently having to seek updated representations from its eligible derivative party counterparties. Such a requirement would also place undue administrative burdens on dealers, the costs of which would ultimately be passed along to their trading counterparties.

In addition, requiring regularly updated representations would significantly slow down the trade execution process. That in turn could result in some trades not getting executed at all, given the volatile prices in many derivatives markets, including for energy derivatives such as electricity, natural gas and petroleum. Nimbleness in trade execution can represent a competitive advantage for some derivatives dealers and their counterparties and undue administrative burdens jeopardize that advantage, resulting in lost trade opportunities and less competitive trade pricing.

Rather than requiring such granular level representations concerning derivatives knowledge and experience, Capital Power respectfully submits that an entity that is sophisticated enough to otherwise satisfy the criteria for being an eligible derivatives party will also be sophisticated enough to know what types of derivatives it is competent, or comfortable, transacting. Such an entity will have in place internal policies and procedures regulating its derivatives activities, including allowed product types, position limits and requisite market knowledge and experience among its trading staff. Considering these sorts of internal safety controls a general representation concerning requisite derivatives knowledge and experience should be sufficient.

Concerning the question of whether it is practical for a derivatives dealer, or adviser, to make eligible derivatives party determinations (and manage its relationships) at the product-type level versus for all purposes, Capital Power has already partially answered that question in the preceding paragraphs. In addition to the above, Capital Power respectfully submits that the CSA should clarify in the Proposed Instrument that:

- Eligible derivatives parties giving the "knowledge and experience" representation contemplated in clause (m) of the eligible derivatives party definition may give the representation within master derivatives trading agreements, or industry-wide protocols amending master trading agreements,

and that such representations would be deemed repeated for each transaction under an applicable master trading agreements;

- Trading parties, including derivatives dealers or advisors, may rely on representations given to them by their counterparties without further independent investigation, unless the party receiving the representation had reasonable grounds to believe that the representation was false or unreliable. Reasonable grounds in such instances would be based on the "reasonable person in like circumstances" legal principle.

- The $25 million asset threshold in sub-clause (ii) of clause (m) of the eligible derivatives party definition should be based on gross assets and not net assets (both as revealed in most recently prepared financial statements). Basing the threshold value on gross assets, rather than net assets, would align the threshold in the eligible derivatives party definition with similar thresholds in the "qualified party" and "accredited counterparty" definitions discussed above, as well as in the "eligible contract participant" definition under the Commodity Futures Trading Commission's rules, albeit with a higher threshold than the CFTC's $10 million one[2].

3. Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties (CSA Question 4)

Capital Power generally agrees with the two-tiered approach to business conduct requirements set forth in the Proposed Instrument. Distinguishing between "sophisticated" and "un-sophisticated" derivatives market participants, based on the "eligible derivatives party" definition, and requiring correspondingly different levels of "protection" is both logical and consistent with other existing securities and derivatives regulations. As discussed above however, Capital Power believes that the definition of "eligible derivatives party" should be amended to better align it with the concepts of "qualified party", "accredited counterparty" and "eligible contract participant".

4. Business Trigger Guidance (CSA Question 5)

The proposed Companion Policy to the Proposed Instrument sets out factors that the CSA has described as relevant in determining whether an entity is in the business of trading or advising in derivatives, and therefore potentially a derivatives dealer. One of the factors is as follows:

> *"Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or **routinely quotes prices at which they would be willing to transact in a derivative** or offers to make a market in a derivative or derivatives." [**Emphasis added**]

Similarly, Sub-section 39(c) of the Proposed Instrument sets out that the exemptions set out in Section 39 only apply if "the person or company **does not regularly quote prices at which they would be willing to transact in a derivative** or otherwise make or offer to make a market in a derivative with a derivatives party". [**Emphasis added**]

[2] https://www.law.cornell.edu/uscode/text/7/1a, See sub-clause (A)(v)(I) in the definition of "eligible contract participant".

The CSA has asked whether the guidance in the proposed Companion Policy along with Sub-section 39(c) appropriately describe a situation in which a person or individual should be considered a derivatives dealer because they are functioning in the role of a market maker. In response to that question, Capital Power respectfully submits that simply quoting prices, routinely or not, at which an entity would be willing to transact in a derivative should not, absent other factors, be indicative of functioning as a market maker and therefore being a derivatives dealer.

Capital Power respectfully submits that the logic underlying the assumption, set out by the CSA in the proposed Companion Policy, that it would not be reasonable for an entity that regularly quotes prices on derivatives to other derivatives parties to claim that it is an end-user hedging business activities is flawed. On this point, Capital Power notes and supports the comments made in the Sutherland Letter (pg. 3-4) which provides several energy industry-specific examples illustrating why the logic behind the assumption is wrong. The Sutherland Letter (pg. 4) also provides recommendations regarding how the CSA should revise its guidance concerning the "regularly quotes prices" language and what activities should constitute market making (e.g. regularly providing two-way quotes that are generally agnostic to price movements). Capital Power supports those recommendations and respectfully urges the CSA to adopt them.

In addition to the examples and recommendations on the "regularly quotes prices" language in the Sutherland Letter, Capital Power respectfully asks the CSA to consider how any commercial transaction of any kind would be possible if neither party ever quoted a price at which it was willing to enter into the transaction? A fundamental principle of contract law is the concept of "consideration", or value of some kind being exchanged between the parties to a transaction. How can consideration be exchanged if neither party ever quoted a price at which it was willing to transact? Applied to derivatives transactions, how could any derivatives transaction happen, regardless of the characterization of the parties to the transaction as dealers or end-users, if neither party ever quoted a price at which it was willing to transact?

Capital Power respectfully submits that routinely quoting prices at which an entity is willing to enter into a derivatives transaction is simply an act of potentially initiating, or establishing the consideration for, a commercial transaction. This type of activity, absent other indicia of being a derivatives dealer, is entirely consistent with being a derivatives end-user that is hedging business activities. One specific example of this in the context of Capital Power's business (also mentioned at pg. 4 of the Sutherland Letter) is that of an owner of a natural gas fired power plant that must procure natural gas in the market to run the plant.

To ensure a constant reliable supply of natural gas at optimal prices Capital Power hedges its price and supply exposure to natural gas by entering into natural gas futures and OTC forward transactions on a regular basis. It would be impossible for Capital Power to enter into these types of derivative transactions without regularly quoting prices at which Capital Power was seeking natural gas from suppliers and other derivatives market participants. This price quoting is done to try to establish acceptable prices (i.e. the consideration) for the gas transactions that Capital Power must enter to hedge its natural gas requirements. In this commercial context, Capital Power's quoting of prices for acceptable natural gas hedges should not reasonably be interpreted as making a market in, or acting as a dealer of, natural gas derivatives.

In the alternative, if the CSA remains unconvinced by the discussion and example above and those in the Sutherland Letter on this point, Capital Power respectfully asks that Sub-section 39(c) of the Proposed Instrument be amended as follows:

the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party ***that is not an eligible derivatives party***;

Adopting the suggested revision would better align the derivatives dealer business trigger guidance in the proposed Companion Policy, and the end-user exemption in Sec. 39, with the two-tiered approach to business conduct requirements set out generally in the Proposed Instrument. In other words, routinely quoting prices to or offering to make a market with eligible derivatives parties should not attract the same level of business conduct requirements as engaging in those activities with non-eligible derivatives parties.

5. Senior Derivatives Manager (CSA Question 10)

Section 32 of the Proposed Instrument requires derivatives firms to have policies and procedures in place that establish a system of controls to manage risks associated with the firm's derivatives activities and to ensure that individuals at derivatives firms have the requisite training and expertise to meet the firm's compliance obligations under applicable securities legislation (including the Proposed Instrument). Section 33 of the Proposed Instrument imposes certain compliance related supervisory, management and reporting obligations on "senior derivatives managers". Section 34 imposes duties related to responding to and reporting non-compliance incidents. The CSA has asked whether the proposed senior derivatives manager obligations are practical to comply with and whether they reflect existing best practices.

In response to this question, Capital Power respectfully submits that the proposed responsibilities for senior derivatives managers around compliance with securities law and derivatives regulations, including the Proposed Instrument, do not reflect current best practices. Senior derivatives managers are typically individuals that are responsible for managing the derivatives activities of the company, or a business unit within the company. As such, their primary responsibilities include ensuring the profitability of the derivatives activities that they oversee. Imposing the proposed compliance responsibilities on senior derivatives managers would put such managers into a conflict of interest position between the proposed compliance duties and their existing duties to advance the derivatives trading activities of their firms. Best compliance practices prescribe that the compliance functions within an organization be independent from the business functions to avoid, or mitigate, any inherent conflicts of interest.

For extensive discussion and examples about current compliance framework best practices and the conflict of interest the proposed senior derivatives manager responsibilities would create, Capital Power supports and recommends to the CSA the comments in both the IECA Letter (pgs. 12-13) and the Sutherland Letter (pgs. 10-11). Capital Power confirms that its own compliance framework reflects best practices by separating the compliance function from the business function; not just with respect to derivatives but for all business activities. Capital Power supports the recommendations in both the IECA Letter and the Sutherland Letter that Sec. 33 should either be removed from the Proposed Instrument, or alternatively, the proposed senior derivatives manager responsibilities should instead be designated as responsibilities of a senior compliance officer.

6. Records

Section 36 of the Proposed Instrument places certain requirements on derivatives dealers concerning keeping records related to their derivatives business activities. Although the CSA did not specifically pose any questions about the appropriateness of the recordkeeping requirements, Capital Power reiterates the

comments in both the IECA Letter (pg. 13) and the Sutherland Letter (pgs. 11-12) that the requirements in Section 36 are too broad. They will result in additional, unnecessary compliance costs for derivatives dealers that will simply be passed along to their non-dealer counterparties.

Capital Power supports the recommendations in the IECA Letter and the Sutherland Letter that derivatives dealers' recordkeeping obligations be limited to keeping records of communications related to the negotiation of derivatives, the execution of derivatives, and any amendment or termination of derivatives. Furthermore, keeping records of telephone conversations and instant message communications should not be required if a record of those communications otherwise exists.

7. *De Minimis* Exception from Registration

As stated in the General Comments part of this letter, Capital Power hopes that the Proposed Registration Instrument, when published, will provide greater clarity around the derivatives dealer concept. As part of that clarity Capital Power respectfully urges the CSA to develop and adopt a *de minimis* threshold exception as part of the derivatives dealer definition, like the *de minimis* threshold exception (currently $US 8 billion over a 12-month period) adopted by the CFTC as part of the "swap dealer" definition. For a detailed discussion about the need for a *de minimis* threshold exception and potential approaches for developing an appropriate threshold, Capital Power respectfully urges the CSA to carefully consider and adopt the comments and proposals provided in Exhibit I to the Sutherland Letter ("*White Paper – The Need for a De Minimis Exception from Registration as Derivatives Dealers in Canadian Provinces and Proposed Approaches to Implementation*") as the CSA finalizes the Proposed Registration Instrument. The White Paper effectively addresses the risks posed to Canadian derivatives markets in the absence of a *de minimis* exception, including a reduction in market participants and the corresponding reduction in liquidity and increase in market risk. Capital Power supports the White Paper's comments and proposals.

Conclusion:

Capital Power respectfully requests that the CSA consider its comments and again expresses its gratitude for the opportunity to provide comments. If you have any questions 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