

Capital Power Corporation
Suite 1200, 401 – 9 Avenue SW
Calgary, AB T2P 3C5
www.capitalpower.com

February 1, 2013

Delivered VIA electronic mail

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
Saskatchewan Financial Services Commission

c/o:

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
e-mail: jstevenson@osc.gov.on.ca


c/o:

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec
H4Z 1G3
e-mail: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

RE: Comment Letter to CSA Staff Consultation Paper 91-301 – *Model Provincial Rules – Derivatives; Product Determination and Trade Repositories and Derivatives Data Reporting*

Capital Power Corporation (“**CPC**”), CP Energy Marketing LP (“**CPEM**”) and CP Energy Marketing (US) Inc. (“**CPEMUS**”) and their other affiliates and subsidiaries (collectively, “**Capital Power**”) make this submission to comment on the Canadian Securities Administrators (“**CSA**”) Staff Consultation Paper 91-301 – *Model Provincial Rules – Derivatives; Product Determination And Trade Repositories and Derivatives Data Reporting Paper* (“**Model Rules**”) published by the CSA OTC Derivatives Committee (the “**Committee**”) on December 6, 2012, proposing the broad definition of a derivative as it applies to the reporting of derivatives transaction data by market participants in Canada. Capital Power supports the



efforts of the CSA to address these topics and provides these comments to request reconsideration of the proposed rules to make them more aligned with their US Dodd–Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank Act**”) equivalent rules as being currently implemented by various US agencies.

Capital Power is an independent power producer that owns more than 3600MW of power generation capacity across 15 facilities in Canada and the United States, with an additional 595MW of generation currently under construction or in advanced development. Capital Power operates and optimizes power generation from a variety of fuel sources including coal, natural gas, bio-waste and wind. In Alberta, Capital Power’s portfolio, including interests in joint venture facilities, comprises approximately 1000MW of merchant generation capacity. Assuming an Alberta electricity pool price of \$60/MWh, Capital Power’s Alberta portfolio represents an annual notional value of approximately half a billion dollars for which the commodity price exposure is actively managed and optimized.

Capital Power optimizes and hedges its portfolio using physical forward contracts for electricity, natural gas, environmental commodities and USD/CDN currency exchange, and financial derivative transactions based on those same commodities. Capital Power’s trading counterparties include other independent power producers, utility companies, banks, hedge funds and other energy industry market participants. Trading activities take place through electronic exchanges, such as ICE (Intercontinental Exchange) and NGX (Natural Gas Exchange), brokered transactions and directly with counterparties.

Capital Power is a member of the Canadian Electricity Association (“CEA”) and fully supports the comments, with respect to the Model Rules, recently submitted by the CEA.

Capital Power appreciates the opportunity to comment on the Model Rules and we applaud the Committee’s effort in seeking to develop regulation of the trading of derivatives in Canada that on one hand would “strike a balance between proposing regulation that does not unduly burden market participants in the derivatives market, while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities”. However, proposing rules that deviate from the Dodd-Frank Act equivalent rules that cover the same cross-border transactions will put an unduly heavy cost burden on Canadian market participants. Capital Power has spent in excess of \$1 million to date to prepare for compliance with Dodd Frank Act. Accordingly, Capital Power requests that the Committee give further consideration to the proposed Model Rules.

GENERAL COMMENTS

With respect to the current Model Rules and future Model Rules that the Committee will publish, Capital Power strongly recommends that the Committee align these Model Rules with their Dodd-Frank equivalent rules. It is important that the CSA use the same nomenclature as is commonly used by market participants and has been adopted in the Dodd-Frank Act. Most Canadian market participants such as Capital Power, are also active in derivatives transactions in the US or with US counterparties and therefore have had to develop and implement (or start implementing) Dodd-Frank compliance programs. Capital Power utilizes sophisticated IT systems to support its business which are from US based vendors who have developed functionality to capture, monitor and report information to comply with Dodd Frank. The more the CSA Model Rules deviate from their Dodd-Frank equivalents the more costly, in terms of both time and money, it will be for Canadian derivatives market participants to develop new or different compliance programs for Canadian derivatives market regulation.



SPECIFIC COMMENTS

We have the following specific substantive comments regarding the Model Rules:

Model Rule- DERIVATIVES PRODUCT DETERMINATION (the Scope Rule”)


First, the Scope Rule should have a clear definition of what is and is not a derivative. Capital Power recommends that providing a clear definition of what is and what is not a derivative would provide certainty for market participants. Capital Power urges the Committee to develop a definition for “derivative” that is substantively the same as the definition of a “swap” under Dodd-Frank.

Second, the Committee has not given any reason for the distinction that the Committee has made, in terms of differentiating between excluded derivatives in Sections. 2(c) and (d)¹; forward contracts for physical commodities with intent for physical delivery (to be deemed not derivatives) and forward foreign exchange or forward currency contracts with intent for physical delivery (are to be deemed derivatives). We find the distinction illogical and artificial. We submit that the determining factor for the exclusion should be *the intent for physical delivery* and therefore FX or currency forward contracts, in which there is intent for physical delivery of the relevant currency, should also be excluded from the definition of a “derivative”. We suggest that the Committee after reviewing comments should change either Sec. 2(c) reference to “spot” contracts to also include forward currency contracts, and/or remove “other than ... a currency” language in Sec. 2(d).

To provide the Committee with rationale behind our stance on the distinction that the Committee has made, we ask the Committee to take a look at the explanation given by the US Commodity Futures Trading Commission (“CFTC”) in its implementation of the Dodd-Frank Act to exclude the CFTC’s historical statutory interpretation of the “**Forward Contract Exclusion**”. Under the Dodd-Frank Act, forward contracts are excluded from the definition of a “swap” including exclusion for any sale of a non-financial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.

From our understanding of the Committee’s rationale for this distinction as stated by members of the Committee at the Derivatives Roundtable hosted by the CSA on January 16, 2013, (“**Derivatives Roundtable**”) the Committee concerns are centred on the trading of off-exchange retail foreign exchange transactions which is very different from the OTC trading of FX forwards and swaps. As acknowledged in the Dodd-Frank Act and further determined by the US Department of Treasury (“**US Treasury**”), “the FX swaps and forwards market is markedly different from other derivatives markets. Existing procedures in the FX swaps and forwards market mitigate risk and help ensure stability”. The US Treasury listed three

¹ (c) a spot market contract or instrument for the purchase and sale of currency, (i) that requires the counterparties to make or take physical delivery of the currency within two business days and does not allow for the contract or instrument to be rolled over, (ii) that does not allow for cash settlement in place of physical delivery of the foreign currency, and (iii) that is intended by the counterparties to be physically settled, (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.




unique factors that mitigate risk in FX swaps and forwards market, and Capital Power recommends that the Committee bear them in mind to reconsider its rationale for making the distinction: (i) the FX forwards and swaps market have fixed terms; the market has a well-functioning settlement process; and lastly, the contracts are of shorter duration than other derivatives and as a result pose less counterparty risk.

Third, as a seller of electricity, Capital Power would like to draw the Committee's attention to an issue as explained in the Scope Rule explanatory guidance ("Scope **Rule EG**") that would adversely affect Canadian power generators such as Capital Power. Electricity sales are more or less physical but due to the inability to store electricity and the nature of the transactions entered into in this market, these transactions would likely not fit within the "physical commodity exclusion" category as the Committee has currently worded it. Specifically, ***financial settlement for under/over consumption is not due to a Force Majeure/Termination event.***

Fourth, the Scope Rule should clarify that "physical commodities" include environmental commodities such as renewable energy certificates, emission allowances and offset credits even though these may be "intangible" physical commodities and not "physical goods" as discussed in the Scope Rule EG. Excluding forward contracts for environmental commodities would be consistent with Dodd-Frank approach to these products. In the CFTC's Final Rule to further define a swap, the CFTC interpreted the Forward Contract Exclusion to include intangible commodities if such intangible commodities ***can be physically delivered***. The CFTC interprets physical delivery in this case as an ability to convey ownership of the commodity and that the commodity can be consumed. The CFTC noted in particular that an environmental commodity, such as an emissions allowance is eligible for the Forward Contract Exclusion because it can be physically delivered and consumed. In addition, in determining whether a Calgary-based trading system that facilitates the matching of Alberta emission offsets was an exchange, the Alberta Securities Commission deemed Alberta emission offsets to be commodities and not derivatives.

Fifth, the Scope Rule should clarify that financial "book-outs" of forward physical commodity transactions that were originally intended to be physically settled are not derivatives as long as cash settlement wasn't available as an alternative method of "delivery" from the outset, thereby aligning this with the Dodd-Frank equivalent rule. The CFTC has historically characterized forward contracts with respect to nonfinancial commodities as "commercial merchandising transactions". The CFTC states that "the primary purpose of a forward contract is to transfer the ownership of a commodity between parties; the purpose is not to transfer solely its price risk", therefore this regulatory scheme should not apply to private commercial merchandising transactions that "create enforceable obligations to deliver" and delivery is deferred for commercial convenience or necessity. The CFTC sees a book-out effected through a subsequent, separately negotiated agreement and is not provided for in terms of the initial agreement as still meeting the Forward Contract Exclusion. The CFTC further recognizes that though a book-out agreement may extinguish the delivery obligation of a party, any party in a distribution chain that provides the opportunity to book-out with another party or parties is nonetheless entitled to require delivery of the commodity.

Model Rule- TRADE REPOSITORIES AND DERIVATIVES DATA REPORTING (the TR Rule")



The Model Rules (though not necessarily the TR Rule) should specifically define what a “derivatives dealer” is rather than simply refer to a combined definition of “derivatives” and “dealer” from the Ontario Securities Act.

Second, the TR Rule should address to what extent reporting derivatives data to a “foreign” (i.e. a trade repository registered outside of the province in which the transaction takes place or the transacting parties are located) would satisfy the reporting requirement under the TR Rule. Such “substituted compliance” should be allowed as long as the foreign jurisdiction had a reporting regime substantially similar to the reporting regime in the “home Province”. Requiring market participants to potentially have to report to trade repositories in multiple jurisdictions is onerous and should be avoided.

Third, the interaction between the duty to report described in Sec. 25(1) of the TR Rule and the reporting hierarchy described in Sec. 27(1) is unclear and should be clarified. Under 25(1) it appears that every “local counterparty” has a reporting obligation. Under 27(1) the reporting obligation is determined with reference to a party’s status as a “derivatives dealer” and as between a derivatives dealer and a non-dealer the derivatives dealer has the prima facie obligation to report. It is unclear whether Sec. 25(1) is intended to be subject to Sec. 27(1) or not and it is not currently stated to be so subject. In other words, is the reporting obligation/hierarchy intended to be as follows:


1. Local counterparty that is also a derivatives dealer;
2. Derivatives dealer that is not a local counterparty;
3. Local counterparty that is not a derivatives dealer if non-local derivatives dealer fails to report;
4. As between a non-dealer local counterparty and a non-dealer, non-local counterparty the non-dealer local counterparty must report; and
5. Both local non-dealer counterparties must report (if both counterparties to a transaction are local counterparties and non-dealers and fail to agree which one among them will report)?

A chart illustrating the various reporting obligation permutations and combinations would be useful to have inserted into the TR Rule.

Fourth, with respect to reporting data for pre-existing derivatives under Sec. 26 of the TR Rule, the obligation should simply be to report whatever data were in the possession of the reporting party at the time the transaction was executed. Requiring reporting of the same data elements for pre-existing transactions as for transactions entered into after the enactment of the TR Rule would be onerous to the extent that go-forward reporting could require data elements that are not available in the context of historical transactions because the parties had no way of anticipating in the past that such data elements might become reportable in the future.

Fifth, Capital Power recommends that, as provided under Section 40(1) the “Director” may grant exemptions to the TR Rule, some context should be provided in the TR Rule around the basis or criteria for granting such exemptions and the scope thereof.

Specific Feedback sought by the Committee on Subsection 40(2) of the TR Rule”



Capital Power gives this specific feedback with reference to Subsection 40(2) of the TR Rule to the Committee as the Committee has asked for specific feedback with respect to the exemption it is proposing to provide for reporting requirements for derivatives transactions in the physical commodity market involving market participants with small derivatives exposures.


The reference to “physical commodity transaction” in Sec. 40(2) is confusing in light Section 2 of the Scope Rule under which physical commodity transactions have been excluded from the definition of a derivative as it applies to the TR Rule, i.e. should not be reportable as “derivatives”. The reference in 40(2) and its intersection with Section 2 of the Scope Rule should be clarified to provide certainty to market participants.

In addition in Section 40(2) the \$500,000 aggregate transaction threshold, above which a local counterparty must begin reporting, is unreasonably low and arbitrary. Capital Power urges the Committee to explain how this figure was derived and provide market participants with further opportunity to both comment on the Committee’s methodology and to potentially offer alternative values. In addition, the TR Rule should specify over what time period the \$500,000 (or any other value) applies or is to be calculated.

CONCLUSION

The comments above conclude Capital Power’s comments on the Model Rules. However, as Capital Power participated in the Derivatives Roundtable, we would like to make a few comments regarding the proposals put forward by members of the Committee with respect to the impending Registration Consultation Paper.

1. Registration requirements in Canada should parallel the US Swap Dealer requirements under the Dodd Frank Act, which only captures the largest financial institutions dealing with swaps with U.S. Persons in its ambit.
2. The Business Trigger (adapted from National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* NI31-103) may not be a sufficiently bright line test for market participants to determine registration. The CSA should consider exempting specific categories of market participants from the requirement to register as derivatives dealers consistent with the end-user exemptions under the Dodd Frank Act.
3. Despite the fact that the Committee has not yet published the Registration consultation Paper, Capital Power recommends that the CSA should be signalling the market with respect to these high level issues. The CSA needs to signal determination of how the rules will be made e.g. (adaptation of NI 31-103 which only applies to categories of dealer registration for securities or completely separate rule for derivatives dealers); whether there will recognition of foreign dealers operating in Canadian jurisdictions; or if and how IIROC or other SROs may be involved in the registration and oversight of this category of dealer. This would also provide clarity in the trade reporting to repository requirements.
4. Each provincial and territorial securities regulatory authority will make or enact its own version of the Model Rules. What process does the CSA envisage to ensure consistency over time? Will



there be a process for uniform amendments? If not, regulatory drift will inevitably occur as each jurisdiction must deal with the realities of their own markets and market participants. Non-uniform regulation of derivatives trading in Canada could result in a burden for Canadian market participants and invite systemic risk.

Capital Power continues to support the Committee and the CSA's efforts to regulate the OTC derivatives market in Canada, but would strongly urge the Committee to continue to strive for uniformity in the development and application of all rules and regulations with similar rules in the US that affect the same transactions. A coordinated approach to implementation of reform efforts will be the most effective and least onerous for Canadian market participants. Additionally a rationalised approach will ensure that Canadian market participants are not adversely impacted as a result of complying with regulations that are inconsistent with current commercial practices in the marketplace and with regulation in the US that cover the same transactions.

Capital Power respectfully requests that the Committee consider its comments. Capital Power looks forward to further consultation papers prior to the creation of legislation and regulations to govern the Canadian OTC derivatives markets. If you have any questions, or if we may be of further assistance, please contact either the undersigned at 403-717-8941 (gbarr@capitalpower.com), or Mr. Zoltan Nagy-Kovacs, Senior Counsel, at 403-717-4622 (znagy-kovacs@capitalpower.com).

Yours truly,

"CAPITAL POWER"

Per: 

Gordon R. Barr
Vice President, Commodity Portfolio Management