EquiPower
Resources Corp.

Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Farm Credit Administration
Federal Housing Finance Agency

Re: ***Docket No. R-1415 and RIN 7100: Margin and Capital Requirements for Covered Swap Entities (May 11, 2011).***

Dear Ladies and Gentlemen:

EquiPower Resources Corp. (**"*EquiPower*"**) is pleased to submit the following comments to the Notice of Proposed Rulemaking by the Office of the Comptroller of the Currency ("***OCC***"), the Board of Governors of the Federal Reserve System ("***Board***"), the Federal Deposit Insurance Corporation ("***FDIC***"), the Farm Credit Administration ("***FCA***"), and the Federal Housing Finance Agency ("***FHFA***") (collectively, the "***Prudential Regulators***") regarding Margin Requirements for Covered Swap entities (the "***Margin Proposal***").[1] We appreciate the Prudential Regulators' willingness to reopen the comment period on this important rule. As detailed below, we believe that the Margin Proposal should be changed so that it would: (i) allow swap dealers to exercise their business judgment in determining whether to impose margin requirements on commercial end-users such as EquiPower, without establishing a regulatory minimum requirement; (ii) allow swap dealers to accept non-cash collateral from commercial end-users seeking to hedge or mitigate commercial price risk, to satisfy any margin requirements agreed to by the parties; and (iii) most importantly, allow swap dealers and their end-user counterparties to agree contractually on acceptable margining methodologies.

INTRODUCTION

EquiPower is a competitive power generation company that owns and operates a portfolio of five highly efficient combined cycle natural gas power plants in Connecticut, Massachusetts, and Pennsylvania, and manages affiliate company power plants in New York, New Jersey and Texas collectively representing over 5,100 megawatts of generating capacity. We believe that we meet the definition of a "commercial end-user" for purposes of the exception from the

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1 *See* Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Agency, Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564, 27,569 (May 11, 2011).

clearing mandate.[2] The purpose of our derivative transactions is solely to mitigate inherent market risk with respect to merchant natural gas fired electrical generation. Accordingly, our swaps primarily relate to natural gas and power and, to a lesser extent, locational basis differentials, emissions and interest rates. The vast majority of our swap positions are secured by a first lien on our assets, with a very small amount secured by receivables, or by letters of credit. In some very limited circumstances, and in small, manageable amounts, we do post cash margin where a clearing broker on behalf of a counterparty (e.g. The Intercontinental Exchange Inc. or "ICE") requires cash margin only, but as stated above, this represents a very small part of our hedging program and as such, is manageable. However, the cost to our business of posting cash margin in all circumstances would be excessive—we estimate the potential amount of cash collateral required for an energy-based commercial end-user such as EquiPower to be upwards of $200 million and the annualized cost of the cash collateral at this level to be in the range of $20-25 million. Even if it were possible for businesses such as EquiPower to secure credit facilities to support such potential margin requirements of this magnitude, an important consideration that is far from certain, such a requirement would create substantial liquidity risk for our business and would represent a very inefficient, highly expensive, and duplicative use of capital, impairing the competitiveness of commercial end users. Were such cash margin requirements to apply to non-financial commercial end-users (even with agreed upon thresholds), we believe businesses such as EquiPower would be highly constrained in how much of their business price risk they are able to mitigate through swap transactions, which, in turn, would present a serious threat to the financial stability of such businesses and the broader markets within which they operate.

BACKGROUND

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("***Dodd-Frank***")[3] requires the Prudential Regulators and the Commodity Futures Trading Commission ("***CFTC***") to establish margin requirements in connection with uncleared swaps. Specifically, new Section 4s of the Commodity Exchange Act (**"*CEA*"**) applies a bifurcated approach that requires each covered swap entity (*i.e.*, swap dealers and major swap participants) for which there is a Prudential Regulator to meet margin requirements established by the applicable Prudential Regulators, and each covered swap entity for which there is no Prudential Regulator to comply with CFTC regulations governing margin.

Unlike under the CFTC's proposal,[4] the Prudential Regulators' Margin Proposal would require covered swap entities to collect margin from all counterparties, including for transactions involving non-financial end-user counterparties, to the extent that the bank swap entity's exposure under the swap exceeds a certain threshold.[5] Additionally, the Prudential Regulators'

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2 We believe we meet the definition of an end-user for purposes of the exception to the clearing requirement for swaps because, as detailed in this letter, we enter into swaps for the purpose of hedging or mitigating risk, not to speculate or invest. *See* Final Rule on the End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560 (July 19, 2012).

3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

4 Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (proposed April 28, 2011) (the "CFTC Proposal").

5 *See* Margin Proposal at 27,569.

Margin Proposal would limit the types of acceptable collateral to cash and U.S. government-backed, cash-equivalent securities (subject to specified haircuts).[6]

COMMENTS

EquiPower urges the Prudential Regulators to allow swap dealers broad discretion with respect to margin requirements for commercial end-users and to accept non-cash collateral from commercial end-users to satisfy applicable margin requirements. As correctly noted by the CFTC, commercial end-users pose less risk to swap dealers and the financial markets than other types of entities.[7] Commercial end-users also may have more limited access to liquidity than financial entities, but often have other readily available forms of collateral (such as, for natural gas and power swaps, the underlying physical commodity) that provide effective protection for their counterparties. In our experience, swap dealers have historically managed the credit risk from their commercial end-user counterparties flexibly but prudently, and we strongly suggest that the Prudential Regulators allow them to continue to exercise such discretion. We believe that such an approach with regard to the amount and acceptable forms of collateral is consistent with Congress' intent to "permit the use of noncash collateral, as the [Prudential Regulators] . . . determine to be consistent with—(i) preserving the financial integrity of markets trading swaps; and (ii) preserving the stability of the United States financial system."[8]

EquiPower also urges that the Prudential Regulators recognize that commercial end-users may not as a practical matter maintain sufficient cash to satisfy onerous margin requirements. In the energy market, for example, common forms of collateral used by commercial end-users include letters of credit, liens on assets, and receivables. If commercial end-users in the energy market are forced to use their cash for margin purposes, then that money cannot be used to invest in infrastructure, explore alternative sources of energy, or create new jobs. All of these activities are beneficial to the economy, increase reliability of the power supply, and generally reduce energy prices. A requirement for commercial end-users to use cash for margin purposes would be a duplicative and unnecessary use of capital effectively negating the value of other forms of non-cash collateral resulting in an inefficient capital structure and lessening the competitiveness of the companies impacted. We therefore urge the Prudential Regulators to ensure that energy companies have the flexibility they need to manage risk without creating undue pressure on their liquidity and limited cash resources.

Finally, EquiPower notes that a prohibition on the use of non-cash collateral by commercial end-users would needlessly restrict the ability of such entities and their counterparties to shape their credit support arrangements to transaction and counterparty specific risks and resources. Indeed, imposing overly restrictive margin requirements on swap dealers with respect to commercial end-users could result in swap dealers being unable to act as counterparties for asset owners seeking to hedge commodity risk, in turn, causing broader harm

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6 *See id.* at 27,568.

7 *See* CFTC Proposal, 76 Fed. Reg. at 23,736.

8 *See* CEA at § 4s(e)(3)(C); *see also* Letter from Chairman Christopher Dodd, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and Chairman Blanche Lincoln, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, to Chairman Barney Frank, Financial Services Committee, United States House of Representatives, and Chairman Collin Peterson, Committee on Agriculture, United States House of Representatives (June 30, 2010).

to the liquidity and stability of the financial markets. Such requirements will likely have the effect of greatly diminishing the valuable role that swap dealers play in providing the means for commercial end-users to manage their business risk which, in turn, will not only negatively impact the businesses of the commercial end-users, but will also have a negative impact on the financial strength of the swap dealers themselves. By allowing commercial end-users to elect to rely on an exception from the CEA's clearing mandate and trade execution requirements, Congress effectively approved the ability of such commercial end-users to continue to engage in bilateral swaps with customized terms that are designed to meet the specific needs of such commercial end-users, especially where, as in our case, because of the nature of the hedges we conduct and the assets we own, the collateral actually increases in value as the hedges' value changes. This is one of the primary reasons that swap dealers are very comfortable accepting collateral in the form of a first lien on our assets. Swap dealers that are commodity hedge counterparties with EquiPower, for example, fully realize that as their exposure to EquiPower increases when energy prices rise, the value of the collateral they hold rises even more. Not only do our hedges represent "right-way risk" for such swap dealers, but for liquidity and other reasons, our hedges tend to be for smaller volumes and for smaller tenors than the full output capability or remaining useful life, respectively, of our power generation facilities, which is why the value of collateral the swap dealers hold in the form of a first lien on our assets rises even more than does the exposure they may face on the hedges. For these reasons, we believe that swap dealers should be permitted to negotiate tailored arrangements with commercial end-users with respect to the amount of margin (or other collateral) posted and the form of such margin.

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EquiPower appreciates the opportunity to comment on the Prudential Regulators Notice of Proposed Rulemaking regarding "Margin and Capital Requirements for Covered Swap Entities." We would be happy to elaborate or discuss further any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned.

Sincerely,

Alan Dunlea

Alan Dunlea

Executive Vice President and Chief Financial Officer

Cc: ELLEN MARKS, PETER MALYSHEV, BRETT ACKERMAN – LATHAM & WATKINS, LLP