



**CONFIDENTIAL**

February 4, 2013

British Columbia Securities Commission  
701 West Georgia Street  
Vancouver, BC  
V7Y 1L2

Attention: Mr. Michael Brady, Senior Legal Counsel

Dear Mr. Brady:

**Re: FortisBC Energy Inc. ("FEI") and FortisBC Inc. ("FBC"), (together, "FortisBC")  
Comments re CSA Staff Consultation Paper 91-301**

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1. Introduction

The Canadian Securities Administrators (CSA) OTC Derivatives Committee (the "Committee") has published the CSA Staff Consultation Paper 91-301 regarding Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting (the "Model Rules"). These have been drafted based on existing provisions of Ontario securities law. The CSA has requested comments from affected users on the Model Rules so that it may make appropriate changes and enable each jurisdiction to develop its own rules. The provincial rules are expected to come into effect later in 2013 or early in 2014.

The driving force behind these rules is the Committee's requirement to implement G-20 commitments. These include requirements that all standardized over-the-counter ("OTC") derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties. They also require that OTC derivatives contracts be reported to trade repositories ("TR") and non-centrally cleared contracts should be subject to higher capital requirements.

In developing the rules, the Committee seeks to implement effective regulatory oversight of derivatives markets without unduly burdening market participants. Where possible, rules will be harmonization with international standards and consistent across Canadian jurisdictions.

This letter includes FortisBC's comments and any concerns related to the Model Rules. FortisBC's primary interest in the Model Rules is to ensure that it is able to continue to effectively manage costs for its customers without additional material administrative requirements or costs. Once the Model Rules are established for the individual jurisdictions, FortisBC would like the opportunity to review, understand and potentially comment on them.

## 2. FortisBC Use of Derivatives

In order to mitigate the risk of market price movements on its natural gas rates for customers, FEI has actively engaged in OTC natural gas commodity hedging in the past. FEI has undertaken hedging to protect customers and not for speculative purposes.

FortisBC has also engaged in physical commodity (gas and electricity) trading for the purposes of managing costs for customers. As will be discussed in this letter, FortisBC believes that these types of transactions should not be classified as derivatives per the Model Rules definitions and therefore not subject to the pending derivatives legislation.

FortisBC's financial hedging and physical commodity purchases and trading strategies and plans have been subject to approval by the British Columbia Utilities Commission on a regular basis before their implementation.

Because FortisBC performs financial hedging and physical trading to mitigate risks and reduce costs for customers, FortisBC believes it should be classified as a derivatives end user, rather than a derivatives dealer, derivatives adviser or large derivatives participant. As such, FortisBC expects to be exempt from much of the reporting and capital and margin requirements.

## 3. Comments Regarding Model Provincial Rule – Derivatives: Product Determination

FortisBC's primary comment regarding the Model Rule relating to Product Determination relates to the definition of a derivative. In particular, FortisBC believes there should be greater clarity relating to physically delivered commodity contracts or instruments that are excluded from being derivatives. According to the Model Rule, an instrument is not a derivative if it is for immediate or deferred delivery of a physical commodity other than cash or a currency and:

- Requires counterparties make or take physical delivery;
- Does not allow for cash settlement in place of physical delivery;
- Is intended by the counterparties to be physically settled.

FortisBC would like to point out that there are often circumstances in physical commodities markets where physical delivery is intended but instead does not take place and cash settlement occurs. These are often referred to as net-offs or book-outs in the natural gas and electricity markets. In these arrangements, an end user, such as FortisBC, may purchase physical commodity supply for a period (such as a month or season) in the future, with the intent to physically take the supply from the counterparty. However, once into that period, FortisBC may wish to sell off that physical supply on a particular day, perhaps due to lower customer requirements caused by reduced weather demand. Therefore, FortisBC may sell some or all of this supply back to the same counterparty. In the case where it is all sold back, because the purchase and sell volumes are the same, the parties may choose to not physically flow any of the supply and opt for cash settlement. This helps reduce operational requirements, time and costs for the parties.

These types of arrangements may occur repeatedly as they provide flexibility for utility end users in managing customer load variability and costs. In fact, FortisBC may enter into these arrangements knowing that a net-off or book-out and a cash settlement may occur later – however, FortisBC does not know exactly when, or if, it will happen. Therefore, FortisBC has concerns with the wording in the Model Rules under Section 2: Excluded Derivatives (end of paragraph five) which states:

*“Additionally, in situations where a market participant settles contracts in cash on a repeated basis, we take the position that irrespective of contractual requirements for physical settlement, this may be evidence of a party’s intention not to physically settle”.*

FortisBC believes that this type of arrangement should be excluded from being a derivative even if cash settlement in place of physical delivery occurs on a repeated basis. This is because these arrangements are intended to help manage physical supply and costs for customers, rather than for the purposes of speculating on market prices for financial gain or market manipulation.

Another arrangement frequently used by FEI to manage customer load variability and gas costs relates to peaking supply. FEI will often enter into peaking supply arrangements with a counterparty wherein FEI has the right to call on physical supply for a limited number of days during the peak winter season. Again, this type of arrangement helps FEI manage load variability and costs for customers. Whether FEI calls on this supply or not, a fee is paid by FEI to the counterparty for this optionality. FEI’s intent is to physically take delivery if customer load requirements dictate, however it may not require the supply in the end. In this case, there is not a cash settlement in place of physical delivery but rather cash is paid to have the option of physical delivery. FEI also believes that this type of arrangement should be excluded from being a derivative.

Within the Model Rules, the Committee does discuss cash settlements related to contract termination, breach or frustration provisions and force majeure events that are outside the control of the parties. These do not make an otherwise firm obligation for physical delivery merely an option for physical delivery with cash settlement and so are excluded from being derivatives. FortisBC would like to confirm that the other types of arrangements it enters into, as described herein, are also excluded from being derivatives and therefore the derivatives regulation.

#### 4. Comments Regarding Model Provincial Rule – Trade Repositories and Derivatives Data Reporting

FortisBC also has concerns regarding the Model Provincial Rule – Trade Repositories and Derivatives Data Reporting and so has provided comments here.

The Model Rule requires that all derivatives transactions be reported to a central Trade Repository. The Model Rule also determines the parties responsible for reporting to a TR. In some cases, this may include end users. At a minimum, it is expected that end users be able to

access TRs to confirm their transactions reported by other parties. TRs will be established by the marketplace, as companies interested in being TRs will make an application to do so.

The Model Rules state that each counterparty to a transaction that is subject to reporting requirements must be identified by a single legal entity identifier. However, the steps involved in obtaining this identifier are not laid out.

FortisBC understands that fees may be charged by TRs to cover costs relating to data reporting and access. The Model Rule states that fees imposed by TRs should be fair and publicly disclosed for each service offering. FortisBC would like to emphasize its view that these fees should not be material in amount or change significantly from year to year as they will be costs that our customers will have to pay.

FortisBC would like to express its concerns regarding data transparency and the TR making transaction data available to the public. FEI purchases natural gas at a number of market hubs in B.C. and uses financial hedges to manage price risk at these hubs. While some market hubs are very liquid, such as the AECO/NIT market hub proxy for Alberta gas, others are not so liquid. In particular, the Sumas market hub is relatively illiquid, with a small number of buyers and sellers. As part of its price risk management strategy, FEI typically hedges its Sumas price exposure for each winter period. FEI is concerned that, given the amount of hedging it does at Sumas and the small amount of trading at this hub, making the derivatives data available to the public for this hub could compromise FEI's hedging position or strategy. FEI would prefer that this data is made public in such a manner that protects FEI's positions and strategies to manage price risk and costs for its customers.

FortisBC has some comments regarding data reporting to a TR. FortisBC understands that the Committee is interested in harmonizing derivatives reporting rules with other jurisdictions. However, greater clarity is needed regarding the ability for reporting to a TR in one jurisdiction to satisfy the reporting requirements to a TR under another jurisdiction. For example, if FortisBC, as an end user subject to the B.C. reporting requirements, transacts with a derivatives dealer subject to the U.S. reporting requirements per Dodd-Frank regulations, does the derivatives dealer report under both jurisdictions or just in accordance with the U.S. Dodd-Frank regime? And if it reports only under Dodd-Frank rules and to a U.S. TR, does the Committee recognize this as substitute reporting under the B.C. TR? Also, is there a situation where FortisBC may have to report derivatives transactions, other than where its counterparty is not a derivatives dealer, adviser or large derivatives participant? FEI believes there needs to be greater clarity regarding the degree of similarity between two jurisdictions that will be required for the administrators in either jurisdiction to grant permission for substituted compliance.

While FortisBC may not be subject to reporting requirements under the Model Rules for the most part due to its assumed end user status, FortisBC would like to know more about the penalties for non-compliance with regard to reporting. Specifically, what are the types of non-compliance and penalties for each type of violation? FortisBC believes a grace period once implementation of the legislation begins is appropriate until parties are more familiar with the requirements.

While FortisBC's counterparties may do most of the required TR reporting, FortisBC would still be required to keep records of the derivatives data for each transaction for a minimum of seven years after the transaction has expired. The Model Rules do not make it clear whether the records would have to contain the same type of information as that which must be reported to the TR by the counterparty.

Section 35 of the Model Rule describes the reporting regarding valuation data. It states that valuation data must be reported to the TR at the end of each business day by derivatives dealers and also at the end of each quarter for all reporting counterparties that are not derivatives dealers. FortisBC would like to confirm that this quarterly valuation data reporting would only be performed by FortisBC as an end user if it were a reporting counterparty and therefore dealing with a party who is not a derivatives dealer, adviser or large derivatives participant. If this is not the case, and FortisBC is required to report quarterly valuation data, FortisBC would like more information regarding the requirements for this reporting. In particular, FortisBC would like to know the specific data requirements.

FortisBC also believes that a listing of which companies are derivatives dealers, advisers, large derivatives participants and end users should be updated as participants register. This would help participants in determining their roles in terms of reporting and other obligations under the regulation.

The Committee has requested specific feedback on subsection 40(2) of the TR rule that provides an exemption for reporting requirements for derivatives transactions in the physical commodity market involving market participants with small derivatives exposures. The exemption rule releases a party from reporting if it is not a dealer or adviser and has less than \$500,000 aggregate notional value under all its outstanding transactions. FortisBC believes that this exemption is to remove any administrative reporting burden for small volume end users who are unlikely to pose any threat to financial markets. FortisBC believes that the \$500,000 amount is so minimal that it is almost equivalent to having no minimum threshold at all, given that parties often enter into transactions up to a year or longer and market prices can fluctuate significantly. FortisBC suggests that a more meaningful threshold in the order of \$10 million might be more appropriate. For example, a small volume end user hedging 5,000 GJ per day (about half a standard gas contract) for 365 days at about \$5.50/GJ would result in a notional value of about \$10 million. As FortisBC's past notional values have far exceeded this threshold, FortisBC does not believe it would qualify for this exemption. Therefore, while FortisBC has suggested increasing the threshold amount, the Committee should place more weight on comments received by small volume end users when determining the threshold as these users will be directly impacted.

## 5. Conclusion

FortisBC appreciates the Committee's consideration of comments in developing the derivatives regulation. FortisBC has submitted its concerns and comments in the interests of managing its gas and power supply and costs for its customers. FortisBC welcomes further discussion of

these comments and concerns if it is required and would like to have the opportunity to review and comment on future papers and provincial rules.

Please direct any further questions to Nina Virdee at (604) 592-7859 or Mike Hopkins at (604) 592-7842.

Yours very truly,

*Roger Dall'Antonia*

VP, Strategic Planning, Corporate Development & Regulatory Affairs

**FortisBC Energy Inc.**