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July 11, 2011

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Re: Comments on Margin Requirements for Covered Swap Entities

Ladies and Gentlemen:

NRG Energy, Inc. (together with its affiliates and subsidiaries, "NRG") submits this letter in response to the Notice of Proposed Rulemaking published in Federal Register on May 11, 2011 (the "NOPR") by the Department of the Treasury, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (the "Prudential Regulators") regarding Margin and Capital Requirements for Covered Swap Entities[1].

NRG is an independent power generation company with a significant presence in major power markets in the US, as well as a major retail electricity provider through Reliant Energy and Green Mountain Energy Company. The business activities of NRG include the ownership, development and operation of power generation facilities, the trading of energy and related products, the supply of cleaner energy and carbon offset products to retail electricity customers.

[1] *Margin and Capital Requirements for Covered Swap Entities*, 76 Fed. Reg. 27564 (May 11, 2011).

NRG devotes considerable resources to the development of (i) renewable energy sources with an emphasis on solar power development, (ii) fast start, high efficiency, gas-fired capacity, (iii) electric vehicle ecosystems and (iv) smart grid services.

NRG fully supports the efforts of the Prudential Regulators to strengthen transparency and accountability in the US financial markets. However, in defining the margin requirements that will be applicable to nonfinancial end users, we respectfully submit that the Prudential Regulators should closely follow the intent of Congress as expressed in Senator Christopher Dodd's and Senator Blanche Lincoln's letter dated June 30, 2010 (the "Dodd-Lincoln Letter"), regarding the purposes and goals of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). As pointed out in the Dodd-Lincoln Letter and recently reiterated in a June 20, 2011, letter by Senator Debbie Stabenow, Chair of the Senate Committee on Agriculture, Nutrition and Forestry, and Congressman Frank Lucas, Chair of the House Committee on Agriculture (the "Stabenow-Lucas Letter"), Congress did ***not*** intend the statute to require nonfinancial end users to meet restrictive cash or cash equivalent margin standards for swaps or limit the types of collateral that could be posted. More specifically, the final rule that will follow the NOPR should clarify this point and definitively state that swaps between a "covered entity" and a nonfinancial end user may be supported by a range of collateral and credit support arrangements, including first liens on non-cash assets, letters of credit and other valuable pledges.

The Congressional Intent Behind Dodd-Frank

The Dodd-Lincoln Letter states:

> The legislation does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk. If regulators raise the costs of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth.
>
> In cases where a Swap Dealer enters into an uncleared swap with an end user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction. Congress strongly encourages regulators to establish margin requirements for such swaps or security-based swaps in a manner that is consistent with the Congressional intent to protect end users from burdensome costs.
>
> . . . Congress specifically mandates that regulators permit the use of non-cash collateral for counterparty arrangements with Swap Dealers and Major Swap Participants to permit flexibility.

The Stabenow-Lucas Letter further supports the idea that Dodd-Frank was not intended to require nonfinancial end users to meet restrictive cash or cash equivalent margin standards for swap transactions. And, consistent with both letters, Dodd-Frank specifically provides that non-cash collateral must be permitted by regulators in any margin rule.[2] Thus, it is clear that Congress

[2] *Id.* at § 731 (as codified at 7 U.S.C. § 4s(e)(3)(C)) ("In prescribing margin requirements . . . the prudential regulator[s] . . . shall permit the use of noncash collateral . . . .").

intended nonfinancial end users that are hedging commercial risk to be treated differently from other OTC swap counterparties with respect to margin.

The Commercial Realities Supporting the Dodd-Lincoln and Stabenow-Lucas Letters

The principles in the Dodd-Frank Letter and the Stabenow-Lucas Letter, that non-cash collateral must be permitted to support swap transactions, that margining requirements cannot divert capital from important business activities that contribute to economic growth, and that burdensome swap costs hurt business, are based on commercial realities that many energy companies and other nonfinancial end users face in their day-to-day businesses.

First, to understand how margin requirements can unduly burden a company, it helps to begin by focusing on why and how companies like NRG hedge risk. NRG, like other power producers, is exposed to price volatility risks related to the electricity it generates and the coal, natural gas, refined products and other commodities that it purchases to run its power facilities and other aspects of its business. NRG, like other power generators, hedges these risks by using over the counter ("OTC") swaps so that it can conservatively and efficiently operate its business.

NRG generally collateralizes its obligations for a significant portion of the swaps it enters into by providing counterparties with first liens on substantially all of its assets and those of its affiliates that own electric power generation units. These secured swap positions are fully collateralized and do not pose any systemic risk to the US financial system. At the same time, NRG must also manage finite cash reserves. If NRG were required to pledge its cash reserves as collateral for swaps and be unable to pledge its physical assets, it would dramatically increase the cost of conducting NRG's hedging program. These costs, under historic patterns of electricity and fuel price volatility, would be so substantial that they could force NRG to curtail its hedging program or its investment in productive business activities that create jobs and otherwise contribute to the economy, such as solar energy, electric vehicle and other clean energy projects.

Second, the burden on a power producer of using cash instead of physical assets to collateralize swap obligations is further illustrated by the concept of "right-way-risk" financing. Under a pure mark-to-market regime, when swaps increasingly move into an in-the-money position for a bank counterparty due to increasing commodity prices, the cash collateral costs rise for a power producing counterparty since it will be required to post ever-increasing amounts of margin. This scenario forces the power producer to either cut back on hedging or stop completely. Given the reality of energy commodity price volatility, this scenario presents a tangible risk. However, under the right-way-risk requirements that NRG and other energy providers follow in their first lien asset programs where physical assets are pledged to secure swap obligations, the value of the physical assets pledged increases as the prices for the commodities they consume to produce power rise.

Third, the pledging of non-cash assets to secure swap and other financial obligations is a prudent, well-established business practice, and prudentially regulated financial institutions and other lenders currently readily accept non-cash collateral as support for both the swap and lending obligations of their counterparties. In fact, many of NRG's prudentially regulated swap counterparties are also its lenders.[3] A first priority lien on NRG's power plants and other company

[3] NRG's lenders and swap counterparties include prudentially regulated financial institutions as well as other companies that are not supervised by Prudential Regulators.

assets secures both loans and swaps. This sort of first lien-secured lender/swap counterparty relationship is common in the power generation and oil and gas markets.

In the process of employing this practice, lenders make sophisticated credit judgments concerning the ability of the lien grantors to meet their obligations and the sufficiency of the pledged physical assets to cover obligations in the of a default. The outcome of this structure is that the prudentially regulated entity is fully secured for its extension of credit and that credit extension is hedged by the swap assuring stable cash flows to service the loan. The nonfinancial end user, borrower/swap counterparty can thereby achieve stable cash flows which permit it to operate its business without revenue volatility risk.

Finally, as stated earlier, this is a well-developed, conservative arrangement for lending and providing swaps in the energy market. The Dodd-Frank goals of not imposing burdensome cash margin requirements for swaps and not limiting the type of collateral that can be pledged would not be served if this well-established way of doing business were disrupted by requiring that cash margin be pledged to secure swap transactions. Dodd-Frank does not disturb this structure for prudentially regulated entity lending, and the same should be true for OTC swaps.

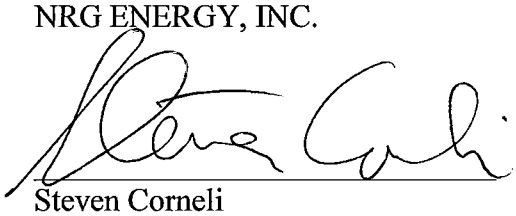
For the reasons stated above, NRG desires to continue hedging with prudentially regulated entities since the swaps that they provide permit NRG to manage price volatility and fix its cash flows and allow us to efficiently plan, operate, and meet investor needs in a stable, predictable fashion. Therefore, NRG requests that the Prudential Regulators follow the intent of Dodd-Frank and clarify the rule that follows the NOPR to permit prudentially regulated swap counterparties to continue to collateralize their swap transactions with nonfinancial physical energy companies as they do today.

NRG is a member of the Coalition of Physical Energy Companies ("COPE"). In addition to these comments, NRG fully supports COPE's comments and the proposals made therein with regard to the NOPR.

NRG respectfully submits the foregoing comments for your consideration. We would be pleased to meet with you and the members of your respective staffs to discuss our comments. If you or your respective staff members have any questions, please do not hesitate to call my colleague, Herbert Thornhill at (609) 524-4604.

Respectfully submitted,

NRG ENERGY, INC.



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