



February 22, 2011

Via Electronic Mail

Mr. David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Shell Energy North America
Two Houston Center
909 Fannin, Plaza Level 1
Houston, TX 77010
www.shell.com/us/energy

**Re: Further Definitions of “Swap Dealer,” “Security-Based Swap Dealer,”
“Major Swap Participant,” “Major Security-Based Swap Participant” and
“Eligible Contract Participant;” Proposed Rule, 75 Fed. Reg. 80174
(December 21, 2010) RIN 3235-AK65**

Dear Mr. Stawick:

On December 21, 2010, the U.S. Commodity Futures Trading Commission (“Commission” or “CFTC”) and the Securities Exchange Commission issued a joint proposed rule, entitled Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant” (“Proposed Rule”),¹ pursuant to Section 712(d)(1) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Act”).² Shell Trading (US) Company (“STUSCO”) and Shell Energy North America (US), L.P. (“Shell Energy”) (collectively, “Shell Trading”) respectfully submit these limited comments specifically to address the proposed definition of swap dealer.

Both in the plain language of the Dodd-Frank Act and public statements made by its members, Congress made clear its intent to regulate the swap activities of those participants that act as financial intermediaries, while at the same time protecting the swap activities of commercial entities that use the swap markets primarily to manage their commercial risk. Consistent with this goal, the definition of swap dealer in the Dodd-Frank Act distinguishes between those entities that “regularly” enter swap transactions as “an ordinary course of business” and those entities that do not. To ensure that this critical distinction is respected, Shell Trading encourages the Commission similarly to distinguish between swap activities that are, and are not, a part of an entity’s “regular” business in any rule implementing the swap dealer definition. As discussed in more detail below, in making this distinction, Shell Trading suggests that the Commission focus, among other things, on the nature of an entity’s business (*e.g.* physically-oriented business), its purpose for using the swap markets in the aggregate (*e.g.* to manage commercial risk), and how

¹ 75 Fed. Reg. 80,174 (December 21, 2010).

² See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

that entity executes its swap transactions (*e.g.*, via an exchange). Under this standard, and consistent with Congressional intent, commercial entities that participate in the swap markets in response to their natural long or short physical positions, that use swaps primarily to manage their commercial risk, and whose swap transactions are done largely on an anonymous basis, for example on an electronic trading platform, would not be defined as swap dealers.

I. Description of Shell Trading and Its Interest in the Proposed Rule

STUSCO and Shell Energy are indirect subsidiaries of Royal Dutch Shell, plc (“Shell”), a global energy company involved in the production, refining, transportation and marketing of physical energy commodities. STUSCO trades various grades of crude oil, refinery feedstocks, bio-components and finished oil-related products, including such commodities that are produced, manufactured or imported by its affiliates. Shell Energy markets and trades natural gas, electricity and environmental products, including the natural gas produced by its affiliates. Both entities actively participate in the U.S. energy derivatives markets. Together they manage risk and optimize value across physical and financial, exchange-traded and over-the-counter markets.

Companies like Shell Trading typically use “trading desks” to manage the firm’s overall positions – in this case, the physical and financial positions of Shell. The trading desks understand the markets they transact in and the risk to which the firm is exposed through its positions in various commodities and related derivatives. Given the dynamic nature of physical supply and demand coupled with price volatility, a trading desk is best situated to limit the risk to the entity’s portfolio as a whole, rather than try to match physical supply to financial hedges on a transaction by transaction basis. Much like a commodity merchant’s trading desk, STUSCO and Shell Energy are available to provide supply and hedging functions for their affiliated companies. When called upon, STUSCO and Shell Energy can, and do, centralize and manage the risk that otherwise resides in the various Shell end-user affiliates, for example, Shell Chemical Company. This is accomplished through inter-affiliate transactions that often take the form of swaps.³

As an adjunct to its physical marketing and trading activities and the hedging of certain of Shell’s physical exposures, Shell Trading takes proprietary positions in response to market conditions and internal forecasts of supply and demand to position itself ahead of foreseeable physical price movements. Its ongoing participation in the markets affords Shell Trading with an in-depth understanding about the depth of the markets, volatility of prices, and the market’s reaction to various fundamental factors. This information, in turn, enhances Shell Trading’s effectiveness in managing commercial risk for both itself and its end-user affiliates. Shell Trading also transacts in futures and options and enters into swap transactions related to energy commodities with a variety of counterparties to offset its risks, including credit risks, and to facilitate physical transactions.

³ Shell Trading strongly supports the Commission’s proposal not to consider swaps transacted between affiliates in the context of designating swap dealers. 75 Fed. Reg. at 80,183. Shell Trading agrees that these internal allocations of risk are not akin to swaps executed in arm’s length transactions with non-affiliates and, thus, do not possess the “hallmark” elements of swap dealing. *Id.*

II. Focus of Shell Trading's Comments on the Regularity of Swap Activities

Shell Trading understands the Commission's position that swaps entered into through negotiations with bilateral counterparties may well be indicative of "accommodating demand" for swaps and, therefore, constitute swap dealing. Although Shell Trading respectfully disagrees with the Commission's view, for purposes of these comments, it focuses on a distinct set of swap transactions entered into by Shell Trading – namely, swaps that are more directly related to Shell's overall, primary business of producing, refining, transporting and marketing of energy commodities, and are executed anonymously. Because these swaps are not the result of Shell Trading acting as a financial intermediary and because they are not the product of bilateral negotiations, Shell Trading does not believe these swap activities constitute swap dealing. However, because of the breadth of the new statutory requirements that the Dodd-Frank Act imposes on swap dealers, and Shell Trading's uncertainty about the intended scope of the CFTC's Proposed Rule, it requests that the Commission clarify whether it views these activities in the same way; confirm that it intends to distinguish between those entities that do, and do not, regularly enter swaps transactions as an ordinary course of business; and articulate with as much detail as possible how the Commission intends to draw this distinction.

III. Definition of Swap Dealer under the Proposed Rule

Under the Dodd-Frank Act, a swap dealer is any person that engages in any of the following types of activities: (1) holding oneself out as a dealer in swaps; (2) making a market in swaps; (3) regularly entering into swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in activity that causes one to be commonly known in the trade as a dealer or a market maker in swaps.⁴ The Act, however, excludes from the definition of swap dealer any person who engages in swaps for the person's own account but not as part of a regular business.⁵

In the Proposed Rule, the Commission identifies "core tests" and "distinguishing characteristics" that apply to swap dealers.⁶ These characteristics are intended to be consistent with the swap dealer definition that Congress provided and to facilitate the Commission's identification of persons that fit within the definition. The characteristics of a swap dealer include:

- Dealers tend to accommodate demand for swaps from other parties;
- Dealers are generally available to enter into swaps to facilitate other parties' interest in entering into those instruments;

⁴ CEA 1a(49)(A).

⁵ CEA 1a(49)(C).

⁶ 75 Fed. Reg. at 80,176.

- Dealers tend not to request that other parties propose the terms of swaps; but rather dealers tend to enter into those instruments on their own standard terms or terms they arrange in response to other parties' interest; and
- Dealers tend to be able to arrange customized terms for swaps upon request, or to create new types of swaps at the dealer's own initiative.⁷

Shell Trading does not believe that these characteristics apply to the type of swap transactions that are the subject of these comments.

IV. The Definition of Swap Dealer Should Distinguish Between Swap Activities that Are and Are Not a Part of a Person's "Regular" Business.

The Dodd-Frank Act expressly excepts from the definition of swap dealer a person who enters swaps for its own account, but not as part of a regular business. In the Proposed Rule, however, the Commission's formulation of the swap dealer definition does not distinguish between a person who, for example, accommodates demand for swaps from other parties, does so regularly and as its ordinary course of business and a person who does not. Shell Trading respectfully submits that the Commission's Proposed Rule, absent this limiting language, is overbroad with respect to the energy markets, and could be read in a manner that causes commercial market participants, such as commodity merchants, to be classified as swap dealers inadvertently, even though their activities fall squarely outside typical dealing activities. For example, the term "accommodating demand" could apply to almost any entity participating in the U.S. swaps market. The Commission's language implementing the swap dealer definition, therefore, should be qualified to refer to persons whose principal function is to accommodate demand for swaps. This would make it clear that commercial entities whose regular business involves the production, refining, transportation, and marketing of physical commodities and who use the swaps markets as an adjunct to their physical business, for example, to manage their commercial risk, would not be classified as swap dealers under the Act.

Shell Trading appreciates that it may be difficult to distinguish clearly between those persons that do, and do not, for example, accommodate demand as an ordinary course or regular business. However, as the Commission acknowledges, the Dodd-Frank Act requires the CFTC to interpret the swap dealer definition in a functional manner rather than relying upon "rigid standards" or "fixed criteria."⁸ Below, Shell Trading identifies criteria that it hopes will be useful to the Commission in drawing this distinction.

⁷ *Id.*

⁸ 75 Fed. Reg. at 80,176.

V. The Nature of a Person's Business Should be a Factor in the Determination of Whether Swap Activities Are or Are Not a Part of a Person's Regular Business.

Shell Trading believes that in the Dodd-Frank Act, Congress intended to focus the new regulatory structure on those participants that act as financial intermediaries because Congress considered their participation in the swaps markets to be a contributing factor to the financial crisis. In doing so, Congress made clear that it intended to except from regulation commercial end-users who tend to use the swaps markets to manage their commercial risk.⁹ Participants that act as financial intermediaries in the swaps markets facilitate transactions between buyers and sellers. Entities that perform this function tend to make money on the spread between what they pay for the purchase of swaps and what they receive for the sale of the same, *i.e.*, the bid/ask spread. Intermediaries, in turn, may lay off the risk they assume associated with this business or they may choose to carry the risk on their books. Unlike commercial end-users, financial intermediaries typically do not participate in the swaps markets in order to manage price and risks embedded in their underlying businesses. Rather, the swaps markets present an opportunity to make a profit by standing between buyers and sellers and seeking to maximize the bid/ask spread. Therefore, for many participants who act as financial intermediaries, dealing in swaps is done, in its own right, as an ordinary course of business.

In contrast, commodity merchants typically enter the swap markets as the result of their naturally long or short positions in physical commodities. Shell, for example, is in the business of producing, refining, transporting and marketing physical energy commodities. These natural long or short positions expose Shell to commercial risk, including fluctuations in the prices of the underlying energy commodities that are the bedrock of its business. Thus, a main driver for Shell's participation in the swaps markets is to manage commercial risk. Shell Trading, which acts as a central hedging affiliate for Shell's end-user affiliates, effectively stands in the shoes of its end-user affiliates and its use of swaps, therefore, is closely related to the regular, physical business of Shell. Further distinguishing the nature of Shell Trading's use of the swaps markets from that of participants acting as financial intermediaries, Shell Trading's swap trading is generally confined to commodities that are associated with Shell's physical business. Thus, for example, while Shell Trading actively participates in the markets for swaps tied to natural gas and crude oil, it does not transact in swaps connected to the metals markets or interest rates. Likewise, Shell Trading limits its swap activities to the regions in which Shell has physical assets, such as refineries, pipelines and storage facilities, suppliers and/or customers that consume the physical commodities that Shell Trading markets.¹⁰

⁹ See 156 Cong. Rec. H5245 (daily ed. June 30, 2010)(statement of Rep. Peterson) (“[Congress] focused on creating a regulatory approach that permits the so-called end users to continue using derivatives to hedge risks associated with their underlying businesses, whether it is energy exploration, manufacturing, or commercial activities. End users did not cause the financial crisis of 2008. They were the victims of it.”)

¹⁰ As part of Shell Trading's business, it participates in the swaps markets for purposes other than, and in addition to, managing Shell's commercial risk. For example, Shell Trading may take a view about market

Drawing a distinction based upon a participant's use of the swaps markets and, more particularly, what draws an entity to the swaps market, is consistent with the regular/non-regular dichotomy that Congress established. It would further serve to relieve many commodity merchants of the regulatory burdens and costs associated with designation as a swap dealer, which Congress made clear was an important goal of the Dodd Frank Act.

VI. How Swaps are Transacted Should be a Factor in the Determination of Whether Swap Activities Are or Are Not a Part of a Person's Regular Business

Shell Trading understands that the Commission may find that the execution of swaps on a designated contract market ("DCM") or a swap execution facility ("SEF") constitutes swap dealing. Under certain circumstances (*e.g.* in the instance of a "high-frequency" trader), the Commission appears inclined to conclude that this activity is consistent with the distinguishing characteristics of, for example "accommodating demand". Shell Trading respectfully questions the appropriateness of such a broad interpretation under any circumstances. With but few exceptions, transactions on a DCM, or going forward a SEF, are anonymous. When done anonymously, a counterparty does not know the identity of the person with whom it is ultimately matched. Instead, the exchanges match up participants based on price and volume. Under these circumstances, a participant transacting on an exchange cannot hold itself out to the market, or to a specific counterparty, as available to enter into swap transactions. Nor can it meet the specific price and volume needs of any specific counterparty with whom it may want to transact or impose its own terms with regard to any such transaction. Similarly, because no market participant knows who is associated with a particular bid or offer, it would seem implausible for any one person to be known as a swap dealer based on its activity on the DCM or SEF. In short, where a person's participation in a swap market is anonymous, it is difficult, if not impossible, to reconcile a finding that such person performs the role of a dealer.

To the extent that the Commission's point of view is informed by the regularity with which a participant enters into swaps, even if done anonymously, Shell Trading again urges the Commission to assess this factor in the context of the participant's overall business and reasons, generally, for using the swaps markets. Using Shell Trading as an example, STUSCO and SENA could be viewed to regularly enter into swaps as an ordinary course of business based solely on the frequency of their swap activities. However, as discussed above, Shell Trading uses swaps along with other derivatives to manage and optimize its large portfolio of physical energy commodities. The number of swap transactions entered into by Shell Trading must be considered in the context of its overall portfolio and the scale of Shell and Shell's end-use affiliates businesses. The ordinary course of business for Shell and its end-user affiliates is not

fundamentals or the anticipated direction of prices and pursue opportunities in the markets, such as price arbitrage. Based on this view, Shell Trading might enter into new physical or financial transactions, or might elect to hedge certain exposures. Participating in the energy derivatives markets on a daily basis allows Shell Trading to monitor the depth of the markets, trends in the markets, and the markets' reaction to changing fundamentals. This, in turn, allows Shell Trading most effectively to perform its primary function of marketing and trading the types of energy commodities that Shell produces.

transacting in swaps. Rather, its main business is the production, refining, transportation and marketing of physical energy commodities. Against this backdrop, Shell Trading does not regularly enter swaps as an ordinary course of business, and does not “accommodate demand” despite the number of swaps it enters into.

VII. Conclusion

In summary, Shell Trading urges the Commission to specify clearly what does and what does not constitute “swap dealing”. Shell Trading strongly recommends that the Commission’s definition of “Swap Dealer” should consider the nature of an entity’s business, its purpose for using the swaps markets, and how it executes its swap transactions. In particular, commercial entities that have a large physical market presence, who enter into swaps as an adjunct to their physical business, and who primarily trade swaps anonymously through DCMs and SEFs should not be found to engage in swap dealing.¹¹

Shell Trading appreciates the opportunity to provide these comments and would be pleased to provide any additional information on the further definition of swap dealer. Please contact me at (713) 767-5632, if you have any questions regarding these comments.

Respectfully submitted,



Robert Reilley
Vice President – Regulatory Affairs
Shell Energy North America (US), L.P.

cc: Chairman Gensler
Commissioner Dunn
Commissioner Chilton
Commissioner Sommers
Commissioner O’Malia
Daniel Berkovitz, General Counsel

¹¹ As noted above, swaps that are traded anonymously and are undertaken for hedging or for speculation are distinct from bilateral “customer facing” swaps.