CADWALADER

Cadwalader, Wickersham & Taft LLP
New York London Charlotte Washington Beijing

700 Sixth Street, N.W., Washington, DC 20001
Tel +1 202 862 2200 Fax +1 202 862 2400
www.cadwalader.com

February 22, 2011

VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: End-User Exception to Mandatory Clearing of Swaps (RIN 3038-AD10)

Dear Mr. Stawick:

On behalf of Hess Corporation and its affiliates (collectively "Hess"), we submit comments in response to the proposed rule ("Proposed Rule")[1] issued by the U.S. Commodity Futures Trading Commission ("Commission" or "CFTC") regarding the end-user exception to mandatory clearing of swaps ("end-user exception") under Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2] Hess appreciates the opportunity to provide the Commission with the perspective of a commercial end-user on the notification procedures and other provisions described in the Proposed Rule.[3] In contrast to the Commission's proposal, Hess believes that a one-time notice will provide the Commission with the information it needs to confirm that end-users are able to meet their financial obligations associated with entering into non-cleared swaps in an effective and efficient manner, and are using the exception for its intended, limited purpose. In addition, Hess believes that other aspects of the end-user exception can be implemented more effectively through contractual representations and other procedures than through the new reporting requirement described in the Proposed Rule.

I. Description of Hess and its Interest in the Proposed Rule

Headquartered in New York, Hess is a fully integrated energy company engaged in the exploration for and the development, production, purchase, transportation, and sale of crude oil and natural gas, and the manufacturing, purchase, transportation, and marketing of refined petroleum and electricity. Hess is listed on the New York Stock Exchange. Through its

---

1 End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, RIN 3038-AD10 (Dec. 23, 2010).

2 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 Hess' comments are limited to the notification and reporting requirements described in the Proposed Rule. Hess intends to comment on other important issues for end-users, including the potential application of minimum margin requirements to swaps between end-users and swap dealers or major swap participants, however, Hess does not believe that it is appropriate to comment on those issues in this proceeding.

Anthony M. Mansfield Tel +1 202 862 2321 Fax +1 202 862 2400 anthony.mansfield@cwt.com

subsidiaries, Hess is involved in exploration and production operations located in the United States, the United Kingdom, Norway, Denmark, Equatorial Guinea, Algeria, Malaysia, Thailand, Russia, Gabon, Azerbaijan, Indonesia, and Libya. Hess' international portfolio has recently grown to include new licenses in Australia, Egypt, Ghana, Norway, Ireland, Russia, Brazil, and Peru.

Hess' Energy Marketing division markets refined oil products, natural gas, and electricity to a vast array of utilities and other industrial and commercial customers located from the Ohio Valley to the East Coast. Hess enters into derivatives contracts to manage the fixed price risk associated with this activity. In addition, Hess operates a network of strategically located petroleum storage terminals that support its marketing operations. Though subsidiaries and joint venture agreements, Hess also operates a fluid catalytic cracking unit in Port Reading, New Jersey, and the Hovensa Refinery in the U.S. Virgin Islands.

Hess' Supply, Trading and Transportation division markets several hundred thousand barrels per day of crude oil and gas liquids, and trades (purchases and sells) hundreds of thousands of physical barrels per day of refinery feedstocks, intermediates, and finished petroleum products. Hess enters into derivatives contracts to manage the price risk associated with these activities as well.

As a commercial participant in the physical commodity market, Hess does not anticipate being required to register with the CFTC as a swap dealer or a major swap participant. However, as a commercial entity that uses swaps to hedge or mitigate its commercial risk, Hess has a significant interest in the Commission's implementation of the end-user exception.[4] In particular, the manner in which the Commission implements the exception and associated reporting requirements may substantially affect how Hess negotiates, executes, records, and, when necessary, reports its swap transactions, as well as the costs associated with these activities. Accordingly, Hess has an interest in the Proposed Rule.

II. Scope of the End-User Exception to Mandatory Clearing of Swaps

The Dodd-Frank Act generally subjects all standardized swaps to new clearing and trade-execution obligations.[5] However, Section 2(h)(7) of the Commodity Exchange Act, as amended by the Dodd-Frank Act ("CEA"), excepts certain swaps from the clearing and trade-execution

---

[4] Hess is commenting on this Proposed Rule even though "swap" has not yet been further defined by the Commission through a proposed or final rule. Hess respectfully reserves the right to amend or supplement its comments in the future depending on how that term is defined.

[5] Section 723(a)(3) of the Dodd-Frank Act amends the CEA to provide that "it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization [("DCO")] that is registered under [the CEA] or a [DCO] that is exempt from registration under [the CEA] if the swap is required to be cleared." Dodd-Frank Act § 723(a)(3) (to be codified as CEA § 2(h)(1)(A)). In a separate rulemaking, the CFTC proposed a process for determining which swaps are sufficiently standardized to be eligible for mandatory clearing. Process for Review of Swaps for Mandatory Clearing, 75 Fed. Reg. 67,277 (Nov. 2, 2010).

requirements.[6] Specifically, any non-financial entity[7] that is using swaps to hedge or mitigate commercial risk may elect to use the end-user exception provided it "notifies the Commission, in the manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared swaps."[8] Separately, CEA Section 2(j) obligates an entity's board of directors or governing body to review and approve the decision to enter into non-cleared swaps pursuant to the end-user exception if the entity is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") or is an issuer of securities under Section 12 of the same.[9]

The Commission proposes to implement the end-user exception and other sections of the Dodd-Frank Act by requiring end-users to report ten or twelve items of information *each time* the entity enters into a swap in reliance on the end-user exception.[10] Pursuant to CEA Section 2(h)(7)(A)(iii), the Commission proposes Rule 39.6(b)(5) ("Financial Obligation Notice") which requires each entity that elects to use the end-user exception to notify the Commission "how it generally meets its financial obligations associated with entering into non-cleared swaps."[11] This Rule specifically directs any entity invoking the end-user exception to provide (or cause to be provided) for each non-cleared swap, information regarding the end-user's use of: (1) written credit support agreements, (2) pledged or segregated assets, (3) third-party guarantees, (4) its own financial resources, and (5) any other means.[12]

The Commission further proposes Rules 39.6(b)(1)-(4), which require an end-user claiming the exception to "confirm compliance with particular requirements of the CEA" by supplying five or seven additional items of information in connection with each non-cleared swap.[13] This information includes verification that the end-user is a non-financial entity and that it is using the swap to hedge or mitigate commercial risk. In addition, proposed Rule 39.6(b)(6)

---

6 Dodd-Frank Act § 723(a)(3) (to be codified as CEA § 2(h)(7)).

7 Section 2(h)(7)(C) of the CEA provides that, for the purposes of the end-user exception, the term "financial entity" means, in relevant part—

(I) a swap dealer;
(II) a security-based swap dealer;
(III) a major swap participant;
(IV) a major security-based swap participant; . . .
(VIII) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956.

Id.

8 Dodd-Frank Act § 723(a)(3) (to be codified as CEA § 2(h)(7)(A)(iii)).

9 Dodd-Frank Act § 723(b) (to be codified as CEA § 2(j)).

10 75 Fed Reg. at 80,749. All reporting end-users are required to report at least 10 items, while end-users that are issuers of securities under Section 12 of the Exchange Act or required to file reports under Section 15(d) of the Exchange Act must report two additional items.

11 Dodd-Frank Act § 723(a)(3) (to be codified as CEA 2(h)(7)(A)(iii)).

12 Proposed Rule § 39.6(b)(5)(i)-(v), 75 Fed. Reg. at 80,757.

13 Proposed Rules § 39.6(b)(1)-(4), 75 Fed. Reg. at 80,757.

requires an end-user to confirm that its decision to rely on the end-user exception has been reviewed and approved by an appropriate committee of the end-user's board of directors or governing body.[14] According to the Commission, this information is necessary to "prevent abuse of the end-user exception."[15]

III. The Commission Should Adopt a Rule that Permits an Appropriately Authorized Committee to Approve the Use of the End-User Exception on a Periodic Basis.

CEA Section 2(j) provides that any end-user that is an issuer of securities registered under Section 12 of the Exchange Act or required to file reports under Section 15(d) of the same must obtain the approval of an appropriately authorized committee of its board of directors or equivalent governing body in order for it to rely on the end-user exception.[16] Hess believes that the Commission should adopt a rule that expressly permits an appropriately authorized committee of an end-user's board of directors or governing body to adopt a blanket approval for use of the end-user exception for a specified period of time (*e.g.*, one or more years). Such an approval process would fully and effectively implement the requirement in CEA Section 2(j), while imposing a minimal burden on end-users. Notably, Hess' approach is consistent with what the Commission appears to have contemplated when it explained in the Proposed Rule that:

> a board resolution or an amendment to a board committee's charter could expressly authorize such committee to review and approve decisions of the electing person not to clear the swap being reported. In turn, such board committee could adopt policies and procedures to review and approve decisions not to clear swaps, on a periodic basis or subject to other conditions determined to be satisfactory to the board committee.[17]

Nevertheless, the language in proposed Rule 39.6(b)(6) that implements the review and approval requirement in CEA Section 2(j) is silent on how the review and approval procedure should operate in practice. A rule that requires end-users to obtain board approval for each swap that relies on the end-user exception would be so onerous in practice that it would effectively nullify the end-user exception. The Proposed Rule does not appear to contemplate such a severe result. Accordingly, Hess agrees with the Commission's approach to the review and approval process, as described in the Proposed Rule, but respectfully requests that it provide certainty for market participants by codifying its intent in the final regulatory text, as stated above.

---

[14] Proposed Rule § 39.6(b)(6), 75 Fed. Reg. at 80,757.

[15] 75 Fed. Reg. at 80,750.

[16] Dodd-Frank Act § 723(b) (to be codified as CEA § 2(j)). As explained above, Hess does not believe that requiring end-users to confirm through a new reporting requirement that their use of the end-user exception has been approved by an appropriate committee of their board of directors or equivalent governing body is "necessary or useful to aid the Commission in its efforts to prevent abuse of the end-user clearing exception." 75 Fed. Reg. at 80,750.

[17] 75 Fed. Reg. at 80,750, n.18.

IV. The Commission Should Implement the End-User Notification Requirement in a Manner that is Effective, Efficient and Consistent with Congress' Intent.

A. *The Plain Language of the Dodd-Frank Act Contemplates a "General" Notification Requirement.*

CEA Section 2(h)(7) requires any end-user who elects to use the end-user exception to notify the Commission "how it *generally* meets its financial obligations associated with entering into non-cleared *swaps*." The language in Section 2(h)(7) is unique from other CEA sections that require reporting. For example, Section 4r(a) provides that "*each swap* . . shall be reported" to a swap data repository.[18] Similarly, Section 2(a)(13) provides for "*real-time* public reporting."[19] In contrast, in the context of the end-user exception, Congress simply mandated end-users to submit a "general" report of how they meet their financial obligations associated with entering into non-cleared swaps. Hess respectfully submits that requiring end-users to provide information detailing how they satisfy their financial obligations in connection with *every swap* that relies on the end-user exception creates a reporting obligation that is broader than Congress intended and is unnecessary to meet the goals that Congress set out to achieve.

In addition, Hess respectfully suggests that providing the Commission with the specific types of information identified in the Proposed Rule may not be the most effective way to effectuate the Financial Obligation Notice in CEA Section 2(h)(7)(A)(iii). Hess understands that information indicating whether an end-user relies upon written credit support agreements, pledged assets, third-party guarantees, available financial resources, or other means could be relevant to how that entity meets its financial obligations associated with non-cleared swaps. However, evidence that an end-user does or does not have, for example, a written credit support agreement in place for a specific transaction, without more, may provide limited meaningful information about how that entity actually manages its risk. As a result, Hess believes that the Proposed Rule may provide the Commission with only cursory information about an end-user's credit risk mitigation procedures. At the same time, it will likely require end-users to report often identical information following each non-cleared swap transaction. Accordingly, Hess believes that the benefits of receiving the information requested in the Proposed Rule are unlikely to outweigh the administrative burden (for both end-users and the Commission) associated with the proposed reporting requirement.

B. *A Well-Tailored One-Time Notice Can be Both Effective and Efficient.*

As an alternative, Hess believes that a one-time, general financial notice requirement that focuses on an end-user's approach to risk management can be effective, efficient, and consistent with Congress' intent. For example, a one-time financial notice that requires an end-user to provide a general description of its credit risk management procedures could provide the Commission with useful details on how the end-user analyzes its risk and the specific procedures

---

[18] Dodd-Frank Act § 729 (to be codified as CEA § 4r(a)(1)(A)) (emphasis added).

[19] Dodd-Frank Act § 727 (to be codified as CEA § 2(a)(13)) (emphasis added).

it employs to mitigate that risk. This general description could include a discussion of the credit instruments that the end-user typically employs to meet its financial obligations associated with entering into non-cleared swaps (*e.g.*, written credit support agreements, pledged assets), in connection with a discussion about how the end-user, using these instruments, manages risk in practice (*e.g.*, daily mark-to-market, periodic audits). Moreover, if coupled with a requirement that end-users notify the Commission of any material exception to or changes in the information provided in the end-user's original notification, the Commission would also be certain that the information provided remains correct. Hess believes that such a well-tailored, but one-time, notice requirement would more accurately represent how end-users and other market participants actually manage risk, and would be less burdensome for both the Commission and end-users.

Nevertheless, should the Commission conclude that periodic reporting is necessary, Hess requests that the Commission require end-users to report no more than once per year.[20] As discussed above, the Commission is proposing to require submission of information from end-users that is unlikely to differ from swap to swap. An annual reporting requirement with a duty to report any material exceptions or changes would provide sufficient information for the Commission to monitor non-financial entities that use swaps to hedge or mitigate commercial risk and elect to use the end-user exception.

C. *End-Users Should be Permitted to Make any Notification Directly to a Swap Data Repository (or the Commission).*

The Proposed Rule requires end-users to satisfy the Financial Obligation Notice requirement by delivering the specified information to the "reporting counterparty" for each transaction.[21] As proposed in the Swap Data Recordkeeping and Reporting Requirements rule, the "reporting counterparty" would typically be a swap dealer or major swap participant.[22] However, in certain circumstances an end-user would be required to report the details of the transaction.[23] In addition, the Proposed Rule states that "[i]f there is more than one [party] to a swap [that elects to use the end-user exception], the [specified] information . . . shall be provided with respect to each of the electing counterparties."[24]

---

[20] An annual reporting requirement is consistent with other reporting requirements in the CEA. For example, the Commission proposed to implement CEA Section 4s(l)(1) (Segregation of Assets Held as Collateral in Uncleared Swap Transactions) by requiring swap dealers and major swap participants to notify end-users *annually* of the end-users' right to segregate collateral. Proposed Rule on Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75,432 (Dec. 3, 2010).

[21] 75 Fed. Reg. at 80,748-49.

[22] Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76.574 (Dec. 8, 2010).

[23] For example, an end-user would be the reporting counterparty if neither party to the swap is a swap dealer or major swap participant, or if the end-user's counterparty is a non-U.S. person. *Id.*

[24] 75 Fed. Reg. at 80,757.

Hess believes that the Commission should permit end-users to make any required notification directly to an appropriate swap data repository or the Commission. This approach is consistent with Hess' suggestion to adopt a one-time notice because there would be no "reporting counterparty" for a one-time or periodic notification requirement. However, even if the Commission does not adopt Hess' proposed one-time notice, Hess believes that permitting end-users to report directly to a swap data repository or the Commission will be a more efficient and reliable procedure. For example, if the Commission requests that end-users provide the Commission with general information regarding their risk management practices, it may be difficult for an end-user to compile and provide this information to a counterparty within the short time frames proposed in the swap reporting rules.[25] Moreover, without established procedures for transmitting this information to a counterparty (and then to a swap data repository), it is possible that information could be incorrectly communicated or delayed. Permitting end-users to satisfy the notification requirement directly would minimize operational problems that could potentially disrupt reporting of more time-sensitive swap transaction data.

V. The Commission Should Use Contractual Representations to Prevent Abuse of the End-User Exception Rather than Additional Reporting Requirements.

Hess believes that the Commission can effectively prevent abuse of the end-user exception by requiring end-users to represent in their transaction documents that swaps they elect not to clear satisfy the requirements of CEA Sections 2(h)(7) and 2(j) (*i.e.*, they are entered into by a non-financial entity that is using swaps as part of its overall hedging and risk mitigation strategies, and that an appropriate committee of the end-user's board of directors or governing body has reviewed and approved the use of the end-user exception).[26] Such a representation could include the information requested in proposed Rule 39.6(b)(1)-(4), including verification that the end-user is a non-financial entity and that it is using swaps as part of a portfolio to hedge or mitigate commercial risk. The representation also could include the information requested in proposed Rule 39.6(b)(6), which requires an end-user to confirm that its policies and procedures for using the end-user exception have been reviewed and approved by an appropriate committee of the end-user's board of directors or governing body.[27] To the extent that it may occasionally need to confirm compliance with particular requirements of the end-user exception, the Commission may mandate that end-users make information regarding their hedging and risk

---

[25] *Id.*

[26] Hess notes that the proposed rule on Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants would independently require documentation for each swap include: (1) the identity of the counterparty, (2) that the counterparty has elected not to clear a particular swap under CEA Section 2(h)(7), (3) the counterparty is not a financial institution, (4) the counterparty is hedging or mitigating commercial risk, and (5) that the counterparty generally meets its financial obligations associated with non-cleared swaps. Swap dealers and major swap participants must keep all documentation and make it available to the CFTC upon their request. Proposed Rule 23.505, Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. at 6,715, 6,726 (Feb. 8, 2011).

[27] Moreover, as discussed above in Section III, board approval should not be required for every swap that relies on the end-user clearing exception.

mitigation strategies available upon request. Hess believes that such a requirement is consistent with the Commission's position in the Proposed Rule that "whether a position is used to hedge or mitigate commercial risk . . . should take into account the person's overall hedging and risk mitigation strategies."[28] Hess supports this pragmatic approach and believes that it is a reasonable and commercially practicable way in which to implement the end-user exception.

VI. The Commission Should Clarify the Definition of "Hedge or Mitigate Commercial Risk" by Eliminating the Potentially Ambiguous Reference to "Trading."

The Proposed Rule states that for purposes of the end-user exception, "a swap shall be deemed to be used to hedge or mitigate commercial risk" if it satisfies one of three independent tests, provided that the swap is "[n]ot used for a purpose that is in the nature of speculation, investing, *or trading*."[29] Hess believes that the reference to "trading" in this context may create ambiguity as to when the end-user exception may be used. "Trading" is not defined in the CEA or the CFTC's regulations. Although "trading" often refers to a specific type of market activity (*e.g.*., proprietary trading), it also is used colloquially to describe any activity associated with entering into swaps, including swaps that hedge or mitigate commercial risk. Accordingly, Hess is concerned that the Commission's attempt to define hedging or mitigating commercial risk by what this activity supposedly is not, *i.e.* "trading," may prove unhelpful and result in an overly narrow application of the end-user exception. Hess therefore encourages the Commission to remove the reference to "trading" in the context of the Proposed Rule. Hess believes that this modification is fully consistent with the scope of the end-user exception in the Proposed Rule.

VII. The Commission Should Adopt a Limited Designation Procedure that Does Not Frustrate the Purpose of the End-User Exception.

The definition of "swap dealer" provides that "[a] person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities."[30] This "limited designation" provision explicitly contemplates that an entity may be regulated as a swap dealer for a portion of its activity, but not regulated as a dealer for other segments of its business. In the proposed rule further defining "swap dealer" and other key terms in the Dodd-Frank Act, the Commission stated that it "understands that there may potentially be non-financial entities, such as physical commodity firms, that conduct swap dealing activity through a division of the entity, and not a separately-incorporated subsidiary." In these instances, the Commission explained that it anticipated that "certain swap dealer requirements would apply to the swap dealing activities of the division, but not necessarily to the swap activities of other parts of the entity."[31]

---

[28] 75 Fed. Reg. at 80.753.

[29] 75 Fed. Reg. at 80.757 (emphasis added).

[30] Dodd Frank Act § 721(a) (to be codified as CEA § 1a(49)(B)). The definition of "major swap participant" contains an analogous provision. *See* Dodd Frank Act § 721(a) (to be codified as CEA § 1a(33)(C)).

[31] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,182 (Dec. 21, 2010).

Hess supports the Commission's interpretation because it is consistent with a commercially practicable application of the end-user exception, and Congress' expressed intent when it included the limited designation provision in the swap dealer definition. Accordingly, Hess believes that the Commission should not unnecessarily narrow the end-user exception by limiting its use by an entity that is designated as a swap dealer with respect to a different category swaps or activities.[32] Similarly, Hess believes that the requirements applicable to swap dealers should not apply to such entity's non-dealing activities in swaps.[33] Congress included the limited designation procedure in the Dodd-Frank Act in order to accommodate the many ways in which some physical commodity firms are organized and operate.

VIII. Conclusion

Hess appreciates the opportunity to comment on the Commission's Proposed Rule to implement the end-user exception consistent with Congress' intent that end-users receive a broad exemption from the registration and clearing requirements of the Dodd-Frank Act. Hess respectfully encourages the Commission to alter the Proposed Rule so that end-users may avail themselves of the end-user exception in a commercially practicable manner as Congress intended.

Please contact us if you have any questions regarding these comments.

Respectfully submitted,

Anthony M. Mansfield
Jonathan H. Flynn
Cadwalader, Wickersham & Taft LLP
700 Sixth Street, N.W.
Washington DC, 20001
Counsel for Hess Corporation

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

---

[32] In the Proposed Rule, the Commission asked: "If an entity is designated as a swap dealer or a major swap participant with respect to only certain of its swaps or activities, should it be treated as a financial entity under CEA Section 2(h)(7)(C)(i) and thereby be disqualified from electing to use the end-user clearing exception with respect to its other swaps or activities?" 75 Fed. Reg. at 80,754.

[33] In the proposed rule further defining "swap dealer," the Commission asked: "Which of the requirements applicable to dealers should or should not apply to such entity's non-dealing activities in swaps and security-based swaps?" 75 Fed. Reg. at 80,182.