



EDF TRADING

4700 West Sam Houston Parkway North
Suite 250
Houston, Texas, TX 77041
T +1 281 781 0333
F +1 281 781 0360

February 22, 2011

Via Electronic Submission

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant” (RIN 3038-AD06)

Dear Mr. Stawick:

EDF Trading North America, LLC (“EDF Trading”) respectfully submits these comments in response to the joint proposed rule addressing the further definition of the terms swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, and eligible contract participant (the “Proposed Rule”) issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”) and the Securities and Exchange Commission (“SEC”).¹ In the Proposed Rule, the CFTC and SEC also propose a definition for the term “hedging or mitigating commercial risk.”² The CFTC and SEC state in the Proposed Rule that they “are aware of the importance of crafting these [further definitions] carefully to maximize the benefits of the regulation imposed by the Dodd-Frank Act, and to do so in a way that is flexible enough to respond to market developments,” and that they are “very interested in commenters’ views as to whether [the Commission has] achieved this purpose, and, if not, how to improve these proposals.”³

EDF Trading appreciates the opportunity to provide input regarding further definition of these key definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).⁴ In particular, EDF Trading provides the

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

² *Id.* at 80,214 (Proposed Rule 17 C.F.R. § 1.3(ttt)).

³ *Id.* at 80,175

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (2010).



EDF TRADING

David A. Stawick
February 22, 2011
Page 2

Commission with its position on the impact that the definition of “swap dealer,” “major swap participant,” and “hedging or mitigating commercial risk” will have on the business operations of EDF Trading and other commercial energy end users and energy producers.

I. Summary of EDF Trading’s Comments

EDF Trading requests that the Commission provide that it will not regulate as swap dealers or major swap participants energy marketers or suppliers, including those persons that provide risk management services to third parties in connection with “energy management agreements.” The Dodd-Frank Act does not require the registration of end users who enter into swaps with their customers as an adjunct to their physical energy business.

The Commission’s proposed definition of swap dealer may not be sufficiently narrow to protect end users, and could negatively impact end users if not modified or clarified as recommended in this letter. Specifically, EDF Trading requests that the Commission:

- provide end users in the energy markets with practical and predictable exceptions from the definition of swap dealer that do not restrict the use of swaps that are incidental to energy management services;
- not regulate inter-affiliate risk transfers or hedging transactions entered into through centralized hedging affiliates as swap dealing;
- not classify swaps traded for one’s own account for profit as swap dealing; and
- adopt a *de minimis* exception that excepts from the definition of swap dealer entities that engage only in immaterial amounts of swap dealing.

The Commission should also adopt a flexible and practical definition of “hedging or mitigating commercial risk” that encompasses the many ways market participants manage risk.

II. Interest of EDF Trading in the Proposed Rule

EDF Trading is a Texas limited liability company with its principal place of business in Houston, Texas. EDF Trading is a wholly-owned direct subsidiary of EDF Trading North America, Inc., which itself is a wholly-owned indirect subsidiary of Électricité de France, SA. EDF Trading is a natural gas and power marketer authorized by the Federal Energy Regulatory Commission (“FERC”) to engage in the sale at wholesale of natural gas and electricity and related services at market-based rates. EDF Trading also (through its wholly-owned subsidiaries) acts as a competitive retail energy service supplier to commercial and heavy



EDF TRADING

David A. Stawick
February 22, 2011
Page 3

industrial energy consumers as well as providing supply and risk management services to other energy retailers.

EDF Trading's wholesale marketing business focuses on low-risk arbitrage of locational opportunities and the capture of wholesale product opportunities that are primarily driven by its customers' and counterparties' business needs and product requirements. EDF Trading typically purchases and sells wholesale energy products with customer classes that include generators, producers, transporters, municipalities, investor-owned utilities, governmental and quasi-governmental entities. EDF Trading's wholesale marketing operations also involve a wide variety of transactions with other energy marketers that possess market-based rate authority and that conduct wholesale energy marketing operations similar to those of EDF Trading.

EDF Trading engages in physical and financial transactions in various areas of operation for purposes of managing the risk of a producer or end-use customer, as well as for the purpose of managing risks associated with its own contracted assets. Often the risk management that EDF Trading provides stems from the need for a bespoke arrangement that addresses the risks unique to EDF Trading's customers. Moreover, it offers customers whose financial positions may not coordinate with the financial markets the ability to enter into hedging transactions by taking on such risk, providing an invaluable risk management service to its end-use customers.

EDF Trading provides a variety of risk management functions to its customers. For example, EDF Trading has recently expanded its presence in the retail energy markets. Through wholly-owned subsidiaries acting as competitive retail electric suppliers, EDF Trading engages in retail sales of electric energy and related services at market-based rates to customers in Texas, New York, and Illinois. EDF Trading's subsidiaries buy power and/or natural gas from EDF Trading and resell that to their end-use customers, and in turn enter into power and/or natural gas hedge transactions to mitigate price risk.

EDF Trading also provides risk management services to non-affiliated generation owners, electric retailers, natural gas distributors, and energy transmission, storage and transportation operators, providing such services typical of those provided by what are known as "energy management services providers." EDF Trading provides these services as an adjunct to its physical business. In this role, EDF Trading routinely enters into contracts with third-party asset owners to assist the owners in their efforts to manage risks arising from volatile prices in the natural gas, coal, or fuel oil, and electricity markets, and to optimize the owner's generation assets. Where EDF Trading is engaged to provide these services, the owners of such generators retain control over the power plants and EDF Trading provides services for the owner, which include: managing and/or procuring fuel supplies through standard purchase and sale arrangements, providing scheduling and dispatch services at the request and direction of the owner, and providing other logistical services that may be unique to the generation entity



EDF TRADING

David A. Stawick
February 22, 2011
Page 4

involved. In each of these cases, the services are provided to the generation owner and energy retailer in a manner tailored to fit the customer's needs. Many of the asset owners for which EDF Trading provides these services are firms that seek to obtain economies of scale by outsourcing physical management capabilities and expertise to providers like EDF Trading. In exchange for these services, EDF Trading is paid a services fee by the owner. In a similar fashion, EDF Trading provides risk management services to entities serving natural gas and electrical load, such as retail energy service companies. In those cases, EDF Trading assists its customers by identifying and procuring wholesale supplies of natural gas and electricity, and optimizing those supplies with the actual needs of the consumers.

EDF Trading also has a fully integrated coal and freight business and is a major participant in the U.S. gas market, with a network of contracted physical assets. Through lease and other contractual arrangements, it is active in transportation, storage, and wholesale trading, offering customized products and transacting across markets.

In all of these cases, its marketing, operations and management services require EDF Trading to maintain standard energy trading functions and platforms. EDF Trading's trading business executes transactions, manages the associated risk of originated transactions and optimizes EDF Trading's proprietary market position. The trading operations are conducted in a manner consistent with EDF Trading's internal business policies, its market-based rate authorizations, its internal risk management procedures and policies, and the other laws and regulations applicable to EDF Trading's business throughout the United States.

The nature of EDF Trading's business renders it difficult to definitively differentiate between transactions entered into for varying discrete areas of its business, as it may be managing the risk of a customer or risk stemming from its own activities and assets. For example, in order to manage a customer's risk, EDF Trading may transact to purchase a generator's output at a fixed price, and concomitantly transact for offsetting physical and/or financial positions. In order to manage an asset, EDF Trading may inject gas into subscribed storage capacity at a fixed price and sell the gas in the future at an agreed price.

As a commercial end user of physical commodities and an entity that provides risk management services for itself and other commercial participants, EDF Trading will be affected by the Commission's regulations further defining the terms "swap dealer," "major swap participant," and "hedging or mitigating commercial risk" proposed in the Proposed Rule.

III. The Commission Should Adopt a Definition of “Swap Dealer” That is Both Consistent with the Purpose and Structures of the Dodd-Frank Act and Which Does Not Classify End Users as Swap Dealers

A. Congress Intended The CFTC to Register and Regulate as Swap Dealers Financial Entities, Not Commercial End Users

The purpose of Dodd-Frank Act is “to promote the financial stability of the United States by improving accountability and transparency in the financial system”⁵ In its later and final drafts of the Dodd-Frank Act, Congress intentionally “narrowed the scope of the Swap Dealer and Major Swap Participant definitions.”⁶ Senators Lincoln and Dodd stated in support of these narrowed definitions, “We should not inadvertently pull in entities that are appropriately managing their risk.”⁷ Accordingly, the definitions of swap dealer and major swap participant should be narrow in scope, and should be designed to apply only to financial entities whose principal business is swap dealing. Congress directed the CFTC to register and regulate only those financial entities that it determined actually pose systemic risk to the U.S. financial system (*i.e.*, swap dealers and major swap participants).

Congress did not intend to regulate commercial end users as swap dealers or major swap participants. Senators Dodd and Lincoln made clear that certain types of entities should not be considered swap dealers or major swap participants: “Congress . . . created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. These entities could be anything ranging from car companies to airlines or energy companies who produce and distribute power to farm machinery manufacturers. . . . ***These entities did not get us into this crisis and should not be punished for Wall Street’s excesses.***”⁸ To ensure that such end users were not categorized as swap dealers or major swap participants, Lincoln and Dodd expressed Congress’s intent that the Commission clarify the definitions of swap dealer and major swap participant in a manner that “does not capture companies simply because they use swaps to hedge risk in their ordinary course of business.”

⁵ Preamble to the Dodd-Frank Act.

⁶ 156 Cong. Rec. H5248 (daily ed. June 30, 2010) (Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Collin Peterson) (“Dodd-Lincoln Letter”).

⁷ *Id.*

⁸ *Id.* (emphasis added).



EDF TRADING

David A. Stawick
February 22, 2011
Page 6

In particular, Congress did not intend to regulate energy marketers, suppliers, or other utilities as swap dealers or major swap participants. Energy marketers and suppliers are not “financial entities.” At a minimum, those energy marketers that are not affiliates of financial entities cannot significantly impact the U.S. financial system.⁹ Further, Senators Lincoln and Dodd actually stated that “the Major Swap Participant and Swap Dealer definitions are not intended to include an electric or gas utility that purchases commodities that are used either as a source of fuel to produce electricity or to supply gas to retail customers and that uses swaps to hedge or manage the commercial risks associated with its business.”¹⁰

B. The CFTC Proposes a Definition of Swap Dealer that Is Too Broad and Could Negatively Impact End Users

As currently drafted, the CFTC’s proposed definition of swap dealer may have the unintended consequence of capturing commercial end users who should qualify for the exceptions in Section 1a(49)(C) and (D) of the Commodity Exchange Act, as amended by the Dodd-Frank Act (“CEA”). The principal or main business of energy marketers and suppliers and their affiliates is not holding themselves out as swap dealers, making a market in swaps, or engaging in swap dealing. Further, they are not known in the trade as dealers or market makers in swaps. A marketer engaging in swap dealing that is incidental to its main business should be excepted from the swap dealer definition because it is not the regular, usual or ordinary business of such entities.

EDF Trading respectfully believes that the criteria that the Commission proposes to use to identify “persons whose function is to serve as the points of connection in [the swap] markets” are too broad, and may be particularly problematic for end users. The criteria the Commission proposes to use include:

1. accommodating demand for swaps from other parties;
2. tending to propose terms for swaps from other parties;
3. tending to enter into swaps in response to interest expressed by other parties;
4. contacting other parties to solicit interest in swaps;
5. developing new types of swaps;
6. being a member of swap associations; and

⁹ This also may be true of marketers that are affiliated with financial entities. However, that subject is beyond the scope of EDFT’s comments.

¹⁰ 156 Cong. Rec. H5248 (Dodd-Lincoln Letter).



EDF TRADING

David A. Stawick
February 22, 2011
Page 7

7. generally offering a range of financial products, including swaps, to other parties.

From this list of criteria, there arise several issues of particular concern. First, it is not clear from the Proposed Rule what it means to “accommodate demand” for swaps. Second, end users of physical commodities frequently propose their own language for swaps with other parties. End users commonly propose that certain preferred terms and language be included in their swap agreements. Using consistent terminology in its swap agreements provides an end user with greater certainty about the legal treatment of each swap it enters into, and often reflects careful work the end user has done to develop language that is helpful in its aim to mitigate commercial risks, including related legal and regulatory risks. Accordingly, treating “tending to propose terms for swaps from other parties” as dealer-type activity is inappropriate because it will discourage end users from proposing their own commercially reasonable and practicable terms for their swap agreements. Further, designating “developing new types of swaps” as dealer-type activity may discourage end users from crafting innovative hedging solutions that could provide increased efficiencies and better solutions for their own commercial businesses.

According to these proposed criteria, both (1) tending to enter into swaps in response to interest expressed by other parties and (2) contacting other parties to solicit interest in swaps constitute “dealer-type” activity. Given that, in order to enter into a transaction, one party must necessarily contact another party to ask if it would like to transact, and the other party must, in the end, respond to the interest expressed by the first party, it would appear that a vast number of participants in commodity markets—even very small entities—may be engaging in what the Commission proposes to treat as dealer-like behavior. This approach conflicts with Congress’s original intent that end users be excluded from the definition of swap dealer and that the definition of swap dealer only pull in entities that carry the type of risk profile that could allow them to impact the stability of the U.S. financial system.¹¹

EDF Trading believes that the Commission does not intend to regulate end users as swap dealers. Nonetheless, the above-mentioned ambiguities and other problems with the proposed definition of “swap dealer,” if uncorrected in the final definition, could cause energy marketers and suppliers, and other physical commodity market participants, to become subject to the

¹¹ “Congress . . . created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. . . . This is also why we narrowed the scope of the Swap Dealer and Major Swap Participant definitions. We Should not inadvertently pull in entities that are appropriately managing their risk [into the definition of swap dealer or major swap participant]. . . . It is also imperative that regulators do not assume that all over-the-counter transactions share the same risk profile.” *Id.*



EDF TRADING

David A. Stawick
February 22, 2011
Page 8

mandatory clearing and exchange trading requirements of the Dodd-Frank Act, even though they are end users that use swaps to hedge or mitigate commercial risk. This is contrary to Congress's expressed intent. "Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low (*i.e.*, to provide consumers with stable, low prices, promote investment, and create jobs)."¹² EDF Trading believes that the Commission, like Congress, does not intend to regulate end users that are proactively and effectively using swaps to manage commercial risk as swap dealers, and that the over-breadth of the proposed rule was inadvertent on the Commission's part. Accordingly, EDF Trading respectfully asks the Commission to make it clear in the final rule that end users may take an active role in seeking out and negotiating swap agreements, as described above, without being categorized as swap dealers.

C. The Commission Should Provide End Users in the Energy Markets with Practical and Predictable Exceptions from the Definition of Swap Dealer

1. Providers of Energy Management Services Hedge and Mitigate Commercial Risk for Themselves and for Their Customers

Physical market participants that provide swaps to commercial parties as an incidental or ancillary complement to other services (*e.g.*, energy management agreements) are not swap dealers. This is particularly true of physical market participants who are energy marketers and suppliers. Energy marketers, suppliers, and their affiliates have a long-standing practice of hedging their own risks and also providing risk management products and services to their customers in the power and gas industry in connection with cash market transactions. These types of entities are end users because the core of their enterprise is a physical market business.

In its role as an energy marketer and supplier, EDF Trading provides physical commodity services to its customers. As a complement to this physical business, EDF Trading also enters into energy management agreements ("EMAs") with customers. Through these EMAs, EDF Trading provides customers with a variety of risk management services geared toward providing customers with price predictability and operational continuity in the face of market uncertainty. EDF Trading's customer base for energy management services includes independent power generators, industrial facilities, and other energy suppliers, which is the same customer base upon which its core physical business is built. As an experienced energy marketer and supplier, EDF Trading is in a position to offer risk management services that hedge or mitigate risks unique to energy market participants, such as assisting a power generator in hedging the

¹² *Id.*



EDF TRADING

David A. Stawick
February 22, 2011
Page 9

locational risks associated with ensuring that the electricity the generator produces reaches the receipt point where its customer, often a wholesale supplier, will take title to the electricity and deliver it to retail suppliers, and eventually end-use consumers. The energy management services that EDF Trading provides have a direct connection and are incidental to EDF Trading's physical business and the physical businesses of its customers. These products and services facilitate customers' cost-effective hedging of their commercial risks, and through these energy management agreements customers are able to hedge and mitigate their commercial risks much more effectively than they would be able to do on their own. When EDF Trading seeks out or provides hedges for a customer, it engages in hedging activity for that customer that the customer would engage in on its own if it could do so as effectively as can EDF Trading.

EDF Trading provides many risk management benefits to its customers through its energy management services, and these benefits all relate directly to EDF Trading's physical business. The EMA arrangement allows EDF Trading to supply collateral to, and take on the credit risk of, its customers, which EDF Trading can then more effectively hedge than its customer could efficiently do on its own. This also helps EDF Trading's customers to take advantage of the risk management benefits of derivatives transactions when the size of a customer's hedge is smaller than most potential counterparties' desired individual hedge size. In other words, EDF Trading provides a benefit to its customers by aggregating the risks of its customers, in order to use economies of scale to obtain more effective and more cost-effective hedging than its customers could obtain on their own. Lastly, and perhaps most importantly, EDF Trading's EMAs and associated energy management services allow EDF Trading to provide its customers with a known or fixed price for the commodities the customers use in the course of its their physical businesses.

2. **Physical Market Participants Do Not Function as “Points of Connection” in the Swaps Market**

The CFTC and SEC state in the Proposed Rule that “[t]he Commissions can most efficiently achieve the purposes underlying . . . the Dodd-Frank Act—to reduce risk and to enhance operational standards and fair dealing in the swap markets—by focusing their attention on those persons whose function is to serve as the points of connection in those markets.”¹³ End users like EDF Trading often interact with other market participants, but their function in the swaps market is that of physical market participants hedging the risks of their businesses, rather than that of “points of connection” in the commodity markets.

¹³ 75 Fed. Reg. at 80,177.



Regulating as swap dealers end users that provide risk management products and services in connection with physical transactions may substantially disrupt commerce in the electricity and other wholesale energy markets. As such, EDFT requests that the Commission clarify that when physical commodity market participants provide swaps to other end users in connection with physical transactions, it does not constitute acting as “a point[] of connection” between participants in swaps markets, and should not, by itself, cause an entity to be a swap dealer. Such incidental activity is not commonly known in the trade as “dealing” and does not pose a systemic risk to the U.S. financial system.

3. Energy Marketers and Suppliers That Provide Energy Management Services Are Not Dealing in Swaps Because These Services Do Not Constitute a Regular Business

Providing risk management products and services in connection with physical transactions falls within the exception to the swap dealer definition for “a person that enters into swaps for [its] own account . . . but not as a part of a regular business” (the “Regular Business Exception”).¹⁴ In order for the Regular Business Exception to have any substance or practical effect, the Commission should exclude from the concept of swap dealing the provision of risk management products and services in connection with or as an incident to physical transactions, because these products and services support physical transactions and do not themselves represent stand-alone or main businesses. The “regular business” of energy marketers and suppliers is providing wholesale electricity to their customers. The ancillary, incidental, secondary business of many energy marketers or suppliers, like EDF Trading, is providing energy management services, which serve a risk management function in the energy markets. The Commission should clarify that these incidental, ancillary, secondary energy management services do not constitute a “regular business” of energy marketers and suppliers because their swaps business is subordinate and secondary to, and yet intertwined with, their physical business.

4. The Commission Should Not Classify as Swap Dealing Swaps Activity That Is Already Monitored and Regulated by Another Regulator

The Commission should clarify that entities that enter into transactions pursuant to a Federal Energy Regulatory Commission (“FERC”)-approved tariff or a similar authorization from the Electric Reliability Council of Texas (“ERCOT”) are not swap dealers. Section 722(f) of the Dodd-Frank Act provides the Commission with the authority to exempt “an agreement, contract, or transaction that is entered into . . . pursuant to a tariff or rate schedule approved or

¹⁴ CEA § 1a(49)(C).



EDF TRADING

David A. Stawick
February 22, 2011
Page 11

permitted to take effect by the Federal Energy Regulatory Commission.”¹⁵ To the extent that the Commission determines that such agreements, contracts, or transactions may constitute swaps, the Commission should exercise its exemptive authority under Section 4(c) of the CEA to clarify that (i) products and services entered into pursuant to a FERC-approved tariff, and (ii) entities, to the extent that they enter into such transactions, are not subject to regulation as swaps or swap dealers, respectively, under the CEA. In addition, the Commission should provide similar relief for activities entered into pursuant to ERCOT authorization in Texas, because the ERCOT area of Texas is outside the jurisdiction of FERC, but ERCOT and the Public Utility Commission of Texas (“PUCT”) provide regulatory oversight similar to that provided by FERC in other parts of the country to ERCOT- and PUCT-jurisdictional areas of Texas.

D. The Commission Should Not Regulate Inter-Affiliate Transactions through Its Swap Dealer Regulations

1. Inter-Affiliate Risk Transfers Are Not Swap Dealing

Inter-affiliate risk transfers should not be regulated as swaps dealing activity. EDF Trading agrees with the Commission’s sentiment that swaps transactions between affiliates “may not involve the interaction with unaffiliated persons that . . . is a hallmark of the elements of the [swap dealer definition],”¹⁶ and therefore believes that the Commission should explicitly clarify that entering into inter-affiliate risk transfers do not constitute swap dealing. For a variety of economic reasons, affiliated entities frequently enter into arrangements to transfer risks between one affiliate and another. These transactions are essentially internal transfers, an “allocation of risk within a corporate group,”¹⁷ and should not be treated as swap dealing. Risk transfers like these, which are kept “in-house” within the corporate family, do not materially affect the market outside of the affiliate groups, and do not pose a risk to the financial system. Inter-affiliate risk transfers are a long-standing commercial practice and do not constitute an attempt to evade the requirements applicable to swap dealers. Further, treating inter-affiliate swaps as swap dealing would impose a heavy regulatory burden on end users for conduct which poses no risk to the larger economic structure. Imposing such a burden with no discernable benefit would not be practical or helpful toward accomplishing the Commission’s regulatory goals.

¹⁵ CEA § 4(c).

¹⁶ 75 Fed. Reg. at 80,183.

¹⁷ *Id.*

2. **Hedging Risk Through a Centralized Hedging Affiliate Does Not Constitute Swap Dealing**

Further, an end user that serves as a centralized hedging affiliate within a larger corporate family should be allowed to hedge the commercial risk of affiliated end users without being classified as a swap dealer. Commercial companies should be allowed to structure their business operations as efficiently as possible as long as the structure is consistent with the over-arching goals of the Dodd-Frank Act. To that end, end users should be permitted to use one or more centralized hedging affiliates to facilitate the risk management needs of their various affiliates. The Commission should clarify that an end user that serves as a centralized hedging affiliate within a larger corporate family may hedge the commercial risk of affiliated end users without being classified as a swap dealer, however the centralized hedging activities are structured, whether they be through a sleeve, a back-to-back transaction, or other means.

End Users within a corporate family can take advantage of increased efficiencies by using a centralized hedging affiliate to enter into swaps transactions to hedge or mitigate their commercial risks. The use of a centralized hedging desk can increase hedging efficiency in the many ways without sacrificing hedge effectiveness. Using a single hedging desk: (1) reduces the cost of maintaining hedging capability, including staffing, facilities, and technology costs; (2) allows traders within the hedging affiliate to focus more narrowly on risk management needs instead of the other tasks they might also be tasked with if they were housed within the main commercial enterprise; (3) takes advantage of synergies between the hedging needs of the various affiliates (*e.g.*, more than one affiliate might need to hedge a certain type of power, and the centralized desk can manage both, and can net and offset risk exposures between affiliate entities); and (4) facilitates more transparent inter-affiliate communication regarding risk-management issues. EDF Trading requests that the Commission continue to permit this beneficial practice among end users of physical commodities.

3. **The Commission Should Not Regulate International Inter-Affiliate Transactions through Its Swap Dealer Regulations**

An end user's corporate family may include cross-border affiliates, and a U.S. end user may enter into hedging transactions with or on behalf of a cross-border affiliate. These transactions, like domestic inter-affiliate transactions, represent transfers of risk within a corporate family and should not be regulated as swap dealing. Cross-border swaps involving U.S. counterparties are subject to the Dodd-Frank Act,¹⁸ and international inter-affiliate transactions have the same risk allocation properties that counsel against swap dealing treatment

¹⁸ CEA § 2(i) (setting forth the Commission's jurisdiction over certain activities outside the U.S.).



EDF TRADING

David A. Stawick
February 22, 2011
Page 13

as do domestic inter-affiliate transactions. Accordingly, EDF Trading requests that the Commission confirm that it will treat cross-border swap transactions with U.S. affiliates the same as it treats domestic transactions of similar character under the Dodd-Frank Act.

4. The Commission Should Not Limit “Common Control” to Include Only Wholly-Owned Affiliates

In the Proposed Rule the SEC and CFTC characterize affiliates as “legal persons under common control with the person at issue,” and request guidance regarding “how the Commissions should interpret common control” for the purpose of treatment of affiliates under the definition of swap dealer and security-based swap dealer, and comments as to “whether this interpretation should be limited to wholly-owned affiliates.”¹⁹ EDF Trading believes that the SEC and CFTC have correctly characterized generally what it means to be an affiliate, and encourages the SEC and CFTC to conclude that being under “common control with the person at issue” should not be limited to include only wholly-owned affiliates. Federal regulators, including the SEC and CFTC, have long recognized that control can be exercised with much less than a 100 percent ownership interest, and the SEC and the CFTC should continue to recognize the same.²⁰

EDF Trading requests that the Commission adopt a definition of affiliate that is consistent with the definitions of affiliate within the energy industry. EDF Trading submits that the most impactful regulator in the domestic energy space is the Federal Energy Regulatory Commission, and that FERC provides two definitions of affiliate that present workable definitions of affiliate within the energy space. First, under the Public Utility Holding Company Act, FERC defines an affiliate of a company as “any company, 5 percent or more of the outstanding voting securities of which are owned, controlled, or held with power to vote, directly

¹⁹ 75 Fed. Reg. at 80,183.

²⁰ EDF Trading provides the following examples of instances in which the CFTC or SEC has defined “common control” or “affiliate” to include ownership relationships of less than 100%:

CFTC Rule 148.4 definition of affiliate (relating to the Equal Access to Justice Act). 17 C.F.R. § 148.4 (“Any individual, corporation or other entity that directly or indirectly controls or owns a majority of the voting shares or other interest of the applicant, or any corporation or other entity of which the applicant directly or indirectly owns or controls a majority of the voting shares or other interest, will be considered an affiliate for purposes of this part”).

SEC Rule 405 definition of common control in the context of the definition of affiliate. 17 C.F.R. § 230.405 (“The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”).



or indirectly, by such company.”²¹ Second, under the Federal Power Act, for the purpose of regulating electricity wholesalers, FERC defines an affiliate as “[a]ny person that directly or indirectly owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting securities of the specified company.”²² Both of these definitions are familiar to energy market participants. Adopting one of these definitions would provide legal certainty to energy end users that entities that have been considered affiliates under FERC’s regulations will also be considered affiliates under the Commission’s regulations, and would provide a practicable standard for energy market participants to apply, since they likely already apply a similar standard to some portion of their existing physical business.

E. The Commission Should Not Apply Swap Dealer Requirements To An Entity’s Non-Swap Dealing Activities

The Dodd-Frank Act does not authorize the CFTC to apply swap dealing requirements to an entity’s non-swap dealing activities. The CFTC does not explain why it would be appropriate to regulate an entity’s non-swap dealing activity. The non-swap dealing activities of energy marketers and suppliers are typically regulated by FERC (or ERCOT) and the State PUCs, and further regulation is not needed to ensure the stability of the energy markets.

F. The Commission Should Clarify that Trading Swaps for a Company’s Own Account to Profit from Changes in the Value of Such Swaps is not “Dealing”

Trading swaps for one’s own account for profit is not “dealing,” and it should not make a swap trader into a swap dealer. EDF Trading engages in a small amount of proprietary swap trading for its own account, a practice that facilitates and supports its physical market business. EDF Trading believes that this should not cause EDF Trading to be considered a swap dealer because: (1) EDF Trading’s proprietary trading activity is part of its strategy for serving its own risk management needs and the needs of its energy management services customers; (2) although EDF Trading is trading for its own account, it is not doing so as part of a regular business; and (3) trading is not the same thing as dealing.

EDF Trading’s proprietary trading is designed to facilitate its physical trading and hedging business. Energy marketers and suppliers like EDF Trading engage in proprietary trading for several purposes that relate closely to their risk management needs and their general physical business, including price discovery and other market intelligence, and providing market liquidity. Trading swaps is the best way to obtain information about the swaps market and to

²¹ 18 C.F.R. § 366.1.

²² 18 C.F.R. § 35.36(a)(9)(i).



EDF TRADING

David A. Stawick
February 22, 2011
Page 15

observe the current character of the market. Without this information, EDF Trading cannot effectively hedge its own risk or that of its energy management customers.

Because EDF Trading's proprietary trading is incidental to its physical business, it should not be deemed to be "part of a regular business" and should be excluded from the definition of swap dealing. EDF Trading engages in proprietary trading precisely because it has a physical business that requires risk management that is often achieved through participation in the swaps market. EDF Trading's swaps trading is a part of the company's overall risk-mitigation strategy, and should not be interpreted to be dealing activity. For this reason, EDF Trading would like the Commission to clarify that proprietary trading that is incidental or ancillary to a physical business does not constitute swap dealing.

Further, EDF Trading calls upon the Commission to recognize the "trader-dealer distinction" that the SEC has traditionally recognized in the securities trade, that the SEC proposes to recognize in the security-based-swaps trade, and that the Congress implicitly recognized in the Dodd-Frank Act by creating two different kinds of large swap entities, "swap dealers" and "major swap participants."²³ The Commission has recognized the special role of traders in the marketplace in the past. For example, the CFTC has adopted a definition of a "floor trader" as a person who "purchases or sells [futures contracts in an exchange ring or other place provided by the exchange] solely for such person's own account"²⁴ Congress implicitly recognized this difference when it created two distinct financial entities, swap dealers and major swap participants, within the main framework of the Dodd-Frank Act, since major swap participants are, essentially large traders that are not also dealers. If traders and dealers were the same, there would be no need for the major swap participant designation under the Dodd-Frank Act.

²³ The SEC noted in the Proposed Rule that because "[t]he definition of 'security-based swap dealer' has parallels to the definition of 'dealer' under the [Securities] Exchange Act . . . [it] would consider the same factors that are relevant to determining whether a person is a 'dealer' under the [Securities] Exchange Act as also generally relevant to the analysis of whether a person is a security-based swap dealer." 75 Fed. Reg. at 80,177. The factors the SEC proposes to consider in determining whether an entity is a "dealer" rather than a "trader" include whether an entity has a regular clientele; holds itself out as buying or selling securities at a regular place of business; has a regular turnover of inventory (or participates in the sale or distribution of new issues, such as by acting as an underwriter); and generally provides liquidity services in transactions with market participants.

²⁴ 17 C.F.R. § 1.3(x); *see also* 17 C.F.R. § 15.00(s) (defining "trader" as "a person who, for his own account . . . makes transactions in commodity futures or options . . ."); CFTC Staff Report on Commodity Swap Dealers and Index Traders (describing "index traders" as "investor[s] in commodity markets.")



EDF TRADING

David A. Stawick
February 22, 2011
Page 16

G. The Commission’s Proposed *De Minimis* Exception from the Definition of Swap Dealer is Too Narrow

The Dodd-Frank Act provides an exemption from the definition of swap dealer for any entity that “engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.”²⁵ This exception facially relates to whether an entity engages in a quantity of swap dealing that is not significant enough to implicate the underlying purposes of the swap dealer registration and regulation requirements of the Dodd-Frank Act. Congress “incorporated a *de minimis* exception to the Swap Dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation.”²⁶ However, as proposed, the *de minimis* exception relies only on the volume and size of market participant’s swap activity rather than the actual systemic risk that the participant poses.

The Commission recognizes that the *de minimis* standard “does not . . . readily translate into objective criteria,” and it concedes that “a range of alternative approaches may be reasonable.” Yet, the Commission proposes to quantify a “*de minimis* quantity of swap dealing” by adopting the following objective conditions:

1. The aggregate effective notional amount (measured on a gross basis) of swaps entered into over the preceding 12 months in connection with dealing activities must not exceed \$100 million;
2. The aggregate effective notional amount of swaps with “special entities” over the preceding 12 months in connection with dealing activities must not exceed \$25 million;
3. The entity must not enter into swaps as a dealer with more than 15 counterparties over the prior 12 months; and
4. The entity must not enter more than 20 swaps as a dealer over the prior 12 months.²⁷

²⁵ CEA § 1a(49)(D).

²⁶ 156 Cong. Rec. H5248 (Dodd-Lincoln Letter).

²⁷ 75 Fed. Reg. at 80,212 (Proposed Rule 17 C.F.R. § 1.3(ppp)(4)). The Commission requests that commenters address the significance of the fact that the statutory *de minimis* exemption specifically references “transactions with or on behalf of a customer.” *Id.* at 80,181. EDF Trading believes that because the *de minimis* exception refers to transactions “with or on behalf of its customers,” swap dealing-like activity that is an accommodation to an entity’s existing *or potential* [physical transaction] customers should not cause an entity to be a swap dealer.



EDF TRADING

David A. Stawick
February 22, 2011
Page 17

EDF Trading believes that the current levels proposed by the Commission for the *de minimis* exception are too low and would unnecessarily regulate immaterial levels of swap dealing activity, *i.e.*, levels of swap dealing activity that so small that they cannot pose systemic risk. The Commission should not regulate dealing activity that is not material to the financial stability of the United States, and the *de minimis* exception should reflect careful consideration of what levels of swap dealing activity are likely to have a material impact on the U.S. financial markets.

These proposed limitations are too low to accommodate the realities of the energy industry. In particular, the proposed aggregate effective notional amount of swaps and the number of swaps permitted over a 12-month period are particularly low. The Commission should set the threshold for the *de minimis* exception at a level that appropriately manages systemic risk, not lower. Setting these levels at \$100 million for swaps with most entities and \$25 million for special entities, and 20 swap dealing transactions in total over the space of a year, potentially captures many entities that pose no systemic risk. The Commission does not provide a reasoned explanation for these limitations. There is no reasonable basis for concluding that entering into more than 20 swaps valued at \$100 million or more in a rolling twelve month period without being registered as a swap dealer will adversely affect Title VII's orderly market goals. Accordingly, EDF Trading requests that the Commission either raise the threshold levels to more reasonable limits and provide a reasonable, practical basis for its final conclusions regarding these levels, or propose a standard for which the Commission can provide a reasonable basis. EDF Trading recommends that the Commission raise the threshold level for the *de minimis* exception to one one-thousandth of one percent of the aggregate gross notional amount of all domestic swaps positions, and one one-ten-thousandth of one percent of the aggregate gross notional amount of all domestic swap positions for which one or more counterparties is a "special entity," over the preceding 12 months, on a rolling basis.

As a related matter, EDF Trading requests that if the Commission decides to make the proposed thresholds, or similar thresholds, the standard for qualification for the *de minimis* exception, the Commission also explicitly clarify that these threshold amounts exclude non-dealing activity, such as hedging activity and proprietary non-dealing trading activity. EDF Trading believes that the Commission intends non-dealing activity to be excluded from these thresholds based on footnote 35 of the Proposed Rule, which states that "these [*de minimis*] limits would not apply to swap . . . activity that does not itself constitute dealing activity, such as activity in which a person hedges or mitigates a commercial risk of its business that is unrelated to a dealing business . . ." ²⁸ EDF Trading would, however, appreciate the Commission confirming or correcting this belief, as appropriate.

²⁸ *Id.* at 80,180 n.35.



EDF TRADING

David A. Stawick
February 22, 2011
Page 18

IV. The Commission Should Clarify That the Proposed Definition of Major Swap Participant Excludes Commercial End Users

Energy marketers and suppliers primarily use swaps to hedge or mitigate commercial risks associated with their businesses. Accordingly, these entities do not maintain a “substantial position” in any category of swaps, and they do not hold positions that create substantial counterparty exposure that could have serious adverse effect on the United States banking system or financial markets. Although EDF Trading believes that it is unlikely that either energy marketers or suppliers will fall within the proposed definition of major swap participant, EDF Trading would like the Commission to clarify in its final rule that commercial end users will not be subject to regulation as major swap participants. Consistent with EDF Trading’s comments in Section III.D of this comment letter, the Commission should also clarify that it will not consider inter-affiliate risk transfers in its calculation of whether an entity holds a “substantial position” or creates “substantial counterparty exposure” within the definition of major swap participant.

As discussed below in Section V, EDF Trading provides further comment on the definition of “hedging or mitigating commercial risk,” which is set forth in the Proposed Rule, and which is an essential component of both the major swap participant definition and the end-user clearing exception.

V. The Commission Should Adopt a Broad and Commercially Practicable Definition of “Hedging or Mitigating Commercial Risk”

EDF Trading respectfully requests further clarification regarding the definition of “hedging or mitigating commercial risk.” EDF Trading agrees with the Commission’s decision to propose a consistent definition of commercial risk for all instances in which it is used in the CEA. As noted in the Commission’s proposed rule for the end-user clearing exception, a consistent approach to defining “hedging or mitigating commercial risk” facilitates “consistency of interpretation across the CEA as a whole and help[s] provide for fair and equivalent treatment for similarly situated parties.”²⁹ We do, however, ask the Commission to clarify that “hedging or mitigating commercial risk” includes the many different ways that commodity market participants use swaps to manage their commercial risks. EDF Trading would like the Commission to carefully ensure that its rules will not inhibit the ability of end users to manage the commercial risks that are part of their commercial businesses.

²⁹ End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 80,753 (Dec. 23, 2010).



EDF TRADING

David A. Stawick
February 22, 2011
Page 19

The Commission should adopt a flexible test for what is appropriate or effective hedging activity. The Commission should not add the phrase “highly effective” to the proposed definition of “hedging or mitigating commercial risk.” The day-to-day hedging activities of end users rarely produce perfect hedges. A standard that treats only “highly effective hedges” as “hedging or mitigating commercial risk” could be construed to encompass only near-perfect hedges, and such a standard would be inconsistent with the purpose of the Dodd-Frank Act and common industry practice. Congress intended for end users’ hedging activities to be excepted from the clearing (and clearing-related) requirements of the Dodd-Frank Act. End users’ appropriate hedging activities often do not represent “perfect” or “highly effective” hedges; rather, each hedge represents a reasonable attempt to offset commercial risks associated with one or more commercial activities. Regardless of the words the Commission uses to define “hedging or mitigating commercial risk,” the Commission should interpret this definition practicably and flexibly so that end users may continue to effectively hedge their commercial risks.

The Commission should determine whether a position hedges or mitigates commercial risk by looking at each position only at the time that the position is established, while also taking into account the person’s overall hedging and risk mitigation strategies. This is the only commercially practical way to evaluate a hedge’s character. The Commission should not require ongoing assessments of hedging effectiveness, and should instead rely on initial assessments of each hedge. A standard that would analyze the hedging or mitigating characteristics of a swap after its inception would be difficult to track, and would present obstacles to hedgers, because the hedging value of a swap fluctuates over time, and the end user is not in control of the fluctuation. In fact, it is precisely this fluctuation uncertainty that is at the heart of why market participants enter into hedging transactions in the first place. Requiring an ongoing, periodic assessment of a hedge’s effectiveness or purpose would be burdensome for commercial entities, and would do little to reduce systemic risk.

EDF Trading encourages the Commission to allow flexibility for trading positions that are not perfect hedges, and for hedging positions that are of varying duration. Market participants need flexibility in order to hedge effectively. A swap that does not perfectly hedge a related physical position should not be deemed to be speculative if its original intended purpose was to hedge or mitigate commercial risk. As noted above, rather than being “perfect,” end users’ hedges are reasonable efforts to hedge commercial risks of conducting a commercial business. Furthermore, whether a hedger intends to hold a position for a short or a long period of time is not relevant to whether the position hedges or mitigates commercial risk. As positions and prices change, hedges can and should be adjusted dynamically to ensure reasonably complete, cost-effective coverage. The Commission should define “hedging or mitigating commercial risk” in a manner that provides end users with sufficient flexibility to operate their physical commodities business.



EDF TRADING

David A. Stawick
February 22, 2011
Page 20

EDF Trading is a provider of energy management services to market participants in the energy industry, and requests that the Commission clarify that that swaps entered into in connection with energy management services fall within the definition of “hedging or mitigating commercial risk.” Energy management services, which are described in detail in Sections I and III.C of this letter, are a critical risk management tool for many energy end users, including energy generators and suppliers, as well as industrial energy customers. They are risk management services geared toward providing customers with price predictability and operational continuity in the face of market uncertainty. Energy marketers and suppliers often offer energy management services as a complement to the physical commodity services they provide to their customers. When energy marketers and suppliers like EDF Trading seek out or provide hedges for a customer as part of its energy management services, they engage in hedging activity that the customer would engage in on its own if it could do so as effectively as can the marketer or supplier. Energy management services are “[n]ot held for a purpose that is in the nature of speculation, investing, or trading.”³⁰ Energy management services are offered for the purpose of hedging the risks involved in operating a physical energy business, and should be encompassed by the definition of “hedging or mitigating commercial risk” under the Dodd-Frank Act.

In addition, the Commission should adopt a definition of “hedging or mitigating commercial risk” for swap transactions that is consistent with the definition of bona fide hedging transactions for futures and swaps. The proposed definition of “hedging or mitigating commercial risk” includes, among other things, positions that qualify for a bona fide hedge exemption from position limits set under the CEA. EDF Trading agrees with the Commission’s decision to include bona fide hedging transactions in the definition of “hedging or mitigating commercial risk.” *However, EDF Trading is unable to provide fully informed and meaningful comments on this issue until the Commission finalizes its proposed definition of the term “bona fide hedging.”*

Lastly, EDF Trading requests that the Commission provide an assurance to entities that the definition of “hedging or mitigating commercial risk” will encompass swaps transactions in which an entity hedges the commercial risk of an affiliate. Consistent with EDF Trading’s comments in Section III.D of this comment letter, the Commission should clarify that it will not regulate inter-affiliate risk transfers.

³⁰ See 75 Fed. Reg. at 80,215 (Proposed Rule 17 C.F.R. § 1.3(ttt)).



EDF TRADING

David A. Stawick
February 22, 2011
Page 21

VI. Conclusion

EDF Trading thanks the CFTC for the opportunity to provide comments on the Proposed Rule during this complex and transformative rule-making process. For the foregoing reasons, EDF Trading respectfully requests that the CFTC adopt definitions of “swap dealer,” “major swap participant,” and “hedging or mitigating commercial risk” that recognize and protect the hedging needs and abilities of energy end users, particularly energy marketers and suppliers.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Eric Dennison", is written over a horizontal line.

ERIC DENNISON
Sr. Vice President and General Counsel
Telephone: 281-653-5811
E-mail: Eric.Dennison@edftrading.com

STEPHANIE MILLER
Assistant General Counsel – Commodities
Telephone: (281) 653-1742
E-mail: Stephanie.miller@edftrading.com

BILL HELLINGHAUSEN
Director of Regulatory Affairs
Telephone: 281-653-1680
E-mail: bill.hellinghausen@edftrading.com

EDF Trading North America, LLC
4700 West Sam Houston Parkway North, Suite #250
Houston, Texas 77041-8210
