Dominion Resources Services, Inc.
120 Tredegar Street, Energy Clearinghouse Building, Richmond, VA 23219

February 28, 2011

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

Re: **Comments of Dominion Resources, Inc. to Proposed Rules on "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants" (RIN 3038–AC96) under the Dodd-Frank Wall Street Reform and Consumer Protection Act.**

Dear Mr. Stawick:

Dominion Resources, Inc. ("Dominion") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") Notice of Proposed Rulemaking on "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants" ("NOPR") which implements the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Dodd-Frank").[1]

I. *Introduction*

Dominion is one of the nation's largest producers and transporters of energy, with a portfolio of more than 27,600 megawatts of generation, 12,000 miles of natural gas transmission, gathering and storage pipeline and 6,000 miles of electric transmission lines. Dominion operates the nation's largest natural gas storage system with 942 billion cubic feet of storage capacity and serves retail energy customers in 13 states. Dominion enters into swap agreements to reduce exposure to market shifts in prices received and paid for electricity, natural gas and other commodities.

Dominion clearly is an end user under the intent of Congress and the Dodd-Frank Act.[2] As such, Dominion had expected to be minimally affected by this NOPR implementing Section 731 of Dodd-Frank, which added a new Section 4s to the Commodity Exchange Act ("CEA") providing for registration and regulation of swap dealers and major swap participants ("MSP"). CEA §4s(i) specifically addresses documentation for the accurate confirmation, processing, netting and valuation of all swaps to which "[e]ach *registered swap dealer and major swap participant* shall conform." The NOPR, however, proposes applying regulation for confirmation and portfolio reconciliation processes more generally to the swap market. As a result of this

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] *See* Dodd-Lincoln Letter from Sens. Christopher Dodd and Blanche Lincoln to Reps. Barney Frank and Colin Peterson, 156 Cong. Rec. H5248 (daily ed. June 30, 2010); *see also* further statements of Sen. Lincoln, 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (noting differences between the House version and the Senate version that was more restrictive).

approach, the Commission achieves a regulatory scope that has the potential to encompass end users and require changes in their business practices, although these practices have not resulted in backlogs, counterparty confusion regarding contract terms, or valuation disputes, which these rules are intending to address.

The Commission states that it "has taken care to minimize the burden on those parties that will not be registered with the Commission as swap dealers or major swap participants."[3] It also acknowledges that "swap dealers and major swap participants would be able to comply with each of the proposed rules by executing a swap on a swap execution facility ("SEF") or on a designated contract market ("DCM") or by clearing the swap through a derivative clearing organization ("DCO")."[4] Since the NOPR indicates that the statutory requirements are not to include end user-to-end user transactions, the impact of the proposed rules affects, by default, the contractual relationship between swap dealers and end users and between MSPs and end users mostly relating to either swaps exempt from clearing or customized swaps that are executed off a regulated facility, i.e., a SEF or DCM or not cleared by a DCO. These contractual relationships and swaps transactions are not intended to be within the focus of CEA §4s(i). Consequently, further tailoring and clarification of the proposed rules are required to carry out the intent of Dodd-Frank and to ensure that the rules' effect is limited to those entities properly designated as swap dealers and MSPs.

II. ***Confirmation Process***

The NOPR professes that confirmation, portfolio reconciliation and portfolio compression *have been recognized* as important post-trade processing mechanisms for reducing risk and improving operational efficiency.[5] Consistent with energy industry standards, Dominion has negotiated confirmation and reconciliation processes in contracts with its counterparties that comply with prudent risk management practices. Generally, swap transactions are executed under standardized agreements, most generally ISDAs, or ISDA-like contracts. The processes by which a trade becomes enforceable, confirmed and collateralized are subject to existing contractual terms that were negotiated as part of these master agreements. Dominion recommends that the Commission clarify that it does not intend that any of the rules implemented under CEA §4s(i) pursuant to this NOPR should affect end user contractual rights and obligations under existing master agreements or business practices.

The proposed confirmation rule would obligate swap dealers and MSPs to "establish, maintain, and enforce written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction that it enters into . . . with a counterparty that is **not** a swap dealer, major swap participant, or a financial entity [i.e., end user] not later than the next business day after execution."[6] While the proposed rule is addressed to swap dealers and MSPs, it conflicts with existing industry practice and with existing contract rights of end users. At least among energy end users, industry standard provides for verification of confirmation terms within three business days. There is no sufficient reason to replace the confirmation

[3] 75 Fed. Reg. 81,519, 81,521 (Dec. 28, 2010) [hereinafter *NOPR*].
[4] *Id.* at 81,520.
[5] *Id.*
[6] Proposed §23.501(a)(1), *Id.* at 81,531.

practices under these agreements with the Commission's own determined time requirement for non-SEF/DCM traded and non-DCO swaps entered into between non-swap dealers/MSPs and swap dealers/MSPs. To the extent the Commission requires any end-user confirmations to be addressed in the written policies of swap dealers/MSPs, the Commission should clarify that such confirmations by non-swap dealers/MSPs are governed by the terms of the parties' master agreement.

The confirmation process proposed in the rule is satisfied by the confirmation practices under most master agreements as negotiated by end users in the energy industry. They capture either side of the confirmation process where one party confirms its understanding of the transaction by submitting a writing, which under the Commission's rules is the acknowledgement, and under the master agreement is the confirmation. The counterparty then verifies whether the writing reflects its understanding of the terms. This verification constitutes the confirmation under the proposed rule. Consequently, no operational efficiencies are lost and no risk is increased by allowing the contract to govern the confirmation process. The potential costs of an end user having to change its business processes to accommodate a shortened confirmation time are not justified by any benefit to the end user or to the market. The Commission should affirm its efforts to retain flexibility for the end user, not only in the form of confirmation, but also in the confirmation timing, so long as the timing does not result in confirmation backlogs and does not frustrate other statutory objectives. The Commission should defer to well-established tenets of contract law for determining enforceable contractual terms and it should respect the sanctity of contract where there is no regulatory objective to be gained otherwise – no operational efficiencies, no transparency, or no reduction in systemic risk.

III. *Portfolio Reconciliation*

The NOPR sets out the value of portfolio reconciliation as a risk management technique designed to (1) identify and resolve discrepancies between the counterparties as to the terms of a swap after execution and during the life of the swap; (2) ensure effective confirmation of all the terms of the swap (which seems substantively and effectively identical to the first objective); and (3) identify and resolve discrepancies between the valuation of the swap.[7] However, the confirmation process provides any needed clarification as to what constitutes the agreed-upon, enforceable terms of a transaction, thereby accomplishing the first two of these objectives. Reconciliation would not advance the certainty of contractual terms for purposes of determining their legal enforceability. Consequently, the remaining objective for portfolio reconciliation advocated by the Commission is for identifying and facilitating resolution of discrepancies between counterparties with regard to valuations of collateral held as margin.

As noted above, CEA §4s(i) required the Commission to adopt regulations that included documentation requirements for netting and valuation for swap dealers and MSPs, not end users. In proposing the new rule §23.502 which would require swap dealers and MSPs to reconcile their portfolios with counterparties, the Commission describes the reconciliation requirement relative to end users as an opportunity, which would infer a benefit to them. Swap dealers and MSPs must provide "counterparties who are not registered as swap dealers or major swap

[7] *Id.* at 81,523.

participants with *regular opportunities* for portfolio reconciliation."[8] However, for Dominion to be able to assess the benefit of this opportunity, the NOPR requires clarification regarding the reconciliation process for resolving a valuation dispute between a swap dealer or MSP and an end user.

The proposed reconciliation rule would require that for swap portfolios with entities other than swap dealers or MSPs, the swap dealer/MSP must establish written policies and procedures to perform reconciliation, but such policies and procedures would not need to prescribe the manner in which the reconciliation must be done. The Commission provides an example in the NOPR, noting that "the exchange of terms and valuations between the counterparties may consist of one party reviewing the details and valuations delivered by the other party and either affirming or objecting to such details and valuations."[9] It then later states that "[s]wap dealers and major swap participants would be required simply to establish written procedures reasonably designed to resolve any discrepancies in the material terms or valuation of each swap indentified as part of a portfolio reconciliation process in a timely fashion."[10]

A primary concern arising under the proposed rule requiring an exchange of information on which a party bases its valuation of the transaction is the possibility that an end user will be required to turn over proprietary sensitive commercial and market information to the swap dealer, or an MSP which may be a competitor, that could give such party a competitive advantage to the detriment of the end user in either or both the swap marketplace or the physical market relating to the end user's regular business. Energy end users correctly protect their forward market valuations. The transparency goals in Dodd-Frank apply to transparency of executed swaps transactions, not the release of internal market sensitive data that could allow one party to arbitrage the information against the interests of the end-user counterparty, especially an end user seeking to mitigate large risks in an illiquid market. The Commission should clarify that the written procedures described in the NOPR and discussed above would not require end users to disclose any proprietary market information for purposes of initial valuation or for resolution of valuation disputes. Further, the rule should recognize the contractual rights that end users may have with a swap dealer or MSP regarding reconciliation, including, but not limited to, the frequency of such reconciliation and any process for resolving disputes as to the transaction valuation, in lieu of a regulatory mandate via a dealer or MSP's written procedures.

The Commission has recognized the movement of the industry to address problems experienced in the OTC market regarding valuation disputes. The only actual and practical benefit of any valuation reconciliation process to end users is for purposes of collateral management. Collateral management is better determined by the commercial entity operating in the end-use market, who understands the hedging purpose of its swap transactions and the underlying value being protected. The energy industry has experienced multiple bankruptcies in which transactions were liquidated, and during such events, the valuation associated with settlement payments were managed without any systemic impact. Consequently, the valuation and dispute resolution processes are best addressed, not through regulatory requirements, but through negotiated and mutually agreeable collateral annexes, such as is part of the ISDA

[8] *Id.* at 81,524.
[9] *Id.* at 81,524.
[10] *Id.* at 81,525.

agreements. Where certain failures have been experienced in transaction valuation in the OTC market, the ISDA organization responded and developed protocols for resolution of disputed collateral calls, as noted by the Commission in the NOPR.[11] This is how such issues should be addressed – by the self-regulation of the entities involved, consistent with the principles-based regulation that has been the hallmark of the CFTC.

IV. ***Portfolio Compression***

Dominion agrees that portfolio compression, when applied in the appropriate circumstances, is an effective and efficient tool for netting transactions and generally managing an entity's overall exposures when applied in the appropriate circumstances. The Commission highlights the efficiencies gained by netting "*substantially similar* transactions" and transactions that contain "*substantially similar economic* terms and/or that would result in *redundant payments*," and in "*redundant or economically-equivalent* positions."[12] However, notwithstanding the economic equivalency, as highlighted by the Commission, among transactions to be netted for compression purposes, portfolio compression requires the swap product also be common among the transactions. For swaps between swap dealers and MSPs that are executed on a SEF or on a DCM or cleared through a DCO, portfolio compression is appropriate as the swap transactions are generally standardized products. As already noted in this NOPR and other rulemakings by this Commission, it is these market participants and these types of swap transactions that can affect systemic risks, and therefore, portfolio compression for these transactions do indeed diminish operational risks; lessen systemic risk and enhance the stability of the financial markets.[13] However, off-facility swaps entered into between end users and a swap dealer/MSP are more likely to be customized products, designed to hedge certain specific assets, or otherwise represent specific and illiquid transactions tailored to the specific needs of the end user. Direct offsetting transactions may not be available relative to these transactions. Consequently, in formulating a response to the question as to whether it should require swap dealers and MSPs to engage in bilateral and multilateral compression exercises with respect to transactions where the counterparty is not a swap dealer or MSP, the Commission should consider that mandating portfolio compression in all cases is impractical, if not irrelevant.

The Commission states in the NOPR that it is limiting the compression obligation to swaps in which the counterparty is also a swap dealer or MSP. It further states that the proposed rule § 23.503, would not "mandate portfolio compression exercises for swaps outstanding between a swap dealer or a major swap participant and counterparties that are neither swap dealers nor major swap participants," but rather again require swap dealers and MSPs to "maintain written policies and procedures for periodically terminating all fully offsetting swaps and periodically engaging in compression exercises."[14] However, the Commission should further clarify that such written policies (i) should not include any requirement for a counterparty which is neither a swap dealer nor a MSP to participate in a compression exercise unless it elects to participate at its own discretion; and (ii) should not allow the swap dealer or MSP to unilaterally offset and terminate swap transaction with such counterparty unless otherwise

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[11] *Id.* at 81,523.
[12] *Id. at* 81,525.
[13] *Id.*
[14] *Id. at* 81,526.

provided under an agreement between the parties. As presently drafted, the proposed rule requires that the written policies and procedures to be adopted by a swap dealer or MSP must include periodic termination of ***all*** offsetting swaps and periodic compression exercises, without consideration of the end user's transactions. Without these clarifications, the proposed rule would accomplish what the NOPR says it does not do: mandate portfolio compression exercises for outstanding swaps with counterparties that are neither swap dealers nor MSPs.[15]

IV. *Conclusion*

As previously noted, the Commission stated in the NOPR that it took "care to minimize the burden on those parties that will not be registered with the Commission as swap dealers or major swap participants."[16] However, the proposed rules seem to unnecessarily extend regulatory obligations for post-trade processing beyond swap dealers and MSPs and thus fail to minimize the regulatory burdens on end users. Accordingly, as detailed above, Dominion recommends that the Commission clarify for each of the proposed rules under this NOPR that non-swap dealer/MSP entities are intended to be excluded, directly and indirectly, from any regulatory requirements under this rulemaking. Further, we recommend that the Commission clarify that to the extent non-swap dealer/MSP swap transactions are affected by the requirements of the proposed rules, such rules are to be narrowly construed to minimize the resulting regulatory burden for non-swap dealer/MSP entities and to allow such end users to rely on existing contractual rights under established and prudent risk management practices. These modifications would be consistent with Congressional intent, the Commission's historic approach of principles-based regulation, and the Commission's stated goal in this rulemaking.

Dominion appreciates the opportunity to provide these comments to the NOPR. We respectfully request that the Commission consider these views before issuing its final rules on Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants. The Commission's reading and proposed application of these rules, while on the surface applicable only to swap dealers and MSPs, in fact greatly affects non-swap dealers and MSPs and could alter the way such entities conduct business and hedge their commercial risks. If you have any questions, or if we may be of further assistance, Dominion is willing to discuss these issues further with the Commission or its Staff at your convenience.

Respectfully,

/S/ David C. Holden

David C. Holden
Vice President
Enterprise Risk Management

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[15] Id.
[16] NOPR, *supra* note 3.