Dominion Resources Services, Inc.
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February 22, 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 the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant" (RIN 3038-AD06; RIN 3235-AK65) 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 the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant" ("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 which was never intended by Congress to be regulated as a swap dealer, as reflected in the legislative history of Dodd-Frank.[2] At the time Congress passed the Dodd-Frank Act, then House Agriculture Committee Chairman Collin Peterson specifically noted that Dodd-Frank "focused on creating a regulatory approach that permits the so-called end-users to continue using derivatives to hedge risks associated with their underlying businesses, whether it is energy exploration, manufacturing or commercial activities. End-users did not cause the financial crisis of 2008."[3] Current congressional oversight of the CFTC rulemaking process affirms that intention as House members express concerns relative to the

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

[2] *See* Dodd-Lincoln Letter dated June 30, 2010 from Senators Dodd and Lincoln to Reps. Frank and Peterson; *see also* further statements of Sen. Lincoln, 156 Cong. Rec. S 5921 (daily ed. July 15, 2010) (and differences between the House version and Senate version that was more restrictive).

[3] 156 Cong. Rec. H5245 (daily ed. June 30, 2010).

implications for end users under the Commission's series of NOPRs. Reiterating these concerns, Congressman Peterson again stated during a February 10, 2011 congressional hearing that "[e]nd users did not cause the financial crisis; they were the victims of it."[4] Congressman Leonard Boswell similarly commented in the same hearing: "I hope today's hearing underscores the need to not punish these end-users who, like consumers, were victims in the financial crisis. . . ."[5] And in a related hearing on February 15, 2011, Congressman Frank Lucas added: "The end-users didn't cause any financial catastrophe, nor are they big enough to cause systemic risk. They should not be the targets of increased regulation."[6] In fact, Chairman Gensler's testimony before various congressional committees acknowledged: "Congress recognized the different levels of risk posed by transactions between financial entities and those that involve non-financial entities, as reflected in the non-financial end-user exception to clearing."[7] As the Chairman's statement indicates, end users like Dominion do not contribute to systemic risk that can threaten the national public interest. Congress effectively codified this recognition when it provided non-financial end users an exception to clearing. That exception could be threatened, however, if the definition of swap dealer is applied to activities of end users in physical and energy markets for which the de minimis exception as proposed might not be available. Such a result would subject end users to margin and capital requirements as a swap dealer and eliminate the availability of the end-user clearing exception, which is contrary to congressional intent.

II. ***Swap Dealer Definition***

A. *Dodd-Frank's Functional Approach to the Swap Dealer Definition*

The risk of being denied the protection of the end use designation is evidenced in the NOPR where the Commission asserts that (i) market participants in natural gas markets, as well as other physical commodity markets, and in electric transmission and generation markets "engage in swap dealing activities," and (ii) that such swap dealing activities "are above the proposed *de minimis* threshold."[8] The Commission requests comments as to how the swap dealer definition should be applied to participants in these markets, which would suggest its understanding that making energy market end users into swap dealers may not be consistent with the protections afforded to them by Congress.[9] Establishing rules that broadly interpret the swap dealer definition and applying them to the supposed "swap dealing" activities of end users would

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[4] *Public Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act Before the H. Comm. on Agriculture*, 112th Cong. (Feb. 10, 2011).

[5] Id.

[6] *Public Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Part II Before the H. Comm. on Agriculture*, 112th Cong. (statement of Rep. Lucas) (Feb. 15, 2011).

[7] *Public Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act Before the H. Comm. on Agriculture*, 112th Cong. (statement of Chairman Gary Gensler) (Feb. 10, 2011); *see also Oversight of Dodd-Frank Implementation: A Progress Report by the Regulators at the Half-Year Mark Before the S. Comm. on Banking, Housing, and Urban Affairs* (statement of Chairman Gary Gensler (Feb. 17, 2011); *see also* Meeting of the Joint Advisory Committee on Emerging Regulatory Issues (opening statement of Chairman Gary Gensler) (Feb. 18, 2011).

[8] 75 Fed. Reg. 80,174, 80,183 (Dec. 21, 2010).

[9] *Id.*

deny end users the clearing exemption that was specifically crafted for their protection from regulation. End user activities and the limited risks they pose do not justify such regulation.

Commodity Exchange Act section 1(a)(49) provides a functional definition of swap dealer that attempts to describe dealer activities by vague and broad terms. Generally a swap dealer is any person who (i) "holds itself out as a dealer in swap;" (ii) "makes a market in swaps;" (iii) "regularly enters into swaps with counterparties as an ordinary course of business;" and (iv) "engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps." As discussed above, the Commission reads this definition as sufficiently broad to fit physical market participants and participants in the electric generation and transmission markets within the description of a swap dealer. Concerned about the definition's vague and broad terms, many preliminary public comments, summarized in the NOPR, advocated the need for further guidance and clarification of the terms contained in the statutory definition.[10]

However, the Commission appears to reject these calls for clarity and further description relative to the type of conduct implicating swap dealer regulation. It, instead, espouses the need for flexibility of the statute's functional approach. This approach, the Commission says, "suggests that the definitions should not be interpreted in a constrained or overly technical manner. Rigid standards would not provide the necessary flexibility to respond to evolution in the ways that dealers enter into swaps and security-based swaps."[11] Rather, the Commission states that "persons who are swap dealers may be identified by the functional role they fulfill in the swap markets."[12] While Dominion agrees that under Dodd-Frank the definition of swap dealer should be functionally applied to evaluating swap activities for purposes of a dealer designation, the manner in which the Commission proposes to apply the "functional" approach opens the possibility of back door regulation of end users otherwise clearly intended to be exempt from swap dealer requirements.

The functionality in Congress' approach to defining a swap dealer is reflected, as the Commission advocates, in a combined reading of, first CEA §1a(49)(A)(iii) for what a swap dealer is: any person who "*regularly* enters into swaps with counterparties as an *ordinary course of business* for its own account;" and second, CEA §1a(49)(C): for what a swap dealer is not: "does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, *but not a part of a regular business.*" However, the Commission constructs a reading of the terms "regularly enters into swaps . . . as an ordinary course of business" and "regular business" too narrowly within a context of only the swap market. It would assess how the swap activity relates "to the *other parties* with which [a person] interacts *in the swap markets*. If the person is available to accommodate demand for swaps from other parties, tends to propose terms, or tends to engage in the other activities discussed above, then the person is likely to be a swap dealer. Persons that rarely engage in such activities are less

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[10] *Id.*

[11] *Id.* at 80,176.

[12] *Id.* at 80,177.

likely to be deemed swap dealers."[13] The Commission should assess whether the swap activity relates to other parties with which a participant interacts in its *regular business in the physical market.*

However, end users that engage in swap transactions ancillary to their regular commercial activities, whether that commercial business is in physical markets or the electric generation and transmission markets, do not hold themselves out as a dealer *in swaps and* do not make a market *in swaps* as part of a *regular business in swaps.* Rather, the conduct by end users, which the Commission would characterize as dealing activities, is an integral component of their *regular business in the physical commodity markets.*

Thus, the Commission misapplies the functional test under the Dodd-Frank definition. Its application of the swap dealer definition ignores the commercial function of such end-user activities, in which end users engage for a myriad of business reasons that advance the entity's strategic core business and/or promote the commercial relationships within that business.

Although Dodd-Frank clearly states that physical commodity transactions are excluded from the definition of swaps,[14] the Commission recognized in the NOPR, "the markets in physical commodities . . . are complex and varied. They involve a large number of market participants that, over time, have developed highly customized transactions and market practices that facilitate efficiencies in their market in unique ways."[15] While some of these transactions could be encompassed, as noted by the Commission, by the statutory definition of ''swap,'' these transactions are intrinsically intertwined with but ancillary to the participant's physical market activity. The Commission recognized a similar complexity – and thus need for customization -- of swap transactions within the electric generation and transmission markets due to electricity's operational characteristics. They too are intrinsically intertwined with but ancillary to the participant's market activities in electricity generation and transmission. The swap transactional activity of physical market participants or participants in electricity markets is not the type of activity that warrants the extensive regulation governing swap dealers. Indeed, other NOPRs issued by the Commission relative to Dodd-Frank implementation, i.e., real-time reporting requirements, consider exclusions for these types of customized swaps within these markets because they do not contribute to the swap activities that constitute systemic risk.

The Commission specifically invited comment as to any different or additional factors that should be considered in applying the swap dealer definition to participants in the physical markets, including the energy markets – natural gas, electric generation, transmission.[16] The Commission should consider such physical market-related transactional activity as conduct that is essential to the operation of the physical markets and not part of an "ordinary course of business" in dealing swaps. Accordingly, in applying the swap dealer definition, the Commission should consider the commercial function of the swap transactional activity by a

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[13] *Id.*

[14] CEA § 1a(47)(B).

[15] *Id.* at 80, 183.

[16] *Id.* at 80,184.

market participant, and where such activity is related solely to its participation in the physical energy markets, exclude such activity from inclusion within the definition.

B. *Dodd-Frank's Regulatory Checks Against Potential Abuse of the Proposed Functional Test*

A swap dealer designation is self-executing, as indicated by the Commission in its cost-benefit analysis, noting a market participant's "need to review its activities and determine, as a qualitative matter, whether its activities are of the type described in the proposal." Consequently, there could be concern that entities could abuse the commercial function as a factor in the application of the swap dealer definition and attempt to hide their swap dealing activities behind some tenuous commercial link. However, both Dodd-Frank and the Commission's proposed rules include various regulatory safe guards against potential abuse in the use of the regular business application under CEA §1(a)(49)(A) and (C). Three primary check points include the following:

1. The Dodd-Frank Act requires end-user board approval to enter into swaps subject to the end-user clearing exception. Specifically, under CEA §2(j), the exception to mandatory clearing of swaps is available to SEC filers only if an appropriate committee of the issuer's board or governing body has reviewed and approved the decision to enter into swaps that are subject to the exception. In light of this statutory requirement, board involvement in SEC filer swap activity is likely to increase and members of appropriate boards or governing bodies can be expected to take the corresponding review and approval obligations very seriously, thus reducing the likelihood that these participants will engage in swap activities that have significant interconnectedness with the swap market and pose a high degree of systemic risk. Accordingly, the requirement of board-level review and approval of certain end user swap activity should serve as some limited additional protection against any potential for misuse of the commercial function as a factor in the application of the swap dealer definition.
2. The Dodd-Frank Act established thorough recordkeeping and real-time reporting regimes with respect to swaps and the Commission has addressed these swap data reporting requirements in various rulemaking proposals. The Commission has rightly emphasized the importance of increased swap market transparency to market participants and to financial regulators across the U.S. financial sector. The extensive swap records that will be compiled through this reporting scheme will provide the Commission with far-reaching swap transaction records for use in fulfilling the agency's swap market oversight functions. As a result, even if the Commission chooses to limit the swap dealer definition as described above, the Commission will still have ample information and records concerning swap market activity, including dealer activity, to appropriately monitor and conduct surveillance of swap market participants.
3. Finally, the exclusion under CEA § 1(a)(49)(C) of swap transactional activities by a market participant consistent with the above proposed commercial function application of the swap dealer definition does not compromise the Commission's regulatory objective under Dodd-Frank. While this application preserves the availability of the end-user clearing exemption to these market participants, consistent with legislative intent, to the

extent that the swap activities of these participants do pose a degree of systemic risk as a result of significant interconnectedness with the swap market, they become major swap participants ("MSP") subject to the "same statutory requirements that apply to swap dealers and security-based swap dealers."[17] The Commission has properly and well defined the determining factors for an MSP in terms of substantial position and substantial counterparty exposure. Dominion supports the Commission's proposed rules relative to the MSP definition. The type and level of commercial transactions by end users in swaps that would exist within the regulatory space between the designation of swap dealer and that of MSP are the types of end-use activities that Congress intended should be protected and not targeted for increased regulation, as noted by Congressman Lucas.[18]

III. *Administrative Law Matters*

A. Regulatory Flexibility Act

The Commission has certified that the proposed rules will not have a significant economic impact on a substantial number of small entities because the rules propose definitions which, by themselves, impose no significant new regulatory requirements. However, the rules as proposed provide no certainty as to how the definition of swap dealer may apply to many of the market participants in the energy markets. The NOPR describes certain swap activities that could constitute dealing activities above the proposed de minimis threshold and subject the market participant to regulation as a swap dealer. Many of such swap transactions are likely to include swaps entered into with small natural gas producers and other small energy companies. The uncertainty of whether entering into swaps with such counterparties could constitute accommodating swap demand, notwithstanding that such activity is ancillary to the commercial relationships between small and larger energy companies in the physical commodity market, could result in these smaller energy companies having less ability to transact for swaps associated with their commercial activities in the physical markets, and less able to manage their business risk. This will ultimately impact the liquidity of the swap markets and direct the hedging needs of small producers and energy generators to more expensive swap facilitators, likely resulting in significant additional costs to a substantial number of small entities.

B Paperwork Reduction Act

The Commission states that the proposed rule would not impose any new recordkeeping or information collection requirements, or other collections of information. However, in the Cost-Benefit Analysis included in the NOPR, the Commission acknowledges the substantive effects on market participants. It further states that any entity determined to be a swap dealer or major swap participant would be subject to registration, margin, capital, and business conduct requirements set forth in the Dodd-Frank Act – all activities that will have associated reporting and additional record keeping requirements. Further, as proposed, the central definition that is determinative of other terms, the swap dealer definition is vague and

[17] 74 Fed. Reg. 80,185. See n. 68 noting that MSPs are subject to the same types of margin, capital, business conduct and certain other requirements, unless an exception applies, citing CEA §§ 4s(h)(4) and (5).

[18] *Supra.*, fn. 6.

overly broad. It has the potential to cause some end users to be classified as a swap dealer and subject to registration and regulation relative to swaps from which they would have otherwise been exempted, for the most part, from regulation. As a swap dealer, market participants will be subject to additional reporting and information collection requirements to which they are not now subject nor would be even under other proposed rules except for the over reach of the swap dealer definition contrary to congressional intent, as described in Dominion's introductory comments above.

C. *Cost-Benefit Analysis*

In the Cost-Benefit Analysis included in the NOPR, the Commission acknowledges the substantive effects of this rulemaking on market participants: "The proposed regulations further defining swap dealer and major swap participant are significant because any entity determined to be a swap dealer or major swap participant would be subject to registration, margin, capital, and business conduct requirements set forth in the Dodd-Frank Act, as those requirements are implemented in rules proposed or to be proposed by the CFTC." In addition to the larger costs associated with a swap dealer designation, the Commission also recognizes (i) the costs associated with a market participant's need to review its activities on an on-going basis if it determines that "it should adopt its activities so as to not be encompassed by the definition;" and (ii) the costs of having a "more focused review" to determine if it is a swap dealer arising from the multiple interpretations of the general criteria in the definition by market participants. There are tremendous costs from regulatory uncertainty, not just expenditures but in lost opportunities that could have been pursued if market participants had more specificity as to the applicability of the swap dealer definition. The Commission ignores these costs.

While acknowledging the substantial overall costs to entities designated as a swap dealer under the definition as the Commission proposes to apply it to market participants, the Commission extols the general benefits "in the form of increased market transparency, reduced counterparty risk and a lower incident of systemic crises and other market failures." It includes the benefit of a "level playing field that permits all market participants to determine, on an equal basis, which activities would potentially lead to a designation as a swap dealer." Stating further: "The proposed regulations are set out in plain language terms that may be understood and applied by all market participants . . . The CFTC believes that the proposal can be fairly applied by substantially all market participants who could potentially be swap dealers." As noted earlier, numerous preliminary public comments were submitted to the Commission, concerned about the definition's vague and broad terms, advocating the need for further guidance and clarification of the terms contained in the statutory definition. While it describes the functional test inherent in the statutory definition, the Commission offered nothing to assist market participants in determining which activities are potentially "swap dealing" activities. The lack of clarity remains, contrary to the Commission's claim of plain language.

Rather, the broadness of the definition of swap dealer, and the Commission's proposed functional application of that definition to market participants, contradicts the very cost-benefit assertions made by the Commission in the NOPR. While market participants would incur the substantial costs that the Commission notes are associated with a swap dealer designation, if applied to physical market participants and participants in the electric generation and

transmission markets as the NOPR projects would be the case, regulating these participants as swap dealers would contribute little, if anything, to market transparency, reduced counterparty risk or reduced systemic risk. As discussed in Dominion's introductory remarks, end users such as energy market participants do not contribute to the swap market's systemic risk. Consequently, as Congressman Lucas said: "They should not be the targets of increased regulation.

IV. *Conclusion*

Dominion appreciates the opportunity to provide these comments to the NOPR. We respectfully request that the Commission consider these views before issuing final rules on the definition of swap dealer and the de minimis exception. The Commission's reading and proposed application of the swap dealer definition in a manner it suggests in this NOPR would open a back door to regulation of end users that were clearly intended by Congress to be the beneficiary of Dodd-Frank, and not a regulatory target. This door should be finally closed by any final rule that the Commission should issue in this proceeding. 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

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