



June 3, 2011

VIA ELECTRONIC DELIVERY

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

Re: *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Dealer,” and “Eligible Contract Participant,”* RIN 3038-AD06; *End-User Exception to Mandatory Clearing of Swaps,* RIN 3038-AD10

Dear Mr. Stawick:

I. INTRODUCTION

BG Americas & Global LNG (“BGA”) respectfully submits these comments in response to the request for public comment in the release issued by the Commodity Futures Trading Commission (the “CFTC” or “Commission”) in *Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, which was published in the *Federal Register* on May 4, 2011. The release reopens and extends the comment period of many of the CFTC’s proposed rulemakings until June 3, 2011.¹ The supplemental comments submitted by BGA in the above-referenced proceedings address concerns with the virtually identical language set forth in footnote 128 of the Proposed Definitions Rule applicable to Major Swap Participants (“MSPs”) and footnote 23 the Proposed End-User Exception Rule (collectively, the “Footnotes”).²

¹ *Reopening and Extension of Comment Periods for Rulemaking Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 25,274 (May 4, 2011); *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. 111–203, 124 Stat. 1376 (2010) (the “Act”).

² *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Dealer,” and “Eligible Contract Participant,”* Joint Proposed Rule, 75 Fed. Reg. 80,174 (Dec. 21, 2010) (hereinafter “Proposed Definitions Rule”); *End-User Exception to Mandatory Clearing of Swaps*, Notice of Proposed Rulemaking, 75 Fed. Reg. 80,747 (Dec. 23, 2010) (hereinafter “Proposed End-User Exception Rule”). The Proposed Definitions Rule and Proposed End-User Exception Rule are collectively referred to as the “Proposed Rules.”



BGA is a business unit of the BG Group plc (“BG Group”), a global natural gas company based in the United Kingdom and a major producer and supplier of natural gas in the United States. BGA is responsible for all of BG Group’s operations in North and South America, the Caribbean, the company’s global marine operations and its global liquefied natural gas (“LNG”) operations.

BG Group owns natural gas producing assets in Louisiana and Texas known as the Haynesville Shale and in Pennsylvania and West Virginia known as the Marcellus Shale. BG Group is one of the largest suppliers of LNG to the U.S. and owns import capacity rights at Southern Union Company’s Lake Charles, Louisiana (“Lake Charles”) and El Paso Corporation’s Elba Island, Georgia import terminals. BG Group also has an interest in associated liquids that are extracted from imported LNG at the Lake Charles LNG import terminal. BG Group’s subsidiary, BG Energy Merchants, LLC (“BGEM”), is a major marketer of natural gas and electricity throughout the U.S., natural gas liquids in the isolated market between Texas and Mississippi, and oil produced by BG Group in offshore Brazil to worldwide markets. BGEM regularly engages in swaps to hedge the commercial risk associated with BG Group’s production and marketing activities relating to its natural gas, liquids and oil businesses.

II. SUPPLEMENTAL COMMENTS

A. INTERPRETIVE GUIDANCE IN THE FOOTNOTES IMPROPERLY DISQUALIFIES SWAPS THAT MITIGATE RISK WITH CERTAIN PHYSICAL COMMODITY POSITIONS AS SWAPS THAT “HEDGE OR MITIGATE COMMERCIAL RISK”

New CEA Section 1a(33)(A)(i) provides that positions held for “hedging or mitigating commercial risk” are excluded for purposes of determining whether a person holds a “substantial position” in swaps and is consequently an MSP. In addition, new CEA Section 2(h)(7) provides an exception to the mandatory clearing requirement for a non-financial end-user that is using swaps to “hedge or mitigate commercial risk.” These two provisions make clear that Congress intended that certain activities involving hedging or mitigating commercial risk be treated differently from other swap activities.

Both of the Proposed Rules provide that “hedging or mitigating commercial risk” will include swaps that: (i) are economically appropriate to the reduction of risks in a commercial enterprise; (ii) qualify as bona fide hedging for purposes of an exemption from the position limit rules; or (iii) qualify for hedging treatment under the Financial Accounting Standards Board Accounting Standards. On the other hand, swap



positions held for a “speculative, investing, or trading” purpose would not qualify as swaps that “hedge or mitigate commercial risk.”³

BGA appreciates the rationale underlying the CEA and Commission’s view that swaps used to mitigate risk associated with speculative swap positions do not constitute a hedge of commercial risk. However, the inconsistency between regulatory text in the Proposed Rules and interpretive guidance set forth in the Footnotes introduces uncertainty as to the treatment of swaps entered into by a firm to hedge certain underlying physical commodity positions. Specifically, in the Proposed End-User Exception Rule, this uncertainty is created by the following language set forth in footnote 23:

The Commission preliminarily believes that swap positions that are held for the purpose of speculation or trading are, for example, those positions that are held primarily to take an outright view on the direction of the market, including positions held for short term resale, or to obtain arbitrage profits. Swap positions that hedge ***other positions that themselves are held for the purpose of speculation or trading are also speculative or trading positions.***⁴

Footnote 128 to the Proposed Definitions Rule addressing the definition of MSP contains nearly identical language.⁵ The interpretive guidance in the Footnotes appears to demonstrate a clear intention by the Commission to exclude certain swaps entered into to hedge physical market positions from the definition of “commercial risk.” Based on a literal reading of this guidance, a swap that hedges a “trading” position in a physical commodity (*i.e.*, a wholesale market transaction in the chain between producer and consumer) or a “speculative” inventory position held in anticipation of a potential increase in price would not qualify as “hedging or mitigating commercial risk”

³ Notably, while the Commission uses the terms “speculating,” “trading,” or “investing,” in the Proposals, such terms are neither defined in the Act nor the existing CEA.

⁴ Proposed End-User Exception Rule at 80,752 at n.23. In relevant part, footnote 128 to the Proposed Definitions Rule states that, “[s]wap positions that hedge other positions that themselves are held for the purposes of speculation or trading are also speculative or trading positions.”

⁵ Proposed Definitions Rule at 80,195 n. 128.



even though the owner of the underlying physical commodity has significant price risk.⁶

Under this interpretative guidance, a commercial energy firm, such as BGEM, engaged in “trading” activities would be unable (i) to deduct its exposure on swap positions used to hedge commercial risk associated with its trading positions in a physical commodity in applying the “substantial position” test to determine whether it is an MSP, and (ii) to avail itself of the end-user exception to mandatory clearing for a swap used to hedge commercial risk associated with its trading positions in a physical commodity. Moreover, BGEM and other commercial energy firms would be equally restricted in holding inventory or another position in the underlying physical commodity that was deemed to be “speculative.”

B. TREATING “TRADING” POSITIONS IN A PHYSICAL COMMODITY DIFFERENTLY FROM OTHER PHYSICAL POSITIONS WILL HARM MARKETS

Commodities in the physical marketing chain do not generally pass directly from the producer to the consumer. Rather, marketers and other intermediate physical market participants, such as “merchants” and “merchandisers,” facilitate this process by participating in the wholesale market through transactions sometimes referred to as “trading” transactions. In energy markets, for example, a marketer will buy an energy commodity with an equivalent sales transaction in a physical energy commodity already in place; other times, they will buy and hold a “speculative” or “trading” position in the same physical energy commodity until it can arrange the onward sale of that commodity.

⁶ The following example highlights this concern. Company A owns a gas-fired generation plant which it sells on a “merchant” (*i.e.*, uncommitted) basis into organized wholesale electricity markets. Company A is good at operating power plants, but is not good at managing the price risk associated with procuring gas and selling the power at market or with scheduling gas and power. Company A wants to transfer the physical logistics risk and the price risk to Company B, so Company A enters into a physical tolling arrangement with Company B, who buys the physical gas at price \$X, converts it to power and sells the physical power at market price \$Y.

Company B is managing physical commodity/logistics and price risk, without owning the asset. Thus, it is necessary to hedge the price risk exposure that has been transferred to Company B, which it will likely hedge through swap transactions. Under the interpretative guidance set forth in the Footnotes, Company B’s underlying physical commodity position could be viewed as speculative and, therefore, the swap used to hedge price risk associated with the operation of the plant may not qualify as a hedge of commercial risk.



At other times, a marketer may choose to sell their interest before securing the actual physical energy commodity. In connection with these activities, middlemen will often transport and store the particular commodity, and generally own the commodity and incur all the attendant risks and costs of owning such commodity, including, but not limited to, price risk. Notably, vertically integrated energy firms, as well as other producers, processors and end-users, often participate in the “trading market” for reasons such as: (i) optimizing their returns on their purchases or sales; (ii) reacting to variability in their production or processing or consumption needs; and (iii) capitalizing on trends in market supply and demand fundamentals. Most importantly, commercial market participants hold significant price risk with respect to these positions, and use swaps to prudently hedge or mitigate such price risk.

Congressional intent underlying the Act neither expressly nor implicitly creates a regulatory framework that treats hedges for producing, processing, merchandising or consuming disparately. At most, it is BGA’s view that Congress intended to differentiate between (i) commercial hedges involving ownership or potential ownership of the physical commodity, and (ii) financial transactions on the other. Ironically, the hedging of physical “trading” positions fall with the statutory definition of *bona fide* hedge set forth in Section 737 of the Act, but not as “hedging or mitigating commercial risk” under the Footnotes.

In light of the foregoing, BGA respectfully submits that the interpretive guidance set forth in the Footnotes is inconsistent with the Congressional intent underlying new CEA Sections 1a(33)(A)(i) and 2(h)(7)(A) and is not supported by legal or policy rationale. Any final rule implementing the definition of MSP and the End-User Exception ultimately state that the hedge of a physical market position that is a “trading” position (*i.e.*, held as a merchant or merchandiser in the commodity) or a “speculative” position would not qualify for treatment as “hedging or mitigating commercial risk” will have serious, adverse consequences to physical markets for energy and other commodities.

To the extent that the Commission retains the Footnotes in any final rule issued in the above-referenced proceedings, it should correct the language in the second sentence of each by adopting the following language:

Swap positions that hedge other swap positions that themselves are held for the purpose of speculation or trading are also speculative or trading positions. . . .



C. SWAPS THAT HEDGE ARBITRAGE POSITIONS ALSO CONSTITUTE HEDGES OF “COMMERCIAL RISK”

With respect to physical commodities, many swaps that represent “arbitrage” positions are themselves hedges and not the type of speculative trades that should be denied hedging treatment. Further, the unwinding or offsetting of such a swap should not change its characterization as “hedging or mitigating commercial risk.”

It is well recognized that energy firms often move physical products from one location to another and profit when the price differential between the two points exceeds the various costs associated with transportation or storage of the products. Such price differential exposure is a substantial commercial risk that must be prudently managed by these firms. Given appropriate market conditions, commercial firms will hedge price differential exposures by entering into a basis swap or other type of swap tied to different types of differential risks.

The swaps that are entered into may lock-in the price differentials between the two locations whether or not the entity currently has an underlying physical commitment, as the swap hedges the future profitability of a price differential transaction executed at a future date. In this regard, these transactions are often used in anticipation of future physical transactions. While such a transaction can look like financial “arbitrage” and can generate a profit or avoid loss, the Commission should not alter its characterization as a swap that “hedges or mitigates commercial risk.”



III. CONCLUSION

BGA appreciates this opportunity to comment and respectfully requests that the Commission consider the comments set forth herein as it develops any final interpretive order in this proceeding.

Respectfully submitted,

/s/ Lisa Yoho
Lisa Yoho
Director, Regulatory Affairs

Matt Schatzman
Senior Vice President, Energy Marketing

BG Americas & Global LNG

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Daniel Berkovitz, General Counsel