

June 3, 2011

Via Online Submission

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

Re: **COMMENTS OF THE COALITION OF PHYSICAL ENERGY COMPANIES** – Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act; Global Comment

Dear Mr. Stawick:

On May 4, 2011, the Commodity Futures Trading Commission ("CFTC" or "the Commission") issued a notice in the Federal Register¹ reopening and extending the comment periods of certain proposed rules issued to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").² The Commission stated that since the rulemaking process for Dodd-Frank implementation was "substantially complete," it was "reopening or extending the comment period of many of its proposed rulemakings in order to provide the public with an additional opportunity to comment on the proposed new regulatory framework for swaps, either in part or as a whole."³ The Commission specifically indicated that it was hoping to receive "additional quantitative or qualitative information relating to the costs and benefits of the proposed rules."⁴

The Coalition of Physical Energy Companies ("COPE")⁵ is pleased to provide the Commission with further comments to supplement and tie together previous comments it has

¹ Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011) ("Notice").

² Public Law No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

³ Notice at 25275.

⁴ *Id.*

⁵ The members of COPE are: Apache Corporation; El Paso Corporation; Iberdrola Renewables, Inc.; Kinder Morgan; MarkWest Energy Partners, L.P.; Noble Energy, Inc.; NRG Energy, Inc.; Shell Energy North America (US), L.P.; and SouthStar Energy Services LLC.

filed in response to various Notices of Proposed Rulemaking ("NOPRs") issued by the Commission.⁶ COPE has also filed a letter addressing the Commission's process and proposed timing for implementation of Dodd-Frank regulations.⁷

The members of COPE are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale. COPE members utilize swaps and futures to hedge the commercial risk of their physical businesses. As physical energy companies and swap end-users, COPE's principal concerns regarding Dodd-Frank implementation by the Commission relate to the direct and indirect burdens it will impose, together with the attendant costs. While COPE understands that a new regulatory scheme such as Title VII of Dodd-Frank cannot be implemented without costs, COPE also understands that the Commission is seeking information about the costs and benefits of the proposed rules in an attempt to lighten the ultimate implementation burden. As participants in the physical energy markets, COPE members play an important role in providing U.S. consumers and businesses with needed energy. They should be permitted to continue to focus their resources on that business, and should not be burdened by over-broad rules implementing a financially-focused statute. As the Commission embarks on the path of fashioning final rules, it should make limiting the burden on end-users a priority.

End-users will be directly impacted by the proposed rules, since they will be required to track extensive swap transaction data and create reports regarding positions and individual swaps purely for regulatory purposes, in addition to the much more limited set of data required by existing commercial needs today. In addition, beyond the compliance infrastructure costs, end-users will need to supplement their existing compliance staffs to make certain that all of the above-mentioned activities, as well as other Dodd-Frank implementation requirements, are satisfied by their firms on an on-going basis.

In addition to these direct costs, there will be significant indirect costs imposed by end-users' counterparties such as Swap Dealers. COPE expects the current set of proposals to significantly increase the cost of doing business for Swap Dealers in virtually every aspect of their operations. COPE also expects substantially all of those costs to be passed through in charges to end-users in future transactions.

⁶ See, e.g., Comments of COPE – Definitions Contained in Title VII of Dodd-Frank (Sept. 20, 2010); Comments of COPE – Prohibition of Market Manipulation (Jan. 3, 2011); Comments of COPE – Real-Time Public Reporting of Swap Transaction Data (Feb. 7, 2011); Comments of COPE – Swap Data Recordkeeping and Reporting Requirements (Feb. 7, 2011); Comments of COPE – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (Feb. 22, 2011); Comments of COPE – End-User Exception to Mandatory Clearing of Swaps (Feb. 22, 2011); Comments of COPE – Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties (Feb. 22, 2011); Comments of COPE – Position Limits for Derivatives (March 28, 2011); Comments of COPE – Commodity Options and Agricultural Swaps (April 4, 2011); Comments of COPE – Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants (April 11, 2011).

⁷ COPE Letter to Commission Regarding Dodd-Frank Implementation (March 14, 2011).

COPE believes that all market participants benefit from robust and liquid swaps markets. As end-users that will be hedging with non-cleared over the counter ("OTC") swaps as well as cleared swaps, COPE is concerned that the cost implications of Dodd-Frank implementation could impact the liquidity of OTC markets. Increased costs and regulatory requirements may cause some Swap Dealers to leave the market (particularly non-banks), and some hedgers may cease their hedging programs. The result of such departures from the market would be reduced liquidity and increased counterparty concentration in large banks.

Given these concerns, COPE suggests that the Commission turn to the promulgation of final rules with an eye towards limiting the cost impacts which end-users will be forced to absorb and creating an implementation process that is systematic, with clear and unambiguous regulations. Further, the Commission should permit industry-based standardization to establish commonly accepted processes for implementation wherever possible, and defer compliance until such processes are complete. Set forth below are examples of specific actions the Commission should take to reduce the short term and long term cost burdens of Dodd-Frank implementation. These examples are not intended to be exclusive, but rather, to illustrate actions the Commission should take to streamline implementation and reduce burdens.

I. The Regulations Must be Clear: The Commission should promulgate final regulations that are complete, clear and self-contained. A market participant should be able to read the regulations and understand them without the need to resort to the regulatory preamble or an interpretation by the Commission or outside experts. An example of a proposed regulation which requires specificity and clarity is the definition of "Swap Dealer."⁸ While the Commission has produced a workable analytical framework to define the term "Swap Dealer," it is not included in the regulations the Commission proposes to issue.⁹ An element of Dodd-Frank as key as the definition of Swap Dealer must be clearly and unambiguously included in the text of the regulation issued by the Commission to ensure that industry participants can clearly understand their regulatory status. Regulatory preambles, like legislative history, are not regulations and do not control.¹⁰ The Commission should abandon its "interpretive approach" and promulgate clear regulations as proposed by COPE in its comments to the NOPR containing the proposed definition of "Swap Dealer."¹¹

⁸ Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80174 (Dec. 21, 2010).

⁹ Comments of COPE – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" at p 2 (Feb. 22, 2011) ("While the preamble of the NOPR provides guidance as to the intended meaning of the regulatory text, it is, as courts have observed, not in the nature of law but rather in the nature of legislative history.").

¹⁰ *Nat'l Wildlife Fed'n v. EPA*, 286 F.3d 554, 570 (D.C. Cir. 2002) ("It is the language of the regulatory text, and not the preamble, that controls.").

¹¹ Comments of COPE – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" at pp 5, 8-9, 12.

II. The Commission Must Apply The Regulations Consistent With Their Plain Meaning

As noted in COPE's comments to the End-User Exception NOPR, the Commission has proposed a reasonable, comprehensive, and workable definition of commercial risk.¹² That definition includes risks of a commercial enterprise arising from the potential change in the value of commodities that one owns, produces, manufactures, processes, or merchandises in the ordinary course of business of the enterprise.¹³ The foregoing activities describe the value chain that exists in the physical energy marketplace. Each item individually can describe a stand-alone commercial enterprise. COPE does not believe that the Commission's proposed regulation is unclear. However, COPE is concerned that the regulation may be interpreted more narrowly by the Commission than its plain words would suggest and could thus exclude swaps that are clearly hedging the commercial risks of the ordinary business activities of a physical energy company (i.e. a swap hedging physical supply to be sold by a merchandiser to its wholesale and retail customers). As such, COPE requests that the Commission not only issue clear regulations but also apply them in a manner that tracks the plain meaning of the language used therein. Any physical energy company using a swap to hedge its commercial risk should be eligible to opt out of clearing with respect to such swap.

III. The Regulations Must Be Necessary: The Commission must step back and ensure that it is only issuing regulations that are essential to the implementation of Dodd-Frank. Those regulations must themselves contain only items that are required for such implementation. Examples of proposed regulations that should be revised or eliminated are:

- *Reporting of Physically Settling Transactions:* The proposed rules include reporting requirements for data for physically settling transactions that are not swaps.¹⁴ The Commission should not require market participants to record, report and retain data that is not "swap data." The Commission must limit its proposed data sets to swap data and remove any non-jurisdictional or unnecessary items.
- *Real-Time Reporting for End-Users:*¹⁵ When the burden imposed is considered, there is no meaningful basis upon which to subject end-users to real-time reporting requirements. The amount of transactions for which end-users would be required to undertake such reporting is expected to be inconsequential, while end-users are simply unable to make

¹² Comments of COPE – End-User Exception to Mandatory Clearing of Swaps at 2 (Feb. 22, 2011).

¹³ End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747 at 80757 (Dec. 23, 2010) (proposed § 39.6(c)(1)(i)(D)).

¹⁴ See Comments of COPE – Swap Data Recordkeeping and Reporting Requirements (Feb. 7, 2011) at p 4 (noting that certain primary economic terms proposed to be reported under Recordkeeping and Reporting NOPR relate to physically delivered products, which should be eliminated from the proposed set of reportable data).

¹⁵ Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76140 (Dec. 7, 2010).

such reports consistent with Commission timelines without incurring wasteful expense. This requirement should be eliminated.¹⁶

- *Daily Valuation Reporting for End-Users:*¹⁷ Although Dodd-Frank requires reporting of all swaps, the Commission should not require the daily submission of individual swap data by end-users including valuation information.¹⁸ While there is a statutory requirement for the reporting of a swap, there is no statutory requirement for valuation reporting or daily reporting. As such, no daily valuation or daily reporting should be required.
- *Position Limits:*¹⁹ As made clear by multiple comments filed with the Commission, position limits are not required by Dodd-Frank.²⁰ The proposed position limits rule directly affects physical energy end-users and would be highly burdensome, confusing and costly for those market participants.²¹ The Commission should not issue a final position limits rule.

IV. Direct and Indirect Costs Should be Limited as Much as Possible: In implementing Dodd-Frank, the Commission is faced with a determination of the manner in which requirements should be imposed. When making that decision, it should err on the side of minimizing cost while still ensuring a sound regulatory outcome. As noted above, this is a key issue for COPE members that use swaps as cost-effective tools to hedge commercial risk. The Commission should recognize that the burdens placed on Swap Dealers will be passed on in costs or process inefficiencies to end-users. Examples of rules imposing direct or indirect burdens on end-users are:

- *Swap Dealer/Major Swap Participants Business Conduct Standards:* The Commission has proposed pervasive business conduct standards for Swap Dealer/Major Swap

¹⁶ See Comments of COPE – Real-Time Public Reporting of Swap Transaction Data (Feb. 7, 2011) at p 5.

¹⁷ See Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76574 (Dec. 8, 2010).

¹⁸ See Comments of COPE – Swap Data Recordkeeping and Reporting Requirements at p 5 (February 7, 2011).

¹⁹ See Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011).

²⁰ See Comments of COPE – Position Limits For Derivatives at pp 2-3 (March 28, 2011); Comments of EEI/EPISA – Position Limits For Derivatives at p 6 (March 28, 2011); Comments of Futures Industry Association – Position Limits For Derivatives at p 6 (March 28, 2011); Comments of CME Group – Position Limits For Derivatives at p 7 (March 28, 2011); Comments of ISDA/SIFMA – Position Limits For Derivatives at p 4 (March 28, 2011); see also Dodd-Frank § 737(a)(4) (as codified at 7 U.S.C. § 6a(a)(2)(A)) ("[T]he Commission shall . . . establish limits on the amount of positions, *as appropriate* . . .") (emphasis added).

²¹ Comments of COPE – Position Limits For Derivatives at p 5 (March 28, 2011) (noting that the increase in complexity involved in moving from the tracking of single-exchange positions, as in place now, to tracking aggregate exchange- and OTC-traded positions, as proposed, would be "exponential").

Participants.²² These requirements effectively change the nature of the current relationship that end-users have with their counterparties to one that looks more like the relationship between a securities trader and a broker/dealer.²³ COPE members believe the current counterparty model has functioned efficiently and yielded fair treatment and competitive pricing for end-users. The results of the proposed rule will be increased costs to Swap Dealer/Major Swap Participant counterparties that will be passed on to end-users, coupled with the chilling of commerce due to limited communication from counterparties to avoid disclosure issues.²⁴ The Commission should revisit this rule to recognize the counterparty, as opposed to broker/dealer, status of Swap Dealer/Major Swap Participants.²⁵

➤ *Swap Dealer/Major Swap Participant Documentation Requirements:*

- *Individual Swap Valuation Formula:* The Commission has also proposed that every swap include an objective valuation formula that is susceptible to third party valuation replication.²⁶ As parties to such swaps, COPE does not believe that this burdensome requirement is workable or advisable.²⁷ Similar to the "documentation" requirement addressed below, such a requirement would hinder the efficient execution of trades and potentially prove fatal due to timing issues in a dynamic and constantly moving market.²⁸ This requirement should be eliminated.
- *End-User Eligibility Documentation Submission:* As proposed by the Commission, an end-user that elects to opt out of clearing must not only inform its Swap Dealer/Major Swap Participant counterparty of its decision to opt out, but must also furnish documentation that the counterparty can use to determine

²² Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 Fed. Reg. 80638 (December 22, 2010).

²³ See Comments of COPE - Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties at p 2 (February 22, 2011).

²⁴ *Id.* ("[I]n an effort to act in compliance with the proposed regulations, Dealers may be forced to rely on 'canned' risk disclosures, coupled with instructions to personnel to read from an approved script to avoid a violation.").

²⁵ *Id.* at p 3.

²⁶ Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 at 6726 (proposed § 23.504(b)(4)).

²⁷ See Comments of COPE - Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants at p 4 (April 11, 2011).

²⁸ *Id.* ("Parties enter into swaps in dynamic markets where prices are constantly changing[;] [i]t is unlikely that counterparties can 'hold a price' to negotiate swap-specific valuation formulas while the market is moving.").

that the end-user is acting in accordance with the statute.²⁹ This proposal is not only burdensome and potentially fatal to the trade due to timing issues, but also provides the counterparty with confidential and proprietary information.³⁰ The Commission should eliminate this burdensome proposal and require no more than a representation of compliance from the end-user for counterparty reliance.

- *End-User Exception Notice*: Dodd-Frank requires that end-users "notify" the Commission of the manner in which they generally meet their financial obligations associated with non-cleared swaps.³¹ Rather than permit an end-user to provide such a notification subject to an update for any changes, the Commission has proposed that the notification be made every time an end-user elects not to clear a swap.³² The Commission should replace this approach with a less burdensome one-time notification subject to update.³³

V. End User Implementation Should Await Standardization: In order to efficiently implement Dodd-Frank, an industry-wide, commonly-agreed set of processes and protocols, including significant information technology components, is required. COPE is not aware of any broadly inclusive standardization effort that is on-going at this time. The Commission should take steps to ensure that efficiencies of standardization have time to take shape among those affected by Dodd-Frank, and that COPE members will not be required to develop bespoke software or systems to comply. It would be burdensome and wasteful for end-users to be compelled to comply with Dodd-Frank (for example, the proposed reporting rules) until necessary standardization is accomplished. As such, the Commission should announce a clear process that incorporates a path to standardization and defer end-user compliance until such standardization is accomplished.

Conclusion

COPE respectfully requests that as the Commission finalizes the rules to implement Dodd-Frank, it take steps to minimize the direct and indirect impacts on physical energy end-users. The more expensive and burdensome the implementation process becomes for end-users, the more likely it is that end-users will have to scale back hedging that provides commodity price stability and predictability to their businesses, and this loss of stability and predictability will inevitably be felt by energy consumers. The Commission should make the specific changes

²⁹ Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715, 6726 (Feb. 8, 2011) (proposed § 23.505(a))

³⁰ See Comments of COPE – Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants at p 5 (April 11, 2011) "The requirement is . . . anti-competitive as it obligates end-users to share proprietary commercial information with potential competitors."

³¹ Dodd Frank § 723(a)(3) (as codified at 7 U.S.C. § 2(h)(7)(A)(iii)).

³² See End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747 at 80748 (Dec. 23, 2010).

³³ See Comments of COPE - End-User Exception to Mandatory Clearing of Swaps at p 3 (February 22, 2011).

June 3, 2011

Page 8

proposed above as well as other similar changes that would permit an efficient cost-effective implementation of Dodd-Frank.

Respectfully submitted,

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cc: COPE Members