

July 11, 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 COALITION OF PHYSICAL ENERGY COMPANIES**
Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap
Participants, RIN No. 3038-AC97

Dear Mr. Stawick:

By publication in the Federal Register on April 28, 2011, the Commodity Futures Trading Commission ("CFTC" or the "Commission") issued a Notice of Proposed Rulemaking regarding "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants" ("Margin NOPR").¹ By this letter, the Coalition of Physical Energy Companies ("COPE")² provides comments on the Margin NOPR.

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 to hedge the commercial risk of their physical businesses. COPE members have diverse business models and legal entity structures. Each COPE member has successfully negotiated the credit arrangement underlying its trading relationships with its counterparties, many of which COPE expects to be swap dealers. COPE believes the Commission should let that successful relationship continue to operate as it does today and not subject non-financial end-users, directly or indirectly, to regulatory margin requirements.

¹ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23732 (Apr. 28, 2011).

² 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.; SouthStar Energy Services LLC; and Targa Resources Partners LP.

As stated in the Margin NOPR, the Commission has determined that "[c]onsistent with Congressional intent, the [Margin NOPR] proposal would not impose margin requirements" on trading relationships between swap dealers and major swap participants and non-financial end-users such as COPE members.³ COPE believes that the Commission has properly interpreted Congressional intent and that no regulatory margin requirements should be imposed on such trading relationships.

However, the Commission has proposed two requirements affecting non-financial end-users in the Margin NOPR. These are requirements that: (1) swap trading documentation include "credit support arrangements in place consistent with proposed Section 23.504,"⁴ as well as five other specific credit support agreement components;⁵ and (2) assets may be pledged as "margin" only if their value is "reasonably ascertainable on a periodic basis in a manner agreed by the parties in the credit support arrangements."⁶

COPE believes that these requirements are unnecessary in light of the Commission's determination, and Congressional intent, that no regulatory margin requirements should be imposed on non-financial end-users. As COPE understands it, the intent of the Margin NOPR is that swap dealers/major swap participants and non-financial end-users will negotiate appropriate trading arrangements which may include a margin component if the parties agree. Given the foregoing, the proposed margin-related requirements should be eliminated or clarified to ensure that they are consistent with the Commission's determination regarding margin requirements and Congressional intent.

The Commission Should Eliminate or Clarify Its Proposal to Require Credit Support Arrangements for Non-Financial End-Users

Since the Commission has determined that it will not impose, consistent with Congressional intent, any margin requirements for non-financial end-users, it should eliminate the proposal set forth in Section 23.151 of the Margin NOPR to require credit support arrangements with mandatory elements for swap counterparties including non-financial end-users. If the proposed requirement is not eliminated, it must be clarified to ensure that the scope and substance of any credit support arrangement between a swap dealer or major swap participant and a non-financial end-user is entirely a matter for the parties to negotiate.

Proposed Section 23.151 reads as follows:⁷

§ 23.151 Documentation of credit support arrangements.

(a) Each covered swap entity shall execute with each counterparty swap trading relationship documentation regarding credit support

³ Margin NOPR at 23736.

⁴ *Id.* (proposed § 23.151(a)).

⁵ *Id.* (proposed § 23.151(b)).

⁶ *Id.*

⁷ *Id.* at 23744.

arrangements that complies with the requirements of § 23.504 of this part and this subpart E.

(b) The credit support arrangements shall specify the following:

(1) The methodology to be used to calculate initial margin for uncleared swaps entered into between the covered swap entity and the counterparty; (2) The methodology to be used to calculate variation margin for uncleared swaps entered into between the covered swap entity and the counterparty; (3) To the extent that the alternative method is used pursuant to § 23.155(c), the parties shall specify the reference contracts to be used; (4) Any thresholds below which initial margin need not be posted by the counterparty; and (5) Any thresholds below which variation margin need not be paid by the counterparty.

Proposed Section 23.504 (3) reads as follows:⁸

The swap trading relationship documentation shall include credit support arrangements, which shall contain, in accordance with applicable requirements under Commission regulations or regulations adopted by prudential regulators and without limitation, the following: (i) Initial and variation margin requirements; (ii) Types of assets that may be used as margin and asset valuation haircuts; (iii) Investment and rehypothecation terms for assets used as margin or uncleared swaps; and (iv) Custodial arrangements for margin assets, including whether margin assets are to be segregated with an independent third party, in accordance with § 23.601(e).

If the Commission's premise and Congressional intent is that no regulatory margin requirement be imposed on non-financial end-users, then required adherence to Section 23.151 for swap dealer/end-user transactions is not appropriate. It is entirely possible that a swap dealer or major swap participant and a non-financial end-user could negotiate a trading relationship that did not include one or more elements set forth in those sections, and may agree not to require margin at all. In fact, since the elements of Section 23.151, taken together, contemplate a trading relationship which includes margin, any requirement that a trading relationship between a swap dealer and a non-financial end-user include such provisions is directly contrary to the Commission's determination that no regulatory margin requirement be imposed on transactions with non-financial end-users. Simply stated, these proposed rules imply that margin is required, and then they regulate that margin.

If the Commission continues to require adherence to Section 23.151 in a final rule, it should clarify that the contents of the required credit support arrangements are a matter to be

⁸ *Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 6715 at 6726 (Feb. 8, 2011).

negotiated and agreed by the affected swap dealer or major swap participant and non-financial end-user. That is, if the parties agree to eliminate one or more of the components of Section 23.151 or 23.504 (or to include them with zero values for margin, effectively negating their substance), such an agreement would be in accordance with the Commission's regulations. Any other outcome would effectively mandate a regulatory margin regime.

COPE recommends the Commission eliminate any link to Section 23.504 for non-financial end-users and rely upon slightly modified text of the language in proposed Section 23.154. This way it will be clear that any credit support arrangement that is employed by a swap dealer or major swap participant and a non-financial end-user will be that agreed between the parties.

COPE's proposal is to (1) remove non-financial end-users from the requirements of proposed Section 23.151, and (2) slightly modify Section 23.504 as set forth below:

§ 23.151 Documentation of credit support arrangements.

(a) Each covered swap entity shall execute with each counterparty that is a swap dealer, major swap participant or financial entity swap trading relationship documentation regarding credit support arrangements that complies with the requirements of § 23.504 of this part and this subpart E.

§ 23.154 Margin treatment for uncleared swaps between covered swap entities and non-financial entities.

(a) *Initial margin.* (1) On or before the date of execution of an uncleared swap between a covered swap entity and a non-financial entity, the covered swap entity shall require such non-financial entity to post any initial margin that may be required pursuant to ~~the~~ any credit support arrangement between them.

The Commission Should Eliminate or Clarify Its Proposal To Limit the Scope of Assets That May Be Pledged By Non-Financial End-Users

In the Margin NOPR, the Commission has proposed to limit the scope of assets that non-financial end-users may post to those "for which the value is reasonably ascertainable on a periodic basis."⁹ For example, with respect to initial margin the Commission has proposed:

Each covered swap entity shall accept as initial margin from nonfinancial entities only assets for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the credit support arrangements.¹⁰

⁹ Margin NOPR at 23747 (proposed §§ 23.157(a)(3), (b)(3)).

¹⁰ *Id.* (proposed § 23.157(a)(3)).

Consistent with its comments regarding credit support arrangements above, COPE believes that the Commission should permit a swap dealer or major swap participant and a non-financial end-user to agree upon a pledge of any assets that the parties find acceptable for credit support purposes. The Commission should not interfere with the parties' agreement that a particular asset can be used to collateralize a trading relationship based on the Commission's view of whether the asset has a value that is ascertainable on a periodic basis. Since the Commission appears to agree that the agreement between the parties should govern the manner in which assets can be pledged by a non-financial end-user to a swap dealer or major swap participant,¹¹ the Commission should permit the parties to agree to responsibly incorporate pledged assets as credit support for a trading relationship without *a priori* limitations.

However, if the Commission continues to believe that a non-financial end-user's pledge of assets for collateral must involve only assets for which the value is reasonably ascertainable on a periodic basis, COPE requests that the Commission make clear that the determination of whether an asset is eligible and how it will be periodically valued will be made by the parties. Any such agreement by the parties would be in compliance with the regulations, and the Commission should make clear that it will not invalidate any such agreements.

Conclusion

COPE believes that the Commission has correctly interpreted Congressional intent and determined that no regulatory margin should be imposed on trading relationships between a swap dealer or major swap participant and a non-financial end-user. COPE respectfully requests that the Commission modify the proposed regulations in the Margin NOPR to truly effectuate this determination and permit the parties to responsibly negotiate appropriate trading arrangements which may or may not include margin.

Respectfully submitted,

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cc: COPE Members

¹¹ *Id.* ("[I]n a manner agreed to by the parties . . .").