

June 26, 2012

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

VIA ELECTRONIC MAIL

Re: *Commodity Options Interim Final Rule*, RIN Number 3038-AD62

Dear Secretary Stawick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the “Working Group”), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the Commodity Futures Trading Commission’s (the “Commission” or “CFTC”) request for comment concerning the Commission’s Interim Final Rule on *Commodity Options* (the “Interim Rule”) published in the Federal Register on April 27, 2012.¹

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers and utilities. The Working Group considers and responds to requests for public comment regarding legislative and regulatory developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

II. WORKING GROUP COMMENTS ON INTERIM RULE.

A. The Trade Option Exemption Should Not Be Considered Until the Definition of “Swap” Is Finalized.

In the adopting release to the Interim Rule, the Commission states that the “commodity options” referenced therein “apply solely to commodity options not excluded from the swap definition set forth in CEA section 1a(47)(A), 7 U.S.C. 1a(47)(A)” and “[i]f a commodity option or a transaction with optionality is excluded from the scope of the swap definition, as further defined by the Commission and the SEC, the final rule and/or interim final rule adopted herein

¹ *Commodity Options*, Final Rule and Interim Final Rule, 77 Fed. Reg. 25,320 (Apr. 27, 2012) (the “Interim Rule”).

are not applicable.”² As such, the parameters of the Interim Rule’s trade option exemption cannot be fully examined and understood until the Commission adopts the final rule further defining “swap.” Therefore, the Working Group respectfully requests that the CFTC extend the comment period for the Interim Rule until the swap definition is finalized and interested parties have a sufficient amount of time to analyze the rule and its impact on the parameters of the trade option exemption. In the alternative, the CFTC may also consider reopening the comment period after the final rule further defining “swap” is promulgated, so that interested parties have an additional opportunity to comment.

B. Trade Option Exemption; Generally.

In the Working Group’s initial comment letter to the CFTC regarding the Commodity Options Notice of Proposed Rulemaking (the “NOPR”)³, it requested that, among other things, the Commission adopt the following trade option exemption:

“§ 32.4 Commodity option transactions; general authorization.

“(a) Subject to the provisions of this part, any person or group of persons may offer to enter into, enter into, confirm the execution of, maintain a position in, or otherwise conduct activity related to any transaction in interstate commerce that is a commodity option transaction, subject to all provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap.

“(b) Except for the provisions of §§ 32.8 and 32.9, which shall in any event apply to all commodity option transactions, the provision of this part shall not apply to a commodity option transaction with a person, or group of persons that is a producer, processor, or commercial user of, or a merchant handling the commodity which is the subject of the commodity option transaction, or the products or by-products thereof, and that such producer, processor, commercial user or merchant enters into the commodity option transaction solely for the purposes related to its business as such.

“(c) The Commission may, by order, upon written request or upon its own motion, exempt any other person, either unconditionally or on a temporary or other conditional basis, from any provisions of this part, if it finds, in its discretion, that it would not be contrary to the public interest to grant such exemption.”⁴

² *Interim Rule* at 25,321, n.6.

³ *See Commodity Options and Agricultural Swaps*, Notice of Proposed Rulemaking, 76 Fed. Reg. 6,095 (Feb. 3, 2011).

⁴ Letter from the Working Group of Commercial Energy Firms, to David A. Stawick, Secretary, Commodity Futures Trading Commission re: Commodity Options NOPR (April 4, 2011). The Working Group would like to note that these comments were filed as the Working Group of Commercial Energy Firms (“WGCEF”). The

The Working Group appreciates the extent to which the CFTC considered this suggested language and incorporated it into the Interim Final Rule. The Working Group continues to have concerns, however, with the scope of the restrictions placed on parties wishing to avail themselves of the trade option exemption.

For example, the CFTC has unnecessarily proposed different categories of entities that are eligible as offerors or offerees under the trade option exemption. Under the Interim Final Rule, an offeree must be a “producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity transaction,” while the offeror must either be one of these enumerated entities or an eligible contract participant. In structuring the exemption as such, the Commission is creating a reprieve for certain market participants, particularly financial institutions, to offer commodity options to end-users, but subjecting the converse transaction, in which an end-user offers the commodity option to a financial institution, to more onerous regulations. The Working Group sees no logic for this disparate treatment of market participants, and again urges the Commission to adopt a symmetrical approach, in which only one of the parties in an exempt commodity option transaction must be a producer, processor, commercial user or merchant of the commodity in question.

C. All Exempt Trade Options Should Be Excluded From Part 45 Reporting Requirements, Regardless of the Regulatory Status of the Transacting Parties.

In the Interim Rule, trade options are subject to part 45 reporting requirements⁵ if at least one counterparty has:

“(1) [b]ecome obligated to comply with the reporting requirements of part 45, (2) as a reporting party, (3) during the twelve month period preceding the date on which the trade option is entered into, (4) in connection with any non-trade option swap trading activity...”

The Commission then creates a less onerous reporting regime for trade options in which neither counterparty was obligated to comply with part 45 reporting requirements as a reporting party in the previous 12 months.⁶ This disparity in reporting regimes is unwarranted. Part 45 reporting requirements should not be obligatory for any exempt trade option transactions. The Working Group supports the Commission’s efforts to bring transparency to financial markets, and therefore believes that the less-burdensome, annual filing requirements of Form TO are both necessary and sufficient to capture the needed information regarding trade options and transacting parties. We urge the Commission to remove the part 45 reporting requirements entirely from the trade option exemption, and to adopt Form TO for use by any counterparty to any exempt trade option transaction.

Commercial Energy Working Group is a reconstituted collaboration by substantially all of the members of the WGCEF.

⁵ “Part 45 reporting requirements” refers to the procedures created by the Commission in its final swap data recordkeeping and reporting rules. See *Swap Data Recordkeeping and Reporting Requirements*, 77 Fed. Reg. 2,136 (Jan. 13, 2012) (the “Recordkeeping and Reporting Rule”).

⁶ *Interim Rule* at 25,338.

In the alternative, if the CFTC concludes that Form TO reporting is not appropriate for all trade option transactions, the Working Group requests that, at a minimum, the Commission exclude all unregistered entities from part 45 reporting requirements of the trade option exemption. Over the course of 12 months, many unregistered entities will be reporting parties at least once in swap transactions with other unregistered entities, but overall will engage in substantially more trade options than swaps for which they are reporting parties⁷ (particularly in the energy markets).

The adopting release to the Interim Rule clearly states that it is the Commission's intent to ensure that "no market participant is compelled to comply with part 45's reporting requirements based solely on its trade options activity."⁸ However, subjecting unregistered entities to part 45 would effectively have just such impact, contrary to the Commission's stated intent. Therefore, at a minimum and as an alternative to Form TO reporting for all trade options, the Working Group respectfully requests that unregistered counterparties be exempt from part 45 reporting requirements in the trade option exemption.

Additionally, for trade option transactions that are eligible for the annual filing requirement, the CFTC would require *both* counterparties to submit this filing. The Working Group finds this obligation to be redundant and unessential for the stated purposes of the filing. Rather than requiring both counterparties to file Form TO, the Working Group respectfully requests that the Commission include a provision in its final rulemaking that governs how the transacting parties will determine which one will make the annual filing. Specifically, the Commission should create an analogous provision to the report requirements set forth in CFTC Rule 45.8(d), under which the counterparties must contractually agree prior to the transaction which counterparty shall be the reporting counterparty.⁹

D. Exempt Trade Options Should Not Be Subject to Part 151 Position Limits.

Under the Interim Rule, an exempt trade option will be subject to part 151 position limits¹⁰ "to the extent a trade option position would otherwise be subject to the position limit rules."¹¹ In other words, position limits will only apply to those trade options that are based on speculative positions in the referenced contracts listed in part 151. As was noted by the Commission, trade options are "commonly used as hedging instruments or in connection with some commercial function, [and will] normally qualify as hedges, exempt from the speculative position limit rules."¹² Because nearly all trade options will be exempt from part 151 position limits, transacting parties calculating their position limits would be including and then excluding

⁷ In many instances, unregistered entities will only be reporting parties when transacting in inter-affiliate swaps.

⁸ *Interim Rule* at 25,327 n.47.

⁹ *See Recordkeeping and Reporting Rule* at 2,207.

¹⁰ "Part 151 position limits" refers to the conditions imposed by the CFTC on swaps that are economically equivalent to futures and options contracts traded on designated contract markets in exempt and agricultural commodities. *See Position Limits for Futures and Swaps*, 76 Fed. Reg. 71,626 at 71,685 (Nov. 18, 2011).

¹¹ *Interim Rule* at 25,328.

¹² *Id.* at 25,328 n.50.

trade options from their computations under the trade option exemption as written. As such, the Working Group respectfully requests that the position limits condition be stricken entirely from the trade option exemption. In light of the redundant nature of this exercise, the benefits of engaging in these calculations are unequivocally outweighed by the costs.

E. The Commission Should Give Examples of Exempt Trade Option Transactions.

In the interest of providing certainty and clarity to the markets, the CFTC should provide guidance that highlights certain transactions that are within the bounds of the trade option exemption. For instance, it is unclear whether tolling agreements¹³ between eligible offerors and offerees (as defined in the Interim Final Rule) will be treated as exempt trade options. The Working Group believes these transactions should be treated as forward contracts, not subject to regulation as commodity options. In the alternative, if the Commission believes that the embedded optionality element of some tolling agreements would give rise to their classification as options, the Working Group respectfully requests that the CFTC clarify that they will fall under the trade option exemption.

III. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the swap markets in the United States. The Working Group appreciates this opportunity to submit these comments and looks forward to working with the Commodity Futures Trading Commission to define and clarify the scope of the trade option exemption as part of the formal rulemaking process implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Respectfully submitted,

/s/ R. Michael Sweeney, Jr.

R. Michael Sweeney, Jr.

Alexander S. Holtan

Cheryl I. Aaron

*Counsel for The Commercial Energy
Working Group*

¹³ Here, the Working Group defines “tolling agreements” as temporary lease agreements, in which an owner of an asset and an agent entity contract for the agent to claim ownership and management of the output of the asset (including hedging against the price of the commodity), while the owner focuses on maintenance and development of the asset. As an example, one entity may supply fuel to a power plant, which then converts the fuel to electricity, and the supplier would then market the electricity to customers. The tolling agreement acts both as a lease of the power plant for the supplier, and as a forward contract in which the supplier agrees to purchase the output of the power plant at an agreed-upon price at a set date in the future. The option element of the tolling agreement would exist to the extent that the supplier has a right to plant output at its discretion, subject to specified exercise rules.