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June 29, 2012

SUBMITTED ELECTRONICALLY

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

Re: Comments on Proposed Rules Regarding Aggregation of Position Limits for Futures and Swaps (RIN 3038-AD82)

Dear Mr. Stawick:

The American Petroleum Institute ("API") respectfully submits these comments in response to the notice of proposed rulemaking issued by the Commission concerning the aggregation of position limits for futures and swaps. *See* Notice of Proposed Rulemaking, *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31,767 (May 30, 2012) (the "Proposed Rules").

API is a national trade association representing more than 500 oil and natural gas companies. API's members transact in physical and financial, exchange-traded, and over-the-counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy to wholesale and retail consumers. API members enter into futures, options, and swaps to hedge price risk and facilitate physical transactions. API members range from the largest major oil company to the smallest of independents. They are producers, refiners, suppliers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry. Because API members rely on the integrity of the markets under the Commission's jurisdiction, we appreciate the opportunity to comment on the Proposed Rules.

I. Introduction and Executive Summary

API supports the Commission's attempt to modify the regulations implementing federal position limits for derivatives. API believes that the Commission's decision to apply the information sharing exemption to situations in which the sharing of information would create a "reasonable risk" of violating federal law eliminates unnecessary risk and uncertainty. API also appreciates the Commission's acknowledgement that aggregation is not always appropriate even

when ownership is greater than 10 percent. Nevertheless, certain aspects of the Proposed Rules are overly broad and, therefore, likely to have the unintended effects of deterring legitimate business activity and imposing undue regulatory burden. Specifically, API urges the Commission to consider the following modifications to the Proposed Rules:

1. The Commission should extend disaggregation relief to entities with a greater than 50 percent interest if those entities can demonstrate a lack of control according to the prescribed criteria in Part 151.7(b)(1)(i). In the alternative, the Commission should condition disaggregation relief to entities with a greater than 50 percent interest on Commission approval.

2. The Commission should clarify the required showings for disaggregation when they extend beyond what is necessary to demonstrate lack of control. Specifically, API respectfully requests the Commission to clarify that: (a) the disaggregation relief criteria in Part 151.7(b)(1)(i) does not apply to non-trading employees, (b) entities do not need to establish separately developed and independent trading systems if the entities can modify existing systems to prevent coordinated trading, (c) entities do not need to establish separate physical locations if each entity's trading personnel do not have access to the other entity's trading floor, and (d) information requested by the Commission pursuant to Part 151(h)(2) and (j)(3) are afforded confidential treatment.

3. The Commission should clarify that: (a) the information sharing exemption does not require a formal opinion of counsel, and (b) the information sharing exemption applies equally to potential violations of federal, state, local, and foreign law.

II. The Commission Should Make Minor Modifications To Its Proposed Rules On Aggregation of Positions

A. The Commission Should Reconsider Its Fifty Percent Limit For Disaggregation Relief

API supports the Commission's decision to establish a notice filing procedure to permit an entity to disaggregate the positions of a separately organized entity when the entity has a 10 percent or greater interest. If an entity with a 10 percent or greater ownership in a non-financial entity can demonstrate that the trading operations of the owned non-financial entity are independently controlled, there is no meaningful risk of coordinated trading. Nevertheless, API believes that the proposed 50 percent limit imposes significant new costs on market participants without furthering the purpose of the Commission's aggregation requirement. API therefore requests that the Commission permit disaggregation relief for entities with a greater than 50 percent ownership or equity interest in the owned entity.

The Commission has explained that "[t]he fundamental rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase

the risk of market manipulation or disruption." Notice of Proposed Rulemaking, *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71,626, 71,652 (Nov. 18, 2011). Although ownership and control have been used interchangeably as proxies for the ability of an entity to engage in market manipulation or disruption, ownership by itself is meaningless without the ability to direct or influence the management of the owned entity. As the Commission noted in its Proposed Rules, "the majority owner may have the ability and incentive to *direct, control or influence* the management of the owned entity." 77 Fed. Reg. at 31,774-775 (emphasis added); *see also id.* at 31,775 ("[A] greater than 50 percent ownership interest in multiple accounts would have the ability to hold *and* control a significantly large and potentially unduly large overall position in a particular commodity."). We agree with the Commission that control is the proper catalyst for aggregation of positions. However, in situations where the majority owner does not have the ability to direct, control, or influence the owned entity, there is no risk of coordinated trading and, therefore, no need for aggregation.

There are many situations in which the 50 percent or greater ownership of an entity does not present a risk of coordinated trading. For example, many API members enter into joint ventures to reduce costs, take advantage of economies of scale, and enable investments in new development projects. Such joint ventures often have contractual barriers to the sharing of commercially sensitive data on positions. Although one party to the joint venture might have an ownership interest greater than 50 percent, the joint venture agreement could prohibit the majority owner from controlling the joint venture's trading activities. In addition, some API members may have wholly owned subsidiaries that operate independently in geographically distinct areas. In such situations, the parent entity may not have the ability to direct, control, or otherwise influence the trading activities of each subsidiary.

None of these scenarios present a risk of coordinated trading. Nevertheless, under the Commission's Proposed Rules, the majority owner would be required to aggregate its positions solely on the basis of ownership criteria. API is concerned that the aggregation of positions, regardless of actual control, could undermine the efficiency of the commodities markets without providing the benefits intended by the Commission.

First, the Proposed Rules impose significant compliance costs on API members. Entities that cannot disaggregate their positions are required to design, test, and implement systems that coordinate trading among numerous affiliates. The technology necessary to ensure compliance with the Commission's position limits may be prohibitively expensive for firms to construct. API believes that such commercially burdensome regulatory requirements are unnecessary in the absence of actual control.

Second, the Proposed Rules could limit legitimate hedging activity. Market participants, including API members, use derivatives to reduce risks that arise from the potential change in the value of assets, liabilities, or services. API members rely on such activities to reduce risks attending the operation of their business. *See* API Comments, *Position Limits for Derivatives* (submitted Mar. 28, 2011). Requiring independently controlled and managed affiliates to aggregate their positions may result in unnecessary limits placed on legitimate hedging activities. API members are concerned that the reduction in legitimate hedging that could result from requiring the aggregation of positions across entities that lack control of another's trading could reduce market liquidity.

The Commission noted in the Proposed Rules that the 50 percent limit provides a "useful benchmark for the increased risk of direct or indirect influence over the trading of an owned entity." 77 Fed. Reg. at 31,774. But the 50 percent limit merely elevates an arbitrary benchmark over substance. As Commissioner Sommers noted in her statement appended to the Proposed Rules, "[i]n the absence of knowledge of, and control over, trading of an owned entity, is there any real difference between owning 49 percent and owning 50 percent? I don't think there is." 77 Fed. Reg. at 31,783. Because "control is a question of fact in each case," independently managed affiliates should be able to demonstrate that control is absent and that proper safeguards exist to prevent the coordination of trading activities. *Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules*, 44 Fed. Reg. 33,839, 33,843 (Jun. 13, 1979). API notes that the emphasis on control, rather than ownership, is also consistent with historical practice by designated contract markets.

Accordingly, API respectfully requests that the Commission extend disaggregation relief to entities with a greater than 50 percent interest if those entities can demonstrate a lack of control according to the prescribed criteria in Part 151.7(b)(1)(i). If the Commission nevertheless continues to believe that a 50 percent limit is warranted, API believes that the Commission should condition disaggregation relief on Commission approval. Entities with a 10 percent or greater (but less than 50 percent) ownership are entitled to disaggregation relief as soon as the application is filed. The Commission could require that entities with a 50 percent or greater ownership obtain Commission approval prior to disaggregation relief. This approach would preserve the Commission's important regulatory oversight while easing the burden on market participants that do not present a risk of coordinated trading.

B. The Commission Should Clarify Its Disaggregation Relief Criteria In Part 151.7(b)(1)(i)

API supports the Commission's decision to give disaggregation relief to firms that can demonstrate a lack of control over day-to-day trading activities between affiliated entities. At the same time, API respectfully requests that the Commission clarify certain aspects of the proposed criteria to claim relief under Part 151.7(b)(1)(i). API understands that the proposed disaggregation relief criteria are intended to reveal whether trading personnel at affiliated entities may coordinate their decisions. API's proposed clarifications are consistent with that important goal.

1. *Information Sharing Between Non-Trading Employees.* The Proposed Rules require (1) affiliated entities to demonstrate that they do not have "knowledge" of the trading decisions of each other and (2) affiliated entities to establish written procedures to preclude each other from "having knowledge of, gaining access to, or receiving data about, trades of the other." Under well-settled agency law, the actual or constructive knowledge of each employee is generally imputed to the corporation. *See* Restatement (Third) of Agency § 5.03. API requests the Commission to clarify that "knowledge" cannot be imputed from non-trading personnel who do not direct, participate, or otherwise influence the trading decisions of the entity.

Commercial energy firms, including API members, often employ non-trading personnel who have knowledge of trading activities, but do not have the ability to direct, participate, or otherwise influence trading decisions. For example, many API members have attorneys, accountants, or compliance officers who acquire knowledge of the company's trading decisions, but do not control or make specific trading decisions. Given the restricted duties of such non-trading personnel, their knowledge should not be imputed to the company for the purposes of disaggregation.

API's proposed clarification is consistent with the approach applied by other federal regulatory agencies. For example, the Federal Energy Regulatory Commission ("FERC") prohibits information sharing between particular classes of employees. *See* 18 C.F.R. § 35.39(d); *see also Standards for Conduct for Transmission Providers*, 125 FERC ¶ 61,064 at 131 (2008) (exempting legal, accounting, and risk personnel from the prohibition on the sharing of non-public "transmission function information").

2. *Separately Developed and Independent Trading Systems.* The Proposed Rules require entities with 10 percent or greater ownership or equity interests of an owned entity to trade "pursuant to separately developed and independent trading systems." This requirement could impose significant compliance costs on API members, as firms would be required to design, test, and implement new trading systems to ensure compliance. API believes that such a commercially burdensome requirement is unnecessary if the entities can modify existing systems to prevent affiliated entities from coordinating trading activities.

3. *Separate Physical Locations.* The Proposed Rules require the establishment of "separate physical locations" to "maintain the independence" of trading activities. API respectfully requests the Commission to clarify that the separate physical location requirement is limited to ensuring that each entity's trading personnel do not have access to the vicinity of the other entity's trading floor. A requirement that trading personnel occupy a separate address is unduly burdensome and inconsistent with the approach applied by other regulatory agencies. *See, e.g.*, 18 C.F.R. § 358.5(b)(ii) (FERC regulations prohibit marketing function employees from having access to transmission system control centers, but separate physical locations are not required).

4. *Public Disclosure of Information.* The Proposed Rules permit the Commission to seek additional information concerning an entity's claim for an exemption. The Proposed Rules do not say how much, if any, of this information will be publicly available through requests under the Freedom of Information Act ("FOIA") or otherwise. Given the sensitive and confidential nature of this information, API asks the Commission to clarify that it will not disclose information provided pursuant to this provision. The CEA states that "the Commission may not publish data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers," 7 U.S.C. § 12(a)(1), and the Commission's FOIA regulations permit market participants to apply for confidential treatment of certain information. *See* 17 C.F.R. § 145.9. API urges the Commission to state clearly that information provided in connection with Part 151(h)(2) and (j)(3) will not be made publicly available.

III. The Commission Should Make Minor Modifications To Its Proposed Rules On Information Sharing Restrictions

API supports the Commission's decision to modify the information sharing exemption to situations where the sharing of information could create a "reasonable risk" of a violation of law. API also appreciates the acknowledgement that the exemption should include circumstances that could cause a person to violate federal, state, or foreign law. Absent these modifications, market participants may be required to share information with another entity under circumstances that increase their potential legal risk or refrain from legitimate market activity.

Nonetheless, API respectfully urges the Commission to clarify its requirement that entities may seek an exemption from aggregation for potential violation of law only after filing an opinion of counsel. The Proposed Rules state that the requirement "allows Commission staff to review the basis for the asserted regulatory impediment to the sharing information, and is particularly helpful where the asserted impediment arises from laws and/or regulations that the Commission does not directly administer." The Proposed Rules do not state, however, that the entity claiming an exemption is required to submit a *formal* opinion of counsel -- i.e., an opinion that holds the preparing attorney liable for a third-party's reliance on the opinion. *See* Restatement (Third) of the Law Governing Lawyers § 51 cmt e; *see also id.* § 95. Formal legal opinions are generally offered in the context of corporate transactions, not to assess litigation risks.

API believes that such a formal opinion letter is unnecessary, unduly burdensome, and impractical. Formal opinion letters are difficult to obtain given the high standards that apply and the potential risks and liability to the issuing attorney. At the same time, the Commission's goals would be served by internally prepared legal opinions that fall short of a formal opinion letter. Such internally prepared legal opinions would contain a thorough analysis of the legal basis for the asserted regulatory impediment to the sharing of information, and would allow the Commission to review the legal basis for the entity's exemption.

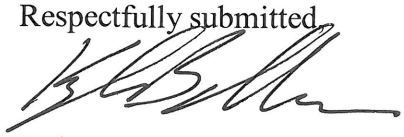
In addition to the opinion of counsel requirement, API believes that the Commission should not take a "case-by-case" approach to the exemption as applied to potential violations of state or foreign law. All 50 states now have antitrust statutes. Although there are differences in the states' statutory schemes, each state has enacted a law that is analogous to Section 1 of the Sherman Act and, with few exemptions, an analogue to Section 2 of the Sherman Act. Because the sharing of information creates a substantial legal risk at the state level, the Commission should approach the federal and state law exemptions in an identical fashion.

Finally, API requests the Commission to extend the information sharing exemption to local law. There may be limitations with regards to information sharing with municipal counterparties. Accordingly, the Commission should also accept legal opinions in support of the information sharing exemption with regards to local law.

IV. Conclusion

API appreciates the opportunity to provide these comments. We will be pleased to provide additional information regarding our views on the Proposed Rules, and would welcome the opportunity to work with the Commission. Should you have any questions, please do not hesitate to contact us.

Respectfully submitted,



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Vice President
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cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner
Honorable Mark P. Wetjen, Commissioner