Edison Electric Institute

Power by Association

June 29, 2012

Via Electronic Submission

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comments on Aggregation, Position Limits for Futures and Swaps (RIN 3038-AD82)

Dear Mr. Stawick:

The Edison Electric Institute ("**EEI**") respectfully submits these comments in response to the Commodity Futures Trading Commission's (the "**Commission**") rulemaking regarding Aggregation, Position Limits for Futures and Swaps (the "**Proposed Rule**").[1]

Under the Commission's Position Limits for Futures and Swaps Final Rule ("**Position Limits Rule**"), an entity that trades in Referenced Contracts is required to aggregate all positions and accounts in which it directly or indirectly has a 10 percent or greater ownership or equity interest, regardless of whether the affiliated entities are subject to common control (the "**Aggregation Standard**").[2] As EEI noted in its comments in support of the petition for disaggregation relief filed by the Working Group of Commercial Energy Firm's ("**Working Group**"), the current Aggregation Standard creates a significant compliance burden for many of its members because of the demanding level of coordination that it requires among all entities with a 10 percent or greater common ownership interest even when their Referenced Contract positions are separately managed and controlled.[3]

EEI appreciates the Commission's issuance of the Proposed Rule and generally supports its proposed exemptions to the Aggregation Standard and proposed changes to the aggregation provision in the Position Limits Rule. However, as discussed below, EEI respectfully requests that the Commission simplify and streamline the Proposed Rule by providing clear and objective

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1 *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31767 (May 30, 2012).

2 *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626, 71692 (Nov. 18, 2011).

3 *See* Comments in Support of the Working Group's Petition to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i), at 2 (March 1, 2012).

standards for applying the owned entity exemption and by expanding the exemption to include *all* commonly owned entities that are subject to independent management and control. In addition, EEI requests that the Commission permit entities to file a legal memorandum instead of a formal legal opinion in order to claim the information sharing prohibition exemption.

I. Summary of EEI's Comments on the Proposed Rule

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI also has more than 65 international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members. EEI's members are physical commodity market participants that rely on swaps and futures contracts primarily to hedge and mitigate their commercial risk. They are not financial entities. Regulations that make effective risk management options more costly for end-users of derivatives will likely result in higher and more volatile energy prices for residential, commercial, and industrial customers. As users of commodity swaps and futures contracts to hedge commercial risk, EEI's members have a significant interest in the Commission's proposal to amend the position limits aggregation requirements applicable to commonly held or controlled accounts.

As noted above, EEI generally supports the Proposed Rule's revisions to the Aggregation Standard and believes that they address many of the concerns raised by EEI's previous comment letters and the Working Group's petition. However, to further reduce the unnecessary burdens that aggregation will impose on companies that use derivatives to hedge or mitigate their commercial risks, EEI respectfully requests that the Commission make the following modifications to the Proposed Rule:

- Eliminate the requirement to obtain a legal opinion in support of the information sharing prohibition exemption. EEI also recommends that the Commission adopt the proposed extension of the information sharing prohibition exemption to *potential* violations of *state* law, regardless of whether a comparable federal law exists;

- Permit entities with a greater than 50 percent ownership interest in an owned entity to disaggregate their positions, provided that they demonstrate independent control and management of their trading in Referenced Contracts, as provided in the Commission's original owned non-financial entity exemption;

- Permit entities seeking disaggregation to use the same trade capture system, provided that that these entities do not use the trade capture system as a means of inappropriately sharing trade information or trade strategy; and

- Permit disaggregated entities to share mid- and back-office personnel.

II. EEI Supports the Expansion of the Information Sharing Prohibition Exemption

EEI supports the Commission's proposed expansion of the exemption for law information sharing restrictions (the "**Information Sharing Prohibition Exemption**") because it would be more practical and would recognize other legal obligations with which companies must comply. As adopted, the Position Limits Rule only permits disaggregation in situations where the "sharing of information associated with such aggregation *would* cause either person to violate Federal law or regulations adopted thereunder [] provided that such a person does not have actual knowledge of information associated with such aggregation."[4] The Proposed Rule appropriately would expand the Information Sharing Prohibition Exemption to include situations where the sharing of information "creates a *reasonable risk* that either person could violate *state* or federal law . . . or regulations provided thereunder."[5] As EEI has commented previously, expanding the exemption to encompass state law advances the underlying purpose of the Information Sharing Prohibition Exemption and the Position Limits Rule by avoiding the conflict that would necessarily result if an entity was obligated to share information under Federal law that it is simultaneously prohibited from sharing under state law.[6] The Commission should retain the "reasonable risk" language in the final rule to enable companies to manage the potential legal risk created by conflicting legal obligations.

A. The Information Sharing Prohibition Exemption Should Extend to Violations of Any Applicable State Law

The Commission asks for comment on whether it should "limit [the] application of the proposed exemption for state law information sharing restrictions to laws that have a comparable provision at the federal law."[7] EEI believes that the Commission should permit entities to claim the Information Sharing Prohibition Exemption where information sharing creates a reasonable risk of a violation of state law, regardless of whether a comparable federal law exists.

State public utility regulations prohibit many of EEI's members from sharing competitively sensitive information, such as position data, with affiliated competitors.[8] Limiting the exemption to situations where sharing information potentially violates comparable state and

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4 17 C.F.R. § 151.7(i) (emphasis added).

5 Proposed 17 C.F.R. § 151.7(i) (emphasis added).

6 *See* Comments in Support of the Working Group's Petition to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i), at 6-7 (March 1, 2012) .

7 *Proposed Rule*, 77 Fed. Reg. at 31772.

8 *See* Comments in Support of Petitions for Order to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i), at 7 (March 1, 2012). In its comment letter with the American Gas Association, EEI cited Texas Public Utility Code Rule 25.503 as an example of state law that could conflict with a company's obligations under the Position Limits Rule. Rule 25.503 prohibits a market participant from "collud[ing] with other market participants to manipulate the price or supply of power."

federal law greatly reduces the benefit of expanding the exemption to include potential state law violations. Where sharing information implicates a federal law, an entity can already rely on the current Information Sharing Prohibition Exemption – the Proposed Rule is not necessary.

If the Commission does not provide an exemption for potential state law violations that are not analogous to Federal law, many commercial energy firms could be subject to inconsistent or contradictory regulatory requirements. Accordingly, the Commission should permit an entity to disaggregate its affiliates' positions when it is able to demonstrate that information sharing required by the Position Limits Rules creates a reasonable risk of violating any state law.[9]

B. The Commission Should not Require a Formal Opinion of Counsel to Qualify for the Information Sharing Prohibition Exemption

EEI respectfully requests that the Commission allow firms to file either a formal legal opinion or a legal memorandum discussing the applicability of the Information Sharing Prohibition Exemption to fulfill the requirement to submit an "opinion of counsel". Legal opinions expose law firms to significant potential liability. As a result, formal legal opinions are time-consuming to prepare and expensive for entities to obtain. Moreover, as a practical matter, entities that operate across jurisdictions, may need to obtain multiple legal opinions to address the various information sharing restrictions implicated by the Aggregation Standard. Furthermore, a formal legal opinion contains numerous qualifications and limits that render it the wrong tool to accomplish the Commission's objective.[10]

EEI recognizes that the opinion of counsel requirement serves an important purpose by "allow[ing] Commission staff to review the legal basis for the asserted regulatory impediment to the sharing of information."[11] However, all of the benefits of a legal opinion can also be achieved by requiring the filing of a comprehensive legal memorandum explaining the legal bases for disaggregation. Accordingly, EEI respectfully requests that the Commission permit legal memorandums establishing the facts and circumstances that warrant the use of the Information Sharing Prohibition Exemption to satisfy the requirement to file an opinion of counsel.

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[9] It is important to note that one cannot simply invoke the Information Sharing Prohibition Exemption. A notice and detailed analysis providing the legal basis for the exemption must be filed, which ensures persons cannot claim the exemption by asserting an unsupportable state law violation.

[10] For example, if any of the material facts relied on in the opinion letter were to change, notwithstanding their effect on the underlying legal conclusion, the opinion letter would need to be revised and presumably a new opinion letter would need to be filed.

[11] *Proposed Rule*, 77 Fed. Reg. at 31771.

C. The Commission Should not Consider Information Sharing Prohibition Exemptions on a Case-By-Case Basis

The Commission asks several times throughout the Proposed Rule if, instead of adopting a generally applicable Information Sharing Prohibition Exemption, it should consider exemption petitions on a case-by-case basis.[12] EEI respectfully submits that the proposed Information Sharing Prohibition Exemption is more efficient and less expensive for market participants (and the Commission) than a case-by-case application process. As proposed, the Information Sharing Prohibition Exemption would create a simple exemption process that can be applied by the Commission predictably and effectively. A case-by-case approach is unnecessary and would result only in a process that is slower, more costly, and more uncertain for market participants.

III. EEI Supports Disaggregation Relief for Owned Entities

EEI supports the Commission's proposal to permit an entity to disaggregate the positions of a separately organized and independently controlled entity in which the person has a 50 percent or less ownership interest (the "**Owned Entity Exemption**"). This proposal addresses many of EEI's concerns with the current Aggregation Standard, including EEI's belief that requiring aggregation based on a 10 percent ownership interest alone, in the absence of actual control, will likely be commercially impracticable and very expensive for many commercial firms. Nevertheless, the Owned Entity Exemption could be improved by eliminating the 50 percent or less ownership limitation. All commonly owned affiliates should be permitted to disaggregate their positions in Referenced Contracts where such entities demonstrate independent management and control.[13] Accordingly, EEI respectfully requests that the Commission not limit this relief to persons with a 50 percent ownership interest or less. In addition, EEI requests that the Commission clarify some of the conditions demonstrating trading independence that must be met in order to claim the Owned Entity Exemption.

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[12] *Id.* at 31771.

[13] Specifically, in order to claim the Owned Entity Exemption, the entity seeking disaggregation and the owned entity must: (1) not have knowledge of the trading decisions of the other; (2) trade pursuant to separately developed and independent trading systems; (3) have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other. Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities; (4) not share employees that control the trading decisions of either; and (5) not have risk management systems that permit the sharing of trades or trading strategy. Proposed CFTC Rule 151.7(b)(1).

A. Disaggregation Relief for Owned Entities Should Not be Limited to Ownership Interests of 50 Percent or Less Where Entities Can Demonstrate Independent Management and Control of Referenced Contract Trading and Positions

The Commission explained in the Position Limits Rule 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."[14] As EEI has noted previously, requiring aggregation when an entity does not have *direct and actual common control* over the positions of an owned entity, regardless of its ownership interest, does not further the underlying purpose of the Position Limits Rule.[15] Where the trading operations of two entities are independently managed and controlled, there is no meaningful risk of coordinated trading, and disaggregation should be permitted.

Although the Owned Entity Exemption recognizes this fact, the Commission proposes to limit the exemption's availability to entities that have a 50 percent or less ownership interest in order to "establish[] a bright-line test that provides certainty to market participants and the Commission" and allows the Commission to avoid making case-by-case assessments of control for all situations.[16] However, EEI respectfully submits that the rationale for permitting disaggregation under the Owned Entity Exemption – namely that the person does not exercise control over the owned entity's trading strategies or positions and so poses no risk of coordinated trading – also extends to situations where a person has an ownership interest greater than 50 percent, but can similarly demonstrate independent management and control of trading in Referenced Contracts.[17] Accordingly, EEI requests that the Commission replace the 50 percent ownership limitation with an Owned Entity Exemption that, like the original owned non-financial entity exemption, is not limited by an arbitrary ownership threshold and is available to all entities able to demonstrate independent management and control of their trading activities and positions.[18]

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[14] *Position Limits Rule*, 77 Fed. Reg. at 71652.

[15] *See* Comments in Support of Petitions for Order to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i), at 4 (March 1, 2012).

[16] 77 Fed. Reg. at 31773.

[17] The Commission also suggests that ownership of 50 percent or more can properly serve as a proxy for control. *See id.* at 31775 n.76. But relying upon such an assumption means that aggregation will be imposed without actual control.

[18] *Position Limits for Derivatives*, 76 Fed. Reg. 4752, 4762 (Jan. 26, 2011).

B. The Commission Should Clarify the Meaning of "Independent Trading Systems"

Under the Proposed Rule, the Owned Entity Exemption is available only to entities that "trade pursuant to separately developed and independent trading systems".[19] Although the Commission explains that the requirement is designed to ensure that "trading is not coordinated through the development of similar trading systems," it does not define what constitutes a "separately developed and independent trading system."[20]

EEI supports the Commission's efforts to ensure that entities seeking disaggregation do not use identical strategies to coordinate their trading of Referenced Contracts. However, many of EEI's members use trade capture systems, as opposed to trading systems that direct trading, to track their positions on an enterprise-wide basis across multiple affiliates for risk management, recordkeeping and other business purposes.[21] Presumably these trade capture systems would not violate the proposed condition because *one cannot trade pursuant to them*, but EEI is concerned that the requirement is ambiguous and could possibly be read broadly to include trade capture systems as well as trading systems that direct trading.

Trade capture systems do not pose the types of risks the Commission seeks to avoid by requiring that persons seeking disaggregation "trade pursuant to separately developed and independent trading systems." For example, a shared trade capture system across an entity's corporate enterprise does not mean that the entities have adopted or employed identical, or even similar, trading strategies. Moreover, existing CFTC Rule 151.7(d) already requires all entities with "identical trading strategies" to aggregate their positions, regardless of any exemptions that might otherwise be available under Part 151. Consequently, disaggregated entities already are prohibited from using a common trading system to coordinate trading strategies. Therefore, EEI respectfully requests that the Commission clarify that entities are permitted to use the same trade capture system across affiliates, provided they have appropriate information barriers in place to prevent the sharing of trade positions.

C. The Commission Should Permit Affiliated Entities to Share Mid- and Back-Office Personnel

Proposed CFTC Rule 151.7(b)(1)(i)(D) requires that entities seeking to rely on the Owned Entity Exemption "not share employees that control the trading decisions of either."[22] The Working Group's petition asked that entities permitted to disaggregate also be permitted to

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[19] Proposed CFTC Rule 151.7(b)(1)(i)(B).

[20] *Proposed Rule*, 77 Fed. Reg. at 31774.

[21] Because these trade capture systems are often developed by the same manufacturer, they may not qualify if they are subject to proposed CFTC Rule 151.7(b)(1)(i)(B).

[22] *Id.* at 31774.

share "attorneys, accountants, risk managers, compliance and other mid- and back-office personnel."[23] The Commission requests comments on whether sharing such personnel would compromise the trading independence of these entities by providing each entity with knowledge of the other's trading decisions.[24]

Related entities seeking disaggregation that satisfy the Commission's independence criteria should be permitted to share mid- and back-office personnel. These employees do not exercise control over specific trading decisions and are not involved in day-to-day trading operations.[25] Because the sharing of mid- and back-office personnel does not undermine the trading independence of the disaggregated entities, the Commission should permit the entities to share such employees. For the same reason, the Commission should permit disaggregated entities to share the same premises, if each entities' employees are physically segregated. Furthermore, EEI urges the Commission to permit shared employees in the legal or risk management departments to have continuous knowledge of position information throughout the day as necessary for risk management or compliance purposes. Shared knowledge of position information among legal and risk management employees is critical to the entities' ability to effectively implement their respective risk management programs and does not compromise the independence of the disaggregated entities, provided that such personnel are prohibited from sharing any position information with trading personnel.

EEI notes that the Federal Energy Regulatory Commission ("**FERC**") has adopted a similar policy toward permitting shared employees under its market-based rate affiliate restrictions.[26] Pursuant to FERC's regulations, employees of a market-regulated power sales affiliate must operate separately, to the maximum extent practical, from the employees of any affiliated franchised public utility with captive customers.[27] However, FERC provides an

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[23] *Id.*

[24] *Id.*

[25] EEI notes that the Commission states in the Proposed Rule that the condition "would include a prohibition on sharing of employees described in the aggregation petition … to the extent such employees are aware of the trading decisions of the person or the owned entity." *Id.* at 31774, n.73. EEI respectfully requests that the Commission clarify that mid- and back-office employees are permitted to know overall end-of-day position information so long as they do not have real-time knowledge of trading decisions.

[26] In 2007 FERC adopted "market-based rate affiliate restrictions that govern the relationship between franchised public utilities with captive customers and their 'market-regulated' power sales affiliates, i.e., affiliates whose power sales are regulated in whole or in part on a market-based rate basis." Order on Request for Clarification, Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services By Public Utilities, 131 FERC ¶61,121, at 2 (April 15, 2010).

[27] FERC Rule 35.39(c)(2)(i) (requiring that "to the maximum extent practical, the employees of a market-regulated power sales affiliates must operate separately from the employees of any affiliated franchised public utility with captive customers"). *See also* Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities, 72 Fed. Reg. 39904, 39970 (July 20, 2007) (hereinafter *FERC Market-Based Rate Affiliate Restrictions*).

exception to this general employee-sharing prohibition and permits franchised public utilities and market-regulated power sales affiliates to share "support employees, and field and maintenance employees" provided that the shared employees do not act as a "conduit" for disclosing market information to employees, officers or directors that are not shared.[28] FERC includes legal, accounting, human resources, travel, and information technology employees among such permissibly shared employees.[29] EEI respectfully requests that the Commission adopt a consistent policy and permit disaggregated entities to share mid- and back-office personnel, provided that such employees do not have control over trading decisions and do not disclose position information of the other entity to non-shared employees.

IV. Conclusion

EEI appreciates the Commission's consideration of its comments on the Proposed Rule. For the reasons stated herein, we respectfully request that the Commission modify the current Aggregation Standard to clarify the conditions for obtaining disaggregation relief and to expand the Owned Entity Exemption to permit disaggregation where entities demonstrate the independent management and control of their Referenced Contracts trading and positions, regardless of percentage ownership.

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Please contact us at the number listed below if you have any questions regarding these comments.

Respectfully submitted,

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[28] FERC Rule 35.39(c)(2)(ii). Franchised public utilities with captive customers are also permitted to share senior officers and boards of directors with their market-regulated power sales affiliates; provided, however, that the shared officers and boards of directors must not participate in directing, organizing or executing generation or market functions.

[29] *FERC Market-Based Rate Affiliate Restrictions*, 72 Fed. Reg. at 39970.