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June 29, 2012

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

VIA ELECTRONIC MAIL

Re: *Proposed Rule on Adaptation of Regulations to Incorporate Swaps*, RIN 3038-AD53

Dear Mr. Stawick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "Working Group"), Sutherland Asbill & Brennan LLP hereby submits these comments to reemphasize those provided on August 8, 2011 by the Working Group of Commercial Energy Firms[1] in response to the "Notice of Proposed Rulemaking on Adaptation of Regulations to Incorporate Swaps" ("Proposed Rule") issued by the Commodity Futures Trading Commission ("CFTC" or the "Commission") and published in the *Federal Register* on June 7, 2011 in order to conform rulemakings created pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") to the Commission's existing regulations.[2]

Due to the length of time that has elapsed since the August 8, 2011, submission, the Working Group reiterates the main discussion points previously filed by the Working Group of Commercial Energy Firms to assist the Commission in its efforts to develop conforming amendments to its regulations that comply with the Act and avoid any unintended consequences for industry participants. Specifically, and as further discussed below, the Working Group submits that the proposed amended definition of "member" under Part 1.3(q) is overly broad and that the substantive amendment to Part 1.35 that requires recordkeeping of electronic communications will impose extraordinary costs and unfeasible compliance obligations on certain market participants with little or no comparable benefit.

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[1] *See* Letter from R. Michael Sweeney, Jr., Mark W. Menezes, and David T. McIndoe, Hunton & Williams, LLP, on behalf of the Working Group of Commercial Energy Firms (*available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48024&SearchText=).

[2] *See* Adaptation of Regulations to Incorporate Swaps, *Notice of Proposed Rulemaking*, 76 Fed. Reg. 33,066 (June 7, 2011).

II. COMMENTS OF THE WORKING GROUP.

A. THE DEFINITION OF "MEMBER" IS OVER-INCLUSIVE CAUSING NUMEROUS UNINTENDED CONSEQUENCES.

As amended by the Proposed Rule, the definition of "member" at Part 1.3(q) states in relevant part:

> An individual, association, partnership, corporation or trust — (i) Owning or holding membership in, or admitted to membership representation on, a registered entity; or (ii) Having trading privileges on a registered entity.[3]

Part 1.3(fff) defines "registered entity" to include boards of trade designated as a contract market (each, a "DCM") and swap execution facilities (each, a "SEF").

The definition of "member" creates a category of persons that includes nearly every commercial firm that trades derivatives through an electronic platform, regardless of whether they are an end-user or not. Potentially thousands of such entities trade on the Intercontinental Exchange, Inc. ("ICE") to use derivatives that reference commodities associated with their core commercial business. ICE offers direct trading privileges to market participants in contrast to other trading platforms, such as NYMEX, for which most market participants can trade only through intermediaries such as introducing brokers and futures commission merchants (each, an "FCM"). As ICE will likely become a registered entity, the logical consequence is that all market participants trading on ICE will become "members" under Part 1.3(q). Furthermore, many voice brokers will likely become SEFs. To the extent an end-user transacts through these voice brokers and as a consequence of other Commission rules, the end-user will be deemed to have trading privileges on a SEF and thus, a "member" under Part 1.3(q). Thus, an overly broad swath of end-users will constitute "members" and will become subject to many of the same regulatory burdens as floor traders and brokers, FCMs, swap dealers and major swap participants. It is difficult, if not impossible, to find Congressional intent for this outcome.

The Working Group respectfully requests that the Commission remove the reference to "having trading privileges on a registered entity" or limit the reference to having trading privileges on a DCM. Thus, parties trading directly on SEFs would not be members solely as a result of their direct trading on an electronic platform or through any other means of execution offered by SEFs. This limitation would further the Commission's stated objective of promoting trading through exchanges by eliminating the possibility of many market participants bearing unnecessary regulatory burdens.

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[3] Adaptation of Regulations to Incorporate Swaps, *Notice of Proposed Rulemaking*, 76 Fed. Reg. at 33,083.

Even before the proposed amendment to Part 1.3(q) in the Proposed Rule the definition of "member of a contract market" was arguably overly broad. Thus, the Proposed Rule worsens an existing provision that is outdated for current markets. When read together with Part 1.35 (discussed later herein), a reasonable inference of the intent of the definition is its application only to people actively trading on the floor of the exchange or people holding seats on the exchange. However, the literal reading covers people who merely acquire an equity ownership in the exchange, but with no capability of engaging in direct floor activity. For example, CME will offer memberships that afford "members" better margin treatment, yet such "members" must still submit orders through FCMs. The Working Group also respectfully requests that the Commission clarify that the definition of "member" be modified in the final rule for conforming amendments to cover only those people holding equity interests in a DCM that permit such holder to submit orders directly on the DCM's floor (or an electronic equivalent).

B. MEMBERS OF DCMS OR SEFS WITH NO CUSTOMERS SHOULD NOT BE SUBJECT TO THE PROPOSED ELECTRONIC COMMUNICATIONS RECORDING AMENDMENT TO PART 1.35.

The Working Group, if the definition of "member" is not modified as requested above, submits that the proposed amendment to Part 1.35 regarding electronic communications recording obligations[4] should not extend to members of SEFs or DCMs that do not handle customer orders. These members are "end-users" that pose minimal systemic risk to the stability of the swap markets and they do not perform any intermediary function for customers analogous to those of a floor trader, FCM or swap dealer.[5]

The cost and administrative burden imposed on end-users by the new obligation far outweigh any benefit that may arise. The Commission acknowledged as much when it approved more limited recordkeeping and reporting requirements for end-users under Parts 43 and 45.[6] The same, less-burdensome treatment should be provided under Part 1.35 to maintain consistency across rulemaking areas and to further the Commission's policy to lessen the burden

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[4] The *Proposed Rule* would require that members of SEFs and DCMs make and keep records of "all oral and written communications . . . whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device or other digital or electronic media." *Proposed Rule* at 33,091.

[5] The Working Group characterizes "end-users" as those market participants that would fall under the definition of "non-financial entity," as defined in the Commission's proposed rules on margin requirements for uncleared swaps. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, *Notice of Proposed Rulemaking*, 76 Fed. Reg. 23,744 (Apr. 28, 2011) ("'Non-financial entity' means a counterparty that is not a swap dealer, a major swap participant, or a financial entity.")

[6] *See* Real-Time Public Reporting of Swap Transaction Data, *Final Rule*, 77 Fed. Reg. 1182, 1228 (Jan. 9, 2012) (providing longer time delays for public dissemination of swaps where a non-swap dealer or non-major swap participant is the reporting party due to their limited access to technology); Swap Data Recordkeeping and Reporting Requirements, *Final Rule*, 77 Fed. Reg. 2136, 2141 (Jan. 13, 2012) (adopting narrower recordkeeping obligations for non-swap dealer and non-major swap participant counterparties to effectuate the Commission's policy to lessen the burden on these counterparties where such treatment does not adversely affect the purposes of the Act).

on end-users where such treatment coincides with the purposes of the Act. Many of these end-users will be exposed to Commission recordkeeping requirements for the first time with minimal guidance on what to record. The Proposed Rule broadly requires retention of all electronic communications "concerning" information that leads to the execution of a transaction.[7] Without further guidance on the meaning of "concerning," the proposed amendment to Part 1.35 casts a wide net for communications that end-users must record and maintain. For example, as currently proposed, the amendment would require end-users to record and maintain all unsolicited pre-trade communications received from swap dealers, voice brokers and similar entities. These communications are arguably "concerning" information that leads to the execution of a transaction, but any recordkeeping obligation should rest on the solicitor rather than the end-user. The proposed amendment's broad language, coupled with the added requirement to capture communications made on mobile devices, will make compliance extremely burdensome and costly, particularly for end-users facing CFTC regulation for the first time.

The Commission has not previously imposed direct record *creation* obligations on "members of contract markets" (now DCMs) that were not also FCMs, introducing brokers, or present on a trading floor. The *Proposed Rule* extends these obligations to end-users that do not interact with customers, which reflects a substantive change from established CFTC precedent. The Working Group respectfully requests that the Commission issue the proposed amendment to Part 1.35 separately for comment, rather than embed the substantive change in a package of "conforming" amendments. A formal rulemaking and comment period will ensure all market participants are made aware of the proposal with an opportunity to respond.

C. COSTS ASSOCIATED WITH RECORD RETENTION ARE UNDULY BURDENSOME.

The *Proposed Rule*'s record retention requirements will be time consuming and unduly expensive for end-users, if not impossible to achieve, due to the lack of IT systems with the automated capabilities necessary to achieve compliance with the proposed amendment to Part 1.35. Even if made available in time to meet the Commission's compliance deadlines, the Working Group contends that such a system would prove prohibitively costly and cause unintended consequences for end-users.

To the extent any class of market participant is subject to the proposed electronic communications recording requirement, the Working Group urges the Commission to allow market participants to make their records searchable by transaction at the time the records are requested by the Commission, rather than require that all records be maintained on a transaction-by-transaction basis in real-time. The Commission should not require end-users to comply with the proposed amendment to Part 1.35 (an unattainable feat as discussed above) or cease membership in a SEF or DCM. Forcing end-users to transact through an FCM or swap dealer will forego current benefits of membership, unduly delay and discourage otherwise appropriate business activities, and do little to promote transparency and stability in the swap markets. The

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[7] *Proposed Rule* at 33,091.

objectives of the Act would be better served by imposing different, less arduous recordkeeping and retention obligations on end-users as compared to FCMs, swap dealers, and other entities handling customer orders. This approach is consistent with the Commission's treatment of non-swap dealer and non-major swap participant counterparties under Parts 43 and 45 and supports the Commission's policy to relieve end-users from overly burdensome recordkeeping and reporting obligations where such treatment has no adverse effect on the purposes of the Act.

Finally, application of the requirements of Part 1.35 to the physical operations of a commercial company is burdensome if Part 1.35 is strictly followed. Part 1.35(a) requires that a member keep records of all "pertinent data and memoranda, of all transactions related to its business of dealing in commodity interests and cash commodities." Every day, commercial energy firms engage in thousands of wholesale and retail transactions that constitute the business of dealing in cash commodities. Part 1.35(a) suggests that commercial firms must keep records of all such transactions, which they do, but not in a manner that is aggregated with derivatives positions except in the most generalized way. Without further guidance from the Commission as to the meaning of "pertinent data and memoranda", commercial firms may adopt different concepts or interpretations of this phrase, each at risk that the Commission will disagree in the context of an audit or enforcement action with that firm's pragmatic interpretation of Part 1.35 in which the firm does not integrate all transactional recordkeeping for swaps with its wholesale and retail physical business. Moreover, there is a tremendous commercial disadvantage in the form of significant costs for firms who take conservative interpretations and save nearly all documents for their buying and selling of cash commodities. While commercial end-users currently face the possibility of a cash commodity recordkeeping requirement under Part 18,[8] this obligation is limited only to traders with reportable positions and applies only to those positions related to reportable positions, not all cash transactions occurring in the normal course of business. As proposed, Part 1.35 would unduly broaden cash commodity recordkeeping obligations. The Working Group respectfully requests that the Commission clarify that "cash commodities" is limited to aggregate cash positions.

III. CONCLUSION.

The proposed definition of "member" at Part 1.3(q) is overly inclusive and should be modified so as not to include end-user members of DCMs or SEFs. The proposed electronic communications recording requirement should not apply to members of DCMs or SEFs that are not FCMs, introducing brokers, or swap dealers. The substantial costs and administrative burden imposed on end-users by the proposed amendment cannot be justified by any benefit that may arise. End-users with no captive customer base pose minimal systemic risk and are not a class of market participants for which extensive recordkeeping obligations are necessary to further the objectives of the Act and the Commission's final rules.

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[8] 17 C.F.R. § 18.05 (2011).

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 reemphasize comments on the *Proposed Rule* previously submitted by the Working Group of Commercial Energy Firms and offers its advice and experience to assist the Commission in implementing the Act.

Respectfully submitted,

/s/ David T. McIndoe
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