

July 23, 2012

Via Electronic Filing

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

Re: Interim Final Rule - CFTC Regulation 17 C.F.R. § 1.3(ggg)(iii), RIN No. 3235-AK65

Dear Secretary Stawick:

On May 23, 2012, the Commodity Futures Trading Commission (“CFTC” or “the Commission”) and the Securities and Exchange Commission published a joint final rule on “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Security-Based Swap Participant,’ And ‘Eligible Contract Participant’” (the “Entities Rule”).¹ The Entities Rule is structured as an “Interim Final Rule” with respect to the appropriate scope of the “hedging exclusion” to be used in the analysis of swap dealing activity.² In considering this issue, the Commission is effectively seeking comment on whether the hedging activity excluded from swap dealing activity³ should be consistent with the hedging activity excluded from the analysis of whether a person is a Major Swap Participant,⁴ as well as the hedging activity that would permit an end-user to elect to not clear a swap.⁵

¹ 77 Fed. Reg. 30596 (May 23, 2012).

² See *id.* at 30611 (“Interim Final Rule Excluding Swaps Entered Into for Hedging Physical Positions”).

³ See 17 C.F.R. § 1.3(ggg)(6)(iii) (2012).

⁴ See *id.* at § 1.3 (kkk).

⁵ See *id.* at § 39.6(c).

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The Coalition of Physical Energy Companies (“COPE”)⁶ hereby provides comment on the issues posed by the Commission in the release of the Interim Final Rule. COPE members are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale. COPE members typically use swaps to hedge the risks of their commercial businesses.

As set forth below, COPE believes that the hedging exclusion from swap dealing activity in the Entities Rule should be conformed to and made fully consistent with the common definition of hedging activity used to define Major Swap Participants and the hedging activity that is excepted from mandatory clearing, as set forth in the Final Rule on the End-User Exception to the Clearing Requirement for Swaps (the “End-User Exception Rule”).⁷

COPE believes that in order for the Commission’s regulation to be effective, it must be clear, understandable, and actionable by regulated entities. One important element of achieving a regulatory regime with which regulated entities can comply is the creation of clear and non-duplicative definitions of key terms where the usage of those terms is similar. In this case, the language of the Interim Final Rule is structured such that hedging the risk of an entity’s commercial business is subject to two definitions: one found in the Entities Rule and the other found in the End-User Exception Rule. The difference between these definitions is not readily clear.⁸

As participants in the physical energy markets, COPE members believe that hedging the risk of a business is a unitary concept that should not be defined in different ways for the same business risks. The test for hedging should be whether the activity reduces commercial risk. It should not be a matter of degree or require the parsing of nuanced regulatory precedent. Simply stated, if an entity is using a given swap to hedge the risk inherent in its commercial business, it is hedging -- not swap dealing. An entity engaged in such hedging is acting to limit its risk – not to accommodate the risk management demands of others seeking hedges.

⁶ The members of the Coalition of Physical Energy Companies are: Apache Corporation; EP Energy LLC; Enterprise Products Partners, L.P.; 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.

⁷ 77 Fed. Reg. 42560 (July 19, 2012); 17 C.F.R. § 39.6(c).

⁸ Apparently, an entity can consult Commission precedent related to futures if it wants to discern the nuances between the two definitions. *See* Entities Rule at 30611-30613. COPE respectfully suggests that a single, clear definition would be superior in terms of compliance and regulatory certainty to one that requires research into CFTC history. Physical energy companies simply have not had the need to do so and such a requirement would be quite burdensome.

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The Commission has recently issued the End-User Exception Rule, which contains a concise and workable explanation of transactions that qualify as hedging and which, therefore, are eligible for the exception to mandatory swap clearing.⁹ The Commission also utilizes a reasonable definition of the commercial risk that is eligible to be hedged in transactions which merit that exception (which is also used in substantially the same form in the Entities Rule with respect to hedging activities excluded from a determination of status as a Major Swap Participant).¹⁰

Under the End-User Exception Rule, a swap is a hedge eligible for the exception to clearing if it is “economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise,” where the risks arise from certain enumerated sources.¹¹ A swap is not a qualifying hedge under the End-User Exception Rule if it is used to: (1) speculate (entered into principally and directly for profit); or (2) trade (entering and exiting swap positions for purposes that have little or no connection to hedging or mitigating commercial risks incurred in the ordinary course of business).¹² Further, the Commission has clarified that “dynamic hedging” qualifies as a hedge for purposes of the exception if the hedges are updated “periodically when pricing relationships or other market factors applicable to the hedges change.”¹³

COPE respectfully suggests that the criteria for qualifying hedges used in the End-User Exception Rule be the same as that describing the types of activities that are hedging and, therefore, not swap dealing in the Entities Rule. While COPE understands that the interim final hedging exclusion in the Entities Rule is viewed by the Commission as somehow less expansive than the hedging activity that is described in the End-User Exception Rule, COPE cannot discern a meaningful difference between the types of activities covered and, more importantly, cannot identify a swap that would qualify as a hedge under the End-User Exception Rule that would be in the nature of swap dealing activity under the Entities Rule. In effect, COPE understands the standards are viewed to be different by the Commission, but does not see how they differ in any material way.

Accordingly, COPE requests that the Commission utilize a single definition for hedging that qualifies both for the “Hedging Exclusion” in the Entities Rule and the election to opt out of clearing in the End-User Exception Rule.

⁹ *Supra* note 7 at 42570-76.

¹⁰ *Supra* note 4.

¹¹ 17 C.F.R. § 39.6(c)(1)(i).

¹² *Id.* at §39.6(c)(2)(i); 77 Fed. Reg. at 42573-74.

¹³ *Id.* at 42575, note 69.

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Answers to the Commission's Specific Questions on the Interim Final Rule

1. Commenters should address whether the exclusion in CFTC Regulation § 1.3(ggg)(6)(iii) should be consistent with the exclusion in CFTC Regulation § 1.3(kkk). If so, why, and if not, why not?

For the reasons set forth above, the exclusion in § 1.3(ggg)(6)(iii) should be consistent with both § 1.3(kkk) and with § 39.6(c) (as further explained in the End-User Exception Rule).

2. If the two exclusions should be consistent, does consistency require that the exclusions be identical, or would there be variations in application of the two exclusions?

For the reasons set forth above, the exclusion in § 1.3(ggg)(6)(iii) should be identical to both § 1.3(kkk) and § 39.6(c), without variation.

3. Are there market participants whose swap positions would be classified as held for the purpose of hedging or mitigating commercial risk under CFTC Regulation § 1.3(kkk) but would not qualify for the exclusion under CFTC Regulation § 1.3(ggg)(6)(iii)?

No. As stated above, COPE cannot discern a meaningful difference between the two definitions but understands the Commission views CFTC Regulation § 1.3(ggg)(6)(iii) as less robust. COPE cannot imagine a scenario where a market participant would have a swap position classified as hedging or mitigating commercial risk under § 1.3(kkk) that would be properly described as swap dealing activity under the Commission's interpretive guidance in the Entities Rule. However, this fact should be made explicit by conforming the regulatory language of the two sections, as market participants need regulatory certainty that is not provided by language that is not included in the regulations themselves.

4. If so, specifically identify the types of market participants and swaps. If the CFTC were to apply in the swap dealer definition the exclusion in CFTC Regulation § 1.3(kkk) in lieu of the exclusion in CFTC Regulation § 1.3(ggg)(6)(iii), would there be negative market impacts? If so, what are they? Would there be positive market impacts? If so, what are they?

As stated above, the use of a single, clear, and actionable definition would eliminate confusion and permit the exclusion of hedging transactions that should be excluded from a dealing analysis.

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5. In particular, what type(s) of swaps that “hedge or mitigate commercial risk,” but that are not excluded under the interim rule, may constitute dealing activity in light of the rules and interpretive guidance regarding the swap dealer definition set forth in this Adopting Release?

As stated above, COPE does not see a substantive difference between the two definitions but expects the Commission must have intended one to exist. The issuance of the End-User Exception Rule, which occurred after the issuance of the instant rule, has provided useful clarification which permits the definition addressed therein to effectively capture the scope of the activities that should be included in the hedging exemption. COPE does not believe that swaps that “hedge or mitigate commercial risk” constitute dealing activity under any scenario; therefore the scope of that term as used in the scope of activities excluded from the dealing analysis should be made consistent with the End-User Exception Rule.

Conclusion

COPE respectfully requests that the Commission revise the Interim Final Rule such that the hedging exemption is based upon the definitions used for hedging for Major Swap Participants and in the End-User Exception Rule. The market will be well served by a single, clear, and concise definition.

Very truly yours,

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