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February 25, 2013

Melissa Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

VIA ELECTRONIC MAIL

Re: *RIN Number 3038-AD85; Comments on the Commission's Further Proposed Guidance Regarding Compliance with Certain Swap Regulations*

Dear Ms. Jurgens:

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits these comments in response to the Further Proposed Guidance Regarding Compliance With Certain Swap Regulations (the "**Further Proposed Guidance**") by the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**").[1] The Working Group appreciates the opportunity to provide the comments set forth herein and respectfully requests the Commission's consideration of such comments.

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. Most member firms are parts of corporate families that have swap traders and supporting staff around the globe, and the application of U.S. regulations to their businesses outside of the United States will have significant consequences.[2] The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

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1 *See Further Proposed Guidance Regarding Compliance With Certain Swap Regulations,* 78 Fed. Reg. 909 (Jan. 7, 2013).

2 The observations and recommendations herein are not particular to the energy industry and likely reflect concerns of other commercial entities with global operations.

I. COMMENTS OF THE WORKING GROUP.

1. Swaps Between Two Non-U.S. Persons Should Not Be (a) Subject to Substantive Regulation by the Commission or (b) Counted for the De Minimis Exception.

The Commission has provided in the Further Proposed Guidance that a non-U.S. Person, when analyzing a portfolio of swaps for purposes of the *de minimis* exception from the definition of "swap dealer," does not include swaps that it or other of its non-U.S. Person affiliates have entered into with non-U.S. Person counterparties.[3] This aggregation policy also appears in the Commission's initial proposed extraterritorial guidance (the "**Proposed Cross-Border Guidance**")[4] and its *Final Exemptive Order Regarding Compliance with Certain Swap Regulations* (the "**Exemptive Order**").[5] The Working Group fully supports this aggregation policy as it appropriately recognizes a universe of activity that is of little to no interest for U.S. regulatory purposes. We respectfully request that the Commission affirmatively state that such swaps are outside its regulatory scope for other purposes – principally (a) any substantive regulation (*e.g.*, recordkeeping, reporting, documentation, etc.) or (b) the aggregation of swaps by a U.S. Person for purposes of the *de minimis* exception.[6]

2. The Commission Should Maintain the Policies in the Exemptive Order for the Aggregation of Swap Dealing Activity by a Non-U.S. Person and Not Adopt the Related Policies in the Further Proposed Guidance.

The Commission inquires in the Further Proposed Guidance whether it should adopt an alternative to the aggregation requirements promulgated in its Exemptive Order for non-U.S. Persons to establish whether they fall under the definition of "swap dealer." In the Exemptive Order, as noted above, the Commission set forth various policies for non-U.S. Persons to determine when to aggregate the swap dealing activities of their affiliates, including that non-U.S. Persons need not aggregate any swap dealing activities of (i) a U.S. Person affiliate under common control, (ii) a non-U.S. Person affiliate that is a registered SD, and (iii) a non-U.S. Person affiliate that engaged in swap dealing activity prior to December 21, 2012, assuming both non-U.S. Persons are under common control with a registered SD. This methodology is appropriate for aggregation by a non-U.S. Person, and the Commission should maintain these policies when it promulgates its final cross-border guidance.

In the Further Proposed Guidance, the Commission suggests an alternative policy that would require a non-U.S. Person to aggregate the swap dealing activities of both U.S. Person and

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3 *Further Proposed Guidance* at 911, footnote 22.

4 *Cross-Border Application of Certain Swaps Provision of the Commodity Exchange Act*, 77 Fed. Reg. 41,218 (proposed Jul. 12, 2012).

5 *See* 78 Fed. Reg. 858 at 868 (Jan. 7, 2013) (The effective date of the Exemptive Order was December 21, 2012).

6 Because the Commission's previous guidance deals only with the application of the Commodity Exchange Act to non-U.S. Persons, the Commission has not specifically addressed this point. We urge the Commission to explicitly state (via footnote or otherwise) that a U.S. Person that aggregates the positions of its non-U.S. Person affiliates can exclude from its *de minimis* calculations all non-U.S. Person-to-non-U.S. Person swap transactions.

non-U.S. Person affiliates (if such affiliates are under common control). The entity would *not*, however, be required to aggregate affiliates that are non-U.S. Persons but are registered with the CFTC as swap dealers.[7] Presumably, non-U.S. Persons would have to aggregate positions of U.S. Person affiliates, even those that register as swap dealers.

This overly inclusive aggregation policy will put offshore affiliates at risk of becoming subject to U.S. regulation due to the swap activities of their U.S. affiliates. At an extreme, a foreign company that executes one swap with a U.S. Person might find itself having to register as a swap dealer if the swap dealing activity of its U.S. Person affiliate results in an aggregate notional amount of swap dealing transactions in excess of the *de minimis* threshold. The Commission did not provide any policy rationale for (i) non-U.S. Persons aggregating the swap dealing activity of U.S. Person affiliates, or (ii) its jurisdiction over non-U.S. Persons with a *de minimis* amount of swap dealing activity in the U.S., simply by virtue of their affiliation with U.S. Persons that engage in a significant amount of swap dealing activity.[8]

The Commission will retain oversight of many swap dealers even without the aggregation policy in the Further Proposed Guidance. The current aggregation rules will result in U.S. Persons aggregating those positions of their non-U.S. Person affiliate for which U.S. Persons are counterparties. For example, if a non-U.S. person has a U.S. Person affiliate registered as a swap dealer, then the Commission already regulates the U.S. Person affiliate.[9] Thus, the Commission has a much lessened interest in regulating the non-U.S. Person as a swap dealer if such non-U.S. Person's swap activities fell below the *de minimis* exception level even after aggregation with other non-U.S. Person affiliates. The same result follows if the U.S. person affiliate, prior to aggregation, has swap activities that fall below the *de minimis* exception level. Aggregation of the swap dealing activities of the affiliates might cause the U.S. person to have to register as a swap dealer.

In contrast, there are policy reasons why the Commission should not adopt such an overly inclusive policy, principal among which is international comity. The United States has a clear interest when offshore actors affect U.S. commerce, but when there is no such effect, the interest of the United States in causing non-U.S. Persons to register with the Commission is lacking. Such registration requirements infringe upon the rights of other countries to regulate their own affairs, and will eventually result in overlapping, inconsistent and conflicting regulations. Rather

[7] *Further Proposed Guidance* at 911.

[8] The effect of departing from its regulatory design in which jurisdiction attaches to a non-U.S. Person's swap by virtue of the counterparty being a U.S. Person includes requiring thousands of non-U.S. Persons to account for the swap activities of their U.S. Affiliates. This result is entirely contrary to the organization of many commercial firms for which foreign affiliates are maintained to separate U.S. and non-U.S. activity. This compliance analysis is not merited when the swap dealing activities of non-U.S. Persons might be below the *de minimis* exception level absent aggregation.

[9] We note that, as proposed in the Further Proposed Guidance, the non-U.S. Person can forego aggregation of swap by a non-U.S. Person registered with the Commission as a swap dealer. The Commission, however, does not state why aggregation of positions of a registered swap dealer by a non-U.S. Person differs depending on whether the swap dealer is or is not a U.S. Person.

than adopting these aggregation policies, the Commission should maintain the requirements set forth in the Exemptive Order.

3. *The Commission Should Provide Interpretive Guidance for U.S. Persons That Is Reciprocal to the Commission's Aggregation Requirements for Non-U.S. Persons.*

The Commission has little interpretive guidance regarding the aggregation by U.S. Persons of the swap dealing activities of their non-U.S. Person affiliates.[10] The Working Group urges the Commission to harmonize the aggregation rules for both U.S. Persons and non-U.S. Persons. In a final rulemaking or interpretive guidance, the Commission should affirmatively state that U.S. Persons are not required to aggregate swap dealing transactions for their *de minimis* calculations:

- By any non-U.S. Person affiliate; and
- By any U.S. Person affiliate that has separately registered with the Commission as a swap dealer.

These parallel aggregation requirements for U.S. Persons and non-U.S. Persons by the Commission would be consistent and logical, and would create certainty for market participants. Importantly, the first prong would permit U.S. Persons and their non-U.S. Person affiliates to effectively separate their derivatives activities within certain legal entities and to act with certitude as to which jurisdiction's laws and regulations are applicable to a given entity and transaction. The second prong would allow U.S. Persons that engage in a *de minimis* amount of swap dealing activity (theoretically as little as one such transaction) to exclude the swap dealing positions of their SD affiliates, thereby obviating the need for an end-user to register as an SD based solely on the swap dealing activity of its SD affiliate.

The Working Group believes these aggregation principles lead to rational and desirable outcomes, and urges the Commission to adopt both prongs as part of its final extraterritorial interpretive guidance.

4. The Working Group Supports Removing Liability Concepts from the Definition of "U.S. Person."

In the Commission's Proposed Cross-Border Guidance it set forth a definition of "U.S. Person" that included firms domiciled outside the United States, but with owners that (i) are U.S. Persons and (ii) have assumed liability for its obligations. However, in a subsequent time-limited no-action letter[11] and the Exemptive Order, the Commission went on to promulgate a

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10 Moreover, the Commission has not advanced policies delineating when U.S. regulation might not apply to swap activities of U.S. Persons that are conducted outside of the United States.

11 *See* CFTC Letter No. 12-22, *Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of a Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant* (Oct. 12, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-22.pdf.

definition of "U.S. Person" without such concepts of upstream liability. The Working Group generally supports the definition of "U.S. Person" as it appears in the Exemptive Order with the criteria regarding (a) the jurisdiction of domicile and (b) the principal place of business.

Whether a particular entity is a U.S. Person should not depend on whether another firm has liability for the debts and obligations of such entity. As the Working Group has advocated previously before the Commission,[12] there is no relevant precedent for determining the jurisdiction of one entity based upon (a) another entity having liability for the obligations of the subject entity and (b) the jurisdiction of such other liable entity.

The assumption of liabilities between affiliates should not be considered when defining "U.S. Person," and the Working Group supports the Commission's statement in the Further Proposed Guidance that the altered definition "would not cover a legal entity organized or domiciled in a foreign jurisdiction simply because the entity's swap obligations are guaranteed by a U.S. Person."[13] Market participants have made critical business decisions with respect to international commercial operations in reliance upon the Exemptive Order and have maintained inter-affiliate guarantee structures that do not result in offshore companies being "U.S. Persons." Should the Commission reintroduce liability concepts into the definition of "U.S. Person," it would be severely disruptive to market participants, who may find offshore entities subject to regulation by the CFTC (in addition to the regulations of other jurisdictions), with little time to restructure their internal credit support arrangements and business structure to avoid this duplicative supervision. Thus, the Working Group respectfully requests that in its final guidance, the Commission reaffirm that a guarantee from a U.S. Person will not be dispositive of a foreign entity's jurisdiction.

The Further Proposed Guidance, among other things, proposes to alter the definition of "U.S. Person" that appears in the Exemptive Order to include certain companies for which the owners have unlimited liability. The Working Group entreats the Commission to make a technical change (denoted in underline, bold and italics) to alternative prong (ii)(B) such that it reads:

> (B) directly or indirectly majority-owned by one or more persons described in prong (i) or (ii)(A) and in which such person(s) bears unlimited responsibility for <u>***all of***</u> the obligations and liabilities of the legal entity (other than a limited liability company or limited liability partnership where partners have limited liability).

Although the Further Proposed Guidance suggests that this alternative prong is geared toward a specific set of entities in non-U.S. jurisdictions,[14] this limited application should not ultimately unintentionally create a precedent that corporate liability arrangements establish jurisdiction. Commercial firms have many different approaches to the inter-company

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12 *See, e.g.,* Letter from the Commercial Energy Working Group to David A. Stawick, Secretary, Commodity Futures Trading Commission, re: *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act* (Aug. 27, 2012).

13 *Further Proposed Guidance* at 912.

14 This criterion will apply to certain companies formed in the U.K. and certain Canadian provinces. *See Id*.

assumption of liability, and these structures are in place to facilitate firms' core physical business of delivering goods, services, commodities and products along the value chain. None of these liability arrangements might serve alone as the proper basis for a U.S. regulator to assert jurisdiction over a foreign business entity or its activities.

Accordingly, the Working Group recommends that the Commission reaffirm its stance that an entity domiciled or organized in a foreign jurisdiction but in receipt of a guarantee from a U.S. Person would not itself be considered a U.S. Person simply by virtue of the guarantee.

II. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the swap markets worldwide. The Working Group appreciates this opportunity to provide comments on the Further Proposed Guidance and respectfully requests that the Commission consider the comments set forth herein as it develops its final guidance regarding the definition of "U.S. Person" and the extraterritorial reach of the CFTC's swap regulations.

If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ David T. McIndoe

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