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VIA ELECTRONIC MAIL

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

Re: Notice of Proposed Rulemaking, *Aggregation of Positions*, RIN 3038-AD82

Dear Ms. Jurgens:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits these comments in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") Notice of Proposed Rulemaking, *Aggregation of Positions* (the "**Aggregation NOPR**" or "**Aggregation Rule**").[1] These comments should be considered in conjunction with the Working Group comments to the Commission's Notice of Proposed Rulemaking, *Position Limits for Derivatives* (the "**Position Limits NOPR**"),[2] as there are numerous instances where the two proposals are interdependent.[3]

The Working Group appreciates the Commission's effort in putting forth a speculative position limits aggregation proposal that is largely workable and, with a few key changes, will be

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1 *See* Notice of Proposed Rulemaking, *Aggregation of Positions*, 78 Fed. Reg. 68,946 (Nov. 15, 2013).

2 *See* Notice of Proposed Rulemaking, *Position Limits for Derivatives*, 78 Fed. Reg. 75,680 (Dec. 12, 2013).

3 For example, under the Position Limits NOPR, proposed CFTC Regulation 150.3(i) states "entities required to aggregate accounts or positions under § 150.4 shall be considered the same person for the purpose of determining whether they are eligible for a *bona fide* hedging position exemption…with respect to such aggregated account or position." Position Limits NOPR at 75,828. In addition, the interaction between (i) the inclusion of trade options in the universe of referenced contracts and (ii) the aggregation requirements in the Aggregation NOPR could prevent entities from utilizing the proposed conditional spot month limit exemption solely because they have affiliates, which are not subject to common trading-level control, that solely engage in commercial physical commodity transactions, some of which may contain embedded volumetric optionality.

reasonable for many market participants to implement. The Aggregation Rule reflects the Commission's willingness to carefully consider the input of market participants. The Aggregation Rule is an improvement on the Commission's aggregation proposal from May 2012 ("**May Aggregation Proposal**"),[4] which was the Commission's response to a petition submitted by a previous formation of much of the current Working Group.[5]

Particularly, the Working Group welcomes (i) the potential for disaggregation relief where a person has a majority ownership interest in an affiliate and (ii) the ability for entities seeking relief from aggregation where aggregation would create a "reasonable risk" of a violation of law to rely upon a memorandum of law to that effect rather than a legal opinion. With the adoption of a few recommended changes, the Aggregation NOPR will provide meaningful relief to commercial enterprises that can be acquired in an efficient manner, while still providing proper protection to participants in commodity derivatives markets.

II. COMMENTS OF THE WORKING GROUP.

A. Aggregation Relief For Majority-Owned Entities Is Critical.

The Aggregation NOPR makes an important conceptual change from the May Aggregation Proposal by recognizing that the existence of majority ownership between entities should not automatically preclude entities from enjoying relief from speculative position limits aggregation requirements. However, the Commission's proposed relief for majority-owned affiliates may not be workable for most commercial enterprises.

The Aggregation NOPR allows a person to apply to the Commission for relief from speculative position limits aggregation requirements pursuant to the Commission's exemptive authority in Section 4a(a)(7) of the Commodity Exchange Act (the "**CEA**"). Specifically, the Aggregation NOPR states that the Commission may provide relief if the following conditions are met:

i. the owned entity is not required to be, and is not, consolidated on the financial statement of the person (the "**Non-Consolidation Requirement**");

ii. the person does not control the trading of the owned entity (based on criteria necessary to receive aggregation relief for entities with 50 percent or less common ownership), with the person showing that it and the owned entity have procedures

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[4] *See* Notice of Proposed Rulemaking, *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31,767 (May 30, 2012).

[5] The petition requested amendments to the aggregation provisions contained in the Commission's Final Rule *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71,626 (Nov. 18, 2011), which was vacated by the District Court for the District of Columbia on September 28, 2012. A copy of the petition is available at: http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgap011912.pdf.

in place that are reasonably effective to prevent coordinated trading in spite of majority ownership;

iii. each representative of the person (if any) on the owned entity's board of directors attests that he or she does not control trading of the owned entity; and

iv. the person certifies that either (a) all of the owned entity's positions qualify as *bona fide* hedging transactions[6] or (b) the owned entity's positions that do not so qualify do not exceed 20 percent of any position limit currently in effect.[7]

The Commission states "that this relief would not be automatic, but rather would be available only if the Commission finds, in its discretion, that the four conditions above are met."[8] However, the Commission goes on to state that if a person "could not meet the [four] conditions in the proposed rule…the person could [still] apply to the Commission for relief from aggregation under CEA [S]ection 4a(a)(7)."[9]

Based on these two statements, it is unclear to the Working Group whether it is necessary for persons to meet the four conditions for majority-owned affiliates to be eligible for aggregation relief or whether the four conditions are factors that will weigh heavily in the Commission's consideration of whether relief is appropriate. If the latter standard is the intended approach, then the Aggregation NOPR may well provide meaningful relief for commercial energy firms. However, if market participants must meet the four conditions, then the provided relief will not be available to the vast majority of commercial energy firms, as they are required to consolidate majority-owned affiliates for accounting purposes. In short, many enterprises that have made concerted efforts to avoid trading-level control and coordination between various segments of their business will be forced to coordinate their trading solely because of unrelated accounting treatment.

The ability to avoid aggregation between majority-owned affiliates that do not coordinate or share information regarding trading in physical commodity derivatives is important to many commercial energy firms. However, the Commission argues that the burden of aggregation imposed on majority-owned entities is negligible because (i) entities have other avenues for relief, such as if aggregation would create a "reasonable risk" of a violation of law, and (ii) very few entities currently come close to relevant speculative position limits.[10] The Working Group disagrees.

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6 This is another instance where the Aggregation NOPR and the Position Limits NOPR are inextricably connected.

7 Aggregation NOPR at 68,960.

8 *Id.*

9 *Id.*

10 *Id* at 68,957.

First, while relief when aggregation would create a "reasonable risk" of a violation of law has immense value in the limited contexts in which it is applicable, the majority of energy market participants would not likely find such relief helpful since they are not subject to relevant legal or regulatory restrictions.

Second, the assertion that so few market participants come close to relevant speculative position limits is flawed. As an initial matter, the data relied upon by the Commission is incomplete. It does not include swaps data, including data on trade options, and is limited to data on trading in certain agricultural futures.[11] Even the energy-specific data relied upon in the Position Limits NOPR in an attempt to make a similar point does not include swaps data. In sum, the Commission's approach falls short because the data does not support the Commission's argument that the burden imposed by the Aggregation NOPR is negligible.

Third, the crux of the Commission's argument is that because only a small number of market participants may be impacted, the value of relief for majority-owned affiliates is limited. The argument fails to account for the magnitude of the impact on that group of market participants. The CFTC's argument also fails to account for the indirect impact the proposed aggregation requirements could have on the relevant markets. Simply put, the Commission does not have enough information to understand the full consequences of failing to provide adequate aggregation relief to majority-owned affiliates.

Fourth, the data cited by the Commission should have little bearing on the availability of aggregation relief for majority-owned entities. As noted above, that data is only a limited snapshot of the markets that will be subjected to speculative position limits under the CFTC's current proposal. The data does not:

i. account for the CFTC's desire to subject additional contracts to Federal speculative position limits;

ii. account for the fact that the Aggregation NOPR would apply to exchange-level speculative position limits regardless of whether there are Federal limits in place for a particular contract; or

iii. anticipate future market conditions, under which a large portion of the market might need the requested relief. In short, the Commission should evaluate the availability of relief for majority-owned affiliates based on its appropriateness and its merits and not refuse to consider the possibility of such relief because the Commission believes the relief is only of value to a small number of market participants.

Fifth, and more importantly, the issue facing many commercial market participants is not whether they will exceed limits if they are required to aggregate the positions of certain affiliates, it is that they will have to build compliance systems and programs to (i) capture the information

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[11] *Id.*

necessary to determine whether they are at risk of violating speculative position limits and (ii) avoid violating such limits on an intra-day basis. The universe of market participants that could be at risk of violating limits is likely significantly larger than those that actually exceed limits on a regular basis, and the obligation to aggregate where there is currently no information sharing and coordination makes that undertaking infinitely more difficult and costly. The CFTC should not ask commercial firms to build expensive systems to merge aggregated positions when it is the very cost of such systems they seek to avoid in a structure of independent control and lack of information sharing.

B. Aggregation Relief For Majority-Owned Entities Should be Available on a Facts and Circumstances Basis.

To provide actual relief for commercial energy firms that engage in uncoordinated trading in swaps and futures through multiple majority-owned entities, the Commission could consider providing relief in two steps. When considering whether relief is appropriate, the Commission should focus its attention on whether the entities at issue are subject to common trading-level control or coordination or share information to the degree that trading coordination is possible.

First, if an entity is able to meet the stringent four conditions noted above, the Commission could provide aggregation relief based on a notice filing. The one advantage of the criteria proposed by the Commission is that they are largely binary in nature in that an applicant either meets the standards or does not (*e.g.*, the entities at issue are or are not consolidated for accounting purposes or relevant board members can or cannot make the necessary attestations).

Second, in the likely event that a commercial market participant is unable to meet the four conditions for aggregation relief for majority-owned affiliates discussed above, the Commission should allow that entity to apply for aggregation relief. That filing should serve to provide temporary aggregation relief to the applicants pending a review of that filing by the Commission. To the extent the Commission does not approve a request for relief, the requesting entities should be required to come into compliance with applicable aggregation requirements within three months of receiving notice from the Commission that their request for relief was denied.

The Commission, in conducting its review of a request for relief, should focus on (i) whether there is trading coordination or shared trading control and (ii) whether there are adequate protections in place to prevent such coordination and control. It should not rely on rigid criteria that, such as the Non-Consolidation Requirement, are imperfect proxies for the presence of potential information sharing and common trading-level control.

The core of the Commission's analysis should focus on the factors required for aggregation relief for affiliated entities that have 50 percent or less common ownership. These factors all go towards the issue of whether trading-level control, coordination, or information sharing exists. The Commission could also look to the factors listed below when making a

determination of whether relief is warranted. The absence or presence of any one of these factors should not be determinative on its own. Each of these conditions reduces the likelihood of common trading-level control, trading coordination, and sharing of trading-related information.

- Lack of common guarantor(s) and/or provision of independent credit support.
- Maintenance of separate identifiable assets.
- Maintenance of separate lines of business (*i.e.*, the business of one entity is not dependent upon the other.
- Any other structural, legal, or regulatory barriers limiting control and inter-dependencies among affiliated entities.

The Commission's analysis should focus on factors that go to whether trading-level control, coordination, or information sharing is present. The Non-Consolidation Requirement is not one such factor. Consolidation for financial reporting purposes is largely predicated on the existence of unilateral control by a parent entity through majority voting interests[12] and does not factor in whether trading-level control, coordination, or information sharing exists. As such, the Working Group believes that the presence or absence of financial reporting consolidation should not factor into the consideration of whether majority-owned affiliates are eligible for aggregation relief.

The Commission should also not focus on the character of the trading engaged in by the entities requesting relief. Requiring that all of the owned entity's positions (i) qualify as *bona fide* hedging transactions or (ii) do not exceed 20 percent of a position limit does not address the question of whether coordination or control exists. If the Commission is worried that the incentive to circumvent compliance barriers is heightened when the entities that are party to an application for relief hold speculative positions, then it should focus on whether the appropriate compliance barriers to coordination of trading activities are present when considering granting relief. It should not treat the mere presence of such positions as an absolute bar to relief.

C. Entities Should be Permitted to Rely Upon the Aggregation Relief Filings of Affiliates Regardless of Location in the Organization Structure.

Proposed CFTC Regulation 150.4(b)(9) permits higher-tier entities to rely upon requests for aggregation relief filed by owned entities. This approach is practical and would limit the regulatory burden associated with multiple requests for relief on both market participants and the Commission. However, because proposed CFTC Regulations 150.4(b)(2) and (3) do not contemplate indirect ownership, it is unclear whether a lower-tier entity can rely on the filing of a higher-tier entity other than its direct owner. A greater reduction in the regulatory burden

[12] Counterparty Risk Management Policy Group, Containing Systemic Risk: The Road to Reform 41-44, *available at* http://www.crmpolicygroup.org/docs/CRMPG-III-Sec-II.pdf.

associated with aggregation relief filings could be realized if, in addition to the reliance contemplated in 150.4(b)(9), owned entities were permitted to rely upon filings made by higher-tier entities under the same conditions required in 150.4(b)(9).

Conceptually, there is little difference in the value, nature, and effect of the filings made with the Commission under either scenario. Many commercial energy firms have ultimate and intermediate holding companies that own large numbers of independently run operating companies. If those holding companies were permitted to file requests for relief, whether such requests were for majority or minority-owned entities, upon which the owned entities could rely, the number of requests submitted to the Commission would likely reduce significantly, saving valuable resources for both the Commission and market participants.

D. The Commission Should Exclude Pension Plans from the Aggregation Requirement Outright.

The Commission's attempt to address the treatment of pension plans under the Aggregation NOPR is an improvement from the May Aggregation Proposal. However, if the proposed exemption utilizing the Independent Account Controller ("**IAC**") exemption were to be included in the final rule, many plans would be unable to utilize the exemption and both retirement plan and plan sponsor investments would be disrupted. By providing an exemption for pension plans within the IAC exemption, the Aggregation NOPR creates an unnecessarily complicated and potentially unavailable route to relief to entities that are, by law, required to operate only in the best interests of plan beneficiaries and are thus legally incapable of being used to further the interests of the pension plan's sponsor. As such, the Working Group requests that the Commission provide an explicit aggregation exemption for retirement plans.

The proposed IAC aggregation exemption may be unavailable to pension plans for two main reasons. *First*, the exemption does not extend relief to several common plan structures, such as those structured under a master trust, or foreign retirement plans which are not governed by the Employee Retirement Income Security Act of 1974 ("**ERISA**").[13]

Second, a common structure for U.S. pension plans is to have employees of the sponsor serve as members of the investment committee of the plan, which is a separate legal entity from and is unaffiliated with the sponsor. This is done for a variety of reasons, including to minimize

[13] If the Commission chooses to adopt the exemption for pension plans contained herein, it would be appropriate to extend the availability of the relief to plans that are structured under a master trust, as well as to foreign plans. The availability of the proposed IAC exemption for pension plans is contingent on the sponsor being excluded from registration as a commodity pool operator under CFTC Regulation 4.5(a)(4). However, plans that are structured under a master trust and foreign plans are not specifically listed under CFTC Regulation 4.5(a)(4) (which defines exclusions from the definition of "commodity pool operator"), which has led to CFTC staff issuing no-action letters granting such plans the same treatment as those otherwise listed in the section. If the Commission provides relief for retirement plans, it should extend this relief to both those identified in Rule 4.5 as well as these other types of commonly excluded plans.

costs and to ensure that plan assets are appropriately invested. These employees typically have an investment background and may serve in trading-related roles for the plan sponsor. As such, these employees may have knowledge of both the plan and the sponsor's trading activity. This knowledge may prevent the plan and the sponsor from utilizing the proposed aggregation exemption for pension plans.[14]

In the absence of a specific exemption for pension plans that does not rely on the IAC exemption, certain plans and their sponsor will have to aggregate their commodity positions. This will put the fiduciaries of these plans in the untenable position of having to account for the trading strategies of the sponsor, which may not be in the best interests of plan participants. Making a trade based on anything other than the best interests of the plan is inconsistent with the investment committee members' fiduciary duties. Specifically, under ERISA Section 406(b), fiduciaries shall not represent a party "whose interests are adverse to the interest of the plan…." When both the plan sponsor and the plan are aggregated and subject to the same limits, it is possible that at some point either the plan or the plan sponsor would have to reduce exposure in order to stay within the limits. This result is unsatisfactory under ERISA.[15] In short, requiring a plan sponsor and the plan to aggregate positions establishes a conflict of interest which did not previously exist.

Creating an exemption from the aggregation requirement specifically for pension plans will not interfere with the goal of the Commission's speculative position limits – preventing excessive speculation. By exempting a pension plan from aggregation with the plan sponsor, the Commission would simply be acknowledging that such plans are separate and distinct entities and are required by law to operate in the interests of the plan without regard to the interests of the sponsor. The plan and sponsor would, of course, still be subject to speculative position limits, but such limits would be applicable to the positions of the plan or sponsor and not those of the other entity, over which it exercises no control.

E. Reliance on U.S. GAAP Is Not Appropriate.

To the extent that the Commission wishes to retain the Non-Consolidation Requirement in some form, the Working Group respectfully requests that the Commission not rely solely on the U.S. Generally Accepted Accounting Principles ("**GAAP**") non-consolidation standard. There are many U.S. market participants that are the subsidiaries of non-U.S. parents. Many of these companies are required to use International Financial Reporting Standards ("**IFRS**") rather than U.S. GAAP. To the extent the Commission adopts a form of Non-Consolidation

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[14] *See* CFTC Regulation 150.1(e)(3). In order to qualify as an IAC, a person must trade independently of the eligible entity, which in this case would be the plan sponsor.

[15] The Working Group notes that the aggregation exemption where information sharing would raise a reasonable risk of the violation of law in proposed CFTC Regulation 150.4(b)(8) would also be unavailable in this circumstance, as the sharing of information between the plan and the sponsor would not violate the law. The trading to avoid exceeding speculative position limits in the aggregate, however, would raise a reasonable risk of violating Section 406 of ERISA.

Requirement, the Working Group suggests that the Commission allows entities that meet that requirement under U.S. GAAP as well as other generally accepted accounting principles to satisfy that requirement.

F. Reponses to Other Commission Requests For Comment.

The Commission requests comment on whether the Commission should require aggregation of only a pro-rata allocation of an owned entity's positions based on a percentage of ownership interest.[16] Such an approach would reflect ultimate economics of the relationship and would be fairly easy to implement as the underlying math is not complex. However, entities should not have to provide notice to the Commission on the applicable allocations, but should have to produce documents describing such allocations upon request from the Commission. However, adopting this approach would do little to alleviate market participants' compliance burden as they still would be required to establish and maintain the systems and process necessary to aggregate and monitor compliance with speculative position limits.

The Commission also requests comments as to what other rules the Commission should take into account when considering the Aggregation NOPR.[17] The Working Group respectfully requests that the Commission consider all other rules that require information sharing or aggregation, such as the rules providing the definitions of "swap dealer" and "major swap participant."[18] Specifically, the Working Group would like the Commission to confirm that information shared in connection with complying with those rules would not cause market participants to lose the ability to enjoy the relief provided in the Aggregation NOPR.

Finally, the development of the compliance systems and process necessary to comply with the Aggregation Rule, when finalized, will be a significant undertaking for many market participants and may require cross-border coordination among numerous entities. As such, the Working Group requests that the Commission provide a nine-month period of time for market participants to come into compliance with any speculative position limits aggregation requirements.

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16 *Id.* at 68,959.

17 *Id.* at 68,960.

18 *See* Final Rule, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596 (May 23, 2012).

III. CONCLUSION.

The Working Group appreciates this opportunity to provide comments on the proposed aggregation standards under the speculative position limits regime and respectfully requests that the Commission consider the comments set forth herein as it develops any final rulemaking in this proceeding.

If you have any questions, please contact the undersigned.

Respectfully submitted,

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