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

Re: Aggregation of Positions, RIN No. 3038-AD82

Dear Ms. Jurgens:

As published in the Federal Register on November 15, 2013, the Commodity Futures Trading Commission ("CFTC" or the "Commission") proposed regulations establishing aggregation requirements to be used in conjunction with its proposal to establish position limits for derivatives ("Aggregation NOPR").[1] The Aggregation NOPR, in large part, tracks the prior Commission aggregation proposal that was issued on May 30, 2012 relating to the Commission's position limits regulations, which were ultimately vacated by the US District Court ("Initial Aggregation NOPR").[2]

The members of the Coalition of Physical Energy Companies ("COPE")[3] are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale. COPE members generally use swaps, futures, options, and trade options in conjunction with their physical businesses, most typically for hedging. In the context of the Aggregation NOPR, COPE members may be equity owners of entities with which they are required to aggregate, or owned entities. As such, the proposed regulations would, if enacted as proposed, have a material effect on them.

The Aggregation NOPR takes note of comments made by market participants regarding the Initial Aggregation NOPR and, as a result, includes some improvements on that previous proposal (such as permitting the use of a memorandum of law rather than a legal opinion to support the reasonable risk of a violation of state, federal, or foreign law by the information

[1] *Aggregation of Positions*, 78 Fed. Reg. 221 (Nov. 15, 2013) ("Aggregation NOPR").

[2] *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 104 (May 30, 2102) ("Initial Aggregation NOPR").

[3] The members 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.

sharing required to implement aggregation for position limits).[4] COPE provided comments on the proposal made in the Initial Aggregation NOPR and appreciates the Commission's consideration of those comments.[5] By this letter, COPE provides the following comments on the Aggregation NOPR.

Where Real-Time Knowledge, Access, and/or Control of Positions Does Not Exist, Aggregation Should Not Be Required

As a general matter, COPE believes that much of the substance of the proposal made in the Aggregation NOPR is appropriate. That is, where an entity has real-time knowledge, access, and/or control of the affected position of an entity in which it owns an equity interest, the proposed regulations reasonably require aggregation of the positions of the entities for the purpose of complying with the proposed position limits for derivatives.

Conversely, where an entity does not have such real-time knowledge, access, and/or control of the affected position of an entity in which it owns an equity interest, aggregation should not be required. The Commission has implemented this concept by providing that aggregation is generally not required without further CFTC action for circumstances where: (1) there is less than a 10% equity interest and no trading control;[6] (2) the equity ownership is of a limited partner nature;[7] and (3) there is more than a 10% and not more than 50% equity ownership, and there is a lack of knowledge, integration, or control of trading in certain other specific circumstances.[8]

COPE believes that if an entity that owns an equity interest in another entity does not have real-time knowledge, access, and/or control of the owned entity's positions, there should not be a requirement for the entities to aggregate positions for the purpose of position limits. Further, COPE believes that the Commission's proposed criteria for an exemption from aggregation when an entity has a more than 10% and not more than 50% equity interest in another entity has properly captured the elements needed to assure that there is no real-time knowledge, access, and/or control of an affected position ("Separation Criteria"). As proposed by the Commission, the Separation Criteria are:

- The entities do not have knowledge of the trading decisions of the other;
- The entities trade pursuant to separately developed and independent trading systems;
- The entities have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other, including document routing and other procedures or security arrangements, and separate physical locations;

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[4] Aggregation NOPR at 68977 (proposed § 150.4(b)(8)).

[5] *Comments of Coalition of Physical Energy Companies*, RIN No. 3038-AD82 (June 29, 2012).

[6] Aggregation NOPR at 68976 (proposed § 150.4(a)).

[7] *Id.* (proposed § 150.4(b)(1)).

[8] *Id.* (proposed § 150.4(b)(2)).

- The entities do not share employees that control the trading decisions of either entity; and
- The entities do not have risk management systems that permit the sharing of trades or trading strategies.[9]

In addition to satisfying the above criteria, the Commission has proposed requiring that the owning entity make a notice filing describing the relevant circumstances qualifying the entity for the exception and containing a statement of a senior officer certifying that the conditions for the exception have been met.[10]

Except where an equity position exceeds 50%, the Commission has recognized that such aggregation is generally not required if less than a 10% equity position exists or if the Separation Criteria is met.

COPE generally supports the Separation Criteria/notification process proposed by the Commission. However, COPE requests a limited clarification. The Commission has stated that the Separation Criteria are designed to capture:

> knowledge of employees who control, direct, or participate in an entity's trading decisions, and would not prohibit information sharing solely for risk management, accounting, compliance, or similar purposes and information sharing among mid- and back-office personnel that do not control, direct, or participate in trading decisions.[11]

Similarly, information gained as a counterparty will also generally not trigger an aggregation requirement.[12]

COPE requests that the Commission clarify, in conjunction with the foregoing, that:

- An employee that participates on the board or similar governing process of an owned entity but does not control, direct, or participate in an entity's trading decisions of the investing entity, will satisfy the Separation Criteria.
- Information gained as a counterparty regardless of the vehicle by which the information is transmitted will satisfy the Separation Criteria (i.e. a trade that, for efficiency, is directly entered into the trading system of an entity by an owned entity).

The 'Greater Than 50%' Category Should Be Eliminated

The Commission has proposed that, where there is an equity position in excess of 50%: (1) it will only consider an exception to aggregation on a case-by-case discretionary basis; and (2) certain additional conditions (beyond the substantive separation and non-coordination criteria above) be employed as prerequisites before an entity can ask that the Commission not require

[9] *Id.* (proposed § 150.4(b)(2)(i)(A)-(E)).

[10] Aggregation NOPR at 68976 (proposed § 150.4(b)(2)(ii)).

[11] *Id*. at 68961.

[12] *Id*.

aggregation.[13] The Commission has further stated that if a person "could not meet the [over 50%] conditions of the proposed rule, the person could [also] apply to the Commission for relief from aggregation" ("Unconditional Application").[14]

As such, in cases where there is more than a 50% equity ownership, the Commission has proposed that it would consider whether to require aggregation on a case-by-case basis if the applicant could demonstrate to the Commission that:

- The owned entity is not required to be, and is not, consolidated on the financial statement of the person,
- The person does not control the trading of the owned entity (based on criteria in rule 150.4(b)(2)(i)), with the person showing that it and the owned entity have procedures in place that are reasonably effective to prevent coordinated trading in spite of majority ownership,
- 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
- The person certifies that either (a) all of the owned entity's positions qualify as bona fide hedging transactions or (b) the owned entity's positions that do not so qualify do not exceed 20 percent of any position limit currently in effect, and the person agrees in either case that:
  - if this certification becomes untrue for the owned entity, the person will aggregate the owned entity for three complete calendar months, and if all of the owned entity's positions qualify as bona fide hedging transactions during that time the person would have the opportunity to make the certification again and stop aggregating,
  - upon any call by the Commission, the owned entity(ies) will make a filing responsive to the call, reflecting the owned entity's positions and transactions only, at any time (such as when the Commission believes the owned entities in the aggregate may exceed a visibility level), and
  - the person will provide additional information to the Commission if any owned entity engages in coordinated activity, short of common control (understanding that if there were common control, the positions of the owned entity(ies) would be aggregated).[15]

COPE believes the foregoing process is unnecessarily burdensome and contains criteria unrelated to the substantive separation and non-coordination criteria principles relating to

[13] *Id.* (proposed § 150.4(b)(3)); *id.* at 68978 (proposed § 150.4(c)(2)).

[14] Aggregation NOPR at 68960.

[15] *Id.* at 68960 (internal citation omitted); *see also id.* at 68976 (proposed § 150.4(b)(3)).

whether the owning entity has real-time knowledge and/or control of the affected position of the owned entity.

Further, since a person may still make an Unconditional Application, it is unclear whether these items are a "safe harbor" which, if met, will likely result in an exception or if they are merely indicative guidelines. Additionally, it is unclear if the opportunity to make an Unconditional Application is a meaningful option or something that would likely be approved only in exceptional circumstances. Notwithstanding the ability to make an Unconditional Application, since the Commission has created the above requirements as the apparent price of admission to an exception for over 50% equity ownership, until the Commission clarifies otherwise, COPE will consider them substantive prerequisites.

COPE appreciates that the Commission has proposed to permit entities with an equity ownership interest in excess of 50% to be eligible for an exception to aggregation. However, the proposal illustrates that there should not be a differing treatment for ownership of over 50% equity.

The purpose of aggregating entities for the application of position limits is to assure that there is no concerted effort by an affiliated group to defeat the limits and engage in collective excessive speculation.[16] The Separation Criteria fully assure that no concerted effort can occur. If, as the Separation Criteria require, the entities have no knowledge of the trading decisions of each other and have material processes and personnel practices to assure that there is no knowledge, access, or control of the others' trading, then there can be no concerted action. If there is no concerted action, then the entities cannot purposefully collectively exceed position limits as a group. The foregoing is true whether there is a 50% equity interest or a 51% equity interest by the owning entity.

The Separation Criteria are meaningful and substantive. Limiting their use as a measure of substantive separation is arbitrary particularly since the additional criteria (as discussed below) do not address the real question of whether affected trading and related information is separated and protected. If the Commission believes the Separation Criteria are inadequate, then it should fix the inadequacy. If the Commission believes the Separation Criteria assure that no concerted trading can occur (as COPE believes), then meeting such criteria should be significant enough to permit an exemption from aggregation. As such, the greater than 50% category should be eliminated, with the Separation Criteria establishing eligibility and the notice filing securing an exemption from aggregation for all equity holdings in excess of 10%.

While the Commission appears to believe that the greater than 50% category in the Aggregation NOPR will affect only a small number of firms,[17] it is COPE's expectation that there will be a significant impact with the result being the material and burdensome compliance requirements described below.

[16] *See id.* at 68951.

[17] *Id*. at 68957.

Aggregation Pending Action on a Case-by-Case Basis Is Inefficient and Burdensome

As proposed by the Commission, when equity ownership exceeds 50%, an entity would be required to aggregate positions with owned entities unless and until the Commission were to act on a request to permit non-aggregation.[18] Since the affected entities must not have real-time knowledge and/or control of the affected positions of the other in order to seek an exemption, during the pendency of the request they would need to put in place processes to coordinate trading and share information on a real-time basis solely for position limits compliance. Upon the receipt of a favorable Commission determination, the entities would then be required to immediately dismantle and prohibit such coordination/information sharing. In effect, they would need to undo everything they just did and forget the information they just learned.

The inefficiency and unnecessary burden of such a process is self-evident. Assuming the Commission finds that a separate category for equity ownership above 50% is required, COPE submits that an entity should be permitted to rely upon its good faith belief that its request will be granted (and comply with the separation requirements) and only be required to aggregate in the event that its application is denied.[19] Otherwise, entities will be required to expend significant time resources and attention to efforts that ultimately are without a purpose and, in fact, would require the type of sharing of information the Commission has determined would preclude upon the grant of an exemption.

Entity Consolidation on Financial Statements Is Not a Meaningful Criteria

As proposed by the Commission, a prerequisite criteria to being able to seek a Commission ruling that it need not aggregate with over 50% owned entities is that the owned entities are not required to be, and are not, consolidated on the financial statements of the owning person.[20] This requirement does not flow from the concept that the owning entity has real-time knowledge, access, and/or control of the affected position of the owned entity.

It is entirely possible that in a large organization with a holding company structure, owned entities can exist in various business lines or regional/geographic business units that hold positions in affected contracts and control their own trading with no knowledge of the each other's activities. For example, North American and European entities with the same ultimate parent could operate independently but still be consolidated on the parent's financial statement. The same could be true for natural gas and oil exploration and production entities and electric generation entities.

Since, in the physical energy business, trading in affected contracts is not the business purpose of the entities, entities with the same ultimate parent may very well be focused on their physical energy business of producing natural gas, oil, or power, using futures, options swaps, or trade options as appropriate to their specific business needs, and never communicating the specifics of

[18] Aggregation NOPR at 68978 (proposed § 150.4(c)(ii)(2)).

[19] In fact, if the request is denied aggregation should be required 60 days thereafter to permit time the entities to implement proper coordination to assure position limits compliance.

[20] Aggregation NOPR at 68976 (proposed § 150.4(b)(3)(i)).

their trading decisions or positions to any other corporate entity. Of course, they would communicate their earnings and other financial information as needed. Whether the gas production is hedged with a forward contract, a trade option, or another affected contract is of little interest to ultimate management as long as factors/targets such as costs, revenues, and environmental compliance were tracked and reported. In fact, it is hard to imagine that those outside the arcane world of CFTC regulation understand (or care) that there is a difference between transactions such as trade options and forward contracts.

Therefore, requiring that entities not be consolidated for accounting purposes as a prerequisite to seeking an exemption to aggregation will preclude entities that can meet the substantive Separation Criteria proposed by the Commission from seeking such an exemption. Barring entities on this basis serves no meaningful purpose and will subject entities that merit an exemption on substantive grounds to the complexity and burden of aggregating positions with entities with which they do not typically interact.

Whether All of an Owned Entity's Positions Qualify as *Bona Fide* Hedging Transactions, or Whether Those That Do Not So Qualify Exceed 20 Percent of Any Position Limit, Is Arbitrary and Unrelated to the Issue of Trading Separation

A further prerequisite for seeking a Commission ruling that an entity need not aggregate with over 50% owned entities is that all of the owned entity's positions qualify as *bona fide* hedging transactions or that those that do not so qualify do not exceed 20 percent of any position limit.[21] Similar to the consolidated financial statement criteria, this requirement does not flow from the concept that the owning entity has real-time knowledge, access, and/or control of the affected position of the owned entity.

If the entities meet the Separation Criteria such that their activities are sufficiently separated and uncoordinated with clear and meaningful information barriers, then the entities should be permitted an exemption from aggregation. Whether all an entity's transactions are *bona fide* hedges or if it holds positions at a level of 20 or 21% of a position limit has no logical relationship to whether aggregation should be required. This prerequisite appears to be an arbitrary barrier to the legitimate ability of an entity to seek a determination that it not be aggregated with an owned entity. Given the complexity and burden of aggregating positions with an entity with which an entity does not typically interact on this level, such a barrier should be removed in favor of a focus on meaningful, substantive criteria.

The Owned Entity Procedures & Board Member Attestation Are Redundant to the Separation Criteria

The Commission has also proposed as prerequisites to an over 50% ownership request for an exemption to aggregation that (1) "The person does not control the trading of the owned entity [...] with the person showing that it and the owned entity have procedures in place that are reasonably effective to prevent coordinated trading in spite of majority ownership";[22] and (2)

[21] *See, id*. at 68977 (proposed § 150.4(b)(3)(iv)).

[22] *Id*. at 68960.

"each representative of the [owning entity] person (if any) on the owned entity's board of directors attests that he or she does not control trading of the owned entity."[23]

COPE believes that these prerequisites are redundant to the elements already existing in the Separation Criteria. As such they should be eliminated together with the over 50% equity interest category. A notification from senior officer certifying the Separation Criteria have been met should satisfy these criteria. A senior officer will take this certification no less seriously than a board member. Further, if such a notification is reliable for 50% ownership, it should be no less reliable for 51%. Given this redundancy, the lack of need for an over 50% category is further highlighted.

However, only in the event the Commission finds it is necessary to maintain an over 50% category with a case-by-case determination, COPE does not object to the inclusion of these two provisions coupled with the ability of an applicant to rely in good faith on its application and not be required to aggregate during its pendency (as discussed above). This way the Commission can have an additional quantum of comfort without imposing problematic burdens, which would only need to be reversed upon a grant of an exception.

Pro Rata Aggregation Should Be Included in the Final Rule.

The Commission has requested comment regarding the concept of the aggregation of only a pro rata amount of an owned entity's position, using the equity ownership ratio of the upstream owner.[24] COPE believes that such a pro rata allocation is an improvement to the proposed Aggregation NOPR. By including a pro rata aggregation, persons not otherwise eligible for an exemption will be impacted by the position limits rule in a manner better aligned with the scope of the affiliation they have with an owned entity.

[23] *Id.*

[24] Aggregation NOPR at 68959.

Conclusion

Consistent with the comments above, COPE requests that the Commission revise its proposed rule: (1) to permit entities that do not have real-time knowledge, access, and/or control of the affected position of an entity in which it owns an equity interest to be exempted from aggregation for the purpose of position limits regulation; and (2) establish that any required aggregation can be effected on a pro rata basis.

Respectfully Submitted,

/s/ David M. Perlman

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CC: COPE Members
Acting Chairman Mark P. Wetjen
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