



BP Energy Company
201 Helios Way
Houston TX 77079

P.O. Box 3092
Houston TX 77253

December 2, 2014

VIA EMAIL

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

RE: RIN 3038-AC97, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

Dear Mr. Kirkpatrick:

Please accept these brief comments from BP Energy Company (“**BPEC**”) in furtherance of the U.S. Commodity Futures Trading Commission’s (“**CFTC**” or “**Commission**”) proceeding on its proposed rule regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (“**Proposed Margin Rule**”).¹ BPEC, located in Houston, Texas, is a marketer of natural gas, electric power, and natural gas liquids with operations throughout the continental United States, and is a swap dealer provisionally registered with the CFTC. Therefore, BPEC would be subject to the CFTC Proposed Margin Rule and outside the scope of the margin rules proposed by the U.S. Department of Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency (“**Prudential Regulators**”).²

BPEC is committed to constructive dialogue with its various regulators, including the CFTC, to mitigate systemic risk. It is in this spirit that BPEC requests that the Commission consider certain modifications to the Proposed Margin Rule recommended by various energy end-user associations, as well as similarly-situated energy swap dealers, as further detailed below. BPEC particularly requests that the Commission implement the recommendations made by Shell Trading Risk Management, LLC (“**STRM**”) in this proceeding (“**STRM Letter**”).

Specifically, BPEC endorses STRM’s observations regarding the need to exempt inter-affiliate swap transactions, the inefficiency of calculating hypothetical margin, and the need for a

¹ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 79 Fed. Reg. 59898 (Oct. 3, 2014) (“**Proposed Margin Rule**”).

² See *Margin and Capital Requirements for Covered Swap Entities*, 79 Fed. Reg. 57348 (Sept. 24, 2014).

clear process for obtaining provisional regulatory approvals of the risk-based models to be deployed by covered swap entities (“CSEs”) whose models are not approved by a Prudential Regulator. BPEC also supports STRM’s request for a more flexible timeframe for CSEs to post and collect initial and variation margin. The proposed next business day deadline to post and collect initial and variation margin imposes a significant burden for non-bank CSEs to complete internal processes to post and collect margin. The proposed deadline also does not take into consideration certain operational considerations, such as the time of execution of the swap, potential system outages, or other system limitations. Therefore, the CFTC should adopt a timeframe for the collection of initial and variation margin based on the second business day after the execution of the uncleared swap transaction.

BPEC shares STRM’s concerns with the proposed requirement that custodial agreements must be legal, valid, binding, and enforceable under the laws of all relevant jurisdictions, including bankruptcy laws. This requirement would impose an impossible legal standard for a party to meet, as further detailed in the STRM Letter. BPEC also supports STRM’s request that the Commission clarify that CSEs may rely on representations from their counterparties as to both (a) their status as a financial end-user, and (b) their material swaps exposure. CSEs will not have all of the information necessary to determine whether or not their counterparties are financial end-users or to calculate a counterparty’s material swaps exposure, and will need to rely on their counterparties for such determinations. This approach would be consistent with the approach that the CFTC has taken in other contexts.³ BPEC also agrees with STRM that CSEs should be permitted to rely on internal curves to satisfy the requirements for calculating variation margin, consistent with the methods CSEs already utilize under their International Swaps and Derivatives Association (“ISDA”) Master Agreements for calculating margin requirements when determining “close-out amounts.”

In addition to the various issues raised by STRM with respect to the Proposed Margin Rule, BPEC supports the comments of the International Energy Credit Association (“IECA”) regarding netting swaps and physical transactions executed pursuant to an eligible master netting agreement.⁴ Specifically, the Commission should explicitly acknowledge that an “eligible master netting agreement” includes an industry standard agreement, such as the ISDA Master Agreement, which has one or more physical annexes whereby the parties net across swap transactions and physical commodity forward transactions. Many energy companies use an ISDA Master Agreement with physical commodity annexes to govern all physical and financial energy commodity transactions with the same counterparties. This allows netting of exposures across all such transactions, thereby reducing each party’s exposure to the other under such agreement. The CFTC should expressly allow for calculation of necessary margin, collateral, or other credit obligations based on netting across all such transactions under a master netting agreement.

³ See CFTC Rules 23.430(d) & 23.402(d) (which allow swap dealers to rely upon representations within the context of the obligation to verify a counterparty’s eligibility to enter into swaps and know-your-counterparty obligations).

⁴ See IECA Letter to the Prudential Regulators, at Section I.H (Nov. 24, 2014).

BPEC also agrees with the comment of the Joint Associations that there is no need to impose additional documentation requirements with respect to variation margin calculations.⁵ Given that non-financial end-users will not be subject to the Proposed Margin Rule, the CFTC should eliminate the burden that additional documentation requirements would impose upon end-users.

More detailed support for the above recommendations is included in the referenced submissions, and BPEC does not wish to duplicate or recast those arguments. Nor do we intend to suggest that the above-referenced comments exhaust the full list of potential enhancements to the Proposed Margin Rule. Instead, we ask the Commission to consider them as particularly relevant to the hedging and risk management services being offered by an increasingly important subset of the CSEs transacting with energy end-users, namely, non-bank swap dealers.

In addition to supporting the comments described above, BPEC also asks the Commission to: (1) avoid creating a duplicative requirement for internal auditing; and (2) clarify that the Proposed Margin Rule does not apply to commodity trade options (“TOs”). First, duplicative functional layers of internal auditing should be eliminated. The effectiveness of initial and variation margin calculations are routinely and regularly evaluated by the Risk Management Unit, as required by the Risk Management Rules.⁶ CFTC Rule 23.600 imposes comprehensive oversight of risk management functions, including margin calculations. For example, CFTC Rule 23.600(c)(7) requires monitoring of compliance with the Risk Management Program, and CFTC Rule 23.600(e) requires review and testing on at least an annual basis, including analysis of the company’s adherence to and the effectiveness of the risk management policies and procedures. That annual testing must be performed by qualified internal audit staff that are independent of the business trading unit being audited or by a qualified third party audit service. Including an additional audit requirement in the Proposed Margin Rule would be unnecessarily duplicative.

Second, the Commission should clarify that the Proposed Margin Rule does not apply to TOs. In the absence of this clarification, the Proposed Margin Rule may apply to certain TOs per CFTC Rule 32.3(c)(5), which does not exempt TOs from Section 4s(e) of the Commodity Exchange Act (Capital and Margin Requirements for Swap Dealers and Major Swap Participants). In the Interim Rule adopting the TO exemption, the CFTC explained that it did not categorically exempt TOs from certain swap dealer requirements, such as margin, because of its concern with the potential for evasive structuring of swaps as trade options.⁷ However, commercial market participants enter into TOs as opposed to other swaps for a variety of legitimate business purposes, including to manage physical supply needs.

⁵ See American Gas Association, American Public Power Association, Edison Electric Institute, Electric Power Supply Association, Large Public Power Council, and National Rural Electric Cooperative Association (“**Joint Associations**”) Letter to the CFTC, at Section III.B. (Dec. 2, 2014).

⁶ See CFTC Rule 23.600(c)(6) (requiring each swap dealer to satisfy all capital and margin requirements).

⁷ *Commodity Options*, 77 Fed. Reg. 25320, 25328 (Apr. 27, 2012) (“Each of these SD and MSP conditions simply confirms that an SD and/or MSP may not avoid certain requirements or obligations by structuring its swap transactions as trade options.”).

In issuing the Interim Rule, the CFTC specifically asked whether it was appropriate to apply Section 4s(e) to TOs.⁸ The CFTC has not yet responded to the comments it received in that rulemaking regarding the application of margin to TOs, or to other issues associated with the TO exemption. However, the CFTC still has the opportunity to carve out TOs in individual rulemakings, including the Proposed Margin Rule.⁹ The CFTC should do so here because TOs, by definition, involve at least one “producer, processor, or commercial user of, or a merchant handling the commodity” that is entering into the transaction in order to address its commercial needs.¹⁰ The CFTC noted in the Proposed Margin Rule that non-financial end-users are not subject to the margin rules because “such entities, which generally are using swaps to hedge commercial risk, pose less risk to CSEs than financial entities.”¹¹ That is also the case here because TOs are required to be entered into for purposes related to the business of the commercial market participant, *i.e.*, TOs pose less risk and therefore should not be subject to margin requirements.

Implementing the Proposed Margin Rule with respect to TOs also would be complicated by the significant confusion surrounding how to characterize physical supply agreements with embedded volumetric optionality and how to value TOs.¹² Given the continued review of this issue by the CFTC, TOs should be expressly carved out of the Proposed Margin Rule. If the CFTC determines that certain TOs should be covered, it should allow for an additional comment period to consider how best to address them.

Conclusion

BPEC appreciates the opportunity to comment in this proceeding, and respectfully requests Commission support for the modifications being advanced by a variety of energy market participants. Please contact Mark Stultz at (713) 323-1301 if you have any questions or would like further clarification regarding BPEC’s submission.

Respectfully submitted,

/s/

Tom Nuelle
Chief Compliance Officer
BP Energy Company

⁸ *Id.* at 25330.

⁹ CFTC Rule 32.3(e).

¹⁰ CFTC Rule 32.3(a)(1)(ii). Note that this includes certain swap dealers that are also commercial market participants.

¹¹ Proposed Margin Rule at 59906.

¹² *Forward Contracts with Embedded Volumetric Optionality*, 79 Fed Reg. 69073 (Nov. 20, 2014).

December 2, 2014

Page 5

cc: Honorable Timothy G. Massad, Chairman
Honorable Mark P. Wetjen, Commissioner
Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
John C. Lawton, Deputy Director
Thomas J. Smith, Deputy Director