FINAL

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December 22, 2014

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
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Washington, D.C. 20581
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Re: Comments of the International Energy Credit Association on CFTC's and SEC's jointly Proposed Interpretation entitled "Forward Contracts with Embedded Volumetric Optionality," 79 Fed.Reg. 69073 (Nov. 20, 2014) RIN 3038-AE24 (the "Proposed Interpretation")

Dear Mr. Kirkpatrick:

The International Energy Credit Association ("IECA") is an association of over 1,400 credit, risk management, legal and finance professionals that is dedicated to promoting the education and understanding of credit and other risk management-related issues in the energy industry. For over ninety years, IECA members have actively promoted the development of best and industry standard practices that reflect the unique needs and concerns of the energy industry. Our members' concerns regarding the relevant rulemakings that followed the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFA") have led us to submit to the Commodity Futures Trading Commission ("Commission" or "CFTC") and other regulators numerous comments on various proposed rulemakings, as well as requests for no action relief and petitions in support of relief requests sought by other energy companies and trade groups.

The IECA seeks to protect the rights and advance the interests of the commercial end-user community that makes up the majority of its membership. IECA membership includes representatives of many small and large energy companies all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that American businesses and consumers require for our economy and our livelihood. Most of the IECA's members are representatives of commercial end-users, which rely on swaps to help them mitigate and manage (i.e., hedge) the risks of energy commodity price volatility to their physical energy businesses.

Correspondence with respect to these comments should be directed to the following individuals:

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Comments on the Proposed Interpretation.

The IECA has previously submitted comments to the Commission on several occasions regarding the Commission's interpretive guidance with respect to forward contracts that provide for variations in delivery amount (i.e., forward contracts that contain embedded volumetric optionality), which is set forth in the *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48,208 at 48,237 (August 13, 2012) (the "Products Release"). In those comments, the IECA expressed various concerns with the Commission's seven factor test ("Seven Factor Test").

The Proposed Interpretation addresses some of the IECA's concerns and we commend the Commission for its efforts to improve the Seven Factor Test. However, some of the IECA's concerns with respect to forward contracts with embedded volumetric optionality as applied to commercial energy supply contracts have not been addressed by the Proposed Interpretation and the IECA respectfully continues to raise those concerns in these comments.

Particularly, we seek clarification regarding the application of the Seven Factor Test as a safe harbor for determining when an agreement, contract or transaction with embedded volumetric optionality would be considered a forward contract and therefore excluded from regulation as a swap by the CFTC.

We are also concerned with the Commission's proposed reliance on the Interim Final Rule for Commodity Options (the "IFR")[1] and its trade option exemption from most swap regulation as an allegedly unburdensome means of addressing commercial energy supply contracts under the Commodity Exchange Act ("CEA") as amended by the DFA.

[1] See 77 Fed.Reg. 25320 (April 27, 2012). Part 32 of the CFTC's regulations includes an exemption for certain physically settled options, termed "trade options." See 17 C.F.R. 32.3. The trade option exemption is currently subject to CFTC staff no-action relief. See CFTC Letter No. 13-08 (April 5, 2013).

Considering that the Commission has changed its Seven Factor Test in the Proposed Interpretation, we also request that the Commission provide relief from any potential "violations" of its recordkeeping or reporting rules that may arise as a result of an entity's classification of any contract, agreement or transaction as either an "excluded forward contract with embedded volumetric optionality" or a "trade option" under the Commission's prior interpretation as set forth in the Products Release. Requiring parties to reclassify all their contracts, agreements or transactions today under the Proposed Interpretation and seek new representations of their counterparties' intent for transactions entered into during 2013 or 2014 is unduly burdensome, if not impossible, and should be the subject of relief granted by the Commission, either in the final version of its Proposed Interpretation or in a related No-Action Letter providing such relief.

As set forth in the final portion of these comments, the IECA believes that the Commission has chosen a path for regulatory interpretation of forward contracts with embedded volumetric optionality with a foundation that is not necessarily within the words of the CEA as amended by the DFA.

The IECA commends the CFTC for taking the time in its Proposed Interpretation, at this stage of the regulatory rulemaking process, to "clarify its interpretation of when … a transaction with embedded volumetric optionality would be considered a forward contract."[2] "Getting it right" in the Proposed Interpretation will benefit markets, market participants, regulators and the public until further sources of certainty emerge in legislation or reported cases. In that spirit, the IECA offers the following as constructive comments.

I. The IECA's Comments on Modified Seven Factor Test in the Proposed Interpretation.

In the Proposed Interpretation, the CFTC has set forth a Modified Seven Factor Test as follows:

1. The embedded optionality does not undermine the overall nature of the agreement, contract, or transaction as a forward contract;

2. The predominant feature of the agreement, contract, or transaction is actual delivery;

3. The embedded optionality cannot be severed and marketed separately from the overall agreement, contract, or transaction in which it is embedded;

4. The seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;

[2] 79 Fed. Reg. 69074 col. 2.

5. The buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;

6. Both parties are commercial parties; and

7. The embedded volumetric optionality is primarily intended, at the time that the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity.

A. The IECA Supports the Changes Proposed to the Fourth and Fifth Elements of the Seven Factor Test.

The IECA supports the clarifications made to the fourth and fifth elements of the Seven Factor Test to make clear that embedded volumetric optionality in the form of both puts and calls will satisfy these elements of the Seven Factor Test.

The IECA also requests that volumetric optionality in the form of increases and decreases in delivery should be treated consistently. If the CFTC were to take a narrow view of the seven-part interpretation, and characterize it as a "pass" or "fail" test, it may view as options many routine physical supply contracts in which the predominant feature is delivery. Each of the 4th and 5th elements provides for delivery of the commodity if the optionality is exercised. However, optionality that allows for a reduction in volume for commercial convenience or necessity may not qualify.

Similarly, the commodity trade option ("CTO") exemption under Rule 32.3 requires that, if exercised, the option would result in the sale of an exempt or agricultural commodity for immediate or deferred shipment or delivery, which could also be interpreted narrowly to exclude decreases in quantities delivered.

In many contracts with a plus or minus delivery term, the parties still make delivery and the plus or minus feature is simply used to adjust the amount of the commodity that is delivered. For example, a power plant that transacts for a baseload amount of gas has the ability to "swing" up or down by ten percent (10%) based on operational factors. The ability to "swing" down by ten percent (10%) may not meet the 4th or 5th elements. This would lead to the illogical result that straight calls and puts may qualify as CTOs, whereas many physical supply arrangements could be regulated as swaps.

Accordingly, the CFTC should clarify that the 4th and 5th elements are not contingent on the "exercise" but that the optionality can take the form of increases or decreases in volume to the extent that physical delivery can take the form of increases or decreases in volume physical delivery is intended. This is consistent with the statements made in the Proposed Interpretation that "[t]he embedded volumetric optionality therefore offers commercial parties the flexibility to vary the amount of the nonfinancial commodity delivered during the life of the contract in response to uncertainty in the demand for or supply of the nonfinancial commodity" and Footnote 12 thereto.

B. The IECA Supports the Changes Proposed to the Seventh Factor of the Seven Factor Test.

The IECA supports the CFTC's modifications to the seventh element. Specifically, we agree that it is appropriate to delete "outside the control of the parties" because such wording created problems during contract negotiations (as noted in the Proposed Interpretation) and resulted in unnecessary regulatory uncertainty. Similarly, we agree with the removal from the seventh factor of the requirement that "exercise or non-exercise" of the embedded volumetric optionality is based primarily on physical factors or regulatory requirements outside the control of the parties. The IECA endorses the CFTC's statement in the Proposed Interpretation that (79 Fed.Reg. at 69075): "the focus of the seventh element is intent with respect to the embedded volumetric optionality at the time of contract initiation.[footnote 18]"

The IECA also endorses the further helpful analysis provided in footnote 18 to the Proposed Interpretation, which says (79 Fed.Reg. 69075):

> "For example, in choosing whether to obtain additional supply by exercising the embedded volumetric optionality under a given contract or turning to another supply source – whether storage, the spot market, or another forward contract with embedded volumetric optionality – commercial parties would be able to consider a variety of factors, including price, provided that the intended purpose for including the embedded volumetric optionality in the contract at contract initiation was to address physical factors or regulatory requirements influencing the demand for or supply of the commodity."

In the Proposed Interpretation the IECA also endorses that portion of the clarification which reads (79 Fed.Reg. 69075):

> "The CFTC is also proposing to clarify that the phrase "physical factors" should be construed broadly to include any facts or circumstances that could reasonably influence supply of or demand for the nonfinancial commodity under the contract. Such facts and circumstances could include not only environmental factors, such as weather or location, but relevant "operational considerations" (e.g., the availability of reliable transportation or technology) and broader social forces, such as changes in demographics or geopolitics."

The immediately following sentence in that paragraph causes us concern, but when coupled with footnote 18, arguably gives the sentence an acceptable context. That sentence reads (79 Fed.Reg. 69075-69076):

> "Concerns that are <u>primarily about price risk</u> (*e.g.*, expectations that the cash market price will increase or decrease), however, would not satisfy the seventh element absent an applicable regulatory requirement to obtain or provide the lowest price (*e.g.*, the buyer is an energy company regulated on a cost-of-service basis)." (Emphasis added.)

Many electric utilities dispatch their resources (which include company assets, as well as purchased power) based on a defined dispatch model. Although these dispatch models are commonly referred to in the energy industry as "economic" dispatch models, they are based on a combination of primary factors, including, but not limited to, price. For example, these "economic" dispatch models also include several primary factors such as need, reliability, and operational considerations (*e.g.*, outages, must-run time, etc.). We believe that such an "economic" dispatch approach to choosing which supply source to call on will satisfy the seventh factor when the optionality has been entered into primarily to address "physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity."

C. The Seven Factor Test Should be Viewed as a Safe Harbor, not a Pass-Fail Test.

In the Products Release, the CFTC supplemented its forward contract precedent by including an additional seven-part interpretation for analyzing forward contracts with embedded volumetric optionality.[3]

The CFTC repeatedly reaffirmed in the Products Release that it will interpret the forward contract exclusion "consistent with the CFTC's historical interpretation."[4] Moreover, in issuing the additional seven-part interpretation for analyzing embedded volumetric options, the CFTC clarified that it was identifying "additional factors that may be considered in its facts and circumstances analysis."[5] In substance and effect, the CFTC treats the seven-part interpretation as a non-exclusive list of factors to consider along with other guidance concerning the scope of the forward contract exclusion from the definitions of "future delivery," "option," and "swap." In other words, whether a transaction containing volumetric flexibility constitutes a forward contract does not depend on whether the transaction "passes" or "fails" the seven-part interpretation as though it were a test. Rather, if a transaction appears not to align with one or more of the seven factors of the interpretation, a commercial market participant still may reasonably conclude that it is an excluded forward contract depending on the totality of the facts and circumstances.

We request that the CFTC clarify that this seven-part interpretation is not a "pass" or "fail" test, but is instead a safe harbor test so that if a transaction satisfies this seven-

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[3] *77 Fed. Reg.* at 48238.

[4] *77 Fed. Reg.* at 48227.

[5] *77 Fed. Reg.* at 48227.

part interpretation, it will be an excluded forward contract and if it does not, it may or may not be an excluded forward contract.

The IECA suggests that the Commission's Office of General Counsel ("OGC"), in a related analysis, got it right with respect to the safe harbor status of the Commission's tests. The Commission's interpretive guidance in the Products Release also included a three part test to be applied to certain physical commercial agreements for the supply and consumption of energy that provide flexibility, such as tolls on power plants, transportation agreements on natural gas pipelines, and natural gas storage agreements, concluding that the CFTC would interpret such agreements not to be a commodity option if the enumerated three elements were satisfied, but concluding with a "however" paragraph that created concern for many market participants with respect to facility usage agreements that included a two-part fee structure.

In response to those concerns, the OGC, in an undated *Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy*[6] (the "OGC FAQ"), provided a meaningful supplement to the interpretive guidance set forth in the Products Release by setting forth a further five factor test ("OGC Five Factor Test") to be applied to certain physical commercial agreements involving facility usage agreements that include a two-part fee structure. This OGC Five Factor Test was also to be used as a safe harbor test for the forward exclusion.

In that OFC FAQ, the OGC offered the following commentary on how the new 5-part test would be applied by market participants (see page 3 of such OGC FAQ):

> "…such a facility usage agreement, contract or transaction [that satisfies the OGC Five Factor Test] is not an option and is not intended to be covered by the "however paragraph." A facility usage agreement, contract or transaction with a two-part fee structure that fails to meet one or more of the conditions above may or may not be an option. Whether such an agreement, contract or transaction is an option depends on the specific facts and circumstances of the agreement, contract or transaction as a whole." (Emphasis added.)

The IECA wishes to clarify that each of the Commission's tests, including the Seven Factor Test, is to be applied as a safe harbor test, so that, just as was described in the OGC FAQ, (i) an agreement, contract or transaction that satisfies one of these safe harbor tests will not be a commodity option and will qualify for the forward exclusion from the definition of a swap, (ii) an agreement, contract or transaction that "fails to meet one or more of the conditions … may or may not be an option," and (iii) whether such an agreement, contract or transaction that fails to meet one or more of the conditions is an option or an excluded forward contract "depends on the specific facts and circumstances of the agreement, contract or transaction as a whole."

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[6] posted by the CFTC at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/leaselike_faq.pdf

The IECA encourages the Commission to make clear in the Proposed Interpretation that its modified Seven Factor Test remains a safe harbor test, so that (i) an agreement, contract or transaction that satisfies the Seven Factor Test will not be an option and will qualify for the forward exclusion from the definition of a swap, (ii) an agreement, contract or transaction that fails to meet one or more of the seven factors may or may not be an option, and (iii) whether such an agreement, contract or transaction that fails to meet one or more of the seven factors is an option or an excluded forward contract will depend on the specific facts and circumstances of the agreement, contract or transaction as a whole.

D. The Provision on Representations.

The IECA appreciates the Commission's authorizing parties to rely on representations made by their counterparties with respect to the counterparties' intent under the Seven Factor Test. This should mitigate against two parties to the same transaction having different interpretations of the results of the application of the Seven Factor Test.

II. The IFR and the Commission's Trade Option Rule Are No Substitute for Getting the Forward Contract Exclusion Right.

A. We Disagree with the CFTC's Statements Regarding the Extent of the Regulatory Burden Imposed on Energy Industry Participants with Respect to the Reporting of their Physically-Settled Energy Supply Contracts Utilizing Form TO.

On the Supporting Statement for New and Revised information Collections OMB Control Number 3038-W, the CFTC responded to industry concern regarding the under-estimated two-hour trade option reporting burden, and discounted the industry's position with:

> "The [CFTC] ***does not believe that an intricate knowledge*** of the CEA or the agency's procedures, personnel, and implementing regulations is necessary in order to accurately prepare and submit a Form TO in approximately two hours to the [CFTC], as required under Regulation 32.3(b)(2) and explained in the instructions attached to the document." (Emphasis added.)

But, the comments docket for the Proposed Interpretation shows that many different market participants all must separately decipher rules, interim final rules, explanatory matter accompanying published rules, various undated interpretive guidance documents published on the CFTC's web site, a proposed guidance published on the CFTC website, and multiple no action letters, much of which seek to override the statute, in order to know what to report. This cannot be done without "intricate knowledge."

Based in part on this representation that the submittals could be completed by personnel that lacked an "intricate knowledge" of the requirements, the Office of Management and Budget approved the CFTC's request to require the industry to submit the Form TO.

B. The Costs and Burden on End-Users Attributable to Complying with the IFR Are Not Insignificant.

The costs to end users of compliance under the IFR are not insignificant. Even if the transaction meets the CTO exemption, it is subject to Part 45 or Form TO reporting, large trader reporting, recordkeeping and other regulations. In the future, CTO's may also be subject to position limits. Moreover, if a transaction is to be reported using Form TO, it requires both of the parties to submit a Form TO. In addition, each party is placed under additional burdens to implement a process to characterize its transactions with volumetric optionality. If a Form TO filing is used to report a transaction classified as a CTO, then a party must track the aggregate notional value of any transactions classified as a CTO to meet the obligation to provide the DMO notice of transactions in excess of $1 billion during any calendar year. Finally, the Form TO requires a certification as to the truth and accuracy of the filing.

In the IFR, the CFTC assumes incorrectly that "[w]ith respect to reporting, … the form prescribed by the CFTC for annual reports will entail <u>*some administrative and legal costs*</u> for such commercials." *See* 77 Fed. Reg. 25333 (emphasis added). However, the costs associated with reporting Trade Options will be much more than "some administrative costs," because the Trade Option data is distinctly different and generally maintained in different recordkeeping systems than transaction data for financial commodity swaps or transactions that are intended to settle financially.

To implement the annual reports, "commercials" that must now be reporting entities will likely have to expend resources to review and interpret all the CFTC's new regulations for "swaps" and apply it to their nonfinancial business operations, hire new personnel with experience in financial markets rather than in the nonfinancial commodity transactions (including options) related to its commercial business, incur additional costs related to software changes, regulatory oversight, data collection and data review efforts. The IECA believes that the new data collection, monitoring, reconciling and reporting burden for commercial energy companies for the Form TO will be overly burdensome. For the entities that have to comply with the full requirements for part 45 for all Trade Options, these new regulatory costs will be exponentially higher for the same reasons and due to the tight reporting deadlines in part 45.

We also note that the CTO requirements impose a particular burden on non-US persons who are not familiar with the US rules or the required representations and filing. Many non-US persons are reluctant to incur the expense of hiring US counsel to review the CTO rules, review contract language and make required filings. Non-US persons may instead prefer to avoid an additional compliance burden by transacting only with other non-US persons. This reduces liquidity in the affected markets and adversely affects the ability of US persons to find counterparties.

This and other proposed CFTC rules, including those on position limits which as drafted capture trade options and presumably embedded volumetric optionality in forward contracts, threaten to make utility cost-of-service hedging difficult and expensive, thus driving up energy costs in the U.S., thereby driving up the cost of everything that is manufactured in the U.S., all without any conceivable connection to protecting the financial system from the events like those that culminated in 2008.

C. "The CFTC invites comment on whether the IFR's approach to defining the universe of swaps subject to its exemption may provide a clearer and easier mechanism for providing relief from swaps requirements than the CFTC's interpretation of forwards with embedded volumetric optionality and whether the IFR currently provides sufficient relief for such contracts."

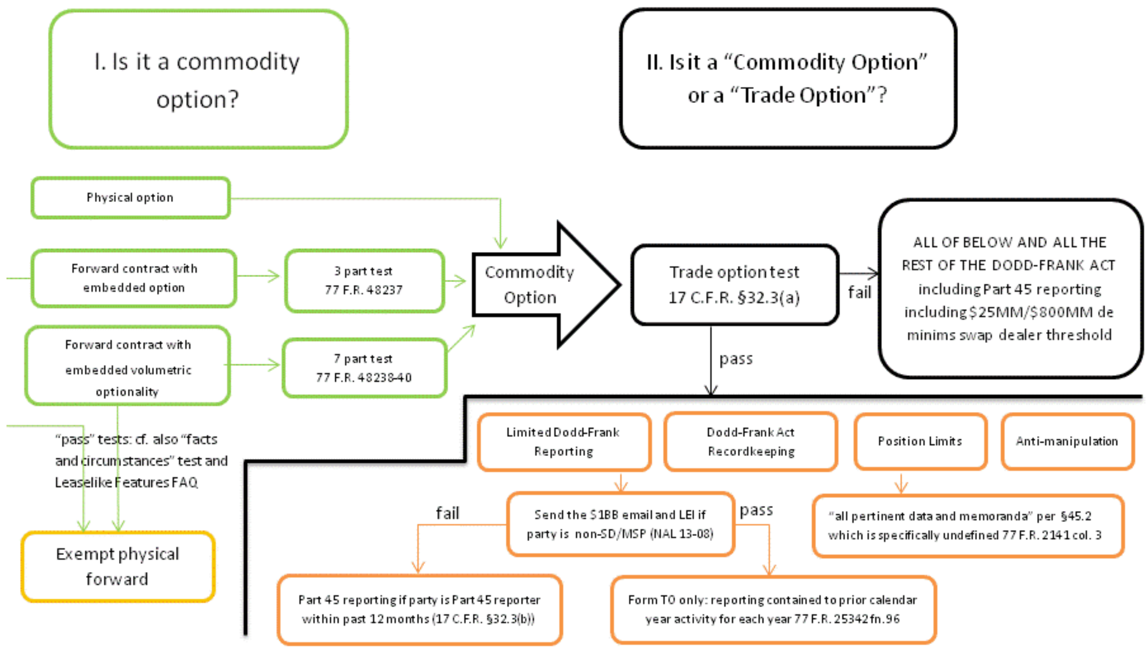
We believe that the best approach is to get the forward contract with embedded volumetric optionality interpretation corrected so that physically-settled nonfinancial commodity contracts, that are intended by Congress to be excluded from the CFTC's regulation of swaps, are not subject to the Trade Option requirements.

While we readily agree that the Commodity Option IFR provides limited, but beneficial, relief to commercial end users, we remind the Commission of our prior comments indicating that such relief will be significantly reduced if Trade Options remain subject to Position Limits.

Although the Trade Option exemption does provide relief, the compliance burden for Trade Options has been significantly underestimated by the CFTC. Requiring every agreement, contract or transaction that fails any factor of the Seven Factor Test to comply with the burdensome requirements of the Commission's IFR for trade options is a much larger burden on end users than has been characterized by the CFTC.

By way of example, under the rules applicable to trade options under the IFR, the following is the compliance map that every commercial end user must apply to every transaction it enters into that is clearly "intended to be physically settled," failing which the party and individual employees of the party face potential civil penalties or possibly jail time:

Trade Option Compliance Flowchart



This is an enormously complex task that Congress did not intend for end users to apply to each and every transaction they utilize to meet their need to purchase or sell a physical commodity as an integral part of their commercial operations. The costs of applying these tests to each and every transaction are ultimately passed on to all businesses and all consumers.

In this regard, the CFTC has estimated that it takes approximately 2 hours to complete a Form TO. Several trade associations for the energy industry provided comments to the CFTC that the burden estimate was grossly understated. In addition, participants at the CFTC's End-user roundtable (April 3, 2014) estimated that the burden to prepare the Form TO was approximately one full time equivalent, and even a larger burden for smaller entities that have less regulatory compliance infrastructure.[7] Despite these concerns and revised burden estimates, the CFTC represented to the United States Office of Management and Budget the following position:

> "The [CFTC] ***does not believe*** that an intricate knowledge of the Commodity Exchange Act or the agency's procedures, personnel, and implementing regulations ***is necessary in order to accurately prepare and submit a Form TO*** in approximately two hours to the [CFTC], as required under Regulation 32.3(b)(2) and explained in the instructions attached to the document."

[7] http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript040314.pdf, at p. 161.

We believe the CFTC's estimate is grossly misleading and severely understated. As provided in the estimate below, we think the burden to comply with the Trade Option requirements is much greater.

D. Responses to Specific Requests for Comments by the CFTC.

"Market participants have argued that the lack of clarity around the seventh element of the CFTC's interpretation has led to costs to end-users. Conceivably, since contracts that fail one or more of the seven elements would be regulated as exempt commodity trade options under the IFR, these costs are attributable to complying with the IFR. The CFTC invites comment on whether or not this is the case, and invites the submission of data quantifying those costs."

A primary factor in determining the burden of complying with the Trade Option rule relates to the number of contracts that are subject to the requirements (*e.g.*, not excluded under the seven part test, etc.). In this regard, after a contract is determined to be a Trade Option, certain document retention requirements must be instituted and the contract has to be reviewed and monitored for Form TO and No-Action reporting. For example, the optionality must be identified and valued to complete the Form TO. The IECA recently conducted a survey of its Dodd-Frank working group members, and others in the industry, to determine the burden companies are experiencing to comply with the Trade Option requirements.[8] From those who responded, the following estimates were derived:

- It takes approximately 80 minutes <u>*per contract*</u> to prepare the Form TO and related No-Action reporting (this does not include the burden to classify the transaction as a Trade Option).

- It takes approximately 38 minutes per Trade Option to comply with the record retention requirements.

- Approximately 30% of the Trade Options require legal review at an approximate cost of $200 per contract (this does not include the burden to classify the transaction as a Trade Option).

- Approximately 55.5% of those that responded stated that the number of Trade Options would be reduced or significantly reduced if the Proposed Interpretation were adopted.

These findings of the time spent per Trade Option (with multiple Trade Options reported on each Form TO) are not consistent with the CFTC's estimated burden of two hours per year for companies to complete the Form TO. As discussed above, we believe that the best approach is to get the interpretation corrected so that contracts that were

[8] In summarizing the survey responses, outliers and non-responsive answers were ignored as a conservatism.

specifically intended to be excluded by Congress are not subject to the Trade Option requirements.

> **"Do the proposed changes provide sufficient clarity on how contracts with embedded volumetric optionality may satisfy all seven elements of the interpretation, particularly the first and second elements?"**
>
> Yes, based on the clarifications requested herein.
>
> **"Are there reasons why trying to provide further relief through the swap definition's forward contract exclusion would not be in the public interest?"**
>
> No. We believe it is in the public interest to do so.

III. Considering that the Commission has made Beneficial, Substantive Changes to the Seven Factor Test in the Proposed Interpretation, the IECA Requests that the Commission Provide Relief from any Potential Violations of the Commission's Reporting or Recordkeeping Rules that May Arise as a Result of an Entity's Classification of any Contract, Agreement or Transaction under the Prior Interpretation set forth in the Products Release or an Entity's Treatment of any such Previously Classified Trade in a Manner Consistent with the Proposed Interpretation.

Considering that the Commission has changed its Seven Factor Test in the Proposed Interpretation, we respectfully request that the Commission provide relief from any potential "violations" of its recordkeeping or reporting rules that may arise as a result of an entity's classification of any contract, agreement or transaction as either an "excluded forward contract with embedded volumetric optionality" or a "trade option" under the Commission's prior interpretation as set forth in the Products Release, or an entity's treatment of any such previously classified contract, agreement or transaction in a manner consistent with the Proposed Interpretation.

In fact, subjecting parties to liability for violations or requiring parties to reclassify all their contracts, agreements or transactions today under the Proposed Interpretation and seek new representations of their counterparties' intent for transactions entered into during 2013 or 2014 is unduly burdensome, if not impossible, and should be the subject of relief granted by the Commission, either in the final version of its Proposed Interpretation or by using other means acceptable to the Commission.

The reporting (and recordkeeping) requirements for commodity trade options are significantly greater than those required for excluded forward contracts. In addition to the reporting requirements for commodity trade options using Form TO, the CFTC also stated in the Commodity Options FAQ that counterparties entering into commodity trade options "are required to comply with the recordkeeping requirements of Part 45 of the

Commission's regulations."[9] For example for non-swap dealers or non-major swap participants," the primary recordkeeping requirements are set out in § 45.2(b),which [require keeping] 'full, complete and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty.'"[10] This includes the continuation data on swap continuation events, such as option exercises, pursuant to § 45.4. "Non-SD/MSPs also are subject to the other general recordkeeping requirements of § 45.2, such as the requirement that records must be maintained for 5 years [following the final expiration or termination of the swap] and must be retrievable within 5 days."[11] Forward contracts with embedded volumetric optionality can often have contract terms of 10 years or even more, and the life of swap plus 5-year retention is very non-standard for such physical commodity transactions.

There are no such reporting or regulatory recordkeeping requirements for forward contracts under the CEA. Because of this increased burden, we believe it is important that the Commission provide relief for parties who previously classified trades as commodity trade options under the Products Release, that would now be classified as forward contracts with embedded volumetric optionality under the Proposed Interpretation, to not be subject to liability for violations of the reporting and regulatory requirements. Similarly, we request that parties not be required to go back and reclassify trades entered into during 2013 and 2014, since obtaining representations from counterparties regarding their intentions at the time each of them entered into such trades may be an impossible task.

We respectfully request that such relief be granted in the final version of this Proposed Interpretation or by some other means acceptable to the Commission.

IV. The Proposed Interpretation Begins with a Fundamental Premise that Contradicts the Plain Words of the CEA.

In its preamble to the Proposed Interpretation, the CFTC sets forth the premise under which it has developed its Proposed Interpretation as follows:

> "In providing its interpretation, the CFTC was guided by and sought to reconcile agency precedent regarding forward contracts containing embedded optionality with ***the statutory definition of "swap" in section 1a(47) of the CEA, which provides, among other things, that commodity options are swaps, even if physically settled."***

[9] CFTC Division of Market Oversight Responds to Frequently Asked Questions Regarding Commodity Options -Commodity Options FAQs issued September 30, 2013 ("Commodity Options FAQ") citing 17 CFR Part 45; 77 FR 2136 (Jan. 13, 2012) ("Swap Data Recordkeeping and Reporting Requirements").

[10] Commodity Options FAQ citing 17 CFR § 45.2(b).

[11] Commodity Options FAQ citing 17 CFR § 45.2(c), 17 CFR §45.2(e)(2).

The IECA respectfully submits that the foregoing statement misstates the statutory definition of "swaps" in section 1a(47) of the CEA as amended by the DFA to apply to swaps.

The definition of "swap" in Section 1a(47) of the CEA contains subparagraphs (A), (B), (C), (D) and (E). Subparagraph (A), which contains the general definition of "swap," begins with the words "Except as provided in subparagraph (B), the term "swap" means any agreement, contract, or transaction -" and then enumerates clauses (i) through (v). Clause (i) of subparagraph (A) of Section 1a(47) includes any agreement, contract, or transaction "that is a put, call, cap, floor, collar or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more … commodities…"

So, subparagraph (A) specifically lists in clauses (i) through (v) what is included in the defined term "swap," but we note that subparagraph (A) of Section 1a(47) of the CEA contains no mention of the words "physically settled."

Subparagraph (B) of Section 1a(47) lists the specific "Exclusions" to the definition of "swap" in clauses (i) through (x). Clause (i) of subparagraph (B) of Section 1a(47) excludes futures contracts and options on futures contracts from the definition of "swap." Clause (ii) of subparagraph (B) of Section 1a(47) excludes "any sale of a nonfinancial commodity or security for deferred shipment or delivery **so long as the transaction is intended to be physically settled**."

Here, in clause (ii) of subparagraph (B) of Section 1a(47), is the only place that the words "physically settled" appear in the definition of "swap" in all of Section 1a(47), but clause (ii) of subparagraph (B) of Section 1a(47) is EXCLUDING "any sale of a nonfinancial commodity for deferred shipment or delivery" to the extent that such sale transaction is "intended to be physically settled."

Recapping the above statements, subparagraph (A) enumerates clauses describing "any agreement, contract or transaction" that is included in the definition of "swap," but subparagraph (A) expressly begins with the words "Except as provided in subparagraph (B)," and clause (ii) of subparagraph (B) excludes "any sale of a nonfinancial commodity for deferred shipment or delivery so long as the transaction is intended to be physically settled."

Moreover, the point of 1a47(B)(ii) is to distinguish swap transactions that are financially settled from "real world" transactions that are physically settled.

Inconsistencies are not surprising when comparing the CFTC's interpretive guidance to the requirements of Section 1a(47)(B)(ii), which says the term "swap" does not include – "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled." "Settled" does not mean "delivered." A physically settled contract is settled by an exchange of money for the commodity if the commodity is delivered, or not delivered, as provided in the contract. This is in contrast to a swap, which is "financially" settled by an exchange of cash flows, such as an exchange of a fixed price for a floating price.

Section 1a(47)(B)(ii) excludes "any sale of a nonfinancial commodity for deferred shipment or delivery"; the exclusion is expansive: "***any*** sale", and not a narrow "any non-volumetrically variable sale".

In its IFR, the CFTC provides "an exemption from certain swaps regulations for trade options on exempt and agricultural (nonfinancial) commodities as between commercial and sophisticated counterparties."[12] In its IFR, the CFTC took the CEA's exclusion from all of DFA of transactions that are intended to be physically settled and made it an element of being subject to some of DFA. Under CEA §1a(47)(B)(ii) "The term 'swap' does not include any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled". Yet, the CFTC in this instance defines "physically settled" as "if exercised, the option would result in the sale of an exempt or agricultural commodity (i.e. non-financial) commodity for immediate (spot) or deferred (forward) shipment or delivery", and adds an element requiring intent of "both parties".[13] Yet "settled" does not mean "purchased" or "sold" or "delivered", and the above phrase added by the CFTC to §1a(47)(B)(ii) at 77 Fed. Reg. 25326 col. 3 is not in the statute at all. Something that can only be physically settled must be intended to be physically settled, whether or not one or both parties "intend" to "purchase" or "sell" or "deliver". The CFTC has added two new elements - "dual intent" to "actually deliver" that are not in the statute.

The statute clearly provides that if the parties to a deferred shipment or delivery transaction for a nonfinancial commodity intend to physically "settle" (not "deliver"), then CEA section §1a(47)(B)(ii) trumps CEA §1a(47)(A)(i) and the CFTC was not given jurisdiction over such commodity options as "swaps." The CFTC has plenary jurisdiction over such commodity options pursuant to CEA §4c and provisions of the CEA pre-dating DFA, but not as "swaps" pursuant to DFA.

Accordingly, an option for deferred shipment or delivery of a nonfinancial commodity that is intended to be physically settled (a "Trade Option") cannot be a swap under CEA §§1a(47)(B)(ii) and 1a(47)(A)(i). Therefore, such an instrument should not be a "swap" subject to position limits.

This is consistent with Congress's intent: nonfinancial commodity transactions (even options) are not exchanges of cash flows, nor did they have or present any risk of deleterious effect on the economy or contribute to the 2008 financial crisis. DFA was not intended to give the CFTC new jurisdiction over the broad "real economy" world of nonfinancial commodities.

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[12] See 77 Fed. Reg. 25326.

[13] "The third element of the trade option exemption is that both parties must intend that the commodity option be physically settled … ." 77 Fed. Reg. 25326

On this basis, the IECA would respectfully restate the premise upon which the CFTC's Proposed Interpretation should be based as follows:

> "In providing its interpretation, the CFTC was guided by and sought to reconcile agency precedent regarding forward contracts containing embedded optionality with ***the statutory definition of "swap" in section 1a(47) of the CEA, which provides, among other things, that (i) commodity options are included in the definition of swaps, and (ii) sales of a nonfinancial commodity for deferred shipment or delivery are excluded from the definition of swaps so long as such sale transactions are intended to be physically settled."***

The IECA believes that this restated premise will help guide the Commission's efforts to finalize its Proposed Interpretation as it attempts to "reconcile agency precedent regarding forward contracts containing embedded volumetric optionality with the statutory definition of swap in section 1a(47) of the CEA."

Conclusion.

The IECA appreciates the opportunity to provide the foregoing comments and information to the CFTC. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member. If you would like for us to expand our discussion of any of the above-listed discussion points, please let us know.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/	/s/
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