

January 13, 2015

Christopher J. Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Re: Records of Commodity Interest and Related Cash or Forward Transactions  
RIN 3038-AE23

Dear Secretary Kirkpatrick:

On November 14, 2014, the Commodity Futures Trading Commission (“CFTC” or the “Commission”) published in the Federal Register a Notice of Proposed Rulemaking to amend Commission Rule 1.35, 17 C.F.R. § 1.35 (2014). (such proposal, the “Records NOPR”).<sup>1</sup> According to the Records NOPR, the purpose of the amendment is as follows: “. . . to provide that all records required to be maintained under this regulation must be searchable; clarify that all records be kept in a form and manner that allows for identification of a particular transaction, except that records of oral and written communications leading to the execution of a transaction in a commodity interest and related cash or forward transactions are not required to be kept in a form and manner that allows for identification of a particular transaction; exclude unregistered members of designated contract markets (“DCMs”) and swap execution facilities (“SEFs”) from the requirements to retain text messages and to maintain records in a particular form and manner; and exclude commodity trading advisors (“CTAs”) from the oral recordkeeping requirement” (the “Revisions”).<sup>2</sup>

By this letter, the Coalition of Physical Energy Companies (“COPE”) provides comments on the Records NOPR. The members of COPE are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale.<sup>3</sup> COPE

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<sup>1</sup> 79 Fed. Reg. 68140 (Nov. 14, 2014).

<sup>2</sup> *Id.* at 68140.

<sup>3</sup> The members are: Apache Corporation; EP Energy LLC; Iberdrola Renewables, Inc.; Kinder Morgan, Inc.; MarkWest Energy Partners, L.P.; Noble Energy, Inc.; Shell Energy North America, L.P.; SouthStar Energy Services LLC; and Targa Resources.

members typically use swaps and futures to hedge their risk, often using Commission-registered entities such as futures commission merchants and introducing brokers to do so. COPE members do not act on swaps or futures exchanges on behalf of customers or others.

COPE supports the proposed Revisions. However, COPE believes that the Revisions do not go far enough. As set forth below, COPE requests that the Commission limit the application of Rule 1.35 to Commission registrants that deal with customers on a fiduciary basis; Rule 1.35 should not extend to physical end-users.

The purpose of Rule 1.35 has always been to ensure that Commission registrants that deal with customers on a fiduciary basis retain the proper records for the Commission to regulate their activities and protect customer interests.<sup>4</sup> The Commission's 2012 amendments to Rule 1.35 extended the scope of the rule by picking up, *inter alia*, any person with the ability to execute a swap on a swap execution facility.<sup>5</sup> At the April 3, 2014, End-User Roundtable held on April 3, 2014 to discuss, among other things, the impact of the amendments to Regulation 1.35(a) on various market participants, one of the primary issues discussed was the fact that many market end-users are subject to Regulation 1.35(a) simply by virtue of having trading privileges on a DCM or SEF.<sup>6</sup>

In addition to the dialog held at the End-User Roundtable, the Commission received follow-up comments. To the degree that the scope of Rule 1.35 was addressed in these comments, it was uniformly suggested that the reach of the rule should be limited to Commission registrants that

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<sup>4</sup> As stated in the Division of Market Oversight's "Advisory for Futures Commission Merchants, Introducing Brokers, and Members of a Contract Market over Compliance with Recordkeeping Requirements," dated February 5, 2009 ("2009 DMO Advisory Letter"), "[t]he Commodity Exchange Act ("Act") and Commission regulations pertaining to recordkeeping impose requirements for recording information and maintaining records relating to the business of all FCMs, IBs and members." In addition, section 4(g)(a) of the Act, 7 U.S.C. §6(g)(a) (2002), provides generally that FCMs, IBs, floor brokers, and floor traders shall make, keep, and hold open for inspection "...such reports as are required by the Commission regarding the transactions and positions of such person, and the transactions and positions of the customer thereof, in commodities for future delivery on any board of trade in the United States or elsewhere." Sections 4g(b) through (d) of the Act, 7 U.S.C. §§6g(b)-(d) (2002), further provide that: registered entities, including designated contract markets, are required to "maintain daily records"; floor brokers, IBs, and FCMs are required to "maintain daily records for each customer in such manner and form as to be identifiable with the trades referred to in subsection (b)..."; and "daily trading records shall be maintained in a form suitable to the Commission for such period as may be required by the Commission."

<sup>5</sup> Adaptation of Regulations to Incorporate Swaps—Records of Transactions, 77 FR 75523 (Dec. 21, 2012).

<sup>6</sup> See, e.g., CFTC Public Roundtable to Discuss Dodd-Frank End-User Issues (April 3, 2014), Official Transcript at pp 18-19, Remarks of Jerry Jeske, Mercuria Energy Trading, Inc. (discussing the "vast expansion" of the scope of the Regulation 1.35 recordkeeping obligations "past the individual who's a fiduciary responsible for the execution of . . . [customer] order[s] . . . into customer activity").

deal with customers on a fiduciary basis.<sup>7</sup> Representative of these comments were those provided by a large group of agricultural organizations which stated:

Absent a completely new and reworked Regulation 1.35, one way the Commission could address customer and end-user issues would be to simply remove the term “member” in the regulation, and insert the congressional definition in the Commodity Exchange Act which strictly applies these recordkeeping regulations to “FCMs, IBs, floor brokers, and floor traders.” Alternatively, the Commission could clarify the definition of “member” as applicable to Regulation 1.35 in a manner consistent with congressional intent and prior CFTC staff precedent. Prior to the December 2012 amendments to Regulation 1.35, the Commission has always applied the recordkeeping requirements to those that execute customer orders and provide a fiduciary duty to customers. Amendments to Regulation 1.35 in December 1948, June 1963, and September 1971, and the February 2009 Division of Market Oversight Advisory all place the recordkeeping burden strictly on those handling or on the opposing side of customer order executions. The recordkeeping burden was never inclusive of the customer and should not now be expanded.<sup>8</sup>

Similarly, COPE requested that physical end-users be excluded from the reach of Rule 1.35, stating:

COPE does not believe that the Commission intended to saddle end-user/customers with the extensive burden of Regulation 1.35. While the requirements make sense for those who do a customer-facing business and have a need to keep extensive records of their customer interactions, these requirements make no sense for the customers themselves. The upshot of mandating Regulation 1.35 recordkeeping for end-users who sign up to transact on a SEF is that end-users will choose not to become enabled with (“members of”) SEFs and, as a result, they will not trade on such platforms. This result is contrary to the public policy goal of moving swap markets to SEFs.<sup>9</sup>

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<sup>7</sup> See, e.g., Comments on CFTC Staff Public Roundtable to Discuss Dodd-Frank End-User Issues Held on April 3, 2014 of Intercontinental Exchange, at pp. 2-3 (stating that the placing of Regulation 1.35 recordkeeping obligations on “a firm that is not intermediating customer transactions is duplicative and unnecessary”) (April 17, 2013); accord Comments of American Farm Bureau Federation, American Feed Industry Association, Commodity Markets Council, National Corn Growers Association, National Council of Farmer Cooperatives, and National Grain and Feed Association regarding Regulation 1.35 Discussion at Public Roundtable to Discuss Dodd-Frank End-User Issue, at pp 1-2 (April 17, 2014).

<sup>8</sup> *Id.*

<sup>9</sup> COPE Comments regarding End-User Roundtable – Follow-Up Comments, at p 3 (April 17, 2014).

Notwithstanding the foregoing, rather than exclude such “unregistered members” from the rule, the CFTC has proposed to “exclude unregistered members of designated contract markets (“DCMs”) and swap execution facilities (“SEFs”) from the requirements to retain text messages and to maintain records in a particular form and manner.”<sup>10</sup> In fact, the Records NOPR does not meaningfully address or acknowledge the comments seeking that the scope of the rule’s requirements be limited to those that have been historically covered (*e.g.*, Commission registrants with customer-facing businesses).

While COPE appreciates the above noted aspect of the Revisions, it simply does not go far enough. Physical end users such as COPE members are already subject to swap record keeping requirements and, through large trader regulation, futures-related record keeping requirements. There is no reason, and the CFTC does not provide one in the Records NOPR, that they should be subject to further requirements due to executing a swap on a SEF rather than over the counter. It appears to COPE that the application of Rule 1.35 to such unregistered members is just regulation for regulation’s sake, and would achieve no public policy purpose. Rather, it will create overlapping and confusing recordkeeping requirements for the same transaction.

Further, as the Commission is well aware, DCMs are structured as vertically integrated clearing platforms in which trades are intermediated by futures commission merchants (“FCM”). Thus, unless an end-user wants to acquire membership status on a DCM to obtain more favorable economics, it will not be a “member” of a DCM for the purposes of Rule 1.35, as its trades will be intermediated by an FCM. In contrast, however, a SEF does not perform a clearing function, and as such participation on a SEF does not require intermediation. Thus end-user participation on a SEF will cause the end-user to be a “member” of the SEF for the purposes of Rule 1.35, due to the ability to directly execute transactions on the SEF.

Accordingly, COPE respectfully requests that the Commission exclude physical end-users from the scope of Rule 1.35. Today, COPE members and their peers in the end-user community are already “voting with their feet” and assuring that they do not become “members” of a DCM or a SEF. Given the CFTC’s goal of an exchange-traded swap market, one would think that its regulations would encourage the use of SEFs, not create impediments to their use. Additionally, it does not make sense to discourage end-users from acting to obtain better economics on a DCM by acquiring membership status. The Commission can still remedy this overstep by excluding unregistered members from the reach of Rule 1.35, and COPE requests that it do so.

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<sup>10</sup> Records NOPR at 68145.

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Respectfully Submitted,

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CC: COPE Members