

January 13, 2015

**VIA ELECTRONIC SUBMISSION**

Mr. Christopher J. Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

***Re: Records of Commodity Interest and Related Cash or Forward Transactions,  
RIN3038-AE23***

Dear Secretary Kirkpatrick:

**I. INTRODUCTION.**

On behalf of The Commercial Energy Working Group (“**Working Group**”), Sutherland Asbill & Brennan LLP hereby submits these comments in response to the Commodity Futures Trading Commission (“**CFTC**” or “**Commission**”)’s Notice of Proposed Rulemaking, *Records of Commodity Interest and Related Cash or Forward Transactions* (“**NOPR**”),<sup>1</sup> which, among other things, proposes to exclude “members”<sup>2</sup> of a designated contract market (“**DCM**”) or swap execution facility (“**SEF**”) that are not registered or required to register with the CFTC (“**Unregistered Members**”) from the requirements to (i) retain text messages and (ii) keep records in a particular form or manner under CFTC regulation 1.35.

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment

<sup>1</sup> See *Records of Commodity Interest and Related Cash or Forward Transactions*, Proposed Rule, 79 Fed. Reg. 68,140 (Nov. 14, 2014).

<sup>2</sup> In this context, “member” is defined as an individual, partnership, corporation, or trust (i) owning or holding membership in, or admitted to membership representation on, a registered entity; or (ii) having trading privileges on a registered entity. See CFTC regulation 1.3(q).

regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

The Commission has made in final regulations or proposes to make in the NOPR significant improvements to CFTC regulation 1.35 that have lessened the regulatory burden on Unregistered Members. The Working Group appreciates these efforts, as they promote the use of derivatives markets by a wide variety of participants, leading to liquidity and effective price discovery. The Commission's relief, however, is not sufficient to remove all the unnecessary burdens that CFTC regulation 1.35 places on Unregistered Members. Accordingly, as further described below, the Working Group recommends the CFTC to limit the definition of "member" set forth in regulation 1.31 to entities that (i) act as intermediaries for unaffiliated entities, (ii) handle customer orders, or (iii) serve as agents on behalf of a customer seeking to trade on an exchange, such as Futures Commission Merchants ("FCMs"), Introducing Brokers ("IBs"), or Swap Dealers ("SDs"). Alternatively, the Working Group suggests the Commission require Unregistered Members to keep pursuant to regulation 1.35 only written records of final relevant agreements.

## **II. THE CFTC SHOULD FURTHER LIMIT THE APPLICABILITY OF CFTC REGULATION 1.35 TO UNREGISTERED MEMBERS.**

The Commission has provided in final regulations or proposes to provide in the NOPR relief to Unregistered Members<sup>3</sup> from the requirements of CFTC regulation 1.35, which largely addresses technical burdens, such as voice recording and capturing text messages. While the Working Group supports this relief, it does not sufficiently reduce the burdens that Unregistered Members bear under CFTC regulation 1.35 and is limited given Unregistered Members use an array of other forms of electronic communication. Even with the relief afforded in the NOPR, commercial firms must consider implementing recordkeeping obligations for commercial activities with only a tenuous connection to derivatives trading.

For the reasons described below, the Working Group recommends that the Commission eliminate the recordkeeping obligations under regulation 1.35 for Unregistered Members by (i) limiting the definition of "member" provided in regulation 1.31 to those entities that act as intermediaries for unaffiliated entities, handle customer orders, or serve as agents on behalf of a customer seeking to trade on an exchange, such as FCMs, IBs, or SDs, or (ii) requiring Unregistered Members to keep under regulation 1.35 only written records of final relevant agreements. Notably, the latter approach was supported on a bipartisan basis last year by the U.S. House of Representatives under H.R. 4413, which provided:

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<sup>3</sup> Many commercial firms are subject to CFTC regulation 1.35(a) because they are "members" of a DCM or SEF. Thus, a rule likely designed to cover intermediaries and substantial principal traders at the exchange arguably now incorporates any commercial firm that trades derivatives on an organized exchange. One can infer by the general design of CFTC regulation 1.35, such as the reference to trading cards, that the rule initially was drafted to govern firms and persons who were trading on the floor of an exchange—a category of persons very different from many commercial firms.

“SEC. 4u. RECORDKEEPING REQUIREMENTS APPLICABLE TO NON-REGISTERED MEMBERS OF CERTAIN REGISTERED ENTITIES.

Except as provided in section 4(a)(3), a member of a designated contract market or a swap execution facility that is not registered with the Commission and not required to be registered with the Commission in any capacity shall satisfy the recordkeeping requirements of this Act and any recordkeeping rule, order, or regulation under this Act by maintaining a written record of each transaction in a contract for future delivery, option on a future, swap, swaption, trade option, or related cash or forward transaction. The written record shall be sufficient if it includes the final agreement between the parties . . . .”<sup>4</sup>

CFTC regulation 1.35 instructs an Unregistered Member, among others, to retain all written communications that lead to the execution of a transaction in a commodity interest or related cash or forward transaction, including instant messages, electronic mail, or other electronic media. This overly broad standard begs the question of which transactions are in scope and subject to the requirements of CFTC regulation 1.35.<sup>5</sup> For a commercial firm that engages in significant commodity transactions, the scope might be quite large, particularly when a firm has integrated risk management systems wherein the risk associated with physical and financial transactions are managed collectively.<sup>6</sup>

More specifically, a market participant must determine what cash market transactions are in scope, such as rack sales of refined products. Strictly interpreted and without further Commission guidance, commercial firms do not have a definitive answer that such transactions categorically are out of scope.<sup>7</sup> It is particularly costly, if possible, to determine whether each communication made by an Unregistered Member ultimately will lead to the execution of a

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<sup>4</sup> H.R. 4413, 113<sup>th</sup> Congress. The Working Group notes that H.R. 4413 retained the requirement that records kept under regulation 1.35 be identifiable and searchable by transaction. However, the CFTC’s current proposal eliminates such requirement, and the Working Group supports this proposal to do so. Should the Commission adopt this recommendation, revised regulation 1.35, as amended by the NOPR, would read:

. . .

(3) Provided, however, for a member of a designated contract market or swap execution facility that is not registered or required to register with the Commission in any capacity, records required to be kept pursuant to paragraph (a)(1) of this section shall be limited to a written record reflecting the final agreement of the parties with respect to each transaction in a contract for future delivery, option on a future, swap, swaption, trade option, or related cash or forward transaction.

<sup>5</sup> The Working Group notes that the term “text message” is not currently used in CFTC regulation 1.35 and that other written communications on mobile devices pose the same challenges that justify the exclusion of text messages from regulation 1.35.

<sup>6</sup> Moreover, because commercial energy firms hedge their physical risk on a portfolio basis, nearly every physical transaction arguably could be related to a transaction in a commodity interest and consequently subject to the record retention provisions of CFTC regulation 1.35.

<sup>7</sup> The Working Group notes that the Commission might not exclude only retail transactions, as many small physical transactions are in the wholesale chain.

transaction in a commodity interest or related cash or forward transaction. Commercial energy companies typically engage in ongoing communication with any number of counterparties over an extended period of time. Some of these communications ultimately lead to the execution of a trade, and some will not. Because a market participant cannot be certain at the time of the communication whether or not it will lead to the execution of a transaction in a commodity interest or related cash or forward transaction, an Unregistered Member might be forced to retain every communication surrounding its commodity trading business.

Moreover, firms must determine whether all persons involved in their organization are subject to the recordkeeping requirements of CFTC regulation 1.35. For example, a firm might have one desk that engages in some derivatives trading of a commodity, but a separate desk that strictly trades physical forwards or spot transactions on the same commodity. Without further clarity, a commercial firm does not know whether the recordkeeping requirements under CFTC regulation 1.35 apply across the organization or, in the foregoing example, to both desks. So even with relief on technical issues for Unregistered Members under CFTC regulation 1.35, commercial firms potentially face (a) uncertainty about the scope of the regulation and (b) if interpreted broadly, a tremendous burden in applying the standards across their entire organization, including application to both derivatives and physical market trading.

These burdens imposed upon Unregistered Members under regulation 1.35 are unnecessary as these commercial end-users do not pose a systemic risk to the U.S. financial markets. Yet if they choose to become a “member” of a DCM/SEF as defined in regulation 1.31, they will be subject to the same recordkeeping obligations incurred by entities that act as market intermediaries or handle customer orders under regulation 1.35. Many commercial firms thus will face a choice of (i) having to comply with onerous recordkeeping obligations as an Unregistered Member<sup>8</sup> or (ii) refraining from obtaining memberships in DCMs/SEFs notwithstanding Congress’s and the CFTC’s objective to increase transparency in the swaps markets. Stated differently, knowing they might simultaneously trigger onerous recordkeeping obligations under CFTC regulation 1.35, these commercial end-users might refrain from obtaining memberships in DCMs/SEFs if the costs of complying with the recordkeeping requirements of CFTC regulation 1.35 (on both physical and financial commodity trading activities) outweigh the economic benefit of reduced fees. The Working Group submits that Congressional intent and public interest support the protection of non-financial end-users from these unintended consequences.

### **III. RESPONSE TO SPECIFIC REQUESTS FOR COMMENT.**

- 1. What are the potential effects of removing the requirement that records of oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and related cash or forward transaction are not required to be kept in a form and**

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<sup>8</sup> Often, non-financial end-users will obtain a membership in a DCM/SEF simply to receive discounts and reduced execution fees.

**manner that allows for identification of a particular transaction?**

The Working Group supports the CFTC's removal of the requirement to keep records under regulation 1.35 in a form and manner allowing for identification of a particular transaction. Requiring records of electronic communications to be identified and tied to an individual transaction is (i) unnecessarily burdensome on commercial end-users who do not pose a systemic risk to the U.S. financial markets and (ii) likely extraordinarily costly. Relief from this type of onerous requirement will allow Unregistered Members to forego spending significant resources and money in complying with the unnecessary obligations applicable to them under CFTC regulation 1.35.

**2. What are the potential effects of excluding Unregistered Members from the requirement to retain text messages?**

The Working Group supports the CFTC's proposal to exclude Unregistered Members from the requirement to retain text messages. As stated above, this relief allows Unregistered Members to avoid unnecessary and costly measures to meet technical challenges. Further, excluding Unregistered Members from the requirement to retain text messages would not disrupt the CFTC's oversight function, as Parts 43 and 45 of the CFTC's regulations would require Unregistered Members to keep full, complete, and systematic records of all their swap transactions, and Parts 18, 20, and 150 of the CFTC's regulations would require Unregistered Members with certain large derivatives positions to retain records of such positions and all related cash market activity.

**3. Is existing technology for storing text messages cost prohibitive for Unregistered Members to use? Are there other impediments to using this technology?**

The Working Group submits that existing technology for storing text messages is cost prohibitive for many Unregistered Members. While current technology might appear to make the cost of capturing and saving data feasible, many difficulties and costs arise in having to produce the data. If that data must be kept for a long a time, then the task of compliance with CFTC regulation 1.35 becomes extraordinarily burdensome. The Working Group submits that the regulatory benefit to the Commission in requiring Unregistered Members to store text messages, if any, is outweighed by the costs that must be borne by the Unregistered Members to comply with such requirement. Unregistered Members do not pose a systemic risk to the U.S. financial markets, and thus, imposing these burdensome requirements on them under regulation 1.35 is unnecessary.

**4. What are the potential effects of excluding Unregistered Members from the requirements to store required records in a form and manner that is searchable and in a form and manner that allows for identification of a particular transaction?**

The Working Group supports the CFTC's proposal to exclude Unregistered Members

from the requirement to retain records in a form and manner that is searchable and identifiable by transaction. Building on the Working Group's answer to Question No. 3, there are costs associated with capturing and maintaining massive amounts of data. Requirements to keep such data in a certain form and manner only multiply such costs. At a certain point, even small commercial firms might be expending significant resources to meet its compliance obligations under regulation 1.35, draining capital away from its core commercial business activities (with uncertain regulatory benefit). Imposing such onerous and costly measures upon entities that do not pose a systemic risk to the U.S. financial markets is entirely unnecessary.

**5. Rather than excluding all Unregistered Members from these aspects of the written recordkeeping obligations of the rule, would the interests of promoting customer protection and minimizing recordkeeping burdens be better balanced by excluding only small Unregistered Members from these requirements? If so, how would "small" Unregistered Members be defined?**

The Working Group believes all Unregistered Members should be exempted from these aspects of the written recordkeeping obligations of CFTC regulation 1.35. There is no evidence that Congress separated market participants by size when indicating that end-users should not suffer unintended consequences under derivatives reform. The Working Group also submits that defining the term "small" could invite further unnecessary dispute and uncertainty.

**6. Would the exclusion of text messages from the written records requirement for all Unregistered Members incentivize Unregistered Members, especially commodity trading firms, to switch their method of communication? If so, should the Commission use a certain threshold in setting this exclusion, ensuring that the Commission can continue to properly oversee and monitor the derivatives market and enforce Commission rules and regulations?**

The exclusion of text messages from the record retention requirements unlikely will cause Unregistered Members to switch to different forms of communication. The mode of communication that traders use in trading commodities, both physically and financially, is largely driven by convention. Additionally, regulated members who transact with Unregistered Members will use methods of communication other than text messaging, which consequently, also will require Unregistered Members to use such methods.

Although firms and traders use text messaging to some extent, the Working Group does not foresee any migrations to text messaging for purposes of formalizing contracts. Firms have invested substantial resources in their trading systems, including their books of record. Moving to text messaging would entail some degree of cost. If the Commission properly scopes the obligations of Unregistered Members under CFTC regulation 1.35, then the cost of such migration to text messaging likely would exceed the benefits.

**7. Would the Proposal impact the Commission's ability to carry out its market oversight responsibilities with regard to the overall derivatives market? If so, how?**

Any proposal to scale back the requirements applicable to Unregistered Members under regulation 1.35 will help alleviate unnecessary burdens on Unregistered Members and would in no way impact the CFTC's ability to carry out its market oversight function. Indeed, Parts 43 and 45 of the CFTC's regulations require end-users to keep full, complete, and systematic records of all their swap transactions. Further, Parts 18, 20, and 150 of the CFTC's regulations require market participants with certain large derivatives positions to retain records of such positions and all related cash market activity.

**8. Does the Proposal serve the public interest? In what ways?**

Yes, the Proposal serves the public interest. As described in Section II above, CFTC regulation 1.35 has produced unintended consequences on commercial firms, including the imposition of unnecessarily burdensome requirements on Unregistered Members even though they do not pose a systemic risk to the financial markets. Congressional intent and public interest is served where commercial end-users are protected from unintended consequences of financial reform.

The Working Group notes that commercial firms that are members of U.S. regulated exchanges subject their trading on such exchanges to U.S. regulatory oversight. CFTC regulation 1.35, in its currently overly broad scope, is a disincentive for commercial firms to become exchange members. Limiting the scope of the rule in an appropriate manner should act as an incentive for firms to become members, thus granting the Commission clear jurisdiction over their trading on such exchanges.

**IV. CONCLUSION.**

The Working Group submits that the recordkeeping requirements under CFTC regulation 1.35 applicable to Unregistered Members are unnecessary and costly. As such, the requirements of CFTC regulation 1.35 should (i) be limited to members of DCM/SEFs that act as intermediaries or agents on behalf of a customer seeking to trade on an exchange, such as FCMs, IBs, or SDs, or (ii) require Unregistered Members to keep only written records of final relevant agreements. The Working Group appreciates this opportunity to provide comments on the NOPR and respectfully requests the Commission's consideration of these comments as it develops its final rule. Please contact the undersigned with any questions.

Respectfully submitted,

*/s/ David T. McIndoe*

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