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The Honorable Debbie Stabenow, Chairwoman
The Honorable Thad Cochran, Ranking Member
U.S. Senate Committee on Agriculture, Nutrition & Forestry
328A Russell Senate Office Building
Washington, DC 20510

VIA ELECTRONIC MAIL

Re: *CFTC Reauthorization*

Dear Chairwoman Stabenow and Ranking Member Cochran:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits these high-level comments in response to the United States Senate Committee on Agriculture, Nutrition & Forestry's request for comment on the Commodity Futures Trading Commission ("**CFTC**") Reauthorization. The Working Group has identified the following issues as the primary areas where Congress can improve the derivatives regulation infrastructure set forth in the Commodity Exchange Act ("**CEA**") to better protect the needs of commercial firms. Members of the Working Group met with your staffs on May 9, 2013 to discuss these issues. This letter provides an outline of the topics discussed during those meetings. The Working Group appreciates the opportunity to provide the comments set forth herein and respectfully requests the Committee's consideration of such comments.

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 energy producers, marketers, and utilities. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

II. COMMENTS OF THE WORKING GROUP.

A. THE DEFINITION OF "FINANCIAL ENTITY" SHOULD NOT INCLUDE "CENTRAL DESKS" WITHIN COMMERCIAL ENTERPRISES.

- The definition of "financial entity" under the CEA refers to banking law which currently treats some trading of physical commodities and the trading of related derivatives as "financial activity."

- Many commercial firms have affiliates that face the market on behalf of the entire company. These market-facing affiliates allow a commercial firm to centralize its hedging, trading and marketing functions. Such companies may be improperly categorized as "financial entities" because of the cross-reference to the banking laws. As a result, certain commercial end-users will be treated like hedge funds and Congress's careful protections for end-users in the Dodd-Frank Act will be significantly diminished.

Recommendation: Amend the definition of "financial entity" to reflect original Congressional intent.

B. THE CFTC SHOULD NOT ALLOW THE *DE MINIMIS* LEVEL TO AUTOMATICALLY REDUCE.

- Under the CFTC's current rules, the *de minimis* level of swap dealing is set to automatically decrease by 60% within 5 years, and possibly sooner. This creates significant uncertainty for nonfinancial companies that engage in a small amount of swap dealing for the benefit of their customers.

- A change in the *de minimis* level would be a significant change in market structure. Congress should set the current $8 billion threshold as the statutory minimum. At the very least the CFTC should be required to undertake a formal rulemaking process in order to change the *de minimis* level. Currently, the prospect of a change in the *de minimis* level because of regulator inaction is very disruptive to market confidence.

- Finally, lowering the *de minimis* level below its current level will drive non-financial companies out of the business of offering their customers risk management products, limiting choices for end-users and further consolidating risk and swap activity in a small number of large Wall Street banks that may pose systemic risk.

Recommendation: Congress should legislatively establish the *de minimis* level at no less than $8 billion as contemplated under the current rule. At the very least Congress should require that any change to the level of the *de minimis* exception be undertaken through a formal rulemaking process and that the *de minimis* level not drop below its current level.

C. FORWARDS AND OPTIONS THAT ARE INTENDED TO BE PHYSICALLY SETTLED SHOULD BE EXCLUDED FROM THE DEFINITION OF "SWAP."

- Under the CFTC's current guidance to the definition of "swap," routine commercial transactions that are completely unrelated to traditional financial contracts are considered swaps. These include options that result in the physical delivery of a commodity and forward contracts that contain some level of variability in how much of a physical product is ultimately delivered, but in all cases do involve the actual sale and delivery of a nonfinancial commodity.

- Regulating these transactions as swaps is inconsistent with the CEA's forward contract exclusion, which excludes from the definition of "swap" transactions that are "intended to be physically settled."

- These transactions ensure the efficient delivery of nonfinancial commodities to companies that require them to conduct their core physical businesses. They do not pose systemic risk and should not be treated like financial contracts and regulated as swaps.

- Even if physical commodity options are excluded from the definition of "swap," the CFTC will still have authority to regulate the transactions under Section 4c of the Commodity Exchange Act. The transactions just will not be regulated as financial products.

Recommendation: Amend the definition of "swap" to exclude physically settling commodity options.

D. THE USE OF THE END-USER EXCEPTION BY AN AFFILIATE SHOULD BE WORKABLE.

- The CEA allows a financial entity to exercise the end-user exception on behalf of a non-financial affiliate if the financial entity is acting on behalf of and as an agent of the nonfinancial affiliate. The CFTC has interpreted this phrase to require an actual agency relationship to exist between the affiliates, which means that the nonfinancial entity must be a principal to the swap. This is contrary to common commercial practice.

- This narrow reading of the phrase vitiates Congress' intent. Requiring the nonfinancial end-user to enter into the swap as principal effectively eliminates the benefits realized by using central hedging affiliates.

Recommendation: Adopt H.R. 677.

E. INTER-AFFILIATE TRANSACTIONS SHOULD NOT BE SUBJECT TO CFTC REGULATION.

- Currently, the CFTC's rules and proposed rules generally treat inter-affiliate swaps like any other swap. As such, among other things, companies must, under certain circumstances, report swaps between majority-owned affiliates and must submit such swaps to central clearing unless the end-user hedging exception applies or complex criteria for the inter-affiliate clearing exemption are met. The CFTC has provided relief in the form of no-action letters, but the no-action letters do not provide adequate relief in many circumstances.

- These regulations impose significant costs upon commercial firms, even though inter-affiliate swaps have little to no impact on the swap markets. For example, the CFTC estimates that compliance costs of its final rule setting forth an exemption from mandatory clearing for inter-affiliate swaps will be almost $700 million.

Recommendation: Adopt H.R. 677.

F. POSITION LIMITS SHOULD ONLY BE IMPOSED BY THE CFTC AFTER A FINDING OF NEED AND EFFECTIVENESS FOR A SPECIFIED CONTRACT.

- Section 4a(a) of the CEA is clear that the CFTC may only implement federal speculative position limits as necessary to prevent excessive speculation. The CFTC has not defined "excessive speculation" and lacks any empirical, quantifiable evidence that large position concentrations harm the markets or the pricing of energy commodities.

- The CFTC should provide substantive cost-benefit analysis (i) establishing the need for the federal speculative position limits for the relevant energy contracts and (ii) discussing the effects that such limits may have on the markets for the relevant energy contracts.

Recommendation: Clarify that the CFTC must make an affirmative finding of need and effectiveness prior to enacting position limits.

G. THE *BONA-FIDE* HEDGING EXEMPTION FROM POSITION LIMITS SHOULD BE AMENDED TO REFLECT CURRENT MARKET PRACTICES.

- A properly functioning position limit regime is not only dependent on a clear understanding of deliverable supply for a particular commodity, but also on a workable hedge exemption process.

- In a change from prior practice, the CFTC's approach in the vacated position limits rule was to limit the availability of the *bona-fide* hedge exemption to a limited set of enumerated transaction forms.

- The *bona-fide hedge* exemption from position limits is necessary to allow end-users of physical commodities to properly hedge commercial risk. The CFTC's limitation of *bona-fide* hedges to enumerated transaction types is overly restrictive. A narrow or formula based definition of what constitutes *bona-fide* hedging will place significant limitations on many end-users' ability to hedge risk properly and efficiently.

Recommendation: Congress should require the CFTC to use general criteria that transactions must satisfy to be considered a *bona-fide* hedge, not just enumerated transaction forms.

H. THE CFTC SHOULD NOT FORCE THE AGGREGATION OF DERIVATIVES POSITIONS FOR POSITION LIMIT PURPOSES UNLESS CONTROL IS EXERCISED OR INFORMATION IS SHARED.

- The CFTC's approach under the vacated position limits rule treated majority ownership as irrebuttable proof that trading-level control existed, and required aggregation under such circumstances. As such, large commercial firms may be obligated to monitor the day-to-day trading activities of their affiliates regardless of whether they have control over or have direct knowledge about such affiliates' swaps trading.

- The rigid application of a majority ownership aggregation requirement does not further Congress' goal of preventing excessive speculation. The focus should be on aggregating positions where trading-level control or coordination exists.

Recommendation: The absence of trading-level control should obviate the need to aggregate for position limits purposes.

I. EXTRATERRITORIAL APPLICATION OF U.S. REGULATION SHOULD NOT HINDER U.S. INTERESTS ABROAD.

- Congress should direct the CFTC to ensure its rules and regulations (i) do not place U.S. companies at a disadvantage when transacting abroad and (ii) do not raise unnecessary barriers for non-U.S. companies seeking to trade in U.S. markets.

- Congress should direct the CFTC to allow U.S. persons and their affiliates to comply with regulations of the relevant nation when doing business abroad, as long as such regulations are consistent with the G-20's derivatives reform principles.

- Given the significance of this issue, Congress should require the CFTC to publish any cross-border guidance as an actual rule so a notice and comment period is required and a proper cost-benefit analysis is performed.

Recommendation: Adopt H.R. 1256.

J. COMMERCIAL FIRMS SHOULD NOT BE SUBJECT TO MARGIN REQUIREMENTS.

- Congress should make clear that it intended not only for margin requirements not to apply to nonfinancial end-users, but it also did not intend for the CFTC and Prudential Regulators to place limitations on the forms of collateral swap dealers and major swap participants can accept from nonfinancial end-users if they agree to collateralize a swap as a commercial matter.

Recommendation: Adopt H.R. 634.

K. THE CFTC'S COST BENEFIT ANALYSIS SHOULD BE IMPROVED.

- Throughout the Dodd-Frank implementation process, the CFTC's rulemakings have consistently not estimated or underestimated the potential costs of its rulemakings, many of which will have substantial impacts on derivatives markets. Similarly, the CFTC has consistently failed to provide meaningful evaluation of the expected benefits of its rules and to explain why one course of action is better than another.

- Congress should amend the CEA to ensure that the CFTC is required to provide thoroughly developed and reasonable estimates of the costs and benefits of its rulemakings.

Recommendation: Adopt H.R. 1003.

III. CONCLUSION.

The Working Group supports appropriate legislation and regulation that bring transparency and stability to the swap markets worldwide. The Working Group appreciates this opportunity to provide comments on the CFTC Reauthorization and respectfully requests that the Committee consider the comments set forth herein.

If you have any questions, please contact the undersigned.

Respectfully submitted,

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