15000 Commerce Parkway, Suite C
Mt. Laurel, NJ 08054

May 23, 2012

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
Telefacsimile: (202) 418-5521 and
Email to secretary@cftc.gov and electronically to http://comments.cftc.gov

Re: Comments of the International Energy Credit Association ("IECA") to Commodity Futures Trading Commission ("CFTC" or "Commission") respecting the Cost-Benefit Analyses in Various Rulemaking Proceedings Currently Pending Before the Commission (17 CFR Part 23, RIN 3038-AC96, 76 Federal Register 29818, May 23, 2011) pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA")

Dear Mr. Stawick:

We are submitting these comments in the docket applicable to the Commission's deliberations on the definition of Swap, but these comments are equally applicable to several other rulemaking proceedings currently pending before the Commission under the Dodd-Frank Act ("DFA").[1] We write in support of Commissioner O'Malia's Letter of February 23, 2012 to the Office of Management and Budget seeking a more thorough approach to cost-benefit analyses. In addition, we write in response to the requests of Commissioner Chilton and other Commissioners, who on several occasions have asked for more public input with respect to the cost-benefit analyses underpinning various rulemakings currently pending before the Commission under the DFA. It is our intent to bring to your attention the substantial increase in the retail costs to US consumers of electricity and natural gas in the home and gasoline at the pump that we believe will result if certain pending rulemakings are finalized as written.

The International Energy Credit Association ("IECA") is not a lobbying group. Rather, we are an association of several hundred energy company credit management professionals grappling with credit-related issues in the energy industry. Our members' concerns regarding the

[1] The IECA previously submitted these comments on April 12, 2012, in the docket applicable to the Commission's deliberations on the Final Rule applicable to the "entity definitions," including the definition of Swap Dealer. As was discussed in one or more of the Commission's public meetings regarding rules being considered under the DFA, the Commission and its Staff may not see or consider comments submitted in response to one rulemaking proceeding under the DFA, when it is deliberating in another rulemaking proceeding. Accordingly, the IECA is submitting these comments in multiple CFTC rulemaking proceedings.

DFA have led us, for the first time in our almost ninety-year history, to comment to a regulator on its rule-makings.

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

Zackary Starbird
Member of the Board
International Energy Credit Association
30 S. Wacker Drive, Suite 900
Chicago, IL 60606
Phone: 312-594-7238
Email: zack.starbird@bp.com

Phillip G. Lookadoo, Esq.
Reed Smith, LLP
Suite 1100 East Tower
1301 K Street, NW
Washington, DC 20005
Phone: 202-414-9211
Email: plookadoo@reedsmith.com

In February, a coalition of six energy Trade Associations[2] wrote to the White House, the National Economic Council, and the Office of Information and Regulatory Affairs explaining that the energy industry needs to use OTC derivatives and that there would be new costs and risks if "swap dealer" was too broadly defined.[3] We support their position. We also support the position of various energy industry representatives with respect to the necessary changes to be made to the Commission's proposed definition of "swap dealer,"[4] including our own comments that were submitted just over a year ago in the Commission's "swap dealer" definition proceeding. The IECA also continues to support the comments we submitted to the Commission on July 28, 2011, with respect to the Further Definition of "Swap," "Security-Based Swap," etc. (17 CFR Part 23, RIN 3038-AC96, 76 Federal Register 29818, May 23, 2011).

Rather than repeating what was said in those letters, we bring to your attention some specific examples of DFA rulemaking with costs that significantly outweigh benefits, and the negative consequences that would hurt our members whether or not they are "swap dealers." These examples are ground level compliance and implementation items that will adversely impact the availability of physical and financial hedging as a risk mitigating tool for our members. Some of these items may seem like minutiae, but their likely impact is that the DFA simply will make unavailable the tools companies need to maximize market participant credit and risk protection. This increases prices to consumers, and increases volatility of prices and supply, while doing nothing to help the reliability and stability of the energy industry.

Placing costs and risks on companies that provide goods and services puts those costs and risks on the consumers of those goods and services. Generally, unduly burdensome DFA regulations could push many jobs and activities to venues overseas with less burdensome

---

[2] The Edison Electric Institute, the Electric Power Supply Association, the American Public Power Association, the American Gas Association, the Independent Petroleum Association of America, the National Rural Electric Cooperative Association, and the Natural Gas Supply Association.

[3] The letter is available at http://www.ipaa.org/news/docs/Energy_End_User_Letter_to_White_House_2-14-12.pdf

[4] See, e.g., the comments submitted in CFTC docket (RIN 3038-AD06) on February 22, 2011, by (i) Edison Electric Institute and Electric Power Supply Association; (ii) Working Group of Commercial Energy Firms; (iii) NextEra Energy Resources, LLC; and (iv) International Energy Credit Association; all of which seek essentially consistent modifications to the CFTC's proposed definition of "swap dealer."

regulatory requirements. The electricity, natural gas and transportation fuel markets, however, are local U.S. markets that cannot be outsourced, so our members will incur the costs and risks that arise from such DFA regulations and, unfortunately, the costs to our customers of providing goods and services will unnecessarily increase.

Here are our examples:

1. The energy industry needs bilateral OTC swap transactions to manage our highly one-of-a-kind volatility risks. Some DFA Proposed Rules could make OTC swap transactions so burdensome, expensive, and potentially less effective that some energy companies may forego their use and instead absorb the risks, which will increase costs to consumers.

    a. The guidance to one proposed rule states that it is a "sound practice" for swap dealers to require senior management to approve agreement templates and "any material modifications" to them.[5] Bilateral OTC swaps used in the energy industry, unlike futures contracts, require extensive negotiation of many different terms. If swap dealers need senior management approval every time before agreeing to any material deviation from their standard forms, then swap dealers will be much less flexible in negotiations with end users. For a swap dealer, if material modifications from its form require distracting extremely busy senior management for an approval, rather than relying on the mid-level professional credit managers and attorneys who make their living understanding and mitigating credit and legal risks, then negotiating agreements will be much more difficult, and take longer to complete, if negotiations can be completed at all. This will lead to fewer counterparties able to transact with one another, and therefore less market liquidity. Less liquidity inevitably translates directly into higher price spreads and higher volatility. This is an example of a very negative consequence of a "sound practice."

    b. A literal reading of the proposed rules seems to require most end-users[6] to obtain board approval for each swap transaction that they elect not to clear.[7] Boards meet infrequently, and are set up to manage the direction of their companies; it would be prohibitively expensive and burdensome to require Boards of Directors to participate in individual trading decisions.

    c. The proposed rules seem to require that all OTC swap transactions be in writing.[8] Bilateral energy commodity transactions often have a term that is shorter than the time it takes to exchange and agree to written confirmations,

[5] Swap Trading Relationship Documentation NOPR, 76 Federal Register p. 6718, col. 2.

[6] Publicly traded companies and every "entity that is an issuer of securities registered under section 12 of, or is required to file reports under 15(d) of, the Securities Exchange Act of 1934".

[7] Proposed Rule §39.6(b)(6)(ii) requires disclosure of "[w]hether an appropriate committee of the board of directors (or equivalent body) has reviewed and approved the decision not to clear the swap" (emphasis supplied).

[8] §§23.504(b)(1), and 23.504(b)(2).

which is why many transactions by OTC market participants are entered into orally.[9] Imposing this obligation would prohibit energy companies from entering into such short-term transactions, thereby eliminating many of the key tools energy companies rely upon to manage unexpected, short-term contingencies, which will increase the costs of managing such contingencies thereby increasing the costs of providing electricity, natural gas and transportation fuel to our customers.

d. The proposed rules are confusing in many areas. One set of proposed rules seems to require a confirmation of receipt of a notice from the Chief Executive Officer or Chief Risk Officer of an end-user company prior to entering into any uncleared swap, or perhaps once a year.[10] Executive time is very expensively misapplied on executing receipts. Even if the rule means to say the receipts are only annual, confusing and conflicting rules make it difficult for companies to structure compliance programs, and do not provide benefits commensurate with their costs if they divert senior management attention away from important matters to deal with trade by trade notifications.

2. Some DFA final rules and proposed rules would make OTC swap contract performance so risky and burdensome that corporate executives would just avoid them:

    a. Collateral valuation disputes, which are common in the OTC markets and routinely resolved by the parties, are to be reported to the CFTC and "any applicable prudential regulator" within a matter of days.[11] No one knows the consequences of being reported to the CFTC for a collateral dispute,[12] and therefore in a dispute an end-user may seek to avoid being reported to the CFTC by conceding the disputed amount, and absorbing the cost of the additional or foregone margin.

---

[9] New York and California amended their statutes of frauds to allow such transactions to be enforceable without being in writing. New York Uniform Commercial Code §2-201(4); New York General Obligations Law §5-701(b) and California Civil Code §1624(b)(2).

[10] Section 23.601: **"**(a) At the beginning of each swap transaction that is not submitted for clearing, a swap dealer … shall notify each counterparty [of] the right to require that any Initial Margin … be segregated… (c) The notification … shall be made to the Chief Risk Officer, or … the Chief Executive Officer … (d) Prior to confirming the terms of any such swap, the swap dealer … shall obtain … confirmation of receipt … of the notification … and an election to require such segregation or not." Although under §23.601(e) "Notification … to a particular counterparty … need only be made once in any calendar year", as the counterparty must actually respond to the notification "at the beginning" of each swap "prior to confirming," the notification must be made both before and after the trade, and that provision does not cover the receipt of an election prior to confirmation of each trade required in §23.601(d). Rather, §23.601(e) only refers to notice once a year, not receipt of election once a year.

[11] Proposed Rule 504(e).

[12] Although the Proposed Rules clearly indicate that utilities have no "prudential regulator," since utilities are regulated for "prudency" by State utility commissions, utilities would be understandably concerned about the risk of a rule being interpreted to require that any collateral disputes be reported to a State commission.

b. The final rules specify there will be no safe harbor for good faith mistakes made in reporting data.[13] A lot of data must be captured in an extremely short time, yet companies may end up being penalized for acting in good faith and doing their best to comply.

c. The essential guidance the industry needs to work within and comply with the overlapping jurisdictions of the CFTC and the Federal Energy Regulatory Commission remains unavailable.[14] The Memorandum of Understanding which Section 720(a)(1) of DFA required within six months of the enactment of DFA has not been issued and is not even rumored to be in progress.

3. The proposed rules seem to seek to bring physical energy and fuel transactions that are not swaps within the CFTC's swap regulation regime:

a. The proposed "swap" definition apparently seeks jurisdiction for the CFTC over all full-requirements and all full-output contracts,[15] and hence over contracts for all of the output of a gas well or of a power plant, for all of the energy required by an aluminum mill, and any other bilateral "full requirements" contract with a volume that automatically adjusts based on need, rather than a unilateral right to elect a different volume, by deeming these embedded options. While we would argue that an agreement that has a variable volumetric delivery amount does not have an embedded option because no right is granted to a party to take more or less than its need or ability to supply, that the CFTC raised the question of whether these types of contracts have embedded options is troubling for energy companies who rely on these contracts to mitigate key risks related to weather, migrations, plant conditions and so forth.[16]

---

[13] Swap Data Recordkeeping Final Rules 77 Federal Register p. 2170 col. 3.

[14] An example that is potentially highly disruptive to energy markets is the CFTC's proposed public interest waiver for RTOs/ISOs, to exempt transactions that otherwise fall into the CFTC's overly broad definition of "swap" so long as they are traded on markets administered by such RTOs/ISOs, which ignores the impact on the bilateral contracts for these products, or physical transactions that use the RTO/ISO mechanisms, which are entered into using bilateral contracts between electric utilities, electric generators, and energy marketers.

[15] Further Definition of "Swap" NOPR, 76 Federal Register p. 29830 col. 2 "where the embedded commodity option(s) render delivery optional, the predominant feature of the contract cannot be actual delivery and, therefore, the embedded option(s) to not deliver preclude treatment of the contract as a forward contract for a nonfinancial commodity." The CFTC's language indicates that an option on whether or not to deliver at all- in other words, an option on the volume of commodities to be delivered under the contract- creates a swap. The "Interpretive Guidance" that "customary consumer or commercial arrangements" are not "swaps" implies that without such "interpretive guidance," the plain meaning of the rule is that they would be "swaps." See also 76 Federal Register p. 29830 col. 2, "That is, a forward contract that contains an embedded commodity option or options would be considered an excluded nonfinancial commodity forward contract (and not a swap) if the embedded option(s): (i) May be used to adjust the forward contract price, but do not undermine the overall nature of the contract as a forward contract; (ii) do not target the delivery term, so that the predominant feature of the contract is actual delivery; and (iii) cannot be severed and marketed separately from the overall forward contract in which they are embedded."

[16] See also 76 Federal Register p. 29830 col. 2, 35. "How would the proposed interpretive guidance set forth in this section affect full requirements contracts, capacity contracts, reserve sharing agreements, tolling agreements, energy management agreements, and ancillary services? Do these agreements, contracts, or transactions have

b. The full costs of applying the DFA regulatory apparatus to physical energy transactions, or of energy companies being forced to abandon full-requirements bilateral contracting, will significantly increase the costs to be paid by the US consumers.

4. Some DFA proposed rules completely ignore the cost to end-users:

   a. The CFTC said that it has determined that swap dealers are not "small entities," and that the proposed rules will not have significant impact on a substantial number of small entities.[17] But the CFTC has failed to consider whether any increase in costs for swap dealers would be passed on to end users, and whether these passed-on costs would have a significant economic impact.

   b. The proposed rule regarding swap documentation examined the costs to swap dealers of compliance but not the costs to end users to review the documentation presented by swap dealers. Using the CFTC's numbers,[18] and assuming an average of five hours of legal work at an allocated in-house attorney's and highly specialized outside attorney's average rate of $300 per hour, additional legal fees to end users from the CFTC's "swap documentation" rules will total nearly a quarter of a billion dollars.

   c. The market is already reacting to the final rule on Business Conduct Standards for Swap Dealers with market price and product availability bifurcation. Risk management products provided to "Special Entities," which include municipalities that can least afford increased costs, have become rarer and more expensive, and will likely become even more expensive, and possibly simply unavailable, as liquidity for municipalities continues to dry up because of the added risks and duties imposed by DFA on energy companies that do business with Special Entities. Even the Special Entities acknowledge that the real cost to Special Entities exceeds the benefits of this aspect of the CFTC's regulations under the DFA.[19]

---

optionality as to delivery? If so, should they—or any other agreement, contract, or transaction in a nonfinancial commodity that has optionality as to delivery—be excluded from the swap definition? If so, please provide a detailed analysis of such agreements, contracts, or transactions and how they can be distinguished from options that are to be regulated as swaps pursuant to the Dodd-Frank Act. …"

[17] Swap Trading Relationship Documentation NOPR, 76 Federal Register p. 6720-6721.

[18] Swap Trading Relationship Documentation NOPR, 76 Federal Register p. 6723, col. 1.

[19] See, for example, Comments of NRECA, APPA, APGA and LPPC dated September 30, 2010, which said on page 14: "The Coalition believes that it is not necessarily an advantage to be treated as a special entity. To the extent that swap dealers or major swap participants face higher costs when dealing with special entities, they may choose not to deal with special entities for certain types of transactions, or they may increase the fees that they (directly or indirectly) charge special entities for engaging in swap transactions. We believe that an entity that is both an ECP [eligible contract participant] and a special entity should be able to "opt out" of the protections afforded by whatever duties the CFTC may establish for swap dealers and major swap participants in their dealings with special entities. … If the CFTC does not accept our recommendation that all ECPs should be able to opt out of being treated as a special entity, then at the very least an eligible commercial entity should not be treated as a special entity

5. Some proposed rules fail to state, or even specifically refuse to state, what is required to obey them, which makes it difficult or impossible to comply with them:

    a. The anti-evasion proposed rules provide that anyone who enters into a transaction that is not defined as a "swap" under the CFTC's eventual final rules for product definitions could nevertheless find itself a party to a "swap," if its counterparty "evaded" DFA, even if the first party knew nothing of the second party's goals, intent, or "evasion." This is an impossible burden on the innocent party, and will cause transactions and counterparties to be subject to even more burdens that the rules did not contemplate.[20]

    b. One proposed rule categorically rejects "any attempt to ... provide a bright-line test of evasion by rule …" or to provide any substantive and meaningful guidance or any safe harbors.[21]

    c. The swap record-keeping final rule specifically provides that the CFTC "does not believe that it should specifically delineate the meaning of 'all pertinent data and memorandum'",[22] leaving everyone to have to guess at what is meant by that phrase. Many companies may choose to be overly inclusive in what records they keep in order not to later be found in violation of the ambiguous phrase. These entities will therefore incur excess and unnecessary costs of compliance when such funds could have been used for other, more productive, purposes simply had the CFTC provided clarity about what it wanted retained.

Additionally, we have read commentary suggesting that the CFTC's position is that Main Street companies should be saddled with the regulatory burdens of being a swap dealer, because DFA imposes such burdens on financial institutions, and there must be a "level playing field." However, DFA "was enacted to reduce systemic risk, increase transparency, and promote market integrity <u>within the financial system</u>"[23] due to a systemic crisis from the unwise actions of financial institutions. No transaction by any energy or commodity company caused the financial crisis or contributed systemic risk to our financial system. And no energy company received funds under any taxpayer bailout for being "too big to fail."

In fact, the playing field would not be leveled even if "swap" transactions entered into by energy companies were subjected to the DFA regulatory burdens of financial institutions, because financial institutions are structured differently, are systemically significant and interconnected, and have access to market liquidity that energy companies typically do not have. In addition, the DFA recognizes that there are legitimate differences between financial entities and energy companies and, where Congress felt it was appropriate, Congress gave a special

---

with respect to transactions in the commodities in respect of which the eligible commercial entity operates a commercial business."

[20] See Weinstein, "Quicksand in the Hedges," Futures & Derivatives Law Report, Nov. 2011.

[21] Further Definition of "Swap" NOPR, 76 Federal Register p. 29866 col. 2.

[22] Swap Data Recordkeeping Final Rules 77 Federal Register p. 2141 col. 3.

[23] Real Time Public Reporting of Swap Transaction Date Final Rule, 77 Federal Register p. 1182 col. 3.

exclusion for "swap" transactions that are part of a credit arrangement under various provisions of the DFA, such as Section 2(h)(7)(C)(iii) of the DFA.[24] That exemption is simply not available to energy companies. These inherent differences do not require the burdening of energy companies to help financial institutions compete.

The IECA is not objecting to CFTC authority to investigate and enforce prohibitions of market-manipulation and fraud, nor does the IECA object to giving the CFTC access to OTC financial derivatives information necessary for it to exercise such authority. The IECA does, however, object to specific provisions in the proposed rules that will increase the costs and regulatory uncertainty for energy companies simply seeking to enter into transactions to responsibly manage exposure to commodity price volatility. These businesses are already subject to comprehensive regulation at the Federal and State level that until now has assured the public of regulatory oversight and access to reliable and affordable energy.

The sampling of severe, if unintended, consequences in the above examples are not resolved merely by ensuring that energy industry end users are not "swap dealers," but the IECA supports such a decision as a good first step. We do not believe Congress intended that energy companies buying and selling "swaps" in energy commodities that they physically produce, consume or trade as the mainstay of their businesses were intended to be treated as "dealers" or "financial institutions" and we support their exclusion from the definition of "swap dealer."[25]

The more rational approach to rule making would be to not only exclude energy industry end users from being "swap dealers," but also ensure that the costs of imposing regulations on swaps and swap dealers do not unduly impact end-users of those swaps. This cannot be done without a true cost benefit analysis, which we believe is the responsibility of the CFTC in the first instance, and which has led us to submit this letter supporting the Commission's efforts to shoulder its responsibility with respect to the requisite cost benefit analyses.

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/
Phillip G. Lookadoo, Esq.	Jeremy D. Weinstein
Reed Smith, LLP	Law Offices of Jeremy D. Weinstein

[24] "Such definition shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company."

[25] We and our members have filed many pages of comments with much more detail, examples, and support.