

CFTC Marathon Rulemaking Team Sprints Past the August "Tsunami Date" and Hurdles Toward the October 2012 Effective Date

11 September 2012

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During the past two months, the Commodity Futures Trading Commission ("CFTC") announced rules, statutory interpretations, proposed rules, interim final rules, no action letters, orders and proposed orders, all of which will dramatically affect the energy industry.

In addition, in response to industry concern about compliance with the impending CFTC rules, the International Swaps and Derivatives Association (ISDA) and the Intercontinental Exchange (ICE) have announced major initiatives.

Barring further CFTC action, we are now headed directly toward **significant** changes in the way in which the energy industry will execute energy commodities and derivatives transactions, and conduct ongoing operations, beginning in **mid-October 2012**. Below is a brief description of 10 of these announcements or events which may affect your business and your business plans.

1. The Definition of "Swap" final rules and guidance further defining the term "Swap". On Monday, August 13, 2012, the "Product Definitions" rules and statutory interpretations were published in the Federal Register, available [here](#). We call this the Dodd-Frank Act "Tsunami Date" – this wave has crested, it's headed toward us, and, barring some action by the regulators, these rules and statutory interpretations (with broad implications for the energy industry), and many of the other Dodd-Frank Act rules affecting "swap dealers," "major swap participants" and their counterparties, that are triggered 60 days after the Tsunami Date, will become effective or compliance will be required beginning on **October 12, 2012**.

On and after this date, firms that meet the definitions of "swap dealer" or "major swap participant" must register with the CFTC and, thereafter, comply with numerous new regulatory requirements. This is also the start date for phase-in of regulatory swap-data reporting by swap dealers and major swap participants for swaps in the interest rate and credit asset classes.

In the Product Definitions release, the CFTC proposed several new statutory interpretations, and asked further questions about such energy industry transactions as tolling agreements, capacity agreements, transmission (or transportation) services agreements, peaking supply agreements and nonfinancial commodity forward contracts "with embedded volumetric optionality." Comments are due to the CFTC on **October 12, 2012, and yet the statutory interpretations and rules in the release are also effective on October 12, 2012**.

Some of the proposed "safe harbors" described in the Product Definitions release for nonfinancial commodity transactions will require operational changes and/or previously

unnecessary documentation in order to be entitled to such “safe harbors” – and not be unknowingly subject to the CFTC’s jurisdiction over “swaps.” We call your attention in particular to the provisions with respect to participants in commodity delivery chains, and a new requirement to document oral “bookout” agreements.

2. Commodity Trade Options. On Wednesday, August 15, 2012, the CFTC announced that it was providing "no action relief" commencing on October 12, 2012 from certain aspects of its "Interim Final Rule" related to commodity trade options. The CFTC's Commodity Option rule, you may recall, was published in the Federal Register on April 27, 2012, and in the rule the CFTC proposed an Interim Final Rule to provide a "trade option exemption" to certain commercial entities entering into nonfinancial commodity trade options under certain circumstances. The CFTC asked a series of questions about the Interim Final Rule and, in particular, as to its potential effects on parties who use trade options to hedge commercial risks. In that release, the CFTC it deferred public comment on whether nonfinancial commodity trade options were “swaps” until the Product Definitions release (see above). The CFTC’s no action letter is intended to allow parties entering into nonfinancial commodity trade options, relief from some of the burdens imposed by the Interim Final Rule, so long as the options and the counterparties meet certain requirements. You will want to study those. A copy of the final Commodity Option Rule, containing the Interim Final Rule on commodity trade options, can be found [here](#). A copy of the CFTC's no-action letter can be found [here](#).

3. Swaps between Affiliated Entities. On Tuesday, August 21, 2012, the CFTC issued a “Proposed Rule” to exempt from clearing those swaps entered into between certain affiliated entities. A copy of the Proposed Rule can be found [here](#). As described in the CFTC’s Press Release, the proposal to exempt such swaps is subject to the following conditions

- (i) The proposed exemption would be limited to swaps between majority-owned affiliates whose financial statements are included in the same consolidated financial statements.
- (ii) The proposed rules would require the following: centralized risk management; swap trading relationship documentation; variation margin payments; and satisfaction of certain reporting requirements.
- (iii) The proposed rules would permit affiliates of the same corporate group to elect the exemption for their inter-affiliate swaps if one of the following four conditions is satisfied for each affiliate: the affiliate is located in the United States; the affiliate is located in a jurisdiction with a comparable and comprehensive clearing requirement; the affiliate is required to clear all swaps it enters into with non-affiliate counterparties; or the affiliate does not enter into swaps with non-affiliate counterparties.

You will want to review this Proposed Rule in light of your particular corporate structure in order to determine whether and how it may affect your inter-affiliate “swaps” and risk management practices. Given the variation margin requirements, the reporting requirements, and the limitations/restrictions on ownership percentages and affiliate locations, you may want to comment on the Proposed Rule. Comments on the Proposed Rule are due on **September 20, 2012**. Note that clearing for energy commodity swaps will not be required until at least the latter half of 2013. Moreover, final rules on margin requirements (from either the CFTC regulating non-bank swap dealers or from prudential regulators regulating bank swap dealers), trading documentation, and other rules that are implicated in these Proposed Rules have not yet been

finalized, especially as they will/may affect affiliated entities that are not related to CFTC-registered "swap dealers." Nonetheless, these Proposed Rules should be reviewed with care in the context of nonfinancial energy companies with either treasury function affiliates or central commercial hedging affiliates.

4. ISDA Dodd-Frank Act Protocol. With all the other Dodd-Frank events at the CFTC, you may not have noticed the ISDA Dodd-Frank Protocol. The Protocol was formally announced and published (on ISDA's website) on Monday, August 13, 2012. Complete details and related materials can be found on the ISDA website [here](#). If you are just beginning to analyze this concept/documentation challenge, we recommend starting with the "Protocol Overview" and the "FAQ." The four basic documents are the Protocol Agreement, the Protocol Supplement, the Protocol Terms Agreement and the Protocol Questionnaire.

NOTE: The ISDA Dodd-Frank Protocol purports to amend all outstanding masters between a particular legal entity and a particular Swap Dealer (or other counterparty), including those entered into to transact interest rate or other financial swaps. Moreover, the ISDA Dodd-Frank Protocol purports to amend master agreements other than the ISDA master agreement, such as the EEI Master Agreement, the WSPP Agreement or the NAESB Agreement under which "swaps," including nonfinancial commodity trade options, may be executed. Consequently, if and when your company decides to "adhere" to the Protocol at the request of counterparty, you should be aware that such action simultaneously amends all outstanding ISDA master agreements and other master agreements under which "swaps" may be executed with the same entity.

If your company transacts under the ISDA Master Agreement in "swaps" (or, likely, even in nonfinancial commodity forwards or nonfinancial commodity options under the Power Annex or the Natural Gas Annex) with entities that expect to register as "swap dealers," you may see and hear about the ISDA Dodd-Frank Protocol during the next few weeks. The ISDA Dodd-Frank Protocol was initiated to facilitate compliance by "swap dealers" with certain external business conduct standards prior to an October 15, 2012 compliance date.

On August 27, 2012, in a rule announced with respect to internal business conduct standards for swap dealers, the CFTC extended the compliance date for some if not all of those external business conduct standard requirements for swap dealers until December 31, 2012. The CFTC press release can be found [here](#) and the draft proposed rule [here](#). See page 152. There is no reason for commercial energy companies to rush into adhering to the ISDA Dodd-Frank Protocol.

The ISDA website contains links to a recent Market Education Call regarding the August 2012 Dodd-Frank Protocol. A call replay and slides are available for download by the general public [here](#). More general information on ISDA's Documentation Initiative is available [here](#).

5. Not-for-Profit Electric Entity Exemption Proposal. On Thursday, August 23, 2012, the CFTC issued a Proposed Order exempting certain transactions between and amongst government-owned utilities and electric cooperatives from certain of the requirements of the Commodity Exchange Act. A copy of the Proposed Order can be found [here](#). Comments are due on **September 24, 2012**.

6. ISO/RTO Exemption Petition. On Tuesday, August 28, the CFTC published a Proposed Order exempting “financial transmission rights,” “energy transactions,” “forward capacity transactions,” and “reserve or regulation transactions” offered or sold pursuant to RTO/ISO tariffs from certain provisions of the Commodity Exchange Act, if the tariff under which a Petitioner operates has been approved by FERC or the Public Utility Commission of Texas, as applicable. The proposed order is available [here](#). The proposed exemption extends to any persons offering, entering into, rendering advice, or rendering other services with respect to such transactions. As proposed, the CFTC requires that the ISO/RTOs comply with three conditions precedent: (i) adoption of all requirements set out in FERC regulation 18 C.F.R. 35.47 including implementation of the “central counterparty” model; (ii) submission of a legal opinion or memorandum from outside counsel that the netting arrangements under such model will provide enforceable rights of setoff against any of its market participants in the event of the bankruptcy of the market participant; and (iii) with respect to Electric Reliability Council of Texas, Inc., the completion of an information-sharing agreement, acceptable to the CFTC. In addition, RTO tariff or governing document amendments are necessary to allow the RTO/ISO to provide member/market participant information to the CFTC without notice to the member/market participant. Comments are due on **September 27, 2012**.

7. Proposed Forms on Account Ownership. Although entities that are not “swap dealers” are not “reporting entities” under the CFTC’s Large Trader Reporting Rules that were effective September 20, 2011 (available [here](#)), the CFTC can issue “special calls” for information from entities that, as a result of swap dealer reports, have been noted as potentially having “reportable positions” in certain swaps and swaptions referencing or related to certain futures contracts, including the NYMEX Henry Hub Natural Gas Contract. In late July, the CFTC issued for comment the forms that will be required from entities receiving such a CFTC “special call.” Comments are due on **September 24, 2012**. Entities that have not, in the past, received a CFTC “special call” for a Form 40, requesting information about the entity’s positions in NYMEX or other futures or options contracts, may want to review the proposed new Form 40S. The new Forms will require the energy industry (including natural gas utilities and marketers and electric entities that use natural gas as a fuel source) to provide information to the CFTC about their swaps and other aspects of their commercial operations and risk management policies. A copy of the Notice can be found [here](#).

8. Special Entity Exemption Petition. On July 12, 2012, the American Public Power Association, the Large Public Power Council, the American Public Gas Association, the Transmission Access Policy Study Group, and the Bonneville Power Administration filed a petition requesting the CFTC to amend Rule 1.3(ggg)(4) to exclude from the “special entity sub-threshold” “utility operations-related swaps” as proposed therein. The Petition is found [here](#). The Petition notes that the special entity sub-threshold in the “de minimis exception” to the definition of “swap dealer” will have a serious and negative affect on regional markets for utility operations-related swaps, unless the proposed rule amendment is adopted or other effective relief is provided by the CFTC prior to October 12, 2012. Although the CFTC has not yet addressed the July 12th Petition and no comment date has been set by the CFTC, if you want your position on this petition considered by the CFTC comments can be submitted to the CFTC Security.

9. CFTC's Announcement re Interim Legal Entity Identifiers (CICIs). On August 21, 2012, the CFTC announced that DTCC-SWIFT was approved by the CFTC as the provider of legal entity identifiers known as CFTC Interim Compliant Identifiers (CICIs), and referred market participants to a website to begin applying for such CICIs. The CFTC's Press Release can be found [here](#) and the CFTC order, published in the Federal Register on September 4, 2012, can be found [here](#). Energy companies that anticipate registering as "swap dealers," whose reporting obligations in respect of energy commodity and other "other commodity" swaps are scheduled to commence in mid-January 2013, will want to request these CICIs, and will also be likely to require CICIs from swap counterparties.

10. ICE to Transition Cleared Energy Swaps in October. On July 30, 2012, the Intercontinental Exchange (ICE), which currently operates an exempt commercial (electronic) market for energy and other nonfinancial commodity swaps, announced that due to industry requests and subject to regulatory approval, all outstanding cleared swaps on its ICE platform would be converted to cleared futures contracts as of January 1, 2013. The initial ICE announcement is found [here](#). On September 4, 2012, ICE announced that, in response to strong industry support and to avoid regulatory uncertainty, and still subject to regulatory approval, such conversion will take effect on October 15. The most recent ICE announcement and FAQs can be found [here](#).

Please contact any of the authors of this Client Alert or any of the other Reed Smith lawyers with whom you regularly interact if we can assist you in analyzing the impacts of these developments on your business and your business plans.

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