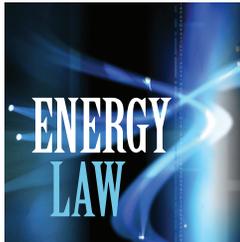


## DODD-FRANK'S NEW RULES FOR OVER-THE-COUNTER SWAP TRANSACTIONS

by CRAIG ENOCHS and PAUL VRANA

**O**n July 21, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, significantly impacting how many Texas energy companies operate on a day-to-day basis. While the act makes a number of important changes, this article will focus on the new requirements Title VII of the act imposes for over-the-counter swap transactions.

Many Texas energy companies — including power generators, manufacturers, energy trading companies, and oil and gas producers — use swaps to hedge commodity price and other risks. A swap occurs when two parties exchange their payment obligations based on the price of something else. If the act governs a company's swap, then the swap may be subject to the following key obligations: mandatory clearing, data reporting, position limits and record-retention requirements.



• *Applicability of the act.* The act generally applies to swaps entered into by major swap participants and/or swap dealers. The act broadly defines a swap as including, but not limited to, commodity swaps, currency swaps and interest rate swaps.

A swap dealer includes, but is not limited to, one who regularly enters into swaps with counterparties as an “ordinary course of business for its own account.”

Furthermore, a person may qualify as a major swap participant if he maintains a “substantial position” in swaps. Notably, the act excludes from its definition of a major swap participant those market participants using swaps for hedging or mitigating their commercial risk.

The act tasks the Commodity Futures Trading Commission (CFTC) with issuing

additional rules to clarify what constitutes a substantial position in swaps, what constitutes an ordinary course of business, and whether a party is holding swaps for hedging or mitigating commercial risk. Lawyers for Texas energy companies that deal in swaps should monitor how the CFTC clarifies these terms through the rulemaking process.

• *Clearing requirements.* The act requires parties to clear most regulated swaps through a derivatives clearing organization (DCO) registered with the CFTC. Clearing the swap through a DCO will require each party to a swap to provide collateral to the DCO to settle, on a daily basis, any credit exposure resulting from fluctuations in market prices.

The CFTC has not finalized which categories of swaps parties must clear. Therefore, lawyers for Texas energy companies should monitor CFTC reports to determine whether their clients' swaps are subject to clearing requirements. They also should note that the act's mandatory clearing obligations may increase significantly the amount of capital or collateral required to support a swap.

• *Reporting requirements.* Parties to swaps must report all existing and future swaps to a registered swap data repository (SDR) or the CFTC. The CFTC adopted an interim final rule on Oct. 14 clarifying that counterparties to swaps entered into prior to July 21 that had not expired as of July 21 must report certain information related to such transactions to an SDR or to the CFTC by the earlier of two dates: 1. within 60 days after an SDR becomes registered with the CFTC; or 2. the compliance date to be established by the CFTC, which must be no later than Jan. 12, 2012.

The interim final rule further clarifies that the act does not require reporting of pre-enactment swaps that expired prior to July 21. Both parties must report post-enactment swaps to an SDR or the CFTC within 90 days following the act's effective date, which is the earlier of July 16, 2011, or 60 into certain types of swaps if the swap would cause the person to exceed the posi-



tion limits established by the CFTC.

• *Record retention.* The act establishes record-retention requirements and operating procedures for major swap participants and swap dealers. Moreover, the CFTC will establish rules detailing business-conduct standards that swap dealers and major swap participants must abide by in transacting swaps with counterparties.

Though the act provides an outline of how the new regulatory structure may affect Texas energy companies, numerous rules issued by the CFTC and other agencies will flesh out the act's substance. In light of this, lawyers for Texas energy companies have three significant action items. They should monitor the CFTC's rules clarifying key definitions, such as swap, major swap participant and swap dealer. They should ensure their clients retain data on existing swaps that they may need to report at a later date. They should analyze the additional cost of capital associated with posting margin to DCOs.

*Craig Enochs and Paul Vrana are partners in the energy practice group of Jackson Walker in Houston and Fort Worth, respectively, where they focus exclusively on energy commodity and derivative transactions.*