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DERIVATIVES

Dodd-Frank Almost 6 Years Later: Where Are We Now? Energy-Related Derivatives Regulation

Assessing the practical implications of recent and upcoming rulemakings on position limits, volumetric optionality, trade options and more

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In the almost six years since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the US Commodity Futures Trading Commission (CFTC) has, in large part, finalized its rulemakings to implement the new comprehensive regulatory framework for swaps. The CFTC's Dodd-Frank Act rulemakings do impose certain compliance obligations that affect commercial end-users and other unregistered entities — including companies in the energy sector — that transact in CFTC-regulated products to hedge the commercial risks associated with their businesses. Because of the potential impact of any such regulation on the energy industry, the CFTC has continued to meet with market participants from the energy sector and is currently refining existing regulations and interpretations in order to ensure that any such finalized rules align with the CFTC's market regulation goals without hindering commercial business and development. To this end, the CFTC has stated that it expects to release final position limit rules in 2016. Regarding other relevant rules, the CFTC has further clarified embedded volumetric optionality for forward contracts and proposed to relieve end-users of certain reporting requirements for trade options.

The following summarizes how far we have come and current topics in energy-related derivatives regulation since the passage of the Dodd-Frank Act and the practical implications for energy producers, processors, manufacturers, merchandisers and other commercial end-users in the energy sector (collectively, energy firms).

Proposed Position Limits and Aggregation Requirements.

The CFTC's proposed rules on position limits and aggregation are among the more controversial rulemakings under the Dodd-Frank Act and would establish specific limits on positions in 28 physical commodity futures and option contracts, as well as on swaps that are economically equivalent to such contracts.[1]

[1] The 28 physical commodity futures contracts (Core Referenced Futures Contracts) include:

- Chicago Board of Trade: Corn (C); Oats (O); Soybeans (S); Soybean Meal (SM); Soybean Oil (SO); Wheat (W);

The CFTC initially proposed position limits in 2011, but faced litigation and extensive public comment which led the CFTC to re-propose its position limits rule in late 2013 (the Proposed Position Limits Rule).[2] In addition, the CFTC proposed a separate rule to address the circumstances under which market participants would be required to aggregate their positions with other entities under common ownership or control (the Proposed Aggregation Requirements)[3] for purposes of the position limits, and published a further supplement to the Proposed Aggregation Requirements (the Aggregation Supplement) on September 29, 2015.[4]

For energy firms, the Proposed Position Limits Rule and the Proposed Aggregation Requirements may significantly impact their commercial businesses. The rules would require energy firms to monitor their positions as well as those of their affiliates to assess whether the position limit levels have been exceeded, and to confirm whether an exemption is available and proper notices have been filed.

Key Aspects of the Proposed Position Limit Rule.

Contracts Subject to Position Limits

The Proposed Position Limits Rule would apply to 28 physical commodity futures and option contracts (Core Referenced Futures Contracts), as well as to swaps that are economically equivalent to such contracts. The designated Core Referenced Futures Contracts are contracts transacted on a specified futures exchange. For example, in the energy industry, the Core Referenced Futures Contracts relevant for energy firms are:

- NYMEX Light Sweet Crude Oil
- NYMEX NY Harbor ULSD
- NYMEX RBOB Gasoline
- NYMEX Henry Hub Natural Gas

Contracts related to power and other energy commodities would not be subject to the CFTC's position limit rules, although the CFTC has indicated that it may expand the position limit requirements to those contracts in further rulemakings.[5] (See endnote 1 for a full list of the Core Referenced Futures Contracts.)

For purposes of the Proposed Position Limits Rule, a swap would be considered ''economically equivalent'' to a Core Referenced Futures Contract if it is either linked or priced at a fixed differential to the price of a particular Core Referenced Futures Contract. The Core Referenced Futures Contracts together with their economically equivalent swaps are referred to in the Proposed Position Limits Rule collectively as ''Referenced Contracts.'' Under the Proposed Position Limits Rule, however, the definition of Referenced Contract would not include a guarantee of a swap, a basis contract or a commodity index contract.[6]

The CFTC has also sought public comment on whether instruments that qualify as trade options (discussed below) should be exempt from position limits.[7] While trade options are exempt from many of the CFTC's regulatory requirements applicable to ''swaps,'' trade options would be subject to position limits under the Proposed Position Limits Rule. Accordingly, absent a further exemption, market participants would be required to count trade options toward the position limit levels.

Position Limit Levels.

The Proposed Position Limits Rule sets the maximum number of Referenced Contracts that a market participant may hold or control, either net long or net short, unless an exemption applies. Separate position limits would apply for: (a) spot months (*i.e.*, the trading period immediately preceding the delivery period for physically-delivered futures contracts as well as for any cash-settled contracts that are linked to such physically-delivered contracts); and (b) non-spot months (*i.e.*, limits applied to positions in all contract months combined or in any single contract month). The levels of the initial spot month limits are set forth in an appendix to the current proposal and would be adjusted after two years. In contrast to spot month limits, which are set based on estimated deliverable supply, non-spot month limits would be based on total open interest for all Referenced Contracts in a commodity.

Last year, at a CFTC Energy and Environmental Markets Advisory Committee (EEMAC) meeting, the CFTC and market participants discussed possible alternatives to the CFTC's proposed position limit levels.[8] The first alternative would call on the CFTC to use a system of position accountability, as opposed to actual limits. With this alternative, the CFTC (or the relevant exchange) would obtain information from market participants when the participants reach a certain threshold,

Rough Rice (RR).
- Chicago Mercantile Exchange: Class III Milk (DA); Feeder Cattle (FC); Lean Hog (LH); Live Cattle (LC).
- Kansas City Board of Trade: Hard Winter Wheat (KW).
- ICE Futures U.S.: Cotton No. 2 (CT); Cocoa (CC); Coffee C (KC); FCOJ–A (OJ); U.S. Sugar No. 11 (SB); U.S. Sugar No. 16 (SF).
- Minneapolis Grain Exchange: Hard Red Spring Wheat (MWE).
- New York Mercantile Exchange: Light Sweet Crude Oil (CL); NY Harbor ULSD (HO); RBOB Gasoline (RB); Henry Hub Natural Gas (NG); Palladium (PA); Platinum (PL).
- Commodity Exchange, Inc.: Gold (GC); Silver (SI); Copper (HG).

[2] Position Limits for Derivatives, 78 Fed. Reg. 75680 (proposed Dec. 12, 2013) (proposing amendment of 17 C.F.R. pts. 1, 15, 17, 19, 32, 37, 38, 140, 150), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-12-12/pdf/2013-27200.pdf (Proposed Position Limits Rule).

[3] Aggregation of Positions, 78 Fed. Reg. 68946 (proposed Nov. 15, 2013) (proposing amendment of 17 C.F.R. pt. 150), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-11-15/pdf/2013-27339.pdf (Aggregation Proposal).

[4] Aggregation of Positions, 80 Fed. Reg. 58365 (proposed Sept. 29, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-09-29/pdf/2015-24596.pdf (Aggregation Supplement). For further discussion, please refer to our *Client Alert* on the Proposed Position Limits Rule and the Aggregation Proposal. CFTC Re-Proposes Position Limits Rule and Proposes Revised Aggregation Requirements, *Client Alert* No. 1624 (Dec. 18, 2013), *available at* http://www.lw.com/thoughtLeadership/LW-CFTC-reproposes-rule-making-aggregation.

[5] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75726.

[6] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75701.

[7] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75711.

[8] *See* EEMAC Meeting Transcript (July 29, 2015), *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/emactranscript072915.pdf. For more information on the EEMAC meeting, visit the CFTC website: http://www.cftc.gov/PressRoom/Events/opaevent_eemac072915.

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and based on such information the CFTC (or the relevant exchange) could order the participant to cap, reduce or even liquidate a position. This would be similar to the accountability regime futures exchanges currently use. The second alternative would necessitate a review and update of the CFTC's deliverable supply estimates, which market participants suggest may be outdated and based on unreliable data. However, whether the CFTC intends to address either concern in its final rulemaking remains unclear.

Exemptions from the Position Limits.

The proposed position limits are subject to numerous exemptions, most notably for contracts that qualify as ''*bona fide* hedging transactions.''

Any position must meet two general requirements to qualify as a *bona fide* hedging position: (a) the purpose of the position must be to offset price risks incidental to commercial cash operations; and (b) the position must be established and liquidated in an orderly manner in accordance with sound commercial practices.[9] Additional requirements would also apply to certain transactions — for instance:

- *Physical Commodities*: For physical commodity positions, the Proposed Position Limits Rule would require the position to:

  – Represent a substitute for transactions or positions taken, or to be taken at a later time, in a physical marketing channel

  – Be economically appropriate to the reduction of risks

  – Arise from the potential change in value of: (a) assets that the person owns, produces, manufactures, processes or merchandises, or for which the person anticipates any of the foregoing; (b) liabilities that the person owes or anticipates incurring; or (c) services provided or purchased, or anticipated to be provided or purchased, by such person, provided the position is also ''enumerated'' as described below[10]

- *Enumerated Hedges*: In addition to the above requirements, positions in physical commodities must qualify as ''enumerated hedges'' in order to qualify as *bona fide* hedging positions. Enumerated hedges include: hedges of inventory and cash commodity purchase contracts; hedges of cash commodity sales contracts; hedges of unfilled anticipated requirements and hedges by agents. Hedges of unsold anticipated production, anticipated royalty hedges, service hedges and cross-commodity hedges are also enumerated hedges.[11]

- *Cross-Commodity Hedges*: The Proposed Position Limits Rule would require that the fluctuation in the value of a position be ''substantially related'' to the fluctuations in the value of the actual or anticipated cash position.[12] In particular, there must be a reason that the prices of the two commodities move in relation to each other, rather than a correlation that does not have a clear cause. The Proposed Position Limits Rule provides for a non-exclusive safe harbor for cross-commodity hedges that are deemed to meet the substantially related test based on certain qualitative and quantitative factors. If a cross-commodity hedge does not satisfy the safe harbor, the CFTC would presume that the positions are not *bona fide* cross-commodity hedging positions. A market participant may, however, rebut this presumption by presenting facts and circumstances demonstrating a reasonable relationship between the spot price series for the commodity to be hedged and either (a) the spot price series for the commodity underlying the commodity derivative contract or (b) the price series for the commodity derivative contract to be used for hedging.[13]

With respect to non-enumerated hedges, the CFTC Chairman has indicated that the CFTC may consider the possibility of exchanges reviewing and granting exemptions (rather than the CFTC). Again, however, whether or how the CFTC will address this topic in its final rulemaking remains unclear.

Recordkeeping and Reporting.

Under the Proposed Position Limits Rule, market participants claiming an exemption would be required to maintain complete books and records in connection with all of their related cash, forward, futures, option and swap positions.[14] The CFTC would be entitled to make ''special calls'' for such records, requiring market participants to provide the CFTC with such information upon request. In addition, market participants seeking exemptions from the Proposed Position Limits Rule could be required to submit a report to the CFTC (in some instances on a monthly basis).

Proposed Aggregation Requirements.

Under the Proposed Aggregation Requirements, a market participant is generally required to aggregate all Referenced Contract positions for which that participant controls the trading decisions with all such positions for which that participant has a 10% or greater ownership interest in an account or position. Positions of two or more persons acting pursuant to an express or implied agreement or understanding would also be required to be aggregated.[15] The CFTC has suggested that market participants manage aggregation issues by allocating the position limits among multiple entities and requiring each to trade within their share of the limit. In many cases, however, this may not be a workable solution. Accordingly, the Proposed Position Limits Rule would require companies to either (a) ensure that all or most Referenced Contracts are entered into for *bona fide* hedging purposes (and that the proper notices are filed) or (b) seek an exemption for position limits aggregation, in particular, under the ''owned entity exemption,'' which, as a practical matter, imposes certain conditions and may require certain filings with the CFTC.

Under the owned-entity exemption, which the recent Aggregation Supplement revised, a person would be permitted to disaggregate the positions of an entity in

[9] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75706.
[10] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75708.
[11] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75712.
[12] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75716.
[13] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75717.
[14] *See* Proposed Position Limits Rule, 78 Fed. Reg. at 75741.
[15] *See* Aggregation Proposal, 78 Fed. Reg. at 68951.

which the person has greater than a 10% ownership or equity interest, provided that the persons, among other requirements, do not have knowledge of the trading decisions of one another, trade under independent trading systems, maintain and enforce written procedures to preclude each other from having knowledge of the others' trades, do not share employees that control trading decisions and do not have systems that permit sharing of risk management strategies.[16] To rely on the exemption, the relevant owner would be required to file a notice with the CFTC and provide certain information about itself and the owned entity.

Embedded Volumetric Optionality.

Last year, the CFTC further clarified certain aspects of the embedded volumetric optionality interpretation under the forward contract exclusion for nonfinancial commodities. This interpretation provides relief from CFTC regulation for nonfinancial forward contracts that are intended to be physically-delivered, notwithstanding the presence of certain embedded optionality in the contract terms.

Physically-delivered forward contracts with optionality have characteristics of both a commodity option (which is subject to CFTC regulation) and a physically-delivered nonfinancial forward contract (which is exempt from CFTC regulation). In 2012, the CFTC set out criteria that nonfinancial forward contracts with embedded volumetric optionality must satisfy in order to be exempt from CFTC regulation (the volumetric optionality test).[17] For example, a forward contract with embedded volumetric optionality (*e.g.*, variable supply rights based on capacity or production under natural gas supply contracts) may avoid being fully regulated as a commodity option (*i.e.*, swaps) if the contract satisfies certain conditions which the CFTC enumerated. In practice, however, the application of these criteria created uncertainty for numerous market participants, particularly in the energy markets, and end-users struggled to decipher the CFTC rules to determine whether and under what circumstances a forward contract with embedded volumetric optionality would fall within the forward contract exclusion or should be treated instead as a swap or a trade option — each of which implicates different regulatory requirements.

Among other concerns, the original seventh prong of the volumetric optionality test — *i.e.*, that the exercise or non-exercise of the embedded volumetric optionality be based primarily on physical factors or regulatory requirements that are outside the control of the parties — was inconsistent with market practice, as the actual exercise of volumetric optionality in a contract for physical delivery is often based on a combination of factors that may or may not be within the parties' control. Accordingly, in May 2015, the CFTC finalized a revised interpretation further clarifying the requirements for a forward contract with embedded volumetric optionality to be excluded from the definition of a ''swap'' (the Embedded Volumetric Optionality Interpretation).[18]

Under the Embedded Volumetric Optionality Interpretation, the CFTC revised its previous interpretation to clarify that a forward contract involving the actual delivery of a commodity that contains embedded volumetric optionality may be treated as an excluded forward contract under the Commodity Exchange Act, if the following, revised seven-part test is satisfied:

- The embedded optionality does not undermine the overall nature of such contract as a forward contract.
- The predominant feature of such contract is actual delivery.
- The embedded optionality cannot be severed and marketed separately from such overall contract in which it is embedded.
- The seller of a nonfinancial commodity underlying such contract with embedded volumetric optionality intends, at the time it enters into such contract, to deliver the underlying nonfinancial commodity, if the embedded volumetric optionality is exercised.
- The buyer of a nonfinancial commodity underlying such contract with embedded volumetric optionality intends, at the time it enters into such contract, to take delivery of the underlying nonfinancial commodity if the embedded volumetric optionality is exercised.
- Both parties to such contract are commercial parties.
- The embedded volumetric optionality is primarily intended, *at the time that the parties enter into such contract*, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity (such requirement referred to herein as the seventh element).

The CFTC further clarified in the Embedded Volumetric Optionality Interpretation that bandwidth contracts (*i.e.*, swing contracts) providing for delivery of a nonfinancial commodity ranging within a certain minimum and maximum quantity may fall within the forward contract exclusion, so long as all seven elements are satisfied.[19] Similarly, a natural gas supply contract where one party may obtain additional supply by exercising the embedded volumetric optionality under the contract or turning to another supply source — whether storage, the spot market, or another forward contract — may fall within the forward contract exclusion where the intended purpose for including the embedded volumetric optionality at the contract's initiation was to address physical factors or regulatory requirements influ-

[16] *See* Aggregation Supplement, 80 Fed. Reg. at 58371.

[17] Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208 (Aug. 13, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf (Final Products Rule). For further discussion, please refer to our *Client Alert* regarding the Final Products Rule. CFTC and SEC Issue Final Rule Defining Certain Swap Products and Triggering Several Dodd-Frank Obligations Relating to Swaps, *Client Alert* No. 1396 (Sept. 19, 2012), *available at* http://www.lw.com/thoughtLeadership/defining-certain-swap-products.

[18] Forward Contracts with Embedded Volumetric Optionality, 80 Fed. Reg. 28239 (May 18, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-05-18/pdf/2015-11946.pdf (Embedded Volumetric Optionality Interpretation); *see also* Final Products Rule.

[19] *See* Embedded Volumetric Optionality Interpretation, 80 Fed. Reg. at 28241.

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encing the demand for or supply of the natural gas. In addition, the CFTC provided the following points of clarification in the Embedded Volumetric Optionality Interpretation with regard to the seventh element:

- *Reliance on Counterparty Representations*: Commercial parties are not required to conduct due diligence in order to rely on counterparty representations regarding the intended purpose for embedding volumetric optionality in the contract, provided the parties do not otherwise have information that would cause a reasonable person to question the accuracy of the representation.
- *Physical Factors*: The reference in the seventh element to ''physical factors'' is to be construed broadly to include any fact or circumstance that could reasonably influence the supply of and demand for a nonfinancial commodity (*e.g.*, environmental factors, operational considerations, changes in demographics or geopolitics); the CFTC clarified that having some influence over such a physical factor would not be inconsistent with the seventh element.
- *Price as a Consideration*: So long as the embedded volumetric optionality is primarily intended as a means of securing a supply source in the face of uncertainty regarding future supply and demand, taking price into consideration is not itself a bar to a contract qualifying for the forward exclusion.
- *Characterization of Existing Contracts*: When characterizing existing contracts (*e.g.*, as an excluded forward contract with embedded volumetric optionality or as a trade option), commercial parties may either (a) rely on their good faith characterization of such existing contract or (b) recharacterize the contract in accordance with the Embedded Volumetric Optionality Interpretation.[20]

Proposed Treatment of Trade Options.

On April 30, 2015, the CFTC proposed a rule that would revise the existing trade option rules to reduce the reporting and recordkeeping requirements for entities that are not swap dealers or major swap participants by, *inter alia*, eliminating the Form TO annual notice reporting requirement for otherwise unreported trade options (Proposed Trade Options Rule).[21] The modified reporting and recordkeeping requirements which the CFTC proposed for commercial end-users entering into trade options are summarized below:

- *Proposed Modified Reporting Requirements*:

– Eliminate Part 45 reporting requirements for commercial-end users

– Eliminate the Form TO notice filing requirement

– Add $1 Billion Notice (defined below) requirement to CFTC regulation 32.3(b)[22]

- *Proposed Modified Recordkeeping Requirements*: Trade option counterparties that are commercial end-users would be subject to the less stringent recordkeeping requirements of CFTC regulation 45.2(b) (rather than the recordkeeping requirements in CFTC regulation 45.2(a), which are applicable to trade option counterparties that are registered swap dealers or major swap participants), plus the following additional Part 45 recordkeeping requirements:

– Each swap must be identified in all recordkeeping by the use of a unique swap identifier (USI).

– Each counterparty to any swap must be identified in all recordkeeping by means of a single legal entity identifier (LEI).

– Each swap must be identified in all recordkeeping by means of a unique product identifier (UPI) and product classification system.[23]

Currently, trade options must be reported pursuant to the CFTC's regulatory reporting rules for swaps if: one of the counterparties is registered as a swap dealer or major swap participant; or both parties to the trade option are not swap dealers or major swap participants but at least one of the parties has been required to report non-trade option swaps during the previous 12 months. If neither party has been required to report non-trade option swaps within with previous 12 months, then each counterparty must: (a) file a form TO reporting each trade option entered into during the previous 12-month period; and (b) notify the CFTC no later than 30 days after entering into trade options having an aggregate notional value in excess of US$1 billion during any calendar year ($1 Billion Notice). In a separate no-action letter (CFTC No-Action Letter 13-08), the CFTC provided relief to those end-users that were required to report non-trade options from the reporting requirements for trade options if they also satisfied the conditions in (a) and (b) above.[24]

Note that, if the Proposed Trade Options Rule is adopted as proposed, the relief CFTC staff provided in CFTC No-Action Letter 13-08 would be terminated.[25]

Trade options are commodity options that, if exercised, would result in the sale of a non-financial commodity for immediate (*i.e.*, spot) or deferred (*i.e.*, forward) shipment or delivery. An instrument must meet the following conditions to qualify as a trade option:

- The offeror of such commodity option is either (a) an eligible contract participant (ECP)[26] or (b) a producer, processor or commercial user of, or merchant handling the commodity that is the sub-

[20] *See* Embedded Volumetric Optionality Interpretation, 80 Fed. Reg. at 28242. For further discussion, please refer to our *Client Alert* on the Embedded Volumetric Optionality Interpretation. UPDATED: CFTC Clarifies Regulation of Forward Contracts with Embedded Volumetric Optionality, *Client Alert* No. 1788 (June 22, 2015), *available at* http://www.lw.com/thoughtLeadership/lw-update-cftc-regulation-forward-contacts-embedded-volumetric-optionality.

[21] Trade Options, 80 Fed. Reg. 26200 (proposed May 7, 2015) (proposing amendment of 17 C.F.R. pt. 32), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-05-07/pdf/2015-11020.pdf (Proposed Trade Options Rule).

[22] Proposed Trade Options Rule, 80 Fed. Reg. at 26202-26204.

[23] Proposed Trade Options Rule, 80 Fed. Reg. at 26204.

[24] *See* CFTC No-Action Letter 13-08 (Apr. 5, 2013), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-08.pdf.

[25] Proposed Trade Options Rule, 80 Fed. Reg. at 26202, n. 23.

[26] For a definition of ''*eligible contract participant*,'' *see* 7 U.S.C. § 1a(18); 17 C.F.R. § 1.3(m).

ject of the commodity option, or the products or by-products thereof (referred to as a commercial party), and is offering or entering into such commodity option for purposes related to its business as such.

- The offeree of such commodity option: (a) is a producer, processor or commercial user of, or a merchant handling the commodity that is the subject of the commodity option, or the products or by-products thereof; and (b) is offered or is entering into the commodity option solely for purposes related to its business as such.
- Such commodity option is intended to be physically settled so that, if exercised, the option would result in the sale of an exempt commodity (*e.g.*, energy commodities)[27] for immediate or deferred shipment or delivery[28]

Like physically-delivered nonfinancial forward contracts, trade options are exempt from most of the CFTC's regulatory requirements, but remain subject to reporting and recordkeeping requirements and certain other requirements, including, as noted above, position limits.

Margin Requirements for Uncleared Swaps.

At the end of October 2015, federal banking regulators voted to adopt rules implementing margin requirements for uncleared swaps (the PR Margin Rules).[29] The PR Margin Rules apply to (among other entities) prudentially-regulated entities, such as certain banks, depositary institutions and insurance companies that are registered swap dealers, security-based swap dealers, major swap participants or major security-based swap participants. The CFTC has also adopted margin rules for uncleared swaps that apply to non-prudentially-regulated entities that are CFTC-registered swap dealers (*e.g.*, large energy firms with a swap dealing arm).[30]

The Dodd-Frank Act mandates the margining of uncleared swaps and requires federal regulators to implement rules that cause swap dealers (such as banks) and certain other entities to collect and post initial and variation margin with certain counterparties. Legislation adopted earlier this year amended provisions of the Dodd-Frank Act to exempt certain counterparties from the margin requirements for uncleared swaps.[31] Specifically, the law prohibits applying any margin requirements promulgated under the Dodd-Frank Act to uncleared swaps with commercial end-users, including treasury affiliates acting as agents, so long as such counterparty is using the uncleared swaps to hedge commercial risk.

Consistent with these requirements, the Prudential Regulators and the CFTC published, concurrently with the PR Margin Rules and the CFTC Margin Rules, interim final rules (the Interim Final Rules) exempting from the PR Margin Rules and the CFTC Margin Rules certain uncleared swaps and uncleared security-based swaps entered into with exempted end-users. The Interim Final Rules are scheduled to go into effect on April 1, 2016. We expect the Interim Final Rules to be finalized in substantially similar form. As a practical matter, this means that most energy firms will not be required—by regulation—to post margin in connection with their uncleared swaps. Nevertheless, energy firms should review the margin rules, once finalized, to confirm that they (and their affiliates) are, in fact, exempt from the margin requirements.

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[27] For a definition of "*exempt commodity*," *see* 7 U.S.C. § 1a(20).

[28] *See* 17 C.F.R. § 32.3(a).

[29] Margin and Capital Requirements for Covered Swap Entities (Nov. 30, 2015) (to be codified at 12 C.F.R. pts. 45, 237, 349, 624, 1221), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf (PR Margin Rules). For further discussion, please refer to our *Client Alert* on the finalized PR Margin Rules. Prudential Regulators Are First to Finalize Uncleared Swap Margin Rules, *Client Alert* No. 1896 (Nov. 20, 2015), *available at* https://www.lw.com/thoughtLeadership/LW-prudential-regulators-finalize-uncleared-swap-margin-rules.

[30] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016) (to be codified at 17 C.F.R. pts. 23, 140), available at https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf (CFTC Margin Rules). For further discussion, please refer to our *Client Alert* on the finalized CFTC Margin Rules. CFTC Uncleared Swap Margin Rules to Take Effect in September, *Client Alert* No. 1928 (Feb. 19, 2016), *available at* https://www.lw.com/thoughtLeadership/lw-cftc-uncleared-swap-margin-september.

[31] *See* Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. No. 114-1, § 302 (2015).

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