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Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

VIA ELECTRONIC MAIL

Re: *Public Comment on the Commission's Proposed Cross-Border Guidance*

Dear Mr. Stawick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "Working Group"), Sutherland Asbill & Brennan LLP hereby submits these comments in response to the Commodity Futures Trading Commission's (the "Commission's") proposed guidance on the *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act* (the "Proposed Guidance").[1] The Working Group appreciates the opportunity to provide the comments set forth herein and respectfully requests the Commission'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. TIMING FOR COMPLETING GUIDANCE ON EXTRATERRITORIAL APPLICATION OF U.S. REGULATION.

The Working Group respectfully requests that the Commission (a) finalize its guidance on the extraterritorial application of its regulations under Title VII of the Dodd-Frank Wall Street

[1] *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act*, 77 Fed. Reg. 30,596 at 41,214 (July 12, 2012) ("Proposed Guidance").

Reform and Consumer Protection Act (the "Dodd-Frank Act"),[2] including publishing the final guidance in the Federal Register and (b) provide firms sufficient time to review the finalized guidance, before requiring firms to register as SDs or MSPs. By all accounts, the implementation of derivatives reform is a complex and international endeavor. It presents a clear burden on U.S. commercial interests, both domestically and abroad, to force compliance with such regulations before final rules and interpretations are available. Many millions of dollars and jobs are at issue. Mid-course corrections are expensive and avoidable. Thus, having final, definitive rules before compliance begins is in the best interests of the Commission, the markets it regulates, and the participants in such markets.

B. DEFINITION OF U.S. PERSON.

The Proposed Guidance contains an apparent internal inconsistency as to which factors are relevant when determining whether a person is a "U.S. Person", and thus *per se* subject to the entirety of both Title VII of the Dodd-Frank Act and the Commission's related rules. Specifically, the Proposed Guidance defines a U.S. Person, in relevant part, as:

> (i) any natural person who is a resident of the United States;
>
> (ii) any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund, or any form of enterprise similar to any of the foregoing, in each case that is either
>
> > (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States ("legal entity") or
> >
> > (B) in which the **direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. Person** . . . .[3]

Immediately below the bolded language, the Commission states "a foreign affiliate or subsidiary of a U.S. Person would be considered a *Non-U.S. Person*, even where such an affiliate or subsidiary has certain or all of its swap-related obligations guaranteed by the U.S. Person."[4] These two statements appear to be in direct conflict.

It is possible that the Commission meant to construct a rule and an exception with these two statements. The rule would be the bolded text. In the absence of an exception, this rule would result in many subsidiaries of U.S. persons, which subsidiaries are organized and operated in foreign countries, being U.S. Persons themselves. The two analytical elements are (a) ownership and (b) responsibility for liabilities of the foreign subsidiary (as discussed below, a

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2 Public Law 111-203, 124 Stat. 1376 (2010).

3 *Proposed Guidance* at 41,218.

4 *Id.* (emphasis added).

criterion more expansive than just guarantees).[5] This would capture any offshore affiliate of a U.S. Person when such U.S. Person guarantees such affiliate.

It is possible that the Commission's second statement – when a U.S. Person guarantees an offshore affiliate, that affiliate is not a U.S. person by virtue of the guaranty – is an exception to the rule stated in the bolded language above. The Working Group would support this exception. As discussed below, regulatory jurisdiction over swap-dealing activity should not attach on the basis of a guaranty alone. Moreover, the exception would reach a correct policy outcome when determining the nature of a customer that transacts offshore with a foreign financial institution. For example, commercial firms often have affiliates across the globe, each of which relies on enterprise-wise credit in the form of a parental guaranty to transact swaps (primarily to hedge commercial operations) with financial institutions in the country of operations. Those offshore affiliates should not be characterized as U.S. Persons. If they were, foreign financial institutions would have a disincentive to transact with such offshore affiliate because doing so would potentially subject it to U.S. regulation on a transaction and entity level.

The Working Group respectfully requests that the Commission clarify that a person is not a U.S. Person solely because his liabilities or obligations are supported by a U.S. Person. As discussed below, Section 722 of the Dodd-Frank Act[6] requires that the foreign entity have more than a mere credit relationship with a U.S. entity before it receives the same legal treatment, at either the transaction or entity level, as a company organized and operated in the United States.

C. TREATMENT OF U.S. PERSONS.

The Proposed Guidance makes clear that a Non-U.S. Person need not aggregate the swap dealing activities of its U.S. affiliates for the purposes of determining whether that Non-U.S. Person exceeds the swap dealer *de minimis* level. However, the Proposed Guidance does not address how a U.S. Person should treat the swap dealing activity of its Non-U.S. Person affiliates for the purposes of determining whether the U.S. Person exceeds the *de minimis* level.

The Working Group respectfully requests that the CFTC clarify that a U.S. Person does not aggregate the swap dealing transactions of its non-U.S. affiliates for purposes of the U.S. Person's *de minimis* calculation. Disaggregation is appropriate even when a U.S. Person is the guarantor of its offshore affiliate's swaps, as discussed more fully below. Clarifying that a U.S.

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[5] The Working Group would support the deletion of subclause (ii)(B) that contains the bolded language. Such language is overly broad, and its deletion would not lessen the robustness of the analytical framework that we understand the Commission to be constructing for handling the extraterritorial issues arising under Title VII of the Dodd-Frank Act and its corresponding regulations.

[6] Section 722(d) states that Title VII of the Dodd-Frank Act "shall not apply to activities outside the United States unless those activities—

(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

(2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the Wall Street Transparency and Accountability Act of 2010."

Person need not aggregate the swap dealing transactions of its non-U.S. person affiliates with its own swap dealing will ensure consistent treatment for U.S. person and Non-U.S. person swap dealers and eliminates a possible source of regulatory arbitrage.

D. SWAP GUARANTEES.

i. Treatment of guarantees generally.

The Commission should finalize its guidance on the treatment of swap guarantees generally before finalizing its extraterritoriality rules. The Commission's treatment of swap guarantees is a necessary building block for constructing pragmatic regulations that comport with principles of comity and international law. The treatment of swap guarantees under Title VII and the Commission's regulations have profound implications to the use of such guarantees by commercial market participants in swaps executed both domestically and abroad. Thus, the legal treatment of swap guarantees must be precise and settled. Unfortunately, it is not, as discussed below.

In its recently published joint final rule *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (the "Final Product Definitions Rule"),[7] the Commission stated that guarantees of swaps would themselves be swaps.[8] Outside of the realm of securities law, this concept is not readily recognized, particularly in the commercial markets. Yet, no guidance was provided as to how the application of the definition of "swap" to guarantees of swaps would work in practice. The Commission suggested that it would address the treatment of guarantees of swaps in a separate, yet-to-be-published release.[9]

The definition of guarantee in the Final Product Definitions Rule is significantly different from the definition in the Proposed Guidance. Under the Final Product Definitions Rule, the Commission considers a guarantee of a swap to be "a collateral promise by a guarantor to answer for the debt or obligation of a counterparty obligor under a swap."[10] Whereas, in the Proposed Guidance, the Commission writes that a guarantee would refer "not only to traditional guarantee of payment or performance of the related swaps, but would also include other formal arrangements to support the …ability [of a person] to pay or perform its obligations, including without limitation, liquidity puts and keepwell agreements."[11] The former definition is much narrower than the latter, which could create inconsistencies in the application of the rules. At a

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7 *Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based, Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48,208 (Aug. 13, 2012) ("Final Product Definitions Rule").

8 *Id.* at 48,225.

9 *Id.* at 48,226.

10 *Id.* at 48,225, n. 186.

11 *Proposed Guidance* at 41,221, n.47.

minimum, the Commission should revise its extraterritorial guidance to return the definition of "guarantee" to the same definition under the Final Product Definitions Rule.

These inconsistencies show that the Commission must undertake a more thorough regulatory analysis with respect to guarantees of swap obligations, particularly as such guarantees are central to three Commission rules — the Proposed Guidance, the Final Products Definitions Rule, and the Commission's joint final rule *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security- Based Swap Participant" and "Eligible Contract Participant"*[12] (the "Final Entity Definitions Rule"). The regulatory process was insufficient with respect to the treatment of guarantees in each rule and among the rules. For example, the Commission did not provide sufficient opportunity for parties to comment on the intersection of Proposed Guidance with the Final Products Definitions Rule, nor did it provide notice or request comments on the fact that it was considering treating guarantees of swaps as swaps.[13] Given the tremendous implications to how the commercial market uses swap guarantees, stakeholders, such as those in the Working Group, should have the chance to comment on how applicable defined terms intersect among various rules. Now that the Commission has provided some indication of its guidance on extraterritoriality, stakeholders should be in position to provide meaningful comments regarding swap guarantees generally.

The Working Group requests that the Commission finalize the regulatory treatment of guarantees of swaps generally prior to considering how guarantees will factor into the Proposed Guidance. Given that the Proposed Guidance's treatment of guarantees of swaps is inexact and unformed, market participants cannot provide fully informed comments on the Proposed Guidance. More importantly, this uncertainty makes it impossible for the Working Group's members, to properly plan for the implementation of Title VII of the Dodd-Frank Act and the Commission's regulations thereunder.

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[12] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant'' and ''Eligible Contract Participant," 77 Fed. Reg. 30,596 (May 23, 2012) ("Final Entity Definitions Rule").

[13] While the Commission did request comment as to whether it should provide guidance as to whether swap guarantees **offered** by non- insurance companies should be considered swaps (*emphasis added)*, the Commission did not request comment on or notice the fact that it was considering treating guarantees of swaps as swaps. Said another way, the Commission provide notice to the fact that it might treat guarantees of swaps offered to customers as swaps. It did not notice the fact that it might treat providing credit support to the swaps of affiliated entities as swaps. *Final Product Definitions Rule* at 48,225.

ii. Treatment of Guarantees in the Proposed Guidance.

In the Proposed Guidance, the Commission would require a Non-U.S. Person to include any swap-dealing transaction with a non-U.S. Person in its *de minimis* analysis if the dealing Non-U.S. Person is guaranteed by a U.S. entity. In addition, in the event that a Non-U.S. Person Swap Dealer enters into a swap with a Non-U.S. Person guaranteed by a U.S. Person, absent the counterparties enjoying substituted compliance, the Proposed Guidance would apply U.S. law to the swap transaction.

The premise that U.S. jurisdiction can be extended to transactions between two Non-U.S. Persons in these circumstances is not supported by law or existing conventions of international jurisdiction. As stated above, Section 722 outlines the basic conditions under which a law that would otherwise apply to a U.S. person may be applied outside the territory of the United States, namely that such activities "have a direct and significant connection with activities in, or effect on, commerce of the United States . . . ." The requirement of a direct nexus between an activity and an effect in the United States limits the reach of U.S. jurisdiction rather than expands it. As such, any guidance in which guarantees result in "direct and significant connection" as a *per se* matter is inconsistent with Congressional intent. Yet, the consequence of a guarantee under the Proposed Rule is to create jurisdiction *per se*.

Section 722 does not override the basic rule of extraterritorial jurisdiction that a foreign person cannot be subject to U.S. law on grounds that would not similarly subject a U.S. person to those same laws. The Proposed Guidance, however, improperly imposes an aggregation requirement offshore that could not be applied onshore. Under the Commodity Exchange Act and the Final Entity Definitions Rule, a person cannot be regulated as a swap dealer solely on the basis of a guarantee. Under the definitional analysis for a "swap dealer," a person must conduct a non-*de minimis* level of dealing activity in swaps. Aggregation of swap dealing of affiliates is done in circumstance of common control. Aggregation is *not* done on the basis of guarantees. For example, if two U.S. Persons traded a swap in the U.S., and the U.S. parent of one party guaranteed the obligations of its subsidiary but does no swap dealing itself, the guaranty itself would not render the U.S. parent a swap dealer. Thus a U.S. person cannot be made a swap dealer simply because it guarantees the trading activity of affiliated entities. Yet, contrary to the Final Entity Definitions Rule, in the presence of a guarantee of a swap, the Proposed Guidance requires aggregation for the definitional analysis for "swap dealer." Under neither the Final Entities Definition Rule nor the statutory definition of swap dealer is the mere presence or absence of a guarantee a condition in determining whether not a person is a swap dealer. The Commission should not use guidance to establish such a condition now.

The "swap dealer" definition under the Dodd Frank Act focuses on the act of swap dealing, and the regulatory scheme applied to swap dealers is concerned with the role of "dealers" as intermediaries or market makers. Two locational components for U.S. jurisdiction of dealing activity are not contested: (a) swap dealing inside the United States and (b) swap dealing where a U.S. Person is a counterparty. Swap dealing activity outside the United States that does not involve a U.S. Person should not be jurisdictional to the Commission. However, under the Proposed Guidance, a swap guarantee creates U.S. jurisdiction for such swap, but without the analytical underpinning that (x) the swap dealing is conducted inside the U.S. or (y)

either person is a U.S. person. Guarantees do not alter the location of activity, nor should they alter the residency of a participant. Without the requisite activity of dealing in the United States and without a counterparty that is a U.S. Person, there is no "direct and significant connection with . . . commerce of the United States." The absence of "dealing" in the U.S. jurisdictional sense is not overcome by the presence of a guarantee.

Given that there is no legal basis under Section 722 for asserting jurisdiction based on a guaranty, the Commission should amend the proposed guidance to clarify that a Non-U.S. Person engaging in swap dealing with another Non-U.S. Person is not subject to CFTC regulation, even where a U.S. Person guarantees either counterparty.

E. TREATMENT OF NON-U.S. PERSONS.

The Proposed Guidance only addresses the treatment of Non-U.S. Person guarantors under limited circumstances. Specifically, the Proposed Guidance only discusses the circumstance of a Non-U.S. Person providing a guarantee to another Non-U.S. Person when transacting with a U.S. Person. In that case, the Proposed Guidance would require the guarantor to include such a transaction in its MSP determination. The Proposed Guidance is completely silent as to the treatment of Non-U.S. Person guarantors of U.S. Persons.

As in the case of the swap dealer determination, the Working Group believes the simple provision of a guarantee should not lead to the application of U.S. law. This tenet should apply without qualification for the reasons stated above regarding principles under the Final Entity Definitions rule. At a minimum, a non-U.S. Person that guarantees the swap obligations of a U.S. Person should not be subject to regulations as a swap dealer should the U.S. Person itself register as swap dealer in the United States. This tenet would create a parallel with the MSP rules in which a person that guarantees an affiliate's swap obligations does not include such guaranteed swaps in its MSP determination if the affiliate registers as an MSP itself.

F. SUBSTITUTED COMPLIANCE.

The Proposed Guidance suggests that, with respect to a swap executed offshore, certain entity level and transactional level requirements under the CFTC regulations might not apply if substituted compliance was possible under the applicable foreign law. However, the participants must petition the Commission to use such substituted compliance to establish the adequacy of the foreign law. The Commission should provide that substituted compliance will not require the Commission approval if the applicable foreign regulator has promulgated applicable regulations in accordance with G20 commitments.[14]

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[14] The Proposed Guidance appears to impose transaction-level requirements to transactions between a Non-U.S. person swap dealer and a Non-U.S. person guaranteed by a U.S. person that would, in effect, treat the latter as a U.S. Person in a manner that does not appear elsewhere in the Proposed Guidance. *See e.g. Proposed Guidance*, at 41,230, Appendix A. Because this treatment would extend U.S. jurisdiction to transactions that are otherwise treated as beyond the reach of the Dodd Frank Act, the Working Group assumes this was not intended.

III. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the swap markets worldwide. The Working Group appreciates this opportunity to provide comments on the Proposed Guidance and respectfully requests that the Commission consider the comments set forth herein as it develops its final rules regarding this matter.

If you have any questions, please contact the undersigned.

Respectfully submitted,

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