I.  INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank") authorizes the Commodity Futures Trading Commission ("CFTC") to comprehensively regulate energy trading activities. Dodd Frank is intended to increase transparency and reduce the risk of default, but to accomplish these objectives it will impose considerable regulatory burdens on market participants.

Energy companies that have not yet begun mapping a Dodd Frank compliance plan should start right away. Many new regulations have been issued in final form, and may require significant adjustments to legacy processes, procedures, and systems this year. Significant implementation will be required to start in first half of 2012 to meet Q3 2012 compliance dates.

II.  WHAT ENERGY PRODUCTS ARE COVERED BY DODD FRANK?

The “energy exemption” from the Commodity Exchange Act will expire no later than July 16, 2012, unless the CFTC adopts a new exemption by regulation. Dodd Frank’s comprehensive new regulatory scheme applies to a wide variety of energy–related agreements, contracts, and transactions classified as “swaps.” Even if you fall under one of the exclusions for “end users,” “de minimis” trading, or bona fide hedging, you still may be subject to Dodd Frank’s data collection and reporting requirements with fast-approaching compliance deadlines.

Energy products that are subject to comprehensive CFTC regulation include, without limitation, swaps or swaptions that are directly or indirectly linked to core energy futures contracts, which include:

- NYMEX Crude Oil Light Sweet
- NYMEX Gasoline Blendstock
- NYMEX natural gas
- NYMEX No. 2 Heating Oil, New York Harbor
- Brent Crude Oil (ICE)
Examples are fixed price swap contracts such as those traded based on reference prices of NYMEX Henry Hub plus a fixed differential, and “look-alike” contracts that are traded over-the-counter but are settled off of the core future contracts for delivery at the same location or locations as specified in the core contract.

The CFTC has requested comments whether to include or exclude from the definition of “swap” products such as full requirements contracts, capacity contracts, reserves sharing agreements, tolling agreements, energy management agreements, and ancillary services. In addition, the CFTC requested comments on whether environmental commodities such as emission allowances should be regulated under the Act.

III. WHICH MARKET PARTICIPANTS ARE SUBJECT TO DODD FRANK?

All market participants are potentially subject to significant new regulations regarding credit, collateral, capital structure, corporate governance, and other matters. However, the most significant regulatory burden will fall on “swap dealers” and “major swap participants.” The Act defines “swap dealer” to include any person who “regularly enters into swaps with counterparties as an ordinary course of business for its own account,” but provides an exemption for a person who “engages in a de minimis quantity of swap dealing.”

A “major swap participant” includes any of the following: (a) a person that maintains a “substantial position” in any of the major swap categories, excluding positions held for hedging or mitigating commercial risk; (b) a person whose outstanding swaps create “substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (c) any “financial entity” that is “highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency” and that maintains a “substantial position” in any of the major swap categories.

The CFTC has a pending rulemaking to further define the terms “substantial position” and “hedging or mitigating commercial risk.”

IV. PHASED IMPLEMENTATION

The CFTC has adopted a phased implementation approach under Dodd Frank. In the initial phase, the CFTC is implementing comprehensive reporting and data collection requirements which will demand significant compliance activity in early 2012 to meet an expected Q3 2012 deadline. Execution and clearing requirements will be implemented after the CFTC completes pending rulemakings.

A. Reporting and Data Collection. To date, CFTC has adopted the following reporting and data collection requirements:

Pre-Enactment Swap Transactions. Counterparties to swaps entered into prior to July 21, 2010, whose terms had not expired as of that date, must provide required reports no later than 60 days after a swap data repository becomes registered with the CFTC and commences operations to receive and maintain data related to such swaps. Swap data repositories are currently being built, with estimated launch dates as early as Q1 2012.
Transition Swaps. A person who enters into a swap on or after July 21, 2010 must retain information pertaining to the terms of such swaps pending completion of the CFTC’s pending rulemaking regarding swap data reporting.9

Swap Data Recordkeeping and Reporting Requirements. The CFTC has adopted comprehensive swap data recordkeeping and reporting requirements for swap execution facilities, designated contract markets, derivatives clearing organizations, swap data repositories, swap dealers, major swap participants, swap counterparties, and end users.10 With respect to commodity swaps, the compliance date is the later of October 2012 or 120 days after the CFTC completes a related rulemaking.11 Swap counterparties who are not swap dealers or major swap participants have an additional 90 days to comply.12

Large Trader Reporting for Physical Commodity Swaps and Swaptions. Clearing organizations, clearing members, swap dealers, and in some cases swap traders must provide position reports for swaps or swaptions that are directly or indirectly linked to: NYMEX Crude Oil, Light Sweet; NYMEX Gasoline Blendstock; NYMEX Natural Gas; NYMEX No. 2 Heating Oil, New York Harbor.13 For clearinghouses, clearing members and persons with books and records obligations, these reporting requirements became effective September 20, 2011.14 For swap dealers that are not clearing members, the regulations will become effective upon the effective date of the CFTC’s pending rulemaking to further define the term “swap.”15

Position Visibility. A person holding physical commodity swaps or swaptions that equal or exceed the levels shown in Table 1 in all months or for any month (including the spot month) must submit to CFTC a “statement of person exceeding visibility level”16 and a Form 404 filing.17 This obligation is effective 60 days after the term “swap” is further defined in a pending rulemaking.18

Table 1 – Visibility Levels

<table>
<thead>
<tr>
<th>Contract</th>
<th>Visibility Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYMEX Henry Hub Natural Gas</td>
<td>50,000</td>
</tr>
<tr>
<td>NYMEX Light Sweet Crude Oil</td>
<td>50,000</td>
</tr>
<tr>
<td>NYMEX New York Harbor Gasoline Blendstock</td>
<td>10,000</td>
</tr>
<tr>
<td>NYMEX Harbor No. 2 Heating Oil</td>
<td>16,000</td>
</tr>
</tbody>
</table>

B. Position Limits.20 The CFTC has adopted position limits for the core energy futures contracts, options thereon, and other contracts that are directly or indirectly linked to them.21 The new regulation is being challenged as arbitrary and capricious by the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association.22

Subject to the pending appeal, initial spot-month position limits in Table 2 below will become effective 60 days after the term “swap” is further defined in a pending CFTC rulemaking, and adjusted biannually thereafter.23 Non-spot-month position limits will become effective on the 1st of August after the CFTC has fixed and published such limits. Exceptions to the position limits are provided for some bona fide hedges24 and contracts that were entered into in good faith prior to the effective date of the limit.25
Additionally, the new regulations impose aggregate position limits on positions in core energy future contracts across designated contract markets. For spot month limits, traders may net their positions within each class but they cannot net across class. In other words, netting across physical delivery and cash-settled contracts is not permitted. In contrast, traders may net all futures, options and swaps referenced contracts across class for non-spot / all month contracts.

V. CONCLUSION

Dodd Frank could significantly affect the way oil and gas companies manage their trading operations and business risk. Compliance mapping should begin now in order to ensure effective implementation of the new law.

1 Dodd Frank Section 723(a)(1); 76 Fed. Reg. 80,233 (Dec. 23, 2011).
2 The CFTC has requested comment on whether there are “any provisions of the Energy Exemption . . . that the Commissions should consider incorporating into the definitions rulemaking.” 76 Fed. Reg. 29,818, 29,831 (May 23, 2011).
3 These core energy futures contracts have high levels of open interest and significant notional value and usually serve as reference prices for a number of cash market transactions.
6 Dodd Frank § 721, 7 U.S.C. § 1a(49); 75 Fed. Reg. 80,174 (Dec. 21, 2010).
7 Dodd Frank § 721, 7 U.S.C. § 1a(33).
8 17 C.F.R. § 44.02.
11 Id.
12 Id.
13 17 C.F.R. § 20.2.
15 17 C.F.R. § 20.10(b).
16 Id. § 151.6(b).
17 Id. § 151.6(c).
18 Id. § 151.6(f).
19 Id. § 151.6(a).
21 17 C.F.R. §§ 151.2(c), 151.1(definition of “Referenced Contract”).
23 17 C.F.R. §§ 151.4(d)(1) and (2)(vi)(B).
24 17 C.F.R. § 151.5.
25 17 C.F.R. § 151.9.
26 17 C.F.R. Part 151, Appendix A.
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