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December 15, 2010

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

VIA ELECTRONIC MAIL

Re: *Cost-benefit Analysis in Rulemaking Establishing the Duties of Swap Dealers and Major Swap Participants under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.*

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms (the “Working Group”), Hunton & Williams LLP respectfully submits this letter in response to the Commodity Futures Trading Commission’s (the “Commission”) request for comment concerning the cost-benefit analysis conducted pursuant to Section 15 of the Commodity Exchange Act (“CEA”) in the Commission’s Notice of Proposed Rulemaking on Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants (the “Proposed Rules”).¹ While the Working Group believes that its members, as end users and traders in the energy derivatives markets, likely are not Swap Dealers or Major Swap Participants, it is submitting this letter in the event that the yet to be published rules on the definitions of the terms “Swap Dealer” and “Major Swap Participant” might apply to members of the Working Group.²

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

¹ *Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants*, 75 Fed. Reg. 71,397 (Nov. 23, 2010).

² For a complete discussion of the Working Group’s views on the definitions of “Swap Dealer” and “Major Swap Participant,” please see the Working Group’s comment letters on such definitions, filed with the Commission on September 20, 2010.

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and responds to requests for public comment regarding legislative and regulatory developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

I. COMMENTS OF THE WORKING GROUP.

The Working Group is concerned that the Commission's average personnel cost estimate of \$20,450 per impacted entity significantly understates the cost of compliance with the Proposed Rules for commercial firms that are deemed Swap Dealers or Major Swap Participants. *First*, the Commission's per hour average salary estimate for compliance and risk management personnel is substantially understated. *Second*, the Commission's estimate of the number of man-hours necessary to fully comply with the Proposed Rules is grossly understated. *Third*, the Commission's analysis does not consider any necessary information technology expenditures or third-party costs.

A. AVERAGE PERSONNEL COSTS.

The Commission's per hour average salary estimate as used in the Proposed Rules of \$100,³ which includes benefits and allocated overhead, is markedly lower than the Working Group's estimate. Personnel with the level of sophistication and qualifications required to implement the Proposed Rules in a manner that creates the culture of compliance that the Commission seeks command a far higher hourly salary rate (inclusive of benefits costs). The Working Group estimates the hourly rate for such personnel at a commercial energy firm to be at or above \$120. Unlike the Commission's estimate, the Working Group's estimate does not include an allocation of overhead. Accordingly, any comparison between the Commission's estimate and the Working Group's estimate must acknowledge that if the Working Group's estimate included an overhead allocation it would be significantly higher than \$120.

B. ESTIMATED MAN-HOURS.

The Working Group acknowledges that the Commission's estimated man-hours necessary for compliance with the Proposed Rules represents an incremental personnel allocation for Swap Dealers and Major Swap Participants as they most likely have risk management programs in place. However, the Commission's estimated compliance burden of

³ The Working Group recognizes that the Commission increased this estimate from \$74.36, the figure used in the Notice of Proposed Rulemaking on Reporting of Physical Commodity Swaps (75 Fed. Reg. 67,258 at 67,266 (Nov. 2, 2010)).

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204.5 man-hours per year, or approximately 11% of one full-time employee,⁴ is a very substantial underestimate.

In order for a commercial energy firm that is deemed to be a Swap Dealer or Major Swap Participant to implement a “comprehensive risk management program”⁵ that “protect[s] against the risks resulting from the activities of interconnected or otherwise related entities... [that] take[s] an integrated approach to risk management at the consolidated entity level”⁶ and provides “diligent supervision reasonably designed to achieve compliance with the CEA and Commission regulations”⁷ the Working Group estimates it will require **at least five new** full-time employees.⁸ Five new full-time employees represents an estimated annual personnel cost of \$1,080,000 for a commercial energy firm, which, at a minimum, is 63 times greater than the Commission’s estimate.

The Working Group’s estimates as to the personnel required to implement individual provisions of the Proposed Rules differ substantially from the Commission’s. For example, the Commission estimates that the required documentation of the quarterly review and testing of the adequacy of a Swap Dealer or Major Swap Participant’s risk management program by internal audit staff or qualified external, third party contractors will require 1 man-hour per report, or 4 man-hours per year. Based on experience with certain annual Federal Energy Regulatory Commission (“FERC”) audits, which are similar, though more well-defined and smaller in scope, the Working Group estimates that each quarterly audit will require 200 man-hours of audit staff time, or an annual expenditure of \$96,000.⁹ The documentation of each audit will be a significant portion of the associated cost, and that cost will far exceed the \$400 annual expenditure estimated by the Commission.

C. CONSIDERATION OF OTHER COSTS.

⁴ The Working Group, like the Commission, assumes an 1,800 hour work year.

⁵ *Proposed Rules* at 71,399.

⁶ *Id.*

⁷ *Id.* at 71,400.

⁸ The five employees represent one new professional in each of the following groups: accounting, legal, credit, risk and compliance.

⁹ This is a low-end estimate because it does not account for the time of risk-management and information technology staff who are also a significant part of the audit process.

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The Commission's cost estimates only represent the annual personnel costs associated with compliance with the Proposed Rules. The estimates do not include one-time and annual costs associated with changes required to adapt information technology systems to comply with the Proposed Rules. The estimates also do not include expenditures on third-party advisors such as accountants or compliance consultants to aide in the drafting and testing of robust risk management programs or third-party advisors to conduct periodic reviews of risk management programs. Finally, these estimates do not reflect the additional compliance and regulatory burden placed on commercial firms that are deemed Swap Dealers or Major Swap Participants imposed by the other requirements of Title VII.

The cost of a "comprehensive risk management program"¹⁰ for a commercial energy firm that is deemed a Swap Dealer or Major Swap Participant will be substantial. By analogy, FERC required Edison Mission Energy to implement a FERC compliance program at a cost of at least \$2 million in connection with a settlement for improper bidding behavior involving the PJM Interconnection and misleading FERC staff in the subsequent investigation.¹¹

Given the large discrepancies between the Commission's cost estimates and the Working Group's cost estimates, the Working Group respectfully requests that the Commission, before promulgating proscriptive regulations, conduct a thorough cost-benefit analysis. The implementation of federal regulation under Title VII of the Act likely will be very expensive for many market participants. However, the Commission should not force the Swap markets to incur additional costs if they outweigh any related benefits. Thus, the Working Group encourages the Commission to conduct its own independent economic analysis.

When the cost discrepancies discussed above are multiplied by (i) the many rules that the Commission is promulgating, and (ii) the many firms that will incur compliance costs to implement those rules given the broad definitions of "Swap Dealer" and "Major Swap Participant," the product is potentially staggering. While the absorption of this cost would be extremely burdensome at any point in time, the imposition of this cost could not come at a worse time as the U.S. economy struggles to recover from a recession.

¹⁰ *Proposed Rules* at 71,399.

¹¹ *In re Edison Mission*, 123 FERC ¶61,170 (2008). For another example see, *In re Duquesne Light Company*, 123 FERC ¶61,221 (2008). FERC required Duquesne Light Company to implement a FERC compliance plan at a minimum cost of \$1,000,000 as part of a penalty for violating cost allocation procedures, the electric quarterly report filing requirement, and FERC standards of conduct.

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II. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the Swap markets in the United States. We appreciate the balance the Commission must strike between effective regulation and not hindering the uncleared energy-based Swap markets. The Working Group offers its advice and experience to assist the Commission in implementing the Act. Please let us know if you have any questions or would like additional information.

Respectfully submitted,

/s/ David T. McIndoe.
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