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What Does the Implementation of the Dodd-Frank Act Mean for the Energy Sector?

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When the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was enacted by Congress in July 2010, it was hailed by its proponents as the most comprehensive financial reform since the 1930s. Others viewed it as a needlessly complex and convoluted morass that would disproportionally complicate hedging in markets or industries that were functioning well without expansive regulation – like the energy sector. Broad in scope, the Dodd-Frank Act gave particular attention to regulating the previously unregulated over-the-counter (OTC) market in derivatives trading – a market in swaps that is now estimated to be worth $650 trillion in notional value.

Over the past two years, the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), and certain other federal governmental agencies have been proposing and issuing rules designed to implement the provisions of Title VII of the Dodd-Frank Act, applicable to OTC derivatives. Over the last year, the CFTC has finalized numerous rules and proposed others that remain pending or subject to public comment, all of which are of critical importance to companies in the energy and natural resources sectors trading in OTC financial derivatives involving commodities.

On October 15, 2012, at the International Energy Credit Association's annual fall conference, Reed Smith partners Andrea Pincus, Andrew Cross and Phil Lookadoo presented a comprehensive seminar on the state of CFTC rulemaking under the Dodd-Frank Act, and what it means for OTC derivatives trading in the energy sector. To review their PowerPoint presentation, please click here.

Key rules went into effect on or before October 12, 2012, with immediate and near-term consequences for OTC trading and your company's operations. These include the definition of what is regulated as a swap subject to mandatory clearing and what is exempt; definitions of who will be regulated as a swap dealer, major swap participant or end-user; and, recordkeeping, reporting and swap documentation requirements. More rules are slated to become effective in the first few months of 2013, while some remain pending as proposals – including margin and capital requirements, and the scope of the Dodd-Frank Act's extraterritorial reach – without a projected date for a final rule. Along the way, on the eve of effective dates for various final and "interim" final rules (most recently on October 12, 2012), the CFTC keeps rolling out "interpretive guidance" letters in response to requests for modifications and clarifications of rules, setting out examples, tests, and refined deadlines for compliance with the rules.

The attached presentation focuses on the most pressing questions faced by clients trading in OTC derivatives as they prepare for compliance with the legal, operational and financial requirements imposed upon them by the CFTC rulemaking under the Dodd-Frank Act, including:

- **What is regulated under the Dodd-Frank Act?** When is a swap subject to regulation and mandatory clearing, and what types of transactions are exempt? What is an exempt physical forward contract? What constitutes embedded optionality and what tests do you apply to determine whether the optionality embedded in a forward contract will transform an exempt forward transaction into a regulated swap?
- **Who will be regulated and who has to register?** How to determine if an entity is a Swap Dealer (SD), a Major Swap Participant (MSP), or an End-User (EU). What are the requirements for trading with "special entities," including "utility special entities"? What is an Eligible Contract Participant (ECP)?
- **How far is the extraterritorial reach of the Dodd-Frank Act?** What is a "U.S. Person" and why does that matter? What will apply if an entity is a foreign sub of a U.S. entity? What if an entity is a Non-U.S. entity subject to regulation by a foreign regime?
- **How can my entity continue to use swaps to hedge or mitigate commercial risk?**
- **Is my entity eligible for the end-user exception?** What special requirements are there for public companies?
- **What are the new recordkeeping, reporting and swap documentation requirements?** When must compliance begin? How to prepare?
- **What are the new business conduct rules?** What are the external and internal conduct rules?
- **What margin and capital requirements will be imposed?**
- **What will happen to position limits?**
- **When do the rules become effective?** Did the CFTC's "no action" letters on October 12, 2012, affect my deadlines or compliance obligations? What identifiers or documentation

protocols do I need to address? What do I need to do *now*? What do I need to do on or after December 31, 2012?

As recently as October 12, 2012, we saw that even the CFTC's final rules are vulnerable to change and comment. The challenge to entities to stay informed and understand the scope and timing of compliance obligations is no small feat. And, the preparation and compliance process itself takes time, coordination and focus across each company. The attached presentation is intended to provide an overview of issues to analyze, with checklists, formulae and exhibits to guide your discussions about what compliance with the Dodd-Frank Act means for you. We advise that you begin those internal discussions right away if you have not as yet, and reach out for further advice and with any questions as soon as you can.

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