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

Elizabeth M. Murphy, Esq.
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Proposed Regulations on Further Definitions of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Swap Participant" – CFTC RIN 3038-AD06; SEC File Number S7-39-10

Dear Mr. Stawick and Ms. Murphy:

Peabody Energy Corporation ("Peabody") is pleased to submit the following comments on proposed regulations of the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (and collectively, "Commissions") under Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to further define the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible swap participant."

Peabody, which is headquartered in St. Louis, Missouri, is the world's largest private-sector coal company, supplying the world's thermal power and steel markets on six continents. It uses swaps to hedge or mitigate the commercial risks related to its worldwide coal mining and sales operations. Peabody has 7,000 employees globally, approximately 5,600 of which are located in the United States. The company controls approximately 9 billion tons of coal reserves and holds a majority interest in 28 coal mining operations in the United States and Australia. Peabody's principal operations include the extraction, transportation, and the purchase and sale of coal with third parties.

Peabody uses swaps and other derivatives to hedge and mitigate the risks related to fluctuations in (i) the price of coal in various markets throughout the world, (ii) ocean-going freight rates and other transportation costs, and (iii) the prices of key supplies, capital equipment and commodities used in extracting coal, such as diesel fuel, and explosives. We also use currency derivatives frequently to hedge and mitigate the substantial currency exchange rate risks inherent in Peabody's global operations, particularly with respect to our Australian mining and sales operations. In addition, we have used interest rate swaps to mitigate the risks of interest rate volatility related to our debt facilities.

Peabody is interested in the proposed rulemaking because its ability to protect itself from the various price risks described above could be severely adversely impacted if the Commissions were to define the term "swap dealer" so broadly that Peabody would come within its terms. We believe Congress clearly intended that Dodd-Frank would preserve the ability of producers like Peabody to continue to conduct their core business and maintain the incentives to use swaps to hedge and mitigate commercial risks. If misclassified as swap dealers, non-financial entities such as Peabody would be forced to divert significant capital and other resources away from creating economic growth to meet the proposed extensive capital and regulatory compliance requirements or possibly accepting greater commercial risks by entering into fewer swaps.

I. THE PROPOSED DEFINITION OF "SWAP DEALER" SHOULD BE REVISED TO PREVENT ARBITRARY RESULTS THAT COULD INCLUDE HEDGING END USERS WITHIN ITS TERMS

A. Summary

Peabody respectfully submits that the Commissions' proposed definition of "swap dealer" ("SD") lacks the clarity and objective criteria necessary for Peabody and other market participants to determine whether they or their counterparties are SDs. The need for clarity is particularly necessary in Dodd-Frank, where an entirely new regulatory framework is being developed and there are no settled precedents that might otherwise guide commercial firms and their counsel in interpreting the regulations. Market participants and end users such as Peabody need clear definitional lines so that they may determine their capital and other commercial requirements. Should the rules be too onerous, and therefore too expensive to comply with, Peabody and others like it may not be able to efficiently manage their commercial risks. In addition, the same market participants and end users need clarity in order to conduct their business activities with a high degree of certainty that they are in compliance with relevant statutes and regulations.

Vagueness could significantly harm commodity markets and commerce in general. The proposed SD definition unnecessarily exposes end users to the legal risk of arbitrary enforcement actions, as well as potential strike suits by counterparties seeking to void and rescind swap transactions, on the purported grounds that an end user failed to register as an SD. Legal uncertainty over the application to end users of the significant regulatory requirements

for SDs could lead end users to minimize their use of swaps in order to avoid the risk of being deemed to be an SD. That could negatively impact market liquidity, market stability, price discovery, and the cost of hedging commercial risks, and in turn hinder capital investment, increase operating costs and consumer prices, and reduce jobs.[1]

The Commissions stated a goal of definitional flexibility.[2] We fully endorse that goal, but believe it is best achieved through the exercise of the Commissions' powers under Dodd-Frank Section 712(d) to amend and expand definitions in the future if new or additional facts warrant such action. Further, we respectfully submit that the Commissions' goal is not advanced by the adoption of a vague definition because vagueness invites the potential for arbitrary application, which will be deleterious to swap markets as described above.

We therefore respectfully submit that the proposed definition of SD be amended to provide expressly that

- the use of swaps to hedge or mitigate commercial risks will not be deemed to be a swap dealing activity;
- Swap transactions between an end user and its subsidiaries or affiliates will be categorically excluded from swap dealing activity;
- the criteria for "making a market" in swaps and for determining when an entity is "commonly known" as an SD are based on objective standards that provide entities with a bright line against which to measure their status and plan their activities.

B. The Definition of SD Should Be Amended to Provide an Express Exception for Swaps Transactions for Hedging or Mitigating Commercial Risk

The SD definition should expressly state that the term does not include swaps entered into by end users used to hedge or mitigate commercial risk. As noted above, if hedging activity could bring an end user within the definition of an SD, that entity may be forced to reduce the use of swaps for hedging and risk mitigation rather than risk being required to comply with the expensive regulatory requirements for SDs. In Peabody's case, compliance with those requirements would be costly and could interfere with its ability to focus on its coal

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[1] The mandatory registration requirement for SDs might render swaps entered into by an unregistered SD unenforceable as illegal instruments. Any definition vague enough to capture an end user thus invites strike suits by counterparties to void unprofitable swaps by contending that the end user was an unregistered SD.

[2] *Id.* at 80,176.

mining business. Discouraging hedging and risk mitigation is contrary to Dodd-Frank's intent, as well as the public interest.

We believe that the Commissions intended that swap activity for hedging and mitigating commercial risks is not "swap dealing activity" that would bring an entity within the scope of the SD definition. The Commissions' discussion of the proposed definition expressly distinguishes between "swap dealing activities" and "commercial activities." The Joint Release states that "a non-financial company that engages in "both" "swap dealing" and "commercial activities" would fall within the definition of swap dealer "*because of its swap dealing activities*, notwithstanding that *it also engages in other commercial activities*."[3] However, without the express amendment to the proposed definition that we recommend, the proposed regulation fails to recognize the distinction.

In addition, as the Commission stated, "the appropriateness of these proposals should be considered in light of the substantive requirements that will be applicable to dealers and major participants, including capital, margin and business conduct requirements."[4] This demonstrates that the proposed SD classification is inappropriate and unnecessary for producers and other end users like Peabody. Therefore, the proposed SD definition should be revised to ensure that result.

C. Clarification of the Exception for Swaps Entered into Not as Part of a "Regular Business"

The "*Exception*" in proposed regulation 1.3(ppp)(2) that "[t]he term 'swap dealer' does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business" should be clarified by inserting the words "swap dealing" between the words "regular" and "business." Without this clarification, the exception's plain terms fail to exclude *on their face* the hedging and risk management activity of end users as part of their "regular business" of entering into swaps to hedge and mitigate commercial risk. In this connection, Peabody enters into swaps for the purpose of hedging or mitigating the commercial risks of its production, transportation and sales activities as an integral part of its "regular business," *i.e.*, mining and supplying coal for its global customers.

The requested clarification is necessary to better reflect the Commissions' intent in the plain terms of the rule and to eliminate the legal risk of future indiscriminate application of the definition.

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[3] 75 Fed. Reg. 80,173, 80,179 at n. 30 (emphasis added).

[4] *Id.* at 80,175 & n. 8.

D. The Definition of "Swap Dealer" Should Exclude Intra-Company Swap Transactions

In response to the Joint Release's specific invitation to comment as to how the SD and security-based SD definitions should be applied to members of an affiliated group,[5] Peabody respectfully submits that the regulatory definition of SD should *expressly state* that the term "swap dealer" does not include persons to the extent their swap activity consists of transactions among an end user's subsidiaries or affiliates.

We cannot discern, and the Joint Release does not seem to identify, any rationale for treating intra-company swaps as a form of swap dealing. To conduct their businesses efficiently, global companies such as Peabody need to operate their different lines of business and operations in different countries through separate affiliates. Each affiliate needs to hedge or mitigate its commercial risks. Often their collective needs will be most efficiently met and coordinated through one or more centralized trading desks. Affiliate to affiliate swaps are required for a host of prudent business reasons (*e.g.*, tax, enterprise risk diversification, transferring revenues from a subsidiary to a parent). Such intra-company swaps have nothing to do with swap dealing. Thus, an end user's decision to conduct swap activities in one entity or through subsidiaries or affiliates and its decisions to engage in intra-company swaps should not be influenced by regulatory concerns over the SD definition.

Additionally, swaps between subsidiaries or affiliates should *not* be limited to those that are wholly-owned, but should include any entity within the definition of "affiliate" under the federal securities laws. For instance, certain countries may not permit Peabody to establish a wholly-owned subsidiary or affiliate.

E. The Definition of Swap Dealer Should Include Clear, Objective Standards for the "Making a Market" and "Commonly Known" Criteria

The SD definition should expressly state clear, objective criteria for what is considered to be "making a market" in swaps under proposed CFTC Regulation 1.3(ppp)(1)(ii), and clear standards for what activity would cause an entity to be "commonly known" as an SD under proposed CFTC Regulation 1.3(ppp)(1)(iv), so that the meaning and indicia of such activity will be clear to all market participants.

1. <u>"Accommodating" another's interest in a swap does not mean a market participant is "making a market"</u>

The "core tests" of SD status proposed in the Joint Release include the concept that "dealers tend to accommodate demand for swaps and security-based swaps from other par-

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[5] *Id.* at 80,183.

ties."[6] Peabody respectfully submits that the CFTC should disavow the position that "accommodating" the interest of another party by entering into a swap transaction is an indication of "making a market" and thus of swap dealing.

Favorably responding to a request to enter into a swap is a prerequisite for each and every swap transaction. For every swap – whether entered into for speculative or hedging purposes – one party must necessarily be the first to make a bid or offer and the other to respond and accept (*i.e.*, to "accommodate" the other's interest). Thus, "accommodating" another's interest in entering into a swap transaction is not an accurate basis to distinguish swap dealing from non-swap dealing activity. Commercial entities such as Peabody must be free to enter into any swap that allows them to hedge or mitigate their commercial risk without concern over which party originated the interest in the swap or whether entering into the swap will somehow be deemed an "accommodation."

If the CFTC continues its position regarding "accommodating" another's interest in a swap transaction as an indication of SD status, Peabody respectfully requests that the CFTC make clear in the rule itself that the concept of "accommodation" is not applicable where the solicited party is an end user and uses the swap to hedge or mitigate commercial risk.

2. <u>The "commonly known as" standard is unreasonably vague</u>.

The Commissions' proposed definitions of "swap dealer" and "security-based swap dealer" includes any person engaging in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps. Unless the regulation sets forth clear and objective criteria to delineate the type of activity that will cause a person to be "commonly known" as a dealer in swaps, Peabody believes this part of the definition of SD will be a vague and subjective test that invites arbitrary and capricious application. The SD regulatory category is completely new, so there are no precedents from which anyone can determine what persons are "commonly known" to be SDs. The Joint Release implicitly acknowledges the subjectivity of the criterion by noting that discerning whether a person is a SD under this standard may require "the perspective of persons with substantial experience with and knowledge of the swap and security-based swap markets."[7] Peabody respectfully requests that this criterion should not include any trading for the purpose of hedging or mitigating commercial risk.

F. The *De Minimis* Exception Should be Expanded

The statutory provision for a *de minimis* exception was intended to provide a safe harbor from SD status for end users in the event some of their swap transactions might be perceived to be swap dealing. The Commissions' proposed *de minimis* exception to the SD definition includes three conditions, all of which are to be measured over the preceding 12 months: (i)

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[6] *Id.* at 80,176

[7] *Id.* at 80,178.

aggregate gross notional amount of swaps of no more than $100 million (with a ceiling of $25 million with "special entities" as defined in CEA Section 4s(h)(2)(C)); (ii) no more than 15 counterparties other than SDs; and (iii) no more than 20 swaps. Peabody believes these terms are too restrictive to provide a reasonable safe harbor for end users.

End users need a reasonable safe harbor for valid non-hedging or non-risk mitigation purposes without being at risk from consideration as a SD for swaps. Such transactions could include accommodating an urgent need of a small market participant for liquidity to hedge its risks in a thin market or to aid price discovery at thinly traded hubs. We respectfully submit that a *de minimis* exception that permits an end user to trade up to 10% of its notional value of swaps in a particular swap category over a twelve month period is reasonable because it will allow needed flexibility for trading in thin markets without impairing the salutary legislative objective underlying the regulation of swap dealers.

Moreover, the limits of 15 counterparties and 20 swaps are arbitrary and not necessarily indicative of risk to the financial system. As Chesapeake Energy notes in its comments, an end user may have many small swaps with many different counterparties, and its position may be less risky than one large swap with only one counterparty.[8] End users like Peabody typically have several different counterparties, which include various end users, financial institutions, and trading firms. It may also be necessary to have different counterparties with respect to different commodities and geographic regions. In particular, when an end user has large scale operations across different commodities and geographic regions, they may need many swaps with many different counterparties to properly mitigate their risks. Even though they are acting prudently, they could nevertheless be above the proposed *de minimis* thresholds.

II. THE PROPOSED DEFINITION OF "HEDGING OR MITIGATING COMMERCIAL RISK" SHOULD BE REVISED TO REFLECT ACCURATELY HOW PRODUCERS AND END USERS USE SWAPS TO HEDGE

Peabody generally supports the proposed definition of the term "hedging or mitigating commercial risk" set forth in proposed CFTC Regulation 1.3 (ttt) for purposes of determining who is a "major swap participant" under CEA Section 1a(33) and proposed CFTC Regulation 1.3 (qqq).[9] However, Peabody respectfully suggests that the reference to "trading" in

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[8] Comments of Chesapeake Energy, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Swap Participant" – CFTC RIN 3038-AD06 (Dec. 14, 2010) at p. 4.

[9] In a separate rulemaking regarding the end user exception to mandatory clearing of swaps, the CFTC is proposing nearly identical regulatory language to define the meaning of the phrase "hedge or mitigate commercial risk." 75 Fed. Reg. 80,747 (December 23, 2010). Peabody will file a separate comment letter addressing that rulemaking.

Proposed Rule 1.3 (ttt)(2)(i) should be deleted. The term "trading" in this context is too generic and therefore could include swap trading for hedging or mitigating commercial risk. The other terms used in the proposed definition, "speculating" and "investing," are sufficient to meet the Commissions' regulatory goals and are consistent with the other proposed rules and the statute.

Peabody also urges that the proposed definition be amended to expressly include the statement in the Joint Release's preamble "that whether a position is used to hedge or mitigate commercial risk should be determined by the facts and circumstances at the time the swap is entered into, and should take into account the person's overall hedging and risk mitigation strategies."[10] This will assist firms wishing to structure their activities to avoid being deemed a "major swap participant." Including the standard expressly within the regulatory text itself is especially important given the number of rulemakings necessary to implement Dodd-Frank and the length and complexity of the various *Federal Register* notices involved in that process.

In response to specific questions posed by the Joint Release,[11] Peabody recommends that the definition of the term "hedging or mitigating commercial risk" include swaps entered into to facilitate asset optimization and dynamic hedging, because both are commonplace and necessary in any physical commodity business, such as Peabody's, where there may be changes in production volumes, customer demand, fuel demand, and market prices between the time a trade is originally entered into and the settlement of a swap. Peabody also recommends that the underlying hedged item of an uncleared swap should *not* be limited to a non-financial commodity. In this regard, the definition should cover foreign exchange rate and interest rate risks relating to domestic and offshore affiliates and operations. Nothing in the Dodd-Frank legislation supports limiting the exemption to risks involving non-financial commodities. Foreign exchange and interest rate risks are very real and substantial risks to end users with global operations and corporate debt programs.

III. CONCLUSION

Peabody appreciates the opportunity to comment on the proposed regulatory definitions of the terms "swap dealer," "major swap participant," and related terms, such as "hedging or mitigating commercial risk." We believe that the revisions and clarifications suggested herein will improve the definitions and help appropriately limit them to the entities that Congress intended. End users such as Peabody need to preserve the ability to hedge commercial risk in order to continue to pursue their activities in the most efficient way possible for the benefit of the markets and a strong and secure economy.

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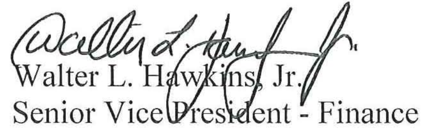
[10] 75 Fed. Reg. 80,173, at 80,195.

[11] 75 Fed. Reg. 80173, at 80,195.

Peabody would be pleased to discuss its comments in further detail with any of the Commissioners or their staffs. Please feel free to contact the undersigned or Robert Brandenburg (314-342-7758) if you have any questions or wish to discuss these issues further.

Very truly yours,



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