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VIA ELECTRONIC MAIL

Cooperative Capital Markets Regulatory System
commentonlegislation@ccmr-ocrmc.ca

Re: Comments Regarding (i) the Consultation Draft of the Provincial Capital Markets Act and (ii) the Consultation Draft of the Federal Capital Markets Stability Act

Dear Sir or Madam:

On behalf of The Canadian Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the request for public comment on (i) the Consultation Draft of the Provincial Capital Markets Act ("**Draft PCMA**")[1] and (ii) the Consultation Draft of the Federal Capital Markets Stability Act ("**Draft FCMSA**")[2] (collectively the "**Draft Consultations**"), which were published in relation to the execution of the Memorandum of Agreement Regarding the Cooperative Capital Markets Regulatory System ("**MOA**").[3] The Working Group welcomes the opportunity to provide comments on the substance of the Draft Consultations. However, the Working Group's participation in this comment process should not be construed as either supporting or opposing the establishment of the Cooperative Capital Markets Regulatory System ("**Cooperative System**"). Rather, the Working Group's hope is that Canada's ultimate derivatives regulatory infrastructure, whether it is the Cooperative System or at the Provincial level, properly accounts for the unique nature of Canada's energy derivatives market.

The proposed Cooperative System and the associated regulatory reforms may lead to significant changes to the manner in which Canadian derivatives markets are regulated. This transformation must be undertaken in a manner that avoids unintended consequences that could adversely affect Canadian energy markets. With this in mind, the Working Group's comments contained herein identify issues that will impact the derivatives markets and offer

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1 *See generally*, Draft PCMA (Sept. 8, 2014), *available at* http://ccmr-ocrmc.ca/wp-content/uploads/PCMA-Engl.pdf.

2 *See generally*, Draft FCMSA (Sept. 8, 2014), *available at* http://ccmr-ocrmc.ca/wp-content/uploads/CMSA-English-revised.pdf.

3 *See* MOA at 3, §3(a)(i)-(ii) (Oct. 9, 2014), *available at* http://ccmr-ocrmc.ca/wp-content/uploads/Oct-9-MOA-English.pdf.

recommendations designed to ensure a workable and appropriately-tailored regulatory framework for the regulation of derivatives markets in Canada.

The Working Group is a diverse group of commercial firms that are active in the Canadian 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 producers, processors, merchandisers, and owners of energy commodities. The Working Group considers and responds to requests for comment regarding developments with respect to the trading of energy commodities, including derivatives, in Canada.

I. INTRODUCTION.

As the Consultation Drafts[4] lay the foundation for the PCMA and FCMSA, which will provide the underlying legislative framework for the Cooperative System, issues pertaining to the following topics must be addressed when drafting the final legislation: (i) reliance on securities concepts; (ii) the definition of "derivative;" (iii) treatment of forward contracts; (iv) recordkeeping; (v) the definition of "related financial instrument;" and (vi) the structure of the insider trading prohibition. Each of these issues will be discussed in detail below.

II. COMMENTS OF THE WORKING GROUP.

1. The Draft Consultations Rely on Securities Concepts, and the Resulting Derivatives-Related Provisions May Not Be Appropriate for Derivatives Markets.

A securities regulatory framework should not be applied whole cloth to derivatives markets in what is essentially a "one-size-fits-all" approach. Securities and derivatives markets each possess unique characteristics in terms of the instruments, the market structure, the market participants, and the market participants' motivations for entering the markets. The Consultation Drafts' reliance on securities concepts, and the resulting derivatives-related provisions, therefore may not be appropriate for derivatives markets. The need for a tailored regulatory approach regarding derivatives and securities is particularly highlighted with respect to the definition of "dealer" in the Consultation Drafts.

The definition of "dealer" and certain obligations imposed on dealers may be appropriate in the context of retail securities markets, but not in the context of derivatives markets where trading relationships are traditionally principal-to-principal. Unlike financial institutions, energy firms primarily trade as principals by transacting energy-related derivatives to, among other things, hedge the risk associated with their core business of providing electricity, crude oil, natural gas, propane, gasoline, and other energy commodities to customers. The Working Group is concerned that the adoption of a definition of "dealer" that is not appropriately tailored for the derivatives markets will unnecessarily disrupt energy markets in Canada, as well as impair the

[4] This comment letter will refer to the Consultation Draft of the PCMA and the Consultation Draft of the FCMSA as the Draft PCMA and the Draft FCMSA, respectively. When discussing the final legislation, this comment letter will refer to the "**PCMA**" and the "**FCMSA**."

operations of energy firms in Canada whose primary business involves the production, refining, marketing, transportation, and sales of physical commodities.

Solution. The PCMA and the FCMSA should be drafted in a manner that takes into account the fundamental differences with respect to the derivatives and securities markets, including establishing separate definitions for derivatives dealers and securities dealers and separate related regulatory obligations.

2. The Definition of "Derivative" Needs to Be Clarified.

The proposed definition of "derivative" is broad and, in part, dependent on whether the Capital Markets Regulatory Authority ("**Authority**") has issued a designation order according status or removing status as a derivative.[5] Further, the proposed definition of "security" includes "a derivative that is designated, or is within a class of derivatives designated, under subsection 95(2) to be a security.[6] The Working Group anticipates that the provisions allowing derivatives to be designated as securities are intended to only potentially apply to securities-related derivatives, such as credit default swaps or certain total return swaps. However, clarification that commodity-based derivatives are not at risk of being regulated as securities would be beneficial.

Solution. Commentary underlying the legislation should clarify that the ability for the Authority to designate derivatives as securities is intended to permit securities-related derivatives to be regulated as securities, when appropriate, and is not intended to permit the regulation of commodity-based derivatives as securities.

3. Forward Contracts Intended to Be Physically-Settled Should Be Omitted from the Definition of "Derivative."

Under both Consultation Drafts, the broad definition of "derivative" captures forward contracts.[7] The Working Group would like to confirm that physically-settled commodity forwards are not captured by the definition of derivative. These contracts: (i) do not pose a systemic risk and should not be treated like financial contracts; and (ii) are necessary to ensure the efficient delivery of nonfinancial commodities to companies that require them to conduct their core physical business.

Further, while the Commentary on the Cooperative Capital Markets Regulatory System Governance and Legislative Framework specifically noted that such contracts "are not intended to be regulated under the PCMA," no similar guidance is provided with respect to the FCMSA.[8] The absence of similar guidance with respect to the FCMSA introduces a degree of regulatory confusion. To clarify matters, the definition of derivative under both the PCMA and the FCMSA should expressly exclude forward contracts that are intended to be physically-settled.

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5 *See* Draft PCMA at 63, §95.

6 *Id*. at 21, §2.

7 *See id*. at 10, §2; *see also* Draft FCMSA at 9, §2.

8 Commentary on the Cooperative Capital Markets Regulatory System Governance and Legislative Framework at 8 (Sept. 8, 2014), *available at* http://ccmr-ocrmc.ca/wp-content/uploads/Commentary-English1.pdf.

Solution. The legislation should expressly omit forward contracts intended to be physically-settled from the definition of "derivative." Alternatively, commentary underlying the legislation should clarify that forward contracts intended to be physically-settled are intended to be excluded from the definition of "derivative" under both the PCMA and FCMSA.

4. Recordkeeping Requirements Are Broad and Lack Detail, Making It Difficult for Companies to Prepare for Recordkeeping Obligations under the Cooperative System.

The Draft PCMA provides that a market participant must keep "records that are necessary for the proper recording of its business transactions and financial affairs and of the transactions that it executes on behalf of others; and any other records required under capital markets law."[9] The Draft PCMA further provides that such records must be kept until the expiry of six years after the end of the year to which they relate or for such longer period as may be prescribed.[10]

The recordkeeping requirements set forth in the Draft PCMA are, at best skeletal, and void of detail, which may prompt companies to conservatively adopt an overly-broad interpretation to avoid potential violations.

Solution. The draft Initial Regulations, which are expected to be published for public comment in the spring of 2015, should include a more robust description of the recordkeeping requirements so that companies can provide comment on the proposed requirements and begin to prepare for potential obligations under the Cooperative System.

5. The Definition of "Related Financial Instrument" Needs to Be Clarified.

The Working Group is concerned that under the Draft FCMSA, the definition of "related financial instrument" is broad enough to potentially capture commodity derivatives transactions that have an impact on the price of the securities issued by an energy company. This is an issue especially in the context of the insider trading provisions in the Draft FCMSA.

Pursuant to Section 67 of the Draft FCMSA, which addresses insider trading:

> Every person in a special relationship with an issuer whose securities are publicly traded commits an offence if they use knowledge of a material change with respect to the issuer, or a material fact with respect to securities of the issuer, that they know has not been generally disclosed to trade a security of the issuer *or to enter into a transaction involving* ***a related financial instrument***.[11]

(emphasis added).

The issue here is tied to the definition of "related financial instrument." Under Section

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[9] Draft PCMA at 41, §54.

[10] *Id*.

[11] Draft FCMSA at 33, §67.

66 of the Draft FCMSA, a related financial instrument means, in relation to a security:

(a) an instrument, agreement or security whose market price or value or payment or settlement obligations are derived from, referenced to or based on the market price, value or payment or settlement obligations of the security; or

(b) an instrument, agreement or understanding that affects, directly or indirectly, a person's economic interest in the security, namely

(i) the person's right to receive or opportunity to participate in a reward, benefit or return from the security, or

(ii) the person's exposure to a risk of financial loss in respect of the security.[12]

The definition of "related financial instrument" under the Draft FCMSA differs from the definition under the Draft PCMA in that it does not specifically reference derivatives; however, there is still concern that the definition of "related financial instrument" is broad enough to potentially capture commodity derivatives transactions.

Solution. The FCMSA should clarify that commodity derivatives transactions that have an impact on the price of the securities of an energy company are not captured in the definitions of "related financial instrument" and "security" in the context of insider trading.

III. CONCLUSION.

The Working Group appreciates this opportunity to provide comments on the Draft PCMA and the Draft FCMSA and respectfully requests that the comments set forth herein are considered as any final legislation or regulations are drafted.

If you have any questions, please contact the undersigned.

Respectfully submitted,
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[12] *Id*. at 32, §66.