Docket at the location provided under the caption "ADDRESSES."

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by removing amendment 39–6330 (54 FR 25591, July 8, 1987), and by adding a new airworthiness directive (AD), amendment 39–8469, to read as follows:

93–01–15. McDonnell Douglas: Amendment 39–8469. Docket 91–NM–220–AD. Supersedes AD 87–14–06, Amendment 39–6330.

Applicability: Model DC–8 airplanes, certificated in any category.

Compliance: Required as indicated, unless accomplished previously.

To ensure the continuing structural integrity of these airplanes, accomplish the following:

(a) Within one year after August 10, 1987 (the effective date of AD 87–14–06, Amendment 39–5631), incorporate a revision into the FAA-approved maintenance inspection program which provides for inspection of the Principal Structural Elements (PSE's) defined in section 2 of volume I of McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated December 1985, in accordance with section 2 of volume III of that document. The non-destructive inspection techniques set forth in Volume II of the SID provide acceptable methods for accomplishing the inspections required by this AD. All inspection results, negative or positive, must be reported to McDonnell Douglas, in accordance with the instructions of section 2 of volume III of the SID. Information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB Control Number 2120–0056.

(b) Within 6 months after the effective date of this AD replace the revision of the FAA-approved maintenance inspection program required by paragraph (a) of this AD with a revision that provides no less than the required inspection of the Principal Structural Elements (PSE's) defined in sections 2 and 3 of volume I of McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated March 1991, in accordance with section 2 of volume III–91, dated April 1991, of that document. The non-destructive inspection techniques set forth in sections 2 and 3 of volume II, dated March 1991, of that SID provide acceptable methods for accomplishing the inspections required by this AD. All inspection results, negative or positive, must be reported to McDonnell Douglas, in accordance with the instructions of section 2 of volume III–91 of the SID. Information collection requirements contained in this regulation have been approved by the OMB under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB Control Number 2120–0056.

(c) Cracked structure detected during the inspections required by paragraphs (a) and (b) of this AD must be repaired before further flight, in accordance with a method approved by the Manager, Los Angeles Aircraft Certification Office, FAA, Transport Airplane Directorate.

(d) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Los Angeles Aircraft Certification Office (ACO), FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Los Angeles ACO.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Los Angeles ACO.

(e) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(f) Certain inspections and reporting shall be done in accordance with McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," dated December 1985, as indicated. This incorporation by reference was approved previously by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51 as of August 10, 1987 (54 FR 25591, July 8, 1987). Certain other inspections and reporting shall be done in accordance with McDonnell Douglas Report No. L26–011, "DC–8 Supplemental Inspection Document (SID)," volume I, revision 3, dated March 1991; volume II, revision 5, dated March 1991; and volume III–91, dated April 1991. Volume I (revision 3, dated March 1991) and volume II (revision 5, dated March 1991) of McDonnell Douglas Report No. L26–011, "DC–8 SID," contain the following list of effective pages:

Volume	Shown on "list of effective pages"	Revision level shown on page	Date shown on page
Volume I	List of effective pages A, B, C	3	March 1991.
Volume II	List of effective pages A, B, C, D, E, F, G, H, I, J, K, L	5	March 1991.

This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from McDonnell Douglas Corporation, P.O. Box 1771, Long Beach, California 90846–1771, attention: Business Unit Manager, Technical Publications—Technical Administrative Support, C1–L5B. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Los Angeles Aircraft Certification Office, 3229 East Spring Street, Long Beach, California; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(g) This amendment becomes effective on February 26, 1993.

Issued in Renton, Washington, on January 11, 1993.

N.B. Martenson,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93–1432 Filed 1–21–93; 8:45 am]

BILLING CODE 4910–13–U

14 CFR Part 39

[Docket No. 92–CE–42–AD; Amendment 39–8474; 93–01–20]

Airworthiness Directives; Beech Model 300 Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment supersedes Airworthiness Directive (AD) 89–22–12, which requires inspecting the upper aft cowling access door latches for proper

tension and total engagement of the adjusting bolts and striker plates on certain Beech Model 300 airplanes, adjusting or modifying the latches if tension or engagement requirements are not met, and modifying the cowling door to provide a more positive retention. A cowling door latch replacement kit has been developed that, if properly installed, provides a level of safety equivalent to the cowling door retention modification required by AD 89–22–12. This action retains the requirements of the previous AD and incorporates this new modification into the AD as a compliance option. The actions specified by this AD are intended to prevent separation of an aft cowling door, which could result in occupant injury if decompression or structural damage occurs.

DATES: Effective March 10, 1993.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of March 10, 1993.

ADDRESSES: Service information that applies to this AD may be obtained from the Beech Aircraft Corporation, P.O. Box 85, Wichita, Kansas 67201–0085. This information may also be examined at the Federal Aviation Administration (FAA), Central Region, Office of the Assistant Chief Counsel, room 1558, 601 E. 12th Street, Kansas City, Missouri 64106; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. James M. Peterson, Aerospace Engineer, Wichita Aircraft Certification Office, FAA, 1801 Airport Road, Mid-Continent Airport, Wichita, Kansas 67209; Telephone (316) 946–4145; Facsimile (316) 946–4407.

SUPPLEMENTARY INFORMATION: A proposal to amend part 39 of the Federal Aviation Regulations to include an AD that would apply to certain Beech Model 300 airplanes was published in the **Federal Register** on September 9, 1992 (57 FR 41114). The action proposed to supersede AD 89–22–12, Amendment 39–6351 (54 FR 41438, October 10, 1989), with a new AD that would (1) retain the inspection and modifications of the aft cowling doors that are required by AD 89–22–12; and (2) allow a cowling door latch replacement kit to be installed in lieu of the cowling door retention modification required by AD 89–22–12. The proposed actions would be accomplished in accordance with Beech SB No. 2394, issued August 1989, revised February 1991.

Interested persons have been afforded an opportunity to participate in the making of this amendment. No comments were received on the proposed rule or the FAA's determination of the cost to the public.

After careful review, the FAA has determined that air safety and the public interest require the adoption of the rule as proposed except for minor editorial corrections. The FAA has determined that these minor corrections will not change the meaning of the AD nor add any additional burden upon the public than was already proposed.

The FAA estimates that 152 airplanes in the U.S. registry will be affected by this AD, that it will take approximately 17 workhours per airplane to accomplish the required action if the operator chose to install the cowling door latch replacement kit (latch replacement option) or approximately 3 workhours per airplane to accomplish the required action if the operator accomplished the modification to provide a more positive cowling door retention (cowling door retention option), and that the average labor rate is approximately $55 an hour. Parts for the cowling door latch replacement kit cost approximately $2,372 per airplane. Based on these figures, the total cost impact of this AD on U.S. operators is estimated to be $505,664 (latch replacement option) or $25,080 (cowling door retention option).

AD 89–22–12, which will be superseded by this AD, requires that the cowling door retention option be accomplished on the affected airplanes. The only difference between that AD and this action is the choice of accomplishing either the latch replacement option or the cowling door retention option. Since the latch replacement option is not mandatory, the required action poses no additional cost impact upon U.S. operators of the affected airplanes than that which is already required by AD 89–22–12.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 12612, it is determined that this final rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

For the reasons discussed above, I certify that this action (1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979); and (3) will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act. A copy of the final evaluation prepared for this action is contained in the Rules Docket. A copy of it may be obtained by contacting the Rules Docket at the location provided under the caption ADDRESSES.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by removing AD 89–22–12, Amendment 39–6351 (54 FR 41438, October 10, 1989), and adding the following new AD:

93–01–20 Beech Aircraft Corporation: Amendment 39–8474; Docket No. 92–CE–42–AD. Supersedes AD 89–22–12, Amendment 39–6351.

Applicability: Model 300 airplanes (serial numbers FA–2 through FA–211 and FF–1 through FF–19), certificated in any category.

Compliance: Required as indicated, unless already accomplished (compliance with superseded AD 89–22–12).

To prevent separation of an aft cowling door, which could result in occupant injury if decompression or structural damage occurs, accomplish the following:

(a) Within the next 25 hours time-in-service (TIS) after the effective date of this AD, inspect the upper aft cowling access door latches for proper tension and total engagement of the adjusting bolts and striker plates in accordance with part I of the Accomplishment Instructions section of Beech Service Bulletin (SB) No. 2329, dated August 1989, revised February 1991.

(1) If improper tension is found, prior to further flight, adjust the cowling door latch in accordance with Beechcraft Super King Air 300 Maintenance Manual, chapter 71–10.

(2) If the adjusting bolts and striker plates do not totally engage, prior to further flight, modify the cowling door in accordance with Beechcraft Safety Communique No. 300–75.

(b) Within the next 50 hours TIS after the effective date of this AD, accomplish one of the following:

(1) Modify the cowlings to provide upper aft cowling access door retention in accordance with part II of the Accomplishment Instructions section of Beech SB No. 2329, dated August 1989, revised February 1991; or

(2) Install cowling door latch replacement Kit No. 101-9052-1 S in accordance with Part III of the Accomplishment Instructions section of Beech SB No. 2329, dated August 1989, revised February 1991.

(c) If the requirements of paragraphs (a), (a)(1), (a)(2), and (b)(1) were previously accomplished (compliance with superseded AD 89-22-12) in accordance with Beech SB No. 2329, dated August 1989, then no further action is required by this AD.

(d) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(e) An alternative method of compliance or adjustment of the compliance time that provides an equivalent level of safety may be approved by the Manager, Wichita Aircraft Certification Office, FAA, 1801 Airport Road, room 100, Wichita, Kansas 67209. The request shall be forwarded through an appropriate FAA Maintenance Inspector, who may add comments and send it to the Manager, Wichita Aircraft Certification Office.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Wichita Aircraft Certification Office.

(f) The inspection and modification or installation required by this AD shall be done in accordance with Beech Service Bulletin No. 2329, dated August 1989, revised February 1991. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from the Beech Aircraft Corporation, P.O. Box 85, Wichita, Kansas 67201-0085. Copies may be inspected at the FAA, Central Region, Office of the Assistant Chief Counsel, room 1558, 601 E. 12th Street, Kansas City, Missouri, or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(g) This amendment (39-8474) supersedes AD 89-22-12, Amendment 39-6351.

(h) This amendment (39-8474) becomes effective on March 10, 1993.

Issued in Kansas City, Missouri, on January 13, 1993.

Michael K. Dahl,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93-1437 Filed 1-21-93; 8:45 am]

BILLING CODE 4910-13-M

14 CFR Part 39

[Docket No. 90-CE-58-AD; Amendment 39-8431; AD 92-26-04]

Airworthiness Directives; Cessna 210 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; suspension of effectiveness.

SUMMARY: This document suspends the effectiveness for Airworthiness Directive (AD) 92-26-04, Amendment 39-8431, published in the **Federal Register** on Monday, December 7, 1992 (57 FR 57658). The Federal Aviation Administration (FAA) has received a petition for reconsideration of this action, and the FAA has concluded that the issues raised by the petition warrant further consideration.

EFFECTIVE DATE: Effective January 22, 1993, AD 92-26-04, Amendment 39-8431, is suspended.

FOR FURTHER INFORMATION CONTACT: Mr. Paul O. Pendleton, Aerospace Engineer, FAA, Wichita Aircraft Certification Office, 1801 Airport Road, room 100, Wichita, Kansas 67209; Telephone (316) 946-4143; Facsimile (316) 946-4407.

SUPPLEMENTARY INFORMATION: AD 92-26-04, Amendment 39-8431, which applies to certain Cessna 210 series airplanes, was published in the **Federal Register** on Monday, December 7, 1992 (57 FR 57658), with an effective date of January 22, 1993. This AD requires accomplishing operational checks of the fuel gauges, modifying the fuel caps and adapters, and incorporating pilot operating procedures that relate to preflight fuel system quantity checks into the airplane flight manual or airplane records.

The FAA has received a petition for reconsideration of this action, and believes that the issues raised by that petition warrant further consideration before compliance is mandated.

This rule would become effective on January 22, 1993. Since a situation exists that requires immediate public notice that the effective date has been suspended, it is found that notice and public procedure hereon are impracticable and good cause exists for making this amendment effective in less than 30 days.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by suspending until further notice AD 92-26-04, Amendment 39-8431 (57 FR 57658, December 7, 1992), effective January 22, 1993.

Issued in Kansas City, Missouri, on January 15, 1993.

Michael K. Dahl,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93-1618 Filed 1-19-93; 11:20 am]

BILLING CODE 4910-13-M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 34

Regulation of Hybrid Instruments

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is adopting final regulations concerning certain "hybrid" instruments that combine equity or debt securities or depository interests with features of either commodity futures or option contracts, or both. The final rules establish an exemption from CFTC regulations under the Commodity Exchange Act ("CEA" or "Act") 7 U.S.C. 1 et seq., for these hybrid instruments, based on the limited nature of the instrument's exposure to price movements in the underlying commodity and in reliance on other applicable regulatory frameworks.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Gregory Kuserk, Industry Economist, or Barry Schachter, Financial Economist, Division of Economic Analysis, Commodity Futures Trading Commission, 2033 K St. NW., Washington, DC 20581. Telephone: (202) 254-6990.

I. Introduction

A. The Proposed Rulemaking

On November 12, 1992, the Commission published for comment proposed regulations to amend its part 34 rules which exempt from regulation under the CEA certain hybrid instruments.[1] The Commission proposed to expand part 34, which previously applied only to hybrid instruments that combine characteristics of commodity option contracts with securities or depository interests, to include hybrid instruments which have a futures-like component as well. As proposed, amended part 34 would establish a new test to determine the predominant character of a hybrid instrument. Those hybrid instruments in which the commodity interest did not predominate, as measured by the new test, would be exempt from regulation under the CEA. These proposals were based, in part, on the direction provided by Congress that the Commission may move promptly to exercise the exemptive authority granted to the Commission contained in section 4(c)(5)(A) of the recently enacted Futures Trading Practices Act of 1992.[2] The Commission proposed to determine the predominant character of a hybrid instrument, by decomposing it into its constituent components and then comparing a measure of the commodity price exposure associated with the commodity-dependent component of the hybrid instrument to the value of its commodity-independent component. Under the proposed test, hybrid instruments would have been exempt from Commission regulation if the measured commodity price exposure is less than the present value of the instrument's commodity-independent payments.[3]

Nothing in the revised test, as proposed or adopted herein, however, would change the underlying requirement that to qualify for this exemption an instrument must be a hybrid instrument; that is, it must combine the characteristics of an equity or debt security or a depository instrument with a futures-like or option-like component. Accordingly, instruments having returns indexed to, or calculated on, the basis of the price of a commodity that are not *bona fide* equity or debt securities or depository instruments will not be viewed as hybrid instruments even though they may incorporate some features common to securities or depository instruments.

B. Comments Received

The comment period ended on December 28, 1992, after having been extended for an additional period of 14 days. The Commission received 26 comment letters on the proposal: Two from futures exchanges (one of which was a joint letter from three futures exchanges), one from a stock exchange, three from law firms, two from banks, one from an individual, four from trade associations, five from investment banks, two from bank holding companies, two from professional associations and four from federal regulatory agencies.

Most commenters generally supported the overall objectives of the rulemaking. They noted that the proposed rule would provide greater legal certainty as to the regulatory framework applicable to specific hybrid instruments, reduce duplicative regulation and enhance financial innovation in U.S. capital markets. Most commenters also expressed the belief that exempting such instruments would be in the public interest. Accordingly, they urged the Commission to act expeditiously in adopting final rules.

However, these commenters also tempered their support with suggestions to modify or clarify certain aspects of the rule. Most requested that the proposed definition of an eligible security be simplified and enhanced to include a wider range of securities. Several also requested that the exempt status of any severable component-hybrids be determined at the time of issuance. In addition to the recommended modifications, other commenters suggested various clarifications, including the use of alternative, but commercially acceptable ways, to value the option components of the instrument when applying the test.[4]

A few commenters, however, strongly disagreed with the proposed rules. Several expressed the view that the technique used to establish predominance is flawed because the test uses a volatility-sensitive measure of exposure for futures-like components. Several also raised a concern that the proposed rule would deprive purchasers of hybrid instruments of protection under the commodity futures laws for that portion of a hybrid instrument that is commodity-dependent. One comment letter argued that the Commission's proposed test is flawed because it treats "the return of the performance bond deposit as if it were part of the return on the customer's investment."[5]

II. Statutory Determinations

As stated above, section 4(c) requires that the Commission make a number of determinations in granting exemptions. If an exemption is granted pursuant to section 4(c) from the requirements of section 4(a), the determinations are that the requirement of section 4(a) should not be applied to the agreement, contract or transaction and that the exemption is: (1) Consistent with the public interest; (2) consistent with the purposes of the Act and (3) the agreement, contract or transaction "will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties" under the Act.[6] The Commission has considered each of these criteria in making its determination that this exemption of certain hybrid instruments is consistent with the public interest.[7]

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[1] 57 FR 53618 (November 12, 1992). The Notice of Proposed Rulemaking contains a fuller description of the statutory basis for the proposed rule and of the history regarding the Commission's regulation of hybrid instruments. It also contains a fuller description, and explanation, of the economic calculations necessary under the rule.

[2] By exempting eligible hybrids from all of the provisions of the Act (other than section 2(a)(1)(B)), the Commission does not intend to suggest that the Commission's jurisdiction and authority under these provisions will be affected, including its authority to determine compliance with the terms of the exemption. See section 4(d) of the Act. As suggested by the Securities and Exchange Commission ("SEC"), the Commission also reiterates that in enacting these final rules, the Commission intends to provide legal certainty to novel instruments without necessarily making a determination that such instruments are subject to the Act. In certain cases the determination as to jurisdiction regarding such novel instruments is not straightforward and as noted in the Commission's proposed rulemaking, the Commission is not required to make such a finding in order to exercise this exemptive authority. See, 57 FR 53618 footnote 2 (November 12, 1992). Moreover, the Commission also notes that participants may continue to rely on its Statutory Interpretation Concerning Certain Hybrid Instruments for existing and new hybrid instruments. 55 FR 13582 (April 11, 1990).

However, the Commission's intention to exempt a direct investment that contains an equity or debt security or depository instrument in combination with a commodity-dependent component, does not apply to a trading vehicle, such as a pooled account, formed for the purpose of trading commodity instruments. Although commodity pools issue securities, such as limited partnership interests, the issuance of such securities, however, does not alter the basic nature of the commodity pool as a vehicle for trading commodity instruments.

[3] By the term "payment" the Commission meant any interest, coupon or dividend payment as well as any return of principal or liquidation preference.

[4] A comment submitted by a stock exchange raised the issue of the Commission's ability, under the authority of the Act, to exempt instruments referred to as "index participations." That action is not being considered by the Commission as part of this rulemaking.

[5] In this regard, the Commission notes that the commenter incorrectly characterized the commodity-independent component of a hybrid instrument as a "performance deposit." The hybrid exemption clearly extends only to certain securities and depository instruments as defined by federal law and regulation, and as such, payment to the issuer is not in the nature of a "performance deposit."

[6] Section 4(c)(2), 7 U.S.C. 6(c)(2). This section also conditions an exemption upon the transaction being entered into solely between appropriate persons.

[7] Persons engaged in activity otherwise subject to the Act would not be exempt for such activity, even

Continued

Public Interest and Purposes of the Act Determination

As is frequently the case when Congress grants a regulatory agency authority to act consistent with "the public interest and the purposes of" its enabling statute, little statutory elaboration is given to the full scope of the phrase. As commonly understood, however, an agency, such as the Commission, is to apply this standard against the template of its regulatory scheme. In this regard, the Conference Report states that the "public interest" under section 4(c) includes "the national public interests noted in the (Act), the prevention of fraud and the preservation of the financial integrity of markets, as well as the promotion of responsible economic or financial innovation and fair competition." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78. The Conference Report goes on to state that "(t)he Conferees intend for this reference to the 'purposes of the Act' to underscore their expectation that the Commission will assess the impact of a proposed exemption on the maintenance of the integrity and soundness of markets and market participants." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78.

Hybrid instruments, in various forms, have been offered to the public under the Commission's Statutory Interpretation Concerning Certain Hybrid Instruments and part 34 of the Commission's regulations. The Commission's intent at the time was to provide regulatory certainty to hybrid instruments which are predominantly a debt, preferred equity or depository instrument but which also incorporate futures or commodity options in innovative formats.[8]

Hybrid instruments have widespread economic utility, offering a novel means of combining capital raising and risk shifting instruments in a single investment vehicle. Hybrid instruments can offer issuers means to raise capital through instruments that better fit the specific risk profile of the issuer. For example, the linking of debt repayment in a hybrid instrument issued by an oil company to the price of oil can allow the issuer to offer the possibility of a greater return in those instances when the issuer is better able to do so. This can allow issuers to obtain a lower cost of funds due to the willingness of the purchasers to pay a premium for the instruments. Purchasers of hybrid instruments may be willing to pay this premium to obtain instruments that fit specific risk management needs. Accordingly, the Commission is of the opinion that these innovative products offer economic utility and serve a *bona fide* capital raising function. In conclusion, the Commission believes that in consideration of the economic utility gained from these instruments, in combination with the protections afforded under the laws and regulations of other regulators, the exemption satisfies the statutory requirement that it be consistent with the public interest and the purposes of the Act.

Material Adverse Effect on Regulatory or Self-Regulatory Responsibilities

In making this determination, Congress indicated that the Commission is to consider such regulatory concerns as "market surveillance, financial integrity of participants, protection of customers and trade practice enforcement."[9]

In adopting these final rules, the Commission has been careful to ensure that any instruments exempted hereunder from CFTC regulation will be covered by alternative regulatory regimes.[10] Hybrid instruments would be subject to the same general regulations, including applicable anti-fraud laws, as apply to the comparable non-hybrid interests and no further limitation on who may purchase, sell, offer or enter into hybrid instruments was therefore deemed necessary.

Moreover, the record before the Commission provides no basis to support a conclusion that the purposes of or regulating efforts under the Act have been adversely affected by the markets in hybrids or will be so affected by the issuance of these rules. In particular, the Commission is unaware that the issuance of these instruments has been a source of fraud or abuse or in any way had a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.

In addition, the structure and size of these offerings has been such that, to date, they do not represent a relevant pricing mechanism for the general price discovery process of the underlying commodity. Nevertheless, the Commission has determined in the final rule to preclude the ability of hybrid instruments to settle by means of a delivery instrument, such as an exchange-approved warehouse receipt or shipping certificate, that is specified in the rules of a designated contract market. This provision would prevent only settlement in delivery instruments specifically defined as such in exchange rules. It would not prevent settlement in the form of a commodity that is of deliverable grade or quality under exchange rules. The Commission believes that this requirement will not interfere with the ability of issuers to provide physical delivery alternatives to cash settlement but provides some protection against interference with deliverable supplies for settlement of designated futures or options contracts.[11] Thus, the Commission is amending the proposed rules to add § 34.3(a)(3)(iii) that will prohibit hybrid instruments from providing for settlement in the form of a delivery instrument such as an exchange-approved warehouse receipt or shipping certificate.

Finally, the Commission notes that under section 4(d) of the Act "the granting of an exemption under this section does not affect the authority of the Commission under any provision of this Act to conduct investigations in order to determine compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of this Act or any rule, regulation or order thereunder caused by the failure to comply with or satisfy such conditions or requirements."

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if it were connected to their exempted hybrid activity. In this regard, the Commission wishes to make clear that the exemption does not apply to any financial, recordkeeping, reporting or other requirements imposed on any person in connection with their activities that remain subject to regulation under the Act. Thus, for example, futures commission merchants must continue to account for any liabilities arising out of any hybrid instruments in meeting the net capital requirements of Commission Rule 1.17 just as they do in the case of other financial instruments not regulated under the Act. Similarly, the risk assessment, recordkeeping and reporting requirements imposed on futures commission merchants by new section 4f(c) of the Act apply to the hybrid activities of their affiliated persons. As part of its ongoing review of its regulations, the Commission is considering revisions to Commission Rule 1.19. Suggestions by some commenters that Rule 1.19 should not be applicable to exempted hybrid instruments will be considered as part of this review.

[8] 54 FR 1128 (January 11, 1989) and 54 FR 1139 (January 11, 1989).

[9] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[10] If a hybrid instrument which is otherwise subject to the Act fails to meet the conditions of this exemption, the Act and Commission regulations would continue to apply.

[11] An important regulatory concern of the Commission is to reduce the likelihood of pricing anomalies on designated contract markets. Such protection against interference with those deliverable supplies represented by delivery instruments facilitates this function. The Commission also specifically wishes to make clear that those provisions of sections 6(c) and 9(a)(2) of the Act concerning manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, would continue to apply to persons engaging in hybrid transactions.

Pursuant to its authority in new section 4(d) of the Act, the Commission intends routinely to consult with other regulators who have information concerning hybrid instruments, *e.g.*, the SEC and bank regulators, to seek to assure they include in their routine examination program these transactions. Under section 4(d) the Commission would exercise its authority to investigate, as appropriate.

Anticompetitive Considerations

Section 15 of the Act provides, in relevant part, that the Commission must consider the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, policies and purposes of the Act in adopting any rule, regulation or exemption under section 4(c).[12] Thus, a formal analysis under the antitrust laws is not, by itself, dispositive of the issues raised by a rule.[13] As a result, the Commission is not compelled by section 15 to take the least anticompetitive course of action. Rather, where alternatives with varying degrees of regulatory benefit exist, the Commission may adopt the approach that appears to be most likely to achieve the objectives, policies and purposes of the Act, even if that approach is not the least anticompetitive.[14]

Accordingly, section 15 requires the Commission to balance the likely anticompetitive impact of adopting a rule against the objective, policy or purpose of the Act which the rule may further. And, although the Commission must consider the public interest in maintaining or promoting competition, it need not weigh this interest equally against an objective, policy or purpose of the Act being served by a rule in reaching its final determination concerning the adoption of the rule.

The Commission's consideration of the proposed rule, and its evaluation of the comments received in this regard, for the following reasons, has led it to conclude that any possible anticompetitive effects are clearly outweighed by the rule's furtherance of the policies, purposes and objectives of the Act. In terms of fair competition, the Commission believes that the exemption of hybrid instruments from Commission regulation does not place regulated exchange-traded instruments at a competitive disadvantage to the commodity components of hybrid instruments. First, hybrid instruments, assessed as a whole, are not economic substitutes for exchange traded futures or options contracts. Exchange traded futures and option contracts serve mainly as risk shifting and price discovery vehicles. Although the commodity-component of a hybrid instrument can also function in this way, hybrid instruments more generally serve as capital raising devices.[15]

Secondly, although certain hybrid instruments would be exempt from Commission regulation, they will remain subject to the rules and regulations governing the issuance and trading of comparable instruments that do not have a commodity-dependent component. Thus, by enacting the exemption, new and innovative products that are predominantly not futures or options contracts can be developed under regulations common to other similar products in their class, without unnecessary, duplicative regulation, thereby fostering healthy competition in those markets.

In conclusion, the part 34 rules as set forth below and adopted herein are supported by appropriate determinations made in accordance with the standards set forth in section 4c of the Act for the granting of exemptions.

III. Substantive Revisions

Based upon its consideration of the comments received, and its own analysis, the Commission, as discussed in greater detail below, is adopting the amendments to part 34, as proposed, with the following modifications.

A. Section 34.2 Definitions

1. Section 34.2(a)—Hybrid Instrument

As proposed, under the definition of "hybrid instrument," the predominance test would be reapplied at the time of severance, for those instruments that could be severed, to determine the exempt status of the individual components. Several commenters suggested, however, that reapplying the proposed test at the time of severance would cast uncertainty on the legality of the severance of the instrument, thereby making such instruments unmarketable. Additionally, determining the exempt status at the time of severance, they argued, would shift to the investor the burden of applying the test.

These commenters suggested that to ameliorate this problem, the test be applied at the time of the instrument's issuance to all of the instruments that would result from its severance. Thus, at issuance, the issuer of an instrument that contained potentially severable components would first test the instrument as a whole to determine whether it was predominantly a security, and secondly, the potential individual instruments resulting from its severance. A hybrid instrument would be exempt from Commission regulation only where the instrument as a whole and each of the resulting potential severable hybrid instruments were deemed to be predominantly a security or depository interest.[16]

The Commission agrees with this suggested treatment of instruments with severable components and is deleting the phrase "and is determined at the time of issuance or severance" from the definition of hybrid instrument. The determination as to whether a hybrid instrument that provides for severability is predominantly an equity or debt security or depository interest, therefore, is to be determined at the time of issuance.[17]

2. Section 34.2(f)—Option premium

The definition of "option premium," proposed as § 34.2(d), stated that the value of the premium must be calculated using the same method as that used to determine the issue price of the instrument. Several commenters

[12] Specifically section 15, as amended by section 502(b) of the 1992 Act, provides:

The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under sections 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act.

[13] *See Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 690–691 (1975); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963).

[14] *See, e.g., British American Commodity Options Corp.* v. *Bagley*, CCH Comm. Fut. L. Rep. ¶ 20,245 at 21,334 (S.D.N.Y. 1976), *aff'd in part and rev'd in part*, 552 F.2d 482 (2d Cir. 1977), *cert. denied*, 98 S.Ct. 427 (1977).

[15] In this regard, it should be noted that the purchaser of a hybrid securities instrument, in addition to obtaining an exposure to commodity prices, also obtains an exposure to the risk-return profile associated with the security of the firm that is bundled in the hybrid instrument.

[16] For example, if after a year, a hybrid instrument could be split into two hybrid instruments—*i.e.* each containing a commodity-independent and commodity-dependent component—the predominance test would be applied at the time of issuance to the instrument as a whole and to each of the two potentially severable hybrid instruments. If the instrument as a whole and each of the potentially severable components met the criteria of the rule, the instrument would be exempted from CFTC regulation.

[17] A comment by the Department of the Treasury asked the Commission to clarify in the rule the timing of the application of the predominance test. In addition, they contended that the statement in proposed § 34.2(a) that a hybrid instrument is "determined at the time of issuance or severance" appears to refer to the determination as to whether an instrument is a hybrid instrument, not to whether or not the hybrid instrument meets the predominance test. The above changes address these points.

noted that an option pricing model may not be used to determine the value of a commodity-dependent component, depending upon the component's nature. For example, it would be unnecessary to price the individual options that make up a synthetic futures position to determine its value. Instead, one could rely on the value of futures prices or some other pricing model which does not explicitly produce the value of the options.

The Commission is clarifying the definition of option premium, now in § 34.2(f), to make explicit that users may rely on commercially reasonable valuation methods to price options when the option prices have not been calculated directly in pricing the instrument. Commercially reasonable valuation methods would be those that conform to generally accepted economic principles and are appropriate to the nature of the instrument being priced. An appropriate model to price the individual options of a commodity-dependent component should result in a value that reflects the value of the commodity-dependent component used to price the hybrid instrument.[18] Similarly, in cases of an index, a spread or a basket of commodities, where an option premium is not directly calculated, issuers could rely on an appropriate option pricing model to price the options for purposes of applying the test. *See,* 57 FR 53622, n. 13.

B. Section 34.3 Hybrid Instrument Exemption

1. Section 34.3(a)(1)—Eligible Security and Deposit Interests

In proposed § 34.3(a)(1), the Commission specified a list of various debt, preferred equity or depository interests that were eligible for exemption under the criteria of part 34. Most comments received by the Commission, including those of the SEC, expressed a view that the list of securities in this section unnecessarily restricts the type of hybrid instruments that could qualify for an exemption. Moreover, the rules, by enumeration, may unnecessarily prevent new securities, not yet in existence, from obtaining exemption without further positive action by the Commission. Most commenters viewed as irrelevant the type of security or depository interest included in a hybrid instrument. In their view, it is important only that the security or depository interest be the dominant component and that the instrument be subject to another regulatory regime.

The Commission finds that these comments have merit. As a consequence, the Commission is amending its proposal to recognize as a hybrid, any instrument which combines a debt or equity security within the meaning of section 2(1) of the Securities Act of 1933 with futures or option-like features.

Similarly, a commenter expressed the view that, the method of offering the instrument is not germane to its predominant character or nature. Rather, it is only important that a hybrid instrument which is predominantly a security or depository instrument be issued in accordance with applicable securities and/or banking laws and regulations. The Commission concurs with this view. Thus, decisions regarding the issuance of hybrids that are predominately depository instruments are properly determined by the applicable banking regulator. Accordingly, the Commission is deleting from the final rule the proposed restriction that a depository instrument be sold through a broker registered in accordance with section 15 of the Securities Exchange Act of 1934.

2. Section 34.3(a)(2)—The Predominance Test

One comment letter argued that the proposed test is flawed because, when applied to a hybrid with an embedded futures contract, "adding the put and call premiums * * * (measures) * * * the volatility of the underlying commodity, just as if one were writing a commodity straddle." Rather than this evidencing a flaw, the Commission believes that, because price volatility is the fundamental source of risk in the commodity, it is desirable that the measure of the commodity price exposure be related to the volatility of the underlying commodity.

The commenter further argued that in designing a test, "volatility cannot be confused with 'commodityness' " and that "the return of principal loaned cannot be treated as part of the return on an investment." The Commission is unpersuaded by both of these assertions. First, as stated above, price volatility is the fundamental source of risk in the commodity, and any measure of commodity price exposure that is not sensitive to this fact can result in an inequitable treatment of potential instruments. Second, the existence of counterparty risk and the fact that there is an opportunity cost of funds loaned for a period of time require that the principal be part of the determination of the commodity-independent value.[19]

The Commission has determined, nevertheless, that the rule could be further clarified. Accordingly, the Commission is adding definitions for commodity-independent value and commodity-dependent value to § 34.2 of the final rules and is making the changes noted below to § 34.3(a)(2). Section 34.2(c), added to the final rules, defines "commodity-independent value" to mean the present value of the payments attributable to the commodity-independent component of a hybrid instrument, the payments of which do not result from indexing to, or calculation by reference to, the price of a commodity.[20] New § 34.2(e) defines "commodity-dependent value" to mean, for purposes of application of Rule 34.3(a)(2), the value of a commodity dependent-component, which when decomposed into an option payout or payouts, is measured by the absolute net value of the put option premia with strike prices less than or equal to the reference price, as defined in § 34.2(g), plus the absolute net value of the call option premia with strike prices greater than or equal to the reference price,

[18] The phrase "value of the commodity-dependent component" used in this sense means the economic value of the commodity-dependent component, where, for example, in the case of a futures-like component, the long option premium is netted against the short option premium, as opposed to the sum of the absolute values of the long and short option premia. This differs from the definition in § 34.2(e) of the final rule which is intended to measure the commodity price exposure of the commodity-dependent component.

[19] The proposed test compares two values, the value of the commodity-independent component to the value of the commodity-dependent component. These values are, by necessity, measured differently, using those measures which are appropriate to ascertain the value of the particular component depending upon its nature. Accordingly, the exposure of the commodity-dependent component of the instrument is reflected by the value of individual option positions, and the value of the commodity-independent component is measured by its present value, a common means of valuation. Moreover, the proposed test achieves regulatory consistency because, under the test, instruments that produce an identical payout would qualify for exemption whether from a portfolio of hybrid instruments with simple commodity-dependent components or from a single instrument containing complex commodity-dependent components. In the simplest case the commodity-dependent component would be a single option combined with an equity or debt security or depository interest. The predominance test, as proposed, would then compare the value of that option to the value of the commodity-independent component. In order to treat a complex hybrid instrument in the same way as a portfolio of such simple hybrids that replicates the payout of the complex instrument, the relevant measure of the commodity-independent component of the complex instrument must be the value of the commodity-independent component. Such value is best reflected by the present value of all payments or considerations made by the issuer to the holder over the lifetime of the instrument.

[20] The term "commodity-dependent value," as defined in § 34.2(e), means the same as the term "commodity-price exposure" which was used in the proposed rule.

calculated as of the time of issuance of the hybrid instrument.

The remaining definitions are renumbered as a result of these additions. Finally, the predominance test of § 34.3(a)(2) is revised to conform to these revised definitions. It now states that for a hybrid instrument to be exempt, the sum of the commodity-dependent values of the commodity-dependent components must be less than the commodity-independent value of the commodity-independent component.[21]

3. Section 34.3(a)(3)—Maximum Loss Provisions of the Rules

Proposed § 34.3(a)(3) would have restricted the maximum loss to which a hybrid instrument holder could be subject. As proposed, the loss on any indexed coupon or interest payment could have been no greater than the commodity-independent coupon or interest payment and the loss on the indexed face value could not have exceeded the face value of the instrument. Several commenters indicated that this criterion could unnecessarily restrict an issuer's ability to allocate indexed returns between principal and interest in the design of the hybrid instrument.

The purpose of the maximum loss provision was not to place constraints on the structure of instruments that otherwise satisfy the criteria of part 34. Such restrictions on the overall structure are handled through the comparison of the commodity-dependent and commodity-independent components. Nevertheless, as stated in the Notice of Proposed Rulemaking, it is the Commission's view that instruments which allow commodity-dependent losses to accrue in excess of the face value of the instruments are more characteristic of a commodity interest than a debt, depository or equity interest. Accordingly, to restrict commodity-dependent losses while avoiding unnecessarily restricting the structure of hybrids deemed to be predominantly security or depository instruments, the Commission is revising § 34.3(a)(3). As revised, § 34.3(a)(3) provides that an issuer must receive full payment of the hybrid instrument's purchase price, and a purchaser or holder of a hybrid instrument may not be required to make additional out-of-pocket payments to the issuer during the life of the instrument or at maturity.[22]

4. Section 34.3(b)—Appropriate Persons

Under section 4(c)(2)(b)(i) of the Act, only transactions that are entered into between "appropriate persons" may be exempted from the requirements of section 4(a) of the Act. Proposed § 34.3(b) would have exempted instruments from regulation under the Act if, among other things, "the instrument is entered into solely between persons set forth in section 4(c)(3)(A)–(J) of the Act or otherwise permitted to enter into or purchase those instruments enumerated in paragraph (a)(1) of this section."

Many commenters requested the Commission to clarify that the exemption would be available to any participant who reasonably believes when entering into a hybrid instrument that the participant's counterparty qualifies as an "appropriate person." As revised, the final rule provides that, for purposes of this exemption, any person permitted by applicable securities or banking requirements to purchase or enter into the security or depository interest of the hybrid instrument would be an "appropriate person." Accordingly, to qualify for this exemption, the issuer or depository institution must have a reasonable basis to believe that its counterparty was permitted to purchase the instrument or to enter into the transaction under applicable federal or state securities or banking laws and regulations.[23]

IV. Other Comments

1. Instruments Beyond the Purview of the CEA and Commission Regulation

The Notice of Proposed Rulemaking noted that floating interest rate lending and depository instruments are not generally subject to the Act. See, 57 FR 53619 n. 8. Several commenters questioned whether this statement covers, in addition to depository or lending instruments, floating rate instruments that are securities. The Commission is clarifying that it did not intend to exclude floating interest rate securities from this list.

The Commission further stated that, regardless of the character of the formula or calculation used to determine the interest payment, floating rate instruments, the principal of which are returned upon maturity or redemption, are beyond the purview of the Act. The interest payment, however, in any period, must be determined solely by reference to interest rates (or indices thereof), or relationships between a constant and one or more interest rates (or indices thereof). See, 57 FR 53619 n. 8.

Several commenters asked whether this statement applies to instruments in which the principal is indexed to interest rates or indices thereof, and whether the term "formula" used in the statement includes multiples of interest rates, rate indices and spreads. In the view of the Commission, instruments in which the periodic payment is determined solely by reference to interest rates or indices, including multiples thereof, are beyond the purview of the Act. However, the Commission reiterates that instruments which are indexed to an interest rate in combination with indexation to a commodity, may fall under the purview of the Act. Of course, such an instrument nevertheless may be exempt from CFTC regulation under the terms of these part 34 rules.[24]

2. Reliance on Representations by Underwriters or Other Advisors

Several commenters noted that issuers typically rely on underwriters, selling agents or others to structure an offering in a manner which accomplishes the issuer's objectives and complies with applicable law. These commenters requested that the Commission clarify that an issuer should not be required to undertake its own analysis to assure compliance, but rather, that the issuer should be able to rely on the representation of the underwriter or other advisor as to compliance with these rules. In this regard, the

[21] As a point of clarification, the Commission notes that a hybrid instrument may contain multiple commodity components—*e.g.*, an instrument that contains both indexed coupons and principal. For such instruments, a value for each of the commodity-dependent components would be calculated and summed to obtain an overall value of the commodity-dependent portion of the instrument. This measure would then be used in the application of § 34.3(a)(2). The Commission further notes that a commodity-dependent component is not necessarily limited to indexing on a single commodity, but may be referenced to an index, a spread or a basket of commodities.

[22] The Commission intends that the issuer must receive full payment of the instrument's purchase price, excluding commissions and other selling costs. However, this restriction is not intended to prevent the purchaser or holder from acquiring the instrument on margin in accordance with applicable federal securities margin requirements.

[23] The above changes eliminate commenter's concerns whether such a hybrid is an eligible security in secondary market transactions.

[24] The Commission also noted in footnote 8 that instruments which simply involve spot translations from one currency into another would not be deemed to be commodity-dependent. Reference made to several interpretative letters—*i.e.*, CFTC Advisory No. 39–88, June 23, 1988 (Interpretative Letter No. 88–10, June 20, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,262) (notes indexed to dollar/Yen exchange rate); CFTC Advisory No. 45–88, July 19, 1988 (Interpretative Letter No. 88–11, July 13, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,284) (notes indexed to dollar/Yen exchange rate); and CFTC Advisory No. 48–88, July 26, 1988 (Interpretative Letter No. 88–12, July 22, 1988, 2 Comm. Fut. L. Rep. (CCH) ¶ 24,285) (notes indexed to dollar/foreign currency exchange rate)—was inadvertent.

Commission is of the opinion that although issuers may not necessarily themselves be required to perform all of the required calculations and analysis regarding whether an issue qualifies for exemption, and may rely on underwriters or other advisors for this analysis, they nevertheless must have a reasonable basis to believe that the instrument complies with these rules.

V. Other Matters

A. Paperwork Reduction Burden

The Paperwork Reduction Act of 1980 ("PRA"), 44 U.S.C. 3501, et seq., imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the Paperwork Reduction Act. As the Commission noted in proposing these rules, it has determined that these rules do not impose any information collection requirements as defined by the PRA. No comments were received concerning the Commission's determination in this regard.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601 et seq., requires that agencies, in promulgating rules, consider the impact of these rules on small entities. The Commission notes that the final rules are not intended to introduce any new prohibition but, rather, to provide exemptive relief from existing regulatory requirements. The adoption of these rules would enable current and potential issuers of hybrid instruments to expand the line of instruments now offered and allow issuers who issue instruments that contain option-like and futures-like components to rely on a single rule to determine regulatory jurisdiction. The Commission anticipates that the rule amendments will dispel uncertainty and establish consistent regulatory requirements for various types of commodity-related hybrid instruments, and thereby facilitate novel forms of financial transactions while fulfilling the mandates of the CEA. The Commission continues to believe that these rules do not have a significant economic impact on a substantial number of small entities. No comments were received concerning the RFA implications of the proposed rules.

List of Subjects in 17 CFR Part 34

Commodity futures, Commodity options, Hybrid instruments.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 2, 4, 4c and 8a thereof, 7 U.S.C. 2, 6, 6c and 12a, the Commission hereby revises part 34 of title 17 of the Code of Federal Regulations as follows:

PART 34—REGULATION OF HYBRID INSTRUMENTS

Sec.
34.1 Scope
34.2 Definitions.
34.3 Hybrid instrument exemption.

Authority: 7 U.S.C. 2, 6, 6c and 12a.

§ 34.1 Scope.

The provisions of this part shall apply to any hybrid instrument which may be subject to the Act, and which has been entered into on or after October 23, 1974.

§ 34.2 Definitions.

(a) *Hybrid instruments.* Hybrid instrument means an equity or debt security or depository instrument as defined in § 34.3(a)(1) with one or more commodity-dependent components that have payment features similar to commodity futures or commodity option contracts or combinations thereof.

(b) *Commodity-independent component.* Commodity-independent component means the component of a hybrid instrument, the payments of which do not result from indexing to, or calculation by reference to, the price of a commodity.

(c) *Commodity-independent value.* Commodity-independent value means the present value of the payments attributable to the commodity-independent component calculated as of the time of issuance of the hybrid instrument.

(d) *Commodity-dependent component.* A commodity-dependent component means a component of a hybrid instrument, the payment of which results from indexing to, or calculation by reference to, the price of a commodity.

(e) *Commodity-dependent value.* For purposes of application of Rule 34.3(a)(2), a commodity-dependent value means the value of a commodity dependent-component, which when decomposed into an option payout or payouts, is measured by the absolute net value of the put option premia with strike prices less than or equal to the reference price plus the absolute net value of the call option premia with strike prices greater than or equal to the reference price, calculated as of the time of issuance of the hybrid instrument.

(f) *Option premium.* Option premium means the value of an option on the referenced commodity of the hybrid instrument, and calculated using the same method as that used to determine the issue price of the instrument, or where such premia are not explicitly calculated in determining the issue price of the instrument, the value of such options calculated using a commercially reasonable method appropriate to the instrument being priced.

(g) *Reference Price.* A reference price means a price nearest the current spot or forward price, whichever is used to price instrument, at which a commodity-dependent payment becomes non-zero, or, in the case where two potential reference prices exist, the price that results in the greatest commodity-dependent value.

§ 34.3 Hybrid instrument exemption.

(a) A hybrid instrument is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice or rendering other services with respect to such exempt hybrid instrument is exempt for such activity from all provisions of the Act (except in each case section 2(a)(1)(B)), provided the following terms and conditions are met:

(1) The instrument is:

(i) An equity or debt security within the meaning of section 2(1) of the Securities Act of 1933; or

(ii) A demand deposit, time deposit or transaction account within the meaning of 12 CFR 204.2 (b)(1), (c)(1) and (e), respectively, offered by an insured depository institution as defined in section 3 of the Federal Deposit Insurance Act; an insured credit union as defined in section 101 of the Federal Credit Union Act; or a Federal or State branch or agency of a foreign bank as defined in section 1 of the International Banking Act;

(2) The sum of the commodity-dependent values of the commodity-dependent components is less than the commodity-independent value of the commodity-independent component;

(3) Provided that:

(i) An issuer must receive full payment of the hybrid instrument's purchase price, and a purchaser or holder of a hybrid instrument may not be required to make additional out-of-pocket payments to the issuer during the life of the instrument or at maturity; and

(ii) The instrument is not marketed as a futures contract or a commodity option, or, except to the extent necessary to describe the functioning of the instrument or to comply with applicable disclosure requirements, as having the characteristics of a futures contract or a commodity option; and

(iii) The instrument does not provide for settlement in the form of a delivery instrument that is specified as such in the rules of a designed contract market;

(4) The instrument is initially issued or sold subject to applicable federal or state securities or banking laws to persons permitted thereunder to purchase or enter into the hybrid instrument.

Issued in Washington DC. on January 14, 1993, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 93–1366 Filed 1–21–93; 8:45 am]

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17 CFR Part 35

Exemption for Certain Swap Agreements

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: On November 12, 1992, the Commodity Futures Trading Commission ("Commission") published for comment proposed new part 35 (the "Proposal") [1] which would exempt swap agreements (as defined herein) meeting specified criteria from regulation under the Commodity Exchange Act (the "Act"). This rule was proposed pursuant to authority recently granted the Commission, a purpose of which is to give the Commission a means of improving the legal certainty of the market for swap agreements. The original 30 day comment period was extended 14 days and closed December 28, 1992.[2]

The Commission has carefully considered the comments received and, based upon its review of the comments and its own reconsideration of the proposed rule, has determined to adopt part 35 in modified form, as discussed herein.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Joanne T. Medero, General Counsel, Pat G. Nicolette, Deputy General Counsel, or David R. Merrill, Deputy General Counsel, Office of the General Counsel, Commodity Futures Trading Commission, 2033 K Street, NW., Washington, DC 20581. Telephone: (202) 254–9880.

SUPPLEMENTARY INFORMATION:

I. Statutory and Other Background

Section 2(a)(1)(A) of the Commodity Exchange Act ("CEA" or "Act") grants the Commission exclusive jurisdiction over "accounts, agreements (including any transactions which is of the character of * * * an 'option' * * *), and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market * * * or any other board of trade, exchange, or market * * *." 7 U.S.C. 2. The CEA and Commission regulations require that transactions in commodity futures contracts and commodity option contracts, with narrowly defined exceptions, occur on or subject to the rules of contract markets designated by the Commission.[3]

On October 28, 1992, the Futures Trading Practices Act of 1992 ("1992 Act") was signed into law.[4] This legislation added new subsections (c) and (d) to section 4 of the Act. New section 4(c)(1) authorizes the Commission, by rule, regulation, or order, to exempt any agreement, contract or transaction, or class thereof, from the exchange-trading requirement of section 4(a) or any other requirement of the Act other than section 2(a)(1)(B).[5] New section 4(c)(2) provides that the Commission may not grant an exemption from the exchange-trading requirement of the Act unless, *inter alia*, the agreement, contract, or transaction will be entered into solely between appropriate persons listed in new section 4(c)(3), and the Commission determines that the agreement, contract, or transaction in question will not have a material adverse affect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.[6]

Finally, new section 4(c)(5)(B) of the Act authorizes the Commission to exercise "promptly" the exemptive authority granted in section 4(c)(1) and to exempt swap agreements that are not part of a fungible class of agreements that are standardized as to their material economic terms to the extent that these instruments may be considered as subject to regulation under the Act.[7]

Pursuant to this new authority, the Commission on November 5, 1992 proposed rules to be set forth in a new part 35 that generally would exempt certain swap agreements from the Act. 57 FR 53627 (Nov. 12, 1992). The comment period, which had been extended by the Commission, expired on December 28, 1992.

The Commission has received in excess of 30 comment letters on the Proposal. The commenters included four futures exchanges; commercial banks, investment banks and other swap market participants; bank, securities industry, futures industry, and other trade associations; bar associations and law firms; government departments and agencies and members of the U.S. House of Representatives. Comments received after December 28 have been considered to the extent the Commission has been able to do so. All commenters, except the four futures exchanges and one commodity trade association, supported the Proposal but suggested modifications or clarifications to certain aspects of its provisions. These

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[1] 57 FR 53627.

[2] 57 FR 58423.

[3] Sections 4(a), 4c(b) and 4c(c) of the Act; 7 U.S.C. 6(a), 6c(b), 6c(c). Section 4(a) of the CEA specifically provides, *inter alia*, that it is unlawful to enter into a commodity futures contract that is not made "on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." 7 U.S.C. 6(a). This prohibition does not apply to futures contracts made on or subject to the rules of a foreign board of trade, exchange or market. 7 U.S.C. 6(a).

[4] Pub. L. 102–546.

[5] Section 4(c)(1), 7 U.S.C. 6(c)(1), reads as follows:

In order to promote responsible economic or financial innovation and fair competition, the Commission by rule, regulation, or order, after notice and opportunity for hearing, may (on its own initiative or on application of any person, including any board of trade designated as a contract market for transactions for future delivery in any commodity under section 5 of this Act) exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to subsection (a) (including any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction), either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, from any of the requirements of subsection (a), or from any other provision of this Act (except section 2(a)(1)(B)), if the Commission determines that the exemption would be consistent with the public interest.

[6] Section 4(c)(2), 7 U.S.C. 6(c)(2), reads as follows: The Commission shall not grant any exemption from any of the requirements of subsection (a) unless the Commission determines that—(A) The requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought and that the exemption would be consistent with the public interest and the purposes of this Act; and (B) The agreement, contract, or transaction—(i) Will be entered into solely between appropriate persons; and (ii) Will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under this Act. In this regard, the Conference Report on the 1992 Act states: The Conferees do not intend for this provision to allow an exchange or any other existing market to oppose the exemption of a new product solely on grounds that it may compete with or draw market share away from the existing market. H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[7] Specifically, new section 4(c)(5)(B) states the Commission may: (B) Promptly following the enactment of this subsection, or upon application by any person, exercise the exemptive authority granted under paragraph (1) effective as of October 23, 1974, with respect to classes of swap agreements (as defined in section 101 of title 11, United States Code) that are not part of a fungible class of agreements that are standardized as to their material economic terms, to the extent that such agreements may be regarded as subject to the provisions of this Act.

commenters generally expressed the view that Part 35 would provide greater legal certainty to swap agreements, promote the development of certain financial safeguards in the swap market, and allow U.S. swap market participants to more effectively compete with foreign participants. Three of the four futures exchanges filed a joint comment letter (hereinafter the "Futures Exchanges Letter") which opposed the proposal on procedural and substantive grounds. Similar issues were raised in the other comment letter filed separately by a futures exchange.[8]

As discussed below, the Commission believes that part 35, as adopted, is responsive to the concerns of the commenters and has determined that it meets the criteria for the issuance of exemptive rules set forth in the Act.

II. Discussion

A. Scope of Rule

Several comment letters, including the Futures Exchanges Letter, have noted the Commission's efforts, both legislative and regulatory, to provide legal certainty for swap agreements. The Commission's review of the regulatory issues raised by swap agreements resulted in the issuance in July 1989 of a Statement of Policy ("Policy Statement") concerning certain swap transactions which recognized a non-exclusive safe harbor for transactions satisfying the statement's criteria.[9] Although the Policy Statement provided much needed clarity at that time concerning the regulatory treatment of swaps, Congress, in enacting the 1992 Act, encouraged the Commission to act promptly to issue an exemption to promote legal certainty in this area.[10] New part 35 is intended to promote domestic and international market stability, reduce market and liquidity risks in financial markets, including those markets (such as futures exchanges) linked to the swap market, and eliminate a potential source of systemic risk. To the extent that swap agreements may be regarded as subject to the provisions of the Act, the rules provide that those swap agreements which meet the terms and conditions set forth therein are exempt from all provisions of the Act, except section 2(a)(1)(B).[11] Although the Commission proposed to reserve certain non-regulatory sections of the Act from the exemption, the Commission agrees with those commenters that this reservation is unnecessary.[12] Nevertheless, in response to suggestions made in the Futures Exchanges Letter and the letter from the fourth commodity exchange, and to the extent that swap agreements may be deemed to be subject to the Act, the Commission has determined specifically to reserve in these rules the antifraud authority applicable to futures contracts and option transactions set forth in Sections 4b and 4o of the Act and Commission Rule 32.9, 17 CFR 32.9 (1992).

The rule is retroactive and effective as of October 23, 1974, the date of enactment of the Commodity Futures Trading Commission Act of 1974. The exemption would thus implement Congressional intent that the exemption from the Act be available for all eligible swap agreements, regardless of when (subsequent to October 23, 1974) the agreements may have been entered into. The issuance of this rule should not be construed as reflecting any determination that the swap agreements covered by the terms hereof are subject to the Act, as the Commission has not made and is not obligated to make any such determination.[13]

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[8] The exchanges questioned the adequacy of the comment period for the rulemaking, noting that the Commission has employed a 60 day comment period in other instances. There is, of course, no legal impediment to the Commission's use of a 30 or 44 day comment period in this rulemaking, as the Administrative Procedure Act requires no fixed period for the submission of comments. *Phillips Petroleum Co.* v. *Environmental Protection Agency,* 803 F.2d 545 (10th Cir. 1986). The Commission notes, however, that its initial selection of 30 days was prompted by its desire to act "promptly" as Congress intended, and the fact that the swaps issue had already been subject to lengthy and careful consideration by both the Commission and the Congress over the past several years. See, e.g. Hearings on S. 207 before the Senate Committee on Agriculture, Nutrition, and Forestry, 102d Cong., 1st Sess. 452 (1991); Advanced Notice of Proposed Rulemaking, 52 FR 47022 (Dec. 11, 1987).

[9] 54 FR 30694 (July 21, 1989). The Commission has also recognized, as have others, that certain swap transactions may fall within the Act's jurisdictional exclusions for forward contracts, or the so-called Treasury Amendment or within the Commission's regulatory trade option exemption. *Id.* at 30695, fn. 12–15. To the extent that swaps transactions do not meet the exemptive criteria of part 35, but nevertheless fall within the trade option exemption, they will continue to be covered by that provision.

[10] In granting exemptive authority to the Commission under new section 4(c), the Conferees on the 1992 Act: recognize[d] the need to create legal certainty for a number of existing categories of instruments which trade today outside the forum of a designated contract market. These instruments may contain some features similar to those of regulated exchange-traded products but are sufficiently different in their purpose, function, design, or other characteristics that, as a matter of policy, traditional futures regulation and the limitation of trading to the floor of an exchange may be unnecessary to protect the public interest and may create an inappropriate burden on commerce. H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992). The Futures Exchanges Letter questions whether the Commission was "directed" by Congress to act promptly in issuing this exemption. A fair reading of section 4(c)(5) and the Conference Report indicates a clear expectation by Congress that the Commission would act promptly. H.R. Rep. No. 978, 102d Cong., 2d Sess. 81 (1992). If the word "promptly" is to be given effect, as it must under rules of statutory construction, its plain meaning argues for agency action sooner rather than later. Indeed the Commission was urged "to act and act swiftly." *Id.* There is no requirement for the Commission to wait until the completion of the study requested by Congress. In fact, Congress expected the Commission to exercise its exemptive authority before the study was completed. *Id.* at 83. In addition, once an agency is granted rulemaking authority it may proceed on a timetable established in its discretion, absent statutory language to the contrary.

[11] Numerous commenters asked that the Commission clarify its views regarding the section 2(a)(1)(B) limitation, part of the Shad/Johnson Jurisdictional Accord. As stated in the Proposal, by enactment of this part 35 the Commission does not intend to affect transactions undertaken in accordance with the Policy Statement. Further, in enacting this limitation, Congress "did not intend to call into question the legality of securities-based swap or other transactions which occur in the private marketplace at the present time, that do not violate the Accord." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992). Swap market participants may continue to rely on the Policy Statement for existing and new swap agreements, including securities-based swaps.

[12] These proposed reservations encompassed sections 1a and 2(b), definitions; section 4(c) and 4(d), the exemptive authority provisions; section 8 dealing with, among other things, the Commission's treatment of confidential information; and, section 12(e)(2)(A), regarding the non-applicability of certain state laws to agreements exempted under section 4(c). By eliminating the reservations as applied to swap agreements, the Commission does not intend to suggest that these sections or any other section of the Act do not continue to apply to the Commission or to its authority and obligations under these sections or to any person or transaction not eligible for the exemption. See section 4(d) of the Act. Pursuant to its authority in new section 4(d) of the Act, the Commission intends routinely to consult with other regulators who have information concerning swap transactions, *e.g.*, the Securities and Exchange Commission pursuant to its risk assessment authority under the Market Reform Act of 1990, the Federal Reserve Board and other bank regulators to seek to assure they include in their routine examination program these transactions. Under section 4(d), the Commission would exercise its authority to investigate, as appropriate. The Commission also specifically wishes to make clear that those provisions of sections 69(c) and 9(a)(2) of the Act concerning manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, would continue to apply to persons engaging in swap agreements but not to the swap agreements themselves. Part 35 does not affect the applicability or protections of state law (other than gaming or "bucket shop" laws), including applicable securities laws or antifraud statutes of general applicability, to these swap agreements or any other protections provided by other applicable federal laws. Congress specifically noted that, in exempting an instrument from the Act, the Commission cannot exempt it from applicable securities and banking laws and regulations. H.R. Rep. No. 978, 102d Cong., 2d Sess. 83 (1992).

[13] The contention expressed in the Futures Exchanges Letter that the Commission must make such a determination ignores the express language of 4(c)(5) and misstates Congressional intent as expressed in the Conference Report: The Conferees do not intend that the exercise of exemptive authority * * * would require any determination beforehand that the agreement * * * is subject to the Act * * *. Rather than making a finding as to

In enacting this exemptive rule, the Commission is also acting under its plenary authority under section 4c(b) of the Act with respect to swap agreements that may be regarded as commodity options.[14] The rule also exempts, as permitted by section 4(c)(1), all persons and entities for the activity of offering, entering into, rendering advice, or rendering other services with respect to swap agreements covered by the rule. Commenters indicated that the placement of this language in the rule was confusing. Accordingly, a clarifying modification has been made. Such persons, however, engaged in activity otherwise subject to the Act would not be exempt for such activity, even if it were connected to their exempted swaps activity. Also in this regard, the Commission wishes to make clear that the exemption does not apply to any financial, recordkeeping, reporting, or other requirements imposed on any person in connection with their activities that remain subject to regulation under the Act.[15] Thus, for example, futures commission merchants must continue to account for any liabilities arising out of any swap agreement in meeting the net capital requirements of Commission Rule 1.17 just as they do in the case of other financial instruments not regulated under the Act. Similarly, the risk assessment recordkeeping and reporting requirements imposed on futures commission merchants by new section 4f(c) of the Act apply to the swap agreement activities of their affiliated persons.

In adopting part 35, it is the intention of the Commission to exempt from regulation (to the full extent permissible by the Act) all swap agreements which satisfy the requirements of the rule and which may otherwise be subject to regulation under the Act.

B. Definition of Swap Agreement

Rule 35.1(b)(1) adopts the definition of "swap agreement" incorporated into new section 4(c)(5)(B) and specifically set forth in 11 U.S.C. 101(55). Although one commenter thought the definition was too restrictive and several encouraged broader application, the majority of those who commented on the use of this definition stated their support for its adoption. This definition reflects Congressional intent that the Commission endeavor to give legal certainty to swap agreements with differing economic and financial characteristics. In addition, as noted by one commenter, the use of the same definition that is used in the Bankruptcy Code will help to create greater certainty in the marketplace for swaps, given the extent to which market certainty has been enhanced by the exemption of "swap agreements" (as defined in the Bankruptcy Code) from the automatic stay and other provisions of the Bankruptcy Code. The definition reflects the diversity and evolving nature of swap transactions in the marketplace.[16] The Commission believes the terms and conditions of Rule 35.2 adequately limit the scope of activity permitted under the exemption.

C. Eligible Swap Participants

Most commenters suggested various modifications to the proposed definition of "appropriate person." The Commission has considered these comments and the final rule reflects the changes discussed below. In addition, in order to avoid confusion with the use in section 4(c)(3) of the Act of the phrase "appropriate person," the final rule substitutes the phrase "eligible swap participant." No substantive change is intended by this new phrase.

In the Proposal, the Commission generally used the list of "appropriate persons" set forth in new section 4(c)(3)(A) through (J) and utilized the authority granted by section 4(c)(3)(K) to determine other persons to be "appropriate persons" provided that a natural person would only qualify to the extent his or her net worth exceeds $5 million or total assets exceed $10 million. This approach is consistent with Congressional intent that the Commission may limit the terms of an exemption to some, but not all, of the listed categories of appropriate persons.[17]

In defining "eligible swap participant" in the final rule, the basic list is retained but is refined to clarify issues raised by the commenters. As the Act specifies that the swap agreement may only be "entered into" by appropriate persons, this determination is to be made at the inception of the transaction.[18] Further, it is sufficient that the parties have a reasonable basis to believe that the other party is an eligible swap participant at such time.[19]

Many commenters noted the international scope of the swaps market. While most of the categories of eligible swap participants are not limited to U.S. persons, subsections (iv), (v), (vii), (ix), and (x) of proposed Rule 35.1(b)(2) reference persons regulated under the United States law applicable to each. Thus, these references exclude regulated foreign persons performing similar roles in their home jurisdictions. Consistent with the policy reflected in section 4(c)(3)(K), the Commission believes that regulated foreign persons are "appropriate persons" and has modified these subsections of the final rule to include such persons as "eligible swap participants."[20]

The eligible swap participant must be acting on its own behalf or on behalf of another eligible swap participant as a counterparty in order to qualify under the Rule. A conforming change to Rule 35.1(b)(2)(i) has therefore been made. In most circumstances, the Commission will not "look through" eligible swap participants to their investors to apply the qualifications of Rule 35.1(b)(2) again. However, investment companies, commodity pools or entities which are collective investment vehicles formed solely for the specific purpose of constituting an eligible swap participant to enter into swap agreements will not be considered eligible swap participants

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whether a product is or is not a futures contract, the Commission in appropriate cases may proceed directly to issuing an exemption. H.R. Rep. No. 978, 102 Cong., 2d Sess. 82–83 (1992). The Futures Exchanges Letter advocates the view that to provide legal certainty to swap agreements the Commission need only exempt such agreements from the requirements of section 4(a) of the Act. The Commission does not read Congressional intent or its authority under section 4(c) so narrowly and has determined to exempt swap agreements which satisfy the requirements of the rule from regulation under the Act.

[14] See also footnote 12, *supra*.

[15] As part of its ongoing review of its regulations, the Commission is considering revisions to Commission Rule 1.19. Suggestions by some commenters that Rule 1.19 should not be applicable to exempted swap agreements will be considered as part of this review.

[16] The words "any similar agreement" in the definition includes any agreement with a similar structure to those transactions expressly included in the definition (e.g., a cap, collar, or floor) without regard to the nature of the underlying commodity interest involved.

[17] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[18] There is no requirement that a swap agreement be terminated if an eligible swap participant no longer qualifies as such. However, in order to permit the orderly winding-down of the positions of counterparties undergoing financial or other distress, an eligible swap participant may enter into a "closing transaction" with a counterparty even if the counterparty no longer qualifies as an eligible swap participant, provided however, that such closing transaction terminates all obligations between the counterparties to the swap. Under this circumstance, the Commission will consider such non-qualifying counterparty an "eligible swap participant" solely for the purpose of terminating any outstanding swap agreements.

[19] An eligible swap participant that has a reasonable basis to believe its counterparty is also an eligible swap participant when it enters into a master agreement may rely on such representation continuing, absent information to the contrary.

[20] The Commission considered comments that all non-United States persons be included in the definition of "eligible swap participant." However, as most categories of eligible swap participants are not limited to U.S. persons, this change accomplishes much the same result without favoring foreign participants over United States participants.

under the exemption. Conforming changes to Rule 35.1(b)(2) have been made to make this clear.

In the Proposal the Commission requested specific comment regarding the net worth and asset tests for "appropriate persons." A number of commenters indicated that the financial thresholds should be lower, particularly for individuals (for example, that the "accredited investor" threshold of Rule 501 under the Securities Act of 1933 be used), and that no financial thresholds should be imposed on individuals who are otherwise registered and regulated under the Act or the Securities Exchange Act of 1934 (such as broker-dealers, futures commission merchants, commodity trading advisors, and investment advisers).[21] Others noted the lower thresholds applicable to partnerships, corporations, or proprietorships under proposed Rule 35.1(b)(2)(vi). At least one commenter indicated that the proposed list of appropriate persons went beyond the existing market.

These financial thresholds are applied as an indication of financial sophistication and background. No commenters suggested that the proposed financial thresholds would adversely affect the market as conducted today, and on further consideration the Commission has determined to alter the financial tests for corporations and other entities, employee benefit plans and natural persons and to require commodity pools to have assets of at least $5,000,000.

In the final rule the Commission has increased the financial threshold tests for entities specified in Rule 35.1(b)(2)(vi) and natural persons to $10 million in total assets, and eliminated the net worth threshold. The Commission has added an alternative test for entities specified in Rule 35.1(b)(2)(vi) having net worth of at least $1 million and which enter into the swap agreement in connection with their businesses or to manage the risk of an asset or liability owned or incurred in the conduct of their businesses or reasonably likely to be owned or incurred in the conduct of their businesses.[22] Finally, the Commission has increased the asset test for employee benefit plans to $5,000,000.

D. Other Conditions

In addition to the condition that the swap agreement be entered into solely between eligible swap participants as specified in Rule 35.2(a), the final rule imposes three further conditions.[23]

First, as specified by section 4(c)(5) of the Act, Rule 35.2(b) provides that swap agreements may not be part of a fungible class of agreements that are standardized as to their material economic terms.[24] This condition is designed to assure that the exemption does not encompass the establishment of a market in swap agreements, the terms of which are fixed and are not subject to negotiation, that functions essentially in the same manner as an exchange but for the bilateral execution of transactions.[25] Standardization of material economic terms is a necessary, but not sufficient, condition for fungibility, as other factors, such as individual negotiation of other material terms or counterparty credit risk also affect fungibility.[26] As a result of, for example, the existence of common conventions in related markets or the hedging of risks incident to common assets or liabilities, a swap agreement may have the same economic terms but yet not be one of a fungible class of standardized agreements. For example, parties hedging the same or similar asset, such as a five year bond with semi-annual interest coupons, may individually negotiate the same economic terms to match cash flows, yet negotiate other terms and conditions, including the consideration of the creditworthiness of the counterparty.

Standardization of terms that are not material economic terms, for example, definitions, representations and warranties, and default and remedies provisions, as found in certain forms and master agreements published by various associations, is not by itself violative of this requirement.[27] Moreover, a swap agreement would not be considered fungible or standardized simply because it is subject to a netting system or arrangement permitted under paragraph (d) of the rule provided the material economic terms of the swap agreement are subject to individual negotiation by the parties.

Second, Rule 35.2(c) requires that the creditworthiness of any party having an actual or potential obligation under the swap agreement be a material consideration in entering into or determining the terms of the swap agreement including pricing, cost, or credit enhancement terms.[28] The

[21] The Futures Exchanges Letter suggested that the financial threshold for natural person floor traders and floor brokers be eliminated if such person's activities are guaranteed by a clearing member. Although the Commission has declined to make this change, it has added an alternative test for proprietorships as described above.

[22] To avoid uncertainty in the application of Rule 35.1(b)(2)(vi), the Commission is deleting reference to "business" before "entities" in this subsection. In addition, based upon comments received, the Commission has added credit unions to 35.1(b)(2)(ii) and made minor clarifying changes to subsections (vi) and (vii). Some commenters requested that the Commission specifically list entities, such as 501(c)(3) organizations under the Internal Revenue Code, in subsection (viii). The Commission believes such entities are contained within this subsection, and such specificity is unnecessary.

[23] The Futures Exchanges Letter proposes that the Commission add as a condition to the exemption that a self-regulatory organization ("SRO") be established to govern the swap market. Although couched in terms of the benefits of self-regulation, the objective underlying this proposal is revealed by the exchanges' statement that "(b)y the time the exchanges are ready to compete effectively * * * the dealers should have made and effectuated their SRO selection." Futures Exchanges Letter at 102. While it may be appropriate in some circumstances or for other reasons to condition an exemption on the existence or establishment of an SRO, the Commission declines to so condition this exemption and thus delay its implementation.

[24] The phrase "material economic terms" is intended to encompass terms that define the rights and obligations of the parties under the swap agreement and that, as a result, may affect the value of the swap at origination or thereafter. Examples of such terms may include notional amount, amortization, maturity, payment dates, fixed and floating rates or prices (including the methods by which such rates or prices may be determined), payment computation methodologies, and any rights to adjust any of the foregoing.

[25] The Futures Exchanges Letter questions the use of this condition and, in particular, one of the Commission's explanations of its purpose. Futures Exchanges Letter at 70–78. Distilled to its essence, the exchanges argue that the Commission's explanation is ambiguous because some swap agreements are as standardized as exchange traded futures, and that a swaps market which functions essentially as an exchange may exist today. The Commission does not find the purposes of this condition to be ambiguous as the exchanges assert. As to the assertion that some swap agreements are as standardized as exchange-traded futures contracts, this ignores the fact that most terms of exchange-traded futures contracts are set by the contract market, while all terms of swap agreements are subject to negotiation. As to the exchanges' other contention, a swaps market that today functions as an exchange would not be entitled to a part 35 exemption since the rule precludes exchange trading. See also Rule 35.2(d). Of course, what constitutes the "essential functions" of an "exchange" is subject to reasonable dispute but is generally left to an expert agency to decide. *Cf. Board of Trade versus Securities and Exchange Commission*, 883 F.2d 525 (7th Cir. 1989).

[26] One commenter suggested that legal certainty would be increased if the Commission deleted 35.2(b) and stated that a swap agreement which is assignable and transferable only with counterparty consent and/or the obligations thereunder are terminable, absent default, only with counterparty consent, is not part of a fungible class of agreements that are standardized as to their material economic terms. While the Commission agrees that transferability is one indicia of fungibility, other facts or circumstances may also determine whether or not a swap agreement meets the requirements of Rule 35.2(b).

[27] Standardization of these terms in published forms is not dissimilar to the standardization of terms for other areas, such as letters of credit. The publication of such standard terms facilitates communications and negotiations, but does not mean the provisions themselves are not subject to substantial negotiation.

[28] The Futures Exchanges Letter asserted that the Commission's choice of certain conditions in the Proposal was an impermissible attempt to employ the criteria from the Senate version of the 1992 Act

standard is intended to be objective, and does not require parties to actually negotiate (or demonstrate that they have negotiated) particular provisions. The clarifying phrase in the rule regarding "any party having an actual or potential future obligation" refers to obligations that create credit risk, not to ancillary obligations, such as obligations to deliver documents or perform (or refrain from performing) financial or business-related covenants. By this criterion, at this time, the exemption does not extend to transactions that are subject to a clearing system where the credit risk of individual members of the system to each other in a transaction to which each is a counterparty is effectively eliminated and replaced by a system of mutualized risk of loss that binds members generally whether or not they are counterparties to the original transaction.[29]

Based upon comments from futures exchanges and others, the Commission has revised the proviso to Rule 35.2(b) and (d) to clarify its meaning and to distinguish bilateral arrangements or facilities from multiparty arrangements or facilities. Under the proviso, bilateral arrangements for the netting of obligations to make payments or transfers of property, including margin or collateral, would be permitted. Multiparty netting arrangements would also be permitted, provided that the underlying gross obligations among the parties are not extinguished until all netted obligations are fully performed.

In addition, the "creditworthiness" condition is not intended to limit the ability of parties to undertake any bilateral collateral or margining arrangements to address credit issues. By expanding the ability of swap participants to utilize collateral and margin arrangements beyond that which is explicitly permitted under the Policy Statement, these rules should promote arrangements that will reduce risk within the financial system.[30]

Third, Rule 35.2(d) provides that the swap agreement may not be entered into and traded on or through a multilateral transaction execution facility. In this context, a multilateral transaction execution facility is a physical or electronic facility in which all market makers and other participants that are members simultaneously have the ability to execute transactions and bind both parties by accepting offers which are made by one member and open to all members of the facility. This limitation is not intended to preclude participants from engaging in privately negotiated bilateral transactions, even where these participants use computer or other electronic facilities, such as "broker screens," to communicate simultaneously with other participants so long as they do not use such systems to enter orders to execute transactions.[31] The Commission understands such facilities are in use today.

The Commission believes that transaction execution facilities could provide important benefits in terms of increased liquidity and price transparency. However, as is the case with clearing facilities, transaction execution facilities for swap agreements are not yet in existence, and present different regulatory issues than are raised by the exemption provided by the final rule. Thus, transaction execution facilities are beyond the scope of part 35 as adopted today. Consistent with the proviso in the final rule, however, the Commission invites applications for appropriate exemptive relief for such facilities as they are developed.

E. Statutory Determinations

As stated above, section 4(c) requires that the Commission make a number of determinations in granting exemptions.[32] If an exemption is granted pursuant to section 4(c) from the requirements of section 4(a), the determinations are that the requirement of section 4(a) should not be applied to the agreement, contract, or transaction and that the exemption is (1) consistent with the public interest; (2) consistent with the purposes of the Act; and (3) the agreement, contract, or transaction "will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties" under the Act.[33] With regard to the exchange trading requirement of section 4(a), the swaps market presently exists outside the forum of exchange trading

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which had mandated a swap exemption. However, as enacted, section 4(c)(1) expressly empowers the Commission to grant exemptions on "stated terms or conditions." As the Conferees recognized, the Commission may impose conditions on the swaps exemption "beyond those of lack of fungibility and standardization." H. Rep. 978, 102 Cong., 2d Sess. at 82 (1992).

[29] As recognized by the Futures Exchanges Letter, such a mutualized system would constitute a clearing system not unlike those employed by the exchanges. See also footnote 30, *infra*.

[30] The Commission shares the goal of financial system risk reduction as expressed in the comment letters from the Department of the Treasury, the Board of Governors of the Federal Reserve System ("Board"), and Office of the Comptroller of the Currency ("OCC"). The Commission understands these comment letters to generally support the promulgation of part 35 but to express concern that Commission rules should go further to promote the reduction of systemic risk. In this regard, while the OCC and the Board endorsed the development of appropriately structured multilateral payment netting for swaps, the Board also observed that the Commission should permit multilateral settlement (or clearing) so risk of loss could be mutualized. The Commission believes that a clearing house system for swap agreements could be beneficial to participants and the public generally. However, as such mechanisms are not yet in existence, and may take many forms and raise different regulatory concerns depending upon their structure or participants or whether another regulatory regime is applicable, the Commission will consider the terms and conditions of such an exemption for swap clearing houses in the context of specific proposals from exchanges, other regulators, or others. The Commission has added a proviso to the final rule to make clear that in this regard any party may apply for exemptions from the Act and that the Commission will consider the terms and conditions that may be appropriate, including other applicable regulatory regimes. While not limiting exemptions to those conditioned upon another regulatory scheme (and not otherwise limiting the imposition of conditions) the Commission is mindful of the costs of duplicative regulation. The Commission intends to give market participants maximum latitude in developing multilateral mechanisms to control credit and settlement risk which may reduce systemic risk. The new proviso reflects the Commission's determination to encourage innovation in developing the most efficient and effective types of systemic risk reduction. The Commission has previously recognized the virtues of clearing systems that mutualize risk and do not believe that this Rule should disadvantage the development of such systems. The Commission believes that the design of swap clearing facilities and the services that the facility will offer should be driven by the needs and desires of swap market participants.

[31] The Futures Exchanges Letter appears to confuse electronic and computer facilities which provide information to those having access to the facility, with physical or electronic facilities which allow participants to execute and trade instruments or contracts. A computer-based trading system for swap agreements is beyond the scope of these rules but may be the proper subject of the Commission's further exercise of its authority under section 4(c). See also footnote 30, *supra*.

[32] Contrary to the contention of the Futures Exchanges Letter, the plain meaning of the statute requires only that the determinations be made when the exemption is granted, but not when an exemption is merely proposed. *See* section 4(c)(2). The four exchanges also contend that the Proposal violates the Administrative Procedure Act ("APA") by failing to provide, among other things, an opportunity for "meaningful comment." The APA requires that a notice of proposed rulemaking include "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. 553(b). In this instance the Proposal met both tests: it not only provided a description of the subject issues involved, it set forth the full text of the proposed rule. Further, this APA provision has been interpreted by one court to mean that the notice should be of sufficient detail and rationale to permit parties to comment meaningfully. *See, Fertilizer Inst.* v. *EPA*, 935 F.2d 1302, 1310–11 (D.C. Cir. 1991). The numerous detailed comment letters received support the conclusion that an opportunity for meaningful comment was provided by the Proposal. Further, despite their protestations to the contrary, the four futures exchanges who filed in opposition (and, in particular, the 108-page Futures Exchanges Letter) appeared to be sufficiently informed of the Commission's rationale to comment "meaningfully" on the Proposal.

[33] Section 4(c)(2), 7 U.S.C. 6(c)(2). This section also places a condition on an exemption from section 4(a) of the Act that the transaction will be entered into solely between appropriate persons. As discussed above, the Commission has made this a prerequisite for the swap agreement to qualify for exemption under Part 35.

and the Commission has determined that the requirement should not be applied to swap agreements meeting the conditions of the exemption. Indeed, one of the prerequisites for the exemption is that the swaps agreement not be standardized like exchange products or entered into or traded on a multilateral execution transaction facility.[34]

Public Interest and Purposes of the Act Determination

As is frequently the case when Congress grants a regulatory agency authority to act consistent with "the public interest and the purposes of" its enabling statute, little statutory elaboration is given to the full scope of the phrase. As commonly understood, however, an agency, such as the Commission, is to apply this standard against the template of its regulatory scheme. In this regard, the Conference Report states that the "public interest" under section 4(c) includes "the national public interests noted in the (Act), the prevention of fraud and the preservation of the financial integrity of markets, as well as the promotion of responsible economic or financial innovation and fair competition." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992).[35] The Conference Report goes on to state that "(t)he Conferees intend for this reference to the 'purposes of the Act' to underscore their expectation that the Commission will assess the impact of a proposed exemption on the maintenance of the integrity and soundness of markets and market participants." *Id.*

Swap agreements are used by corporations, financial institutions, governments, governmental entities, and others, and are important tools that are used by these entities to hedge or manage financial risk and accomplish other financial objectives. In issuing this exemption, the legal risk (that the agreements would be unenforceable), and thus financial risk, is reduced within the financial markets and that legal certainty contributes to the preservation of the financial integrity of the markets.[36] By removing or reducing uncertainty, the final rule should promote innovation in the swaps market by allowing participants to negotiate and structure transactions that most effectively address their economic needs.[37]

Further, the exemption will assist United States financial institutions to compete with foreign rivals in the highly competitive market for swaps by removing a regulatory uncertainty with respect to the market in the United States that has not been present in most other major financial and industrial countries. In this regard, the exchanges' comment that "fair competition" under section 4(c) means that the rule as finalized must permit the exchanges to conduct a swaps market in their own manner is without merit. Exchanges and their members are not excluded from these rules, however, and may participate in swap agreements on the same terms and conditions that apply to all other eligible swaps participants.[38]

Material Adverse Effect on Regulatory or Self-Regulatory Responsibilities

In making this determination, Congress indicated that the Commission is to consider such regulatory concerns as "market surveillance, financial integrity of participants, protection of customers and trade practice enforcement." [39]

The record before the Commission does not support a conclusion that the purposes of the Act or the Commission's regulatory efforts thereunder have been adversely affected by the swaps market or will be so affected by the issuance of this exemption. Swap transactions have been entered into by a variety of participants for more than a decade, and the number of defaults appears to be low.[40] Nor do allegations of fraud appear to be an issue in this market. The Commission has addressed concerns regarding financial integrity and customer protection through the requirement that swaps only be entered into between eligible swap participants and that, as provided in Rule 35.2(b), creditworthiness of the parties be a material consideration. This approach precludes anonymous transactions and ensures that swap agreements will be limited to those persons who are sophisticated or financially able to bear risks associated with the transactions.[41]

The Commission also notes that the existence of the swap market, which by any measurement (*e.g.*, total notional amount at year end 1991 of $4 trillion) has not to date affected the ability of the futures exchanges to fulfill their self-regulatory duties.[42] It is widely acknowledged that the futures market and the swap market are linked, with swap market participants using certain exchange traded futures as hedging vehicles.[43] By creating a more certain legal environment for swaps, the potential for systemic risk is reduced, and there is no reason to conclude that the exchanges' self-regulatory responsibilities will be adversely affected by permitting the swaps market to continue on this basis.[44]

Anticompetitive Considerations

Section 15 of the Act provides, in relevant part, that the Commission must consider the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, policies, and purposes of the Act in adopting any rule, regulation, or exemption under section 4(c).[45] Thus, a

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[34] See discussion above regarding Rule 35.2(c) and (d). See also H. Rep. No. 102–978, 102d Cong., 2d Sess. 80 (1992).

[35] The Futures Exchanges Letter notes that in addressing certain elements of the public interest for futures trading, Congress has indicated that contract market designation and regulation under the Act is necessary to avoid creating an undue burden on commerce. *See* section 3 of the Act. Seventy years after the enactment of section 3, however, Congress enacted section 4(c) authorizing exemptions from section 4(a) of the Act because "traditional futures regulation * * * may create an inappropriate burden on commerce." H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992).

[36] The Futures Exchanges Letter appears to say in several places that the Commission must find that the exemption provides legal certainty. While this is certainly a goal of the final rule, it is not a statutorily mandated finding which the Commission must make.

[37] As noted in several comment letters, including comments from federal regulators, permitting mark-to-market margin and collateral and multiparty payment netting systems reduces financial risk and encourages responsible economic innovation.

[38] In considering fair competition, Congress expected that "the Commission will apply consistent standards based on the underlying facts and circumstances of the transaction and markets being considered and may make distinctions between exchanges and other markets, taking into account the particular facts and circumstances involved * * * where such distinctions are not arbitrary and capricious." H.R. Rep. No. 978, 102d Cong., 2d Sess. 78 (1992).

[39] H.R. Rep. No. 978, 102d Cong., 2d Sess. 79 (1992).

[40] Azarchs, "Banks Face Manageable Risks in Derivative Businesses," Standard & Poors Credit Week, November 1992.

[41] In enacting the 1992 Act, Congress explicitly authorized exemptions from all provisions of the Act (except 2(a)(1)(B)) and simultaneously enacted a "conforming amendment" to 12(e)(2) explicitly acknowledging that state antifraud statutes of general applicability would continue to apply to exempted transactions. See also footnote 12, *supra*.

[42] Indeed, in their lengthy submissions, the futures exchanges do not claim that approval of the Proposal will adversely affect their self-regulatory responsibilities.

[43] See, *e.g.*, Thompson, "Oil Swaps, A Potential Source of New Business for NYMEX," Futures Industry, November–December 1992.

[44] The Commission is unaware of any swap agreements that provide for settlement by tendering a delivery instrument, such as an exchange-approved warehouse receipt or shipping certificate, that is specified in the rules of a designated contract market. Swap agreements of this kind could have an effect upon deliverable supplies for settlement of designated futures or option contracts and, accordingly, the creation of such agreements should occur only after consultation with the Commission.

[45] Specifically section 15, as amended by section 502(b) of the 1992 Act, provides: The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving

formal analysis under the antitrust laws is not, by itself, dispositive of the issues raised by a rule.[46] As a result, the Commission is not compelled by section 15 to take the least anticompetitive course of action. Rather, where alternatives with varying degrees of regulatory benefit exist, the Commission may adopt the approach that appears to be most likely to achieve the objectives, policies, and purposes of the Act, even if that approach is not the least anticompetitive.[47]

Accordingly, section 15 requires the Commission to balance the likely anticompetitive impact of adopting a rule against the objective, policy, or purpose of the Act which the rule may further. And, although the Commission must consider the public interest in maintaining or promoting competition, it need not weigh this interest equally against an objective, policy, or purpose of the Act being served by a rule in reaching its final determination concerning the adoption of the rule.

The Commission's consideration of the proposed rule and its evaluation of the comments received in this regard has led it to conclude that any possible anticompetitive effects are clearly outweighed by the rule's furtherance of the policies, purposes, and objectives of the Act for the following reasons.

First, the proposal does not appear to raise any significant competitive issues. As several commenters noted, the exemption, by improving the legal certainty of the market for swap agreements, will increase growth, innovation, and competition in this market. Competition, in particular, will be promoted because of the flexibility provided by the exemption concerning persons who may appropriately enter swap transactions. In this regard, in addition to those now participating in swap transactions under the Commission's Policy Statement, the exemption would allow other persons, including futures exchanges or affiliates thereof, to engage in swap transactions on the same basis as all other participants.[48]

Second, the exemption furthers a fundamental objective of the Act, i.e., implementing new section 4(c)(5)(B) of the Act, which authorizes the Commission to exercise "promptly" its exemptive authority concerning swap agreements of the kind described therein. In this regard, the Conference Report on the 1992 Act notes that "the Conferees expect and strongly encourage the Commission to use its new exemptive powers promptly upon enactment in * * * areas where significant concerns of legal uncertainty have arisen (including) * * * swap * * *."[49] The Commission believes that the exemption adopted herein is responsive to these Congressional concerns and is properly circumscribed in accordance with the criteria set forth in the 1992 Act.

Finally, the Commission is unaware of any anticompetitive practices or other discernible adverse effects arising during the evolution and development of the swaps market, particularly as the market has developed in reliance on its Swaps Policy Statement. It is therefore reasonable to expect that the exemption will be similarly devoid of adverse effects on competition.

In conclusion, the part 35 rules as set forth below and adopted herein are supported by appropriate determinations made in accordance with the standards set forth in section 4(c) of the Act for the granting of exemptions.

F. Future Exemptive Relief

The Commission will, consistent with section 4(c), consider further exemptive relief on its own initiative or upon application by any person (including futures exchanges) for agreements, transactions, or contracts (including classes thereof) not addressed in this rule. To the extent that market participants wish to use or establish a multilateral transaction execution facility for swap transactions, or clearing systems involving mutualized risk or multiparty netting of payment obligations, the Commission will evaluate the terms and conditions, if any, that would be appropriate under section 4(c) of the Act in connection with any request for exemptive relief involving such a facility.

II. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), Public Law No. 96–354, 94 Stat. 1164 (1980), 5 U.S.C. 601 *et seq.*, requires each federal agency to consider, in the course of proposing substantive rules, the effect of those rules on small entities. A small entity is defined to include, *inter alia*, a "small business" and a "small organization." 5 U.S.C. 601(6).[50] The Commission previously has formulated its own standards of what constitutes a small business with respect to the types of entities regulated by it. The Commission has determined that contract markets,[51] futures commission merchants,[52] registered commodity pool operators,[53] and large traders[54] should not be considered small entities for purposes of the RFA.

The Commission continues to believe that it is unlikely that firms defined as small businesses under section 3 of the Small Business Act could offer or be offered swap agreements and thus be affected by the proposed rule exempting such agreements. Further, the proposed rule would not add any legal, accounting, consulting, or expert costs but rather would broaden the categories of permissible products sold other than on designated exchanges. The determination of whether a swap agreement would qualify for the proposed exemption requires minimal analysis of data that will be readily accessible to the offeror.

No comments were received with respect to the RFA implications of new part 35.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1989 ("PRA"), 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. As the Commission noted in proposing part 35, it has determined that proposed part 35 does not impose any information

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the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under sections 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act.

[46] See *Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 690–691 (1975); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963).

[47] See, *e.g.*, *British American Commodity Options Corp.* v. *Bagley*, Comm. Fut. L. Rep. (CCH) ¶20,245 at 21,334 (S.D.N.Y. 1976), *aff'd in part and rev'd in part*, 552 F.2d 482 (2d Cir. 1977), *cert. denied*, 98 S.Ct. 427 (1977).

[48] The Futures Exchanges Letter argues that the exemption, because it does not permit exchange trading of the swap agreements being exempted, promotes unfair competition. As is noted above, however, the exchanges (or their affiliates) remain free to compete under the final rules on an equal footing with all other eligible swap participants.

[49] H.R. Rep. No. 978, 102d Cong., 2d Sess. 81 (1992).

[50] "Small organizations," as used in the RFA, means "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field * * *" 5 U.S.C. 601(4). The RFA does not incorporate the size standards of the Small Business Administration ("SBA") for small organizations. Agencies are expressly authorized to establish their own definition of small organization. *Id.*

[51] 47 FR 18618 (April 30, 1982).

[52] *Id.* at 18619.

[53] *Id.*

[54] *Id.* at 18620.

collection requirements as defined by the PRA. No comments were received concerning the Commission's determination in this regard.

List of Subjects in 17 CFR Part 35

Commodity futures, Commodity options, Prohibited transactions.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 2, 4, 4c, and 8a, 7 U.S.C. 2, 6, 6c, and 12a, as amended, the Commission hereby adds part 35 of chapter I of title 17 of the Code of Federal Regulations as follows:

PART 35—EXEMPTION OF SWAP AGREEMENTS

Authority: 7 U.S.C. 2, 6, 6c, and 12a.

§ 35.1 Definitions

(a) *Scope.* The provisions of this part shall apply to any swap agreement which may be subject to the Act, and which has been entered into on or after October 23, 1974.

(b) *Definitions.* As used in this part:

(1) *Swap agreement* means:

(i) An agreement (including terms and conditions incorporated by reference therein) which is a rate swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, rate cap agreement, rate floor agreement, rate collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing);

(ii) Any combination of the foregoing; or

(iii) A master agreement for any of the foregoing together with all supplements thereto.

(2) *Eligible swap participant* means, and shall be limited to the following persons or classes of persons:

(i) A bank or trust company (acting on its own behalf or on behalf of another eligible swap participant);

(ii) A savings association or credit union;

(iii) An insurance company;

(iv) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such investment company or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant;

(v) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such commodity pool or foreign person is not formed solely for the specific purpose of constituting an eligible swap participant and has total assets exceeding $5,000,000;

(vi) A corporation, partnership, proprietorship, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible swap participant (A) which has total assets exceeding $10,000,000, or (B) the obligations of which under the swap agreement are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by any such entity referenced in this paragraph (b)(2)(vi)(A) of this section or by an entity referred to in paragraph (b)(2) (i), (ii), (iii), (iv), (v), (vi) or (viii) of this section; or (C) which has a net worth of $1,000,000 and enters into the swap agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business;

(vii) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation with total assets exceeding $5,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. 80a–1 *et seq.*), or a commodity trading adviser subject to regulation under the Act;

(viii) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(ix) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* that if such broker-dealer is a natural person or proprietorship, the broker-dealer must also meet the requirements of either paragraph (b)(2) (vi) or (xi) of this section;

(x) A futures commission merchant, floor broker, or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible swap participant: *Provided, however,* that if such futures commission merchant, floor broker, or floor trader is a natural person or proprietorship, the futures commission merchant, floor broker, or floor trader must also meet the requirements of paragraph (b)(2) (vi) or (xi) of this section; or

(xi) Any natural person with total assets exceeding at least $10,000,000.

§ 35.2 Exemption.

A swap agreement is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such agreement, is exempt for such activity from all provisions of the Act (except in each case the provisions of sections 2(a)(1)(B), 4b, and 4o of the Act and § 32.9 of this chapter as adopted under section 4c(b) of the Act, and the provisions of sections 6(c) and 9(a)(2) of the Act to the extent these provisions prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market), provided the following terms and conditions are met:

(a) The swap agreement is entered into solely between eligible swap participants at the time such persons enter into the swap agreement;

(b) The swap agreement is not part of a fungible class of agreements that are standardized as to their material economic terms;

(c) The creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms of the swap agreement; and

(d) The swap agreement is not entered into and traded on or through a multilateral transaction execution facility;

provided, however, that paragraphs (b) and (d) of Rule 35.2 shall not be deemed to preclude arrangements or facilities between parties to swap agreements, that provide for netting of payment obligations resulting from such swap agreements nor shall these subsections be deemed to preclude arrangements or facilities among parties to swap agreements, that provide for netting of payments resulting from such swap agreements; *provided further*, that any person may apply to the Commission for exemption from any of the provisions of the Act (except 2(a)(1)(B)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited thereto, the applicability of other regulatory regimes.

Issued in Washington, DC on January 14, 1993, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 93-1365 Filed 1-21-93; 8:45 am]

BILLING CODE 6351-01-M

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 284

[Docket Nos. RM90-7-003, CP93-111-000 and CP93-83-000]

Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates; El Paso Natural Gas Company; Order No. 537-B

AGENCY: Federal Energy Regulatory Commission; Energy.

ACTION: Order clarifying final rule.

SUMMARY: Order No. 537-A, III FERC Statutes and Regulations ¶ 30,952 (September 21, 1992), 57 FR 46,496 (October 9, 1992), established a three-month time period, from September 21, 1992 to December 21, 1992, during which pipelines could seek authority under section 7 of the Natural Gas Act to operate facilities which has been constructed and were being operated under section 311 of the Natural Gas Policy Act of 1978. This order clarifies that if a pipeline applied, by December 21, 1992, for appropriate authorization but had not obtained the authorization by that date, it may continue to operate the facilities under the Natural Gas Act until the Commission has issued a final order on the pipeline's application, or the authorization automatically becomes effective under the provisions of section 157.205 of the Commission's regulations, if blanket authority is sought and no protest has been filed. On the other hand, if a pipeline has not applied for appropriate authorization to operate section 311 facilities under part 157 of the Commission's regulations within the three-month time period, its authority to operate said facilities pursuant to the exemption issued in the interim rule expired on December 21, 1992. In order to continue operating such facilities to provide section 7 services, a pipeline will have to apply to the Commission for authority to do so, and must demonstrate good cause for not having filed a timely application for permanent section 7 authority to operate such facilities.

EFFECTIVE DATE: January 14, 1993.

FOR FURTHER INFORMATION CONTACT: Amy R. Heyman, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, DC 20426 (202) 208-0115.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the **Federal Register**, the Commission has made this document available so that all interested persons may inspect or copy its contents during normal business hours in room 3308, 941 North Capitol Street NE., Washington, DC, 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208-1397. To access CIPS, set your communications software to use 300, 1200 or 2400 baud, full duplex, no party, 8 data bits and 1 stop bit. The full text of Order No. 541-A will be available on CIPS for 30 days from the date of issuance. The complete text on diskettes in WordPerfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in room 3308, 941 North Capitol Street NE., Washington, DC 20426.

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terzic.

El Paso Natural Gas Company

Issued January 14, 1993.

On December 17, 1992, El Paso Natural Gas Company (El Paso) filed a motion for an extension of the time provided in Order No. 537-A,[1] for pipelines to obtain certificate authority under section 7(c) of the Natural Gas Act (NGA) to operate facilities previously constructed and operated under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[2] Since El Paso raises an issue which other similarly situated pipelines may raise with regard to the time period provided for in Order No. 537-A, we will clarify that order so that other pipelines will not be required to file similar requests with the Commission.

Background

On September 20, 1991, the Commission issued Order No. 537,[3] a final rule revising the regulations governing transportation by interstate pipelines under section 311 of the NGPA. On September 21, 1992, the Commission issued an order on rehearing of the final rule, Order No. 537-A.[4] In Order No. 537-A, the Commission acknowledged that the final rule should have provided for a reasonable time period during which interstate pipelines could seek authorization under the NGA to operate facilities previously constructed and operated pursuant to authority under section 311 of the NGPA.

This issue arose because contemporaneously with the issuance of the Notice of Proposed Rulemaking in Docket No. RM90-7-000, which proceeding resulted in the issuance of Order Nos. 537 and 537-A, the Commission issued two interim rules. The first, in Docket No. RM90-13-000, provided a time period during which pipelines and shippers could convert non-qualifying section 311 transactions to transactions authorized under section 7 of the NGA.[5] The second, in Docket No. RM90-14-000, exempted from the requirements of section 7 of the NGA the operation of facilities constructed under section 311 of the NGPA, but utilized to provide services converted from section 311 to section 7 authorization.[6] This interim rule also stated that, if necessary, the Commission would prescribe in the final rule in Docket No. RM90-7-000 a reasonable time period within which pipelines could seek permanent authority under section 7 of the NGA to operate facilities constructed and operated under section 311, but utilized

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[1] Revisions to Regulations Governing Transportation Under section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates, Order 537-A, 57 FR 46496 (October 9, 1992), FERC Stats. & Regs. ¶ 30,952 (1992).

[2] 15 U.S.C. 3301-3432 (1988).

[3] Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates, 56 FR 50235 (October 4, 1991), FERC Stats. & Regs., Regs. Preambles, ¶ 30,927 (1991).

[4] See *supra* note 1.

[5] Interim Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates. FERC Stats. & Regs., Reg. Preamble (1986-1990), ¶ 30,894, *amended*, FERC Stats. & Regs. Preambles (1986-1990), ¶ 30,899, *reh'g denied*, 53 FERC ¶ 61,141 (1990).

[6] Interim Revisions to Regulations Governing Construction of Facilities pursuant to NGPA section 311 and Replacement of Facilities, 55 FR 33011 (August 13, 1990), FERC Stats & Regs. ¶ 30,895 (1990) at note 2.

to provide transportation services under the NGA. However, as noted above, such a period was not prescribed until Order No. 537–A was issued.

Although many pipelines had already applied for and obtained authority under section 7 of the NGA to operate facilities formerly operated under section 311 of the NGPA by the time Order No. 537 issued, others had not. Therefore, on rehearing of Order No. 537, certain parties requested clarification regarding the time period during which pipelines still requiring section 7 authorization could apply for it. Order No. 537–A provided that pipelines which had not yet sought section 7 authority to operate their facilities could do so within three months of the date Order No. 537–A issued. Order No. 537–A issued on September 21, 1992; therefore, the three-month period expired on December 21, 1992.

El Paso's Request for an Extension of Time

On November 27, 1992, in Docket No. CP93–83–000 and on December 15, 1992, in Docket No. CP93–111–000, El Paso filed prior notice requests in order to obtain permanent authority to operate certain facilities under its blanket facilities certificate pursuant to part 157, subpart F, of the Commission's regulations. The facilities in question had been constructed and were being operated pursuant to section 311 of the NGPA. El Paso states in its request for an extension of time that the authority it seeks may not be granted within three-month time period provided for in Order No. 537–A. Therefore, El Paso seeks an extension of time in which it may continue to operate the facilities in question pursuant to the exemption issued in the interim rule in Docket No. RM90–14–000.

Clarification

In Order No. 537–A, the Commission referred to a three-month time period during which pipelines could seek authority under the NGA to operate facilities which had been constructed and were being operated under section 311 of the NGPA. The Commission also stated that to the extent authority had not been obtained within the three-month time period, it would consider extensions of time on a case-by-case basis.

We clarify that if a pipeline has applied for appropriate authorization under the NGA to operate section 311 facilities within the three-month time period, *i.e.*, by December 21, 1992, but has not obtained the authorization within that time frame, the exemption issued in the interim rule in Docket No. RM90–14–000 will continue until the Commission has issued a final order on the pipeline's application, or the authorization automatically becomes effective under the provisions of section 157.205, if blanket authority is sought and no protest has been filed. In such situations, an extension of the three-month time period is unnecessary. Since El Paso applied for authorization within the three-month time period, its authority to operate the section 311 facilities, as provided in the interim rule, will continue until the automatic authorization sought becomes effective or the Commission rules on its application. Therefore, we will deny El Paso's request for an extension of time.

On the other hand, if a pipeline has not applied for appropriate authorization to operate section 311 facilities under Part 157 of the Commission's regulations within the three-month time period, its authority to operate said facilities pursuant to the exemption issued in the interim rule expired on December 21, 1992. In order to continue operating such facilities to provide section 7 services, a pipeline will have to apply to the Commission for authority to do so, and must demonstrate good cause for not having filed a timely application for permanent section 7 authority to operate such facilities.

The Commission Orders

(A) Order No. 537–A is clarified to the extent discussed herein.

(B) El Paso's request for an extension of time is denied.

By the Commission.

Lois D. Cashell,

Secretary.

[FR Doc. 93–1498 Filed 1–21–93; 8:45 am]

BILLING CODE 6717–01–M

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Parts 118, 151 and 178

RIN 1515–AB10

[T.D. 93–6]

Centralized Examination Stations

AGENCY: Customs Service, Department of the Treasury.

ACTION: Final rule.

SUMMARY: This document amends the Customs Regulations to set forth a regulatory framework for the establishment, operation and termination of Centralized Examination Stations (CESs). A CES is a privately operated facility at which imported merchandise is made available to Customs officers for physical examination. These regulatory amendments will allow Customs to better use its inspectional resources and clear higher volumes of cargo.

EFFECTIVE DATE: February 22, 1993.

FOR FURTHER INFORMATION CONTACT: Patricia Duffy, Office of Inspection and Control (202–927–1344).

SUPPLEMENTARY INFORMATION:

Background

In recent years there has been a significant increase in the number of Container Freight Stations (CFSs), bonded warehouses, truck and rail terminals, and other facilities which receive and hold imported cargo for purposes of examination and clearance by Customs. As a result of this increase, and due to the fact that these facilities often are not in close proximity to each other within a given port of entry, Customs inspectors have had to spend a greater proportion of their time traveling from one location to another in order to perform cargo examinations necessary to ensure compliance with the law. This increase in travel time has had a negative effect on Customs productivity, has complicated Customs efforts to properly allocate personnel to meet its workload, and has had a corresponding negative effect on Customs ability to render efficient clearance and related services to the importing community.

The Centralized Examination Station (CES) program was developed by Customs in order to address the problems outlined above. A CES is a privately operated facility at which imported merchandise identified by Customs for physical examination is made available to Customs inspectors for that purpose. Once Customs identifies merchandise for examination, the importer or the importer's agent is responsible for selecting the CES to be used (where there is more than one CES within the port and unless the District Director of Customs has reason to make the selection), for arranging the bonded transfer of the merchandise to the CES, and for paying the costs of the transfer as well as any fees charged by the CES facility for its services. The services which the CES operator renders are for the benefit of the importer (who is required under law to make the imported merchandise available to Customs for inspection) and involve storage of the merchandise under bond and with liability insurance, opening the container in which the merchandise is packed, presenting the merchandise to the Customs inspector for examination, and closing the container after examination. A CES may consist of a preexisting warehouse, freight station, terminal or similar facility or portion thereof or may be an entirely new facility developed specifically for operation as a CES. Each CES is designated as such by Customs through a specific application and selection process, and the operation of each CES is governed by a written agreement executed by the selected CES operator and Customs prior to commencement of the CES operation.

Experience with the CES program has shown that CESs provide benefits to both Customs and the trade community. By reducing the number of locations at which examinations are performed, Customs is able to more efficiently allocate inspectional resources while at the same time performing more intensive and effective examinations. In addition, a CES enables Customs to provide improved inspectional supervision and ensure more timely and predictable service to importers by Customs officers. By streamlining the cargo inspection process, CESs ultimately allow Customs to clear higher volumes of cargo and thus improve the overall importation/entry process.

In order to provide an appropriate regulatory framework for the CES program, on July 23, 1991, Customs published a notice in the **Federal Register** (56 FR 33734) proposing to amend the Customs Regulations (19 CFR Ch. I) by adding thereto a new part 118 entitled "Centralized Examination Stations". Proposed new part 118 incorporated four subparts: Subpart A contained general provisions regarding the establishment and operation of a CES; subpart B set forth the specific requirements and procedures for the establishment of a CES; subpart C set forth rules governing the movement of cargo to a CES; and subpart D covered the termination of a CES. The public comment period on the proposed regulations closed on September 23, 1991.

Analysis of Comments

A total of 39 commenters responded to the solicitation of comments during the public comment period. The comments received, and the Customs responses thereto, are set forth below.

Comment: Several commenters suggested that the regulations should prohibit a broker or CFS operator from being selected as a CES operator because of the potential for obtaining a competitive edge in selling its non-CES services. One commenter stated that if a CES operator is a broker or is broker-affiliated, the regulations should prohibit the giving of a preference to its brokerage clients and their entries. Motivated by similar competitive concerns, one commenter suggested adding specific language to § 118.4 to prohibit a CES operator from disclosing any of an importer's confidential business information except to Customs and to provide that any such improper disclosure could result in Federal prosecution and/or cancellation of the CES agreement.

Customs response: With regard to the general relationship between competitive advantage and the CES selection process, the most important consideration remains selection of the applicant best qualified to be a CES operator. Accordingly, Customs believes that the mere potential for obtaining a competitive advantage, so long as that advantage is consistent with normal business practices and does not violate the letter or spirit of applicable Customs laws and regulations, is not a proper basis for limiting the field of potential CES operator applicants as suggested by these commenters. As regards a broker or broker-affiliate CES operator giving preferences to its brokerage clients, Customs believes that the regulations as proposed already address this both by giving to Customs the initial role in determining whether a CES examination will take place and by providing for a basic "first come-first served" operating principle in § 118.4(b).

Customs does not agree with the suggestion to amend § 118.4 to prohibit disclosure of an importer's confidential business information. A CES operator does not have access to invoices, bills of lading, entry summaries and other documents in the entry package which may contain confidential business information. Moreover, since the CES operator is in effect operating for the benefit of the importer, any disclosure of information to the detriment of the importer should be dealt with as a private matter between those parties and thus is not an appropriate matter for these regulations.

Based on the above analysis, Customs no longer believes that it is necessary to require submission of information regarding possible conflicts of interest in the application process. Accordingly, § 118.11 as set forth below has been modified by removing proposed paragraph (h) and redesignating (i) as (h).

Comment: Several commenters suggested a different duration for the agreement to operate a CES. One commenter wanted a 5–7 year term rather than the proposed 3–5 year term, one commenter suggested no pre-set term, and one commenter requested a 1–3 year term. The commenters in favor of a longer term reasoned that this would permit a business to recover the expenses of starting a CES without having to charge high fees to do so.

Customs response: Customs agrees that a duration of more than 5 years will encourage some potential CES operators to make the economic commitment necessary to begin operations. However, Customs still believes a limitation on the duration of an operator's agreement is necessary to keep an operator responsive to those using the CES services and to importing trends. Accordingly, § 118.3 as set forth below has been modified to provide for agreements of from 3 to 6 years.

Comment: Six commenters suggested adding a requirement that there be at least two CESs in any port in order to promote competition so as to keep fees reasonable and allow for choice by the importer.

Customs response: Although Customs agrees in principle that competition is desirable, the number of CESs within a given port more properly should be a function of the volume of examinations to be performed, the availability of Customs resources to perform them, and the willingness of private parties to operate a CES. Accordingly, requiring a minimum of two CESs in a given port would not be appropriate.

Comment: Two commenters stated that § 118.3 was too restrictive in that it would not allow a CES agreement to be transferred under certain conditions such as inheritance by children of the operator or upon sale of stock in a company operating a CES.

Customs response: Customs does not agree that the transfer of an agreement should be permitted even under the special circumstances cited by these commenters. Customs performs background checks on applicants as part of the CES operator selection process, and any transfer of an agreement executed by the selected operator would undermine the purpose behind the background check and thus could ultimately compromise the ability of Customs to perform effective compliance examinations. In addition, Customs considers as material factors in the selection process the physical plant to be used as the CES and the applicant's experience in handling international cargo. Further, it would not be fair to potential users of the CES, or to operator applicants who were not selected, to permit transfer of an operator's agreement.

Comment: Two commenters stated that § 118.2 should be modified to provide for wider dissemination of notice that a CES is to be established or that the term of an existing CES is about to expire. In addition to the proposed posting of a written bulletin at the customhouse, these commenters suggested including publication in the **Federal Register**, in the Customs Bulletin, in local newspapers, in trade journals, and in regional and district pipelines.

Customs response: Customs agrees that it would be beneficial to have wider dissemination of the notice of intent to establish a CES or of expiration of an existing CES term, but Customs also believes that such wider dissemination should not include publications of national interest and circulation but rather should be limited to local distribution channels which are more likely to reach the potential applicants and other interested parties. Accordingly, § 118.2 as set forth below has been modified to provide the district director with more flexibility as regards the local channels to be used for disseminating the notice. In addition, the regulatory text has been changed to refer to a written "notice" rather than "bulletin" since more than posting at the customhouse could be involved under the section as so modified.

Comment: Nine commenters stated that there should be greater consultation with the importing community both when the district director is considering whether a new CES should be established and during the operation of any established CES. A number of these commenters stated that the CES committee (the permissive use of which was provided for in proposed § 118.12 in connection with the review of applications) should be used for these purposes as well, that use of the CES committee should be mandatory for all such purposes under the regulations, and that private sector representation on the CES committee should reflect a broad cross-section of the trade community. With regard to use of a CES committee in reviewing applications, one commenter suggested that a CES committee should not have non-Customs (that is, private sector) members because existing business relationships could improperly influence the selection process.

Customs response: The comments submitted suggest a basic problem with the CES committee concept: While recognizing that a membership consisting of only Customs personnel would not address the need for private sector input in the decision-making process, Customs also believes that it would be difficult to select members from the private sector in such a way as to avoid complaints from one party or another regarding the procedures or results of the member selection process or regarding potential conflicts of interest relating to the committee's intended functions. In addition, the legal requirements that would apply to a CES committee with non-governmental members under the Federal Advisory Committee Act, 5 U.S.C. App. 2, which include publication of a notice in the **Federal Register** both when an advisory committee is initially established and whenever such a committee is planning to meet, would be particularly cumbersome in a CES context because (1) the decision to create or convene a CES committee would normally be made at the local level whereas publication of notices in the **Federal Register** is always initiated at Customs Headquarters and (2) the additional time needed to prepare and approve a notice for publication in the **Federal Register** would only further delay the establishment of a needed CES, thus frustrating the purpose behind the CES program. For these reasons, Customs has concluded that CES committees should not be used for any purpose under the regulations.

Notwithstanding this decision to do away with the CES committee concept, Customs agrees that input from the private sector would be beneficial to the trade and to the CES program, not only in connection with the CES operator selection process as originally provided in proposed § 118.12 but also in connection with the basic determination to establish a CES (or to accept new applications if an existing CES term is about to expire and the district director believes that a CES operation is still needed) under § 118.2. Accordingly, in addition to the public notification procedure changes discussed above and in order to provide a clear context for public procedures, § 118.2 as set forth below has been modified (1) to refer both to the district director's preliminary determination to establish a new CES and to the district director's belief that a CES operation is still needed when the term of a CES is about to expire and (2) in either situation, to provide for submission of relevant comments from the general public within 30 days after publication of the notice that applications are being accepted. In addition, the following changes have been incorporated in § 118.12 as set forth below: (1) The sentence regarding use of a CES committee has been removed; (2) a new opening sentence has been added to provide for public notice and comment procedures (with a cross-reference to § 118.2 for this purpose) with the notice setting forth specific information relevant to each submitted application (the applicant's name, the location of the CES facility, the proposed fee schedule, an equipment list, and the number of employees); (3) the remainder of the section has been modified to refer to the review of public comments submitted under §§ 118.2 and 118.12 and to reflect the possibility that the district director may decide not to select a CES operator (either because it has been decided not to establish or retain a CES or because a suitable applicant has not come forward); and (4) the title of the section has been changed to read "action on application" because the section as modified covers more than merely the review of applications. Finally, in order to ensure trade community awareness of the existence of the CES, § 118.13 as set forth below has been modified to provide for local publication of a notice advising the public of the selection of the CES operator and of the date on which the CES operation will commence.

With regard to private sector input during the operation of a CES, Customs does not believe that it is necessary or appropriate to make formal provision for such input in these regulations. While information regarding the ongoing operation of a CES would be of interest to Customs (in particular as regards observance of CES operator responsibilities under § 118.4), Customs believes that existing informal procedures, whereby any importer or other private party may bring a complaint or other relevant information to the attention of the district director, are sufficient for this purpose. Moreover, in a case involving a CES operator who reapplies when his authority to operate the CES is about to expire, the notice and comment procedures described above will afford the public ample opportunity to comment on that CES operation.

Comment: One commenter stated that, in order to avoid unnecessary expenditures, a CES applicant should not be disqualified for failure to meet one or two specific selection criteria in § 118.11 so long as the applicant agrees to comply with such criteria within 30 days if selected.

Customs response: Customs believes that this commenter has a valid point as regards the avoidance of unnecessary expenditures in the event that a particular applicant is not selected as the CES operator. However, Customs believes that this principle should be limited to cases involving a significant capital expenditure to make an existing facility conform to security and other physical or equipment requirements necessary for the CES operation. Accordingly, § 118.11(b) as set forth below has been modified to give the district director the authority in such circumstances, and if an applicant so requests in the application, to permit the applicant to meet security and other physical or equipment requirements within up to 30 days after tentative selection but with the proviso that the agreement to operate the CES shall not be executed (and thus the selection does not become final and the CES operation may not commence) until the facility conforms to those requirements.

Comment: One commenter stated that the regulations should allow an unsuccessful applicant the opportunity to appeal the nonselection by providing any relevant supplementary information within 10 days, and this commenter further suggested that any selection should be subject to a 180-day probationary period in case a more qualified applicant appeared after the selection was made or in case the selected applicant is unable to operate properly.

Customs response: Customs does not agree with these proposals because they would unnecessarily lengthen, and add uncertainty to, the selection process. Moreover, the problem of a CES selectee operating improperly is adequately covered by the provisions regarding selection revocation and agreement cancellation.

Comment: Eight commenters expressed concern about the responsibility for cargo both while it is being moved to a CES and while it is at the CES. To address these concerns, these commenters suggested the following amendments to the proposed regulatory texts: Clarifying the definition of a CES as a place not in the charge of a Customs officer; requiring operators to carry a minimum of $1 million liability insurance; requiring that such liability insurance cover all damage to merchandise; holding the CES operator liable for any duties or taxes on lost or stolen merchandise; including the broker's importation and entry bond as one of the bonds under which merchandise is transferred; and specifically prohibiting any non-bonded transfer of merchandise. Another commenter stated that the reference to a "performance bond" in the first sentence of § 118.4(g) was unclear and suggested that the text be revised to state that the CES operator agrees that "the terms of its custodial bond will apply to the CES operation".

Customs response: Before responding to the above comments, an issue concerning the organization of the regulations must be addressed. It is noted in this regard that proposed subparts A, B, and D of new part 118 set forth general provisions and establishment and termination rules applicable to CESs, whereas proposed subpart C (consisting of §§ 118.21–118.24) sets forth specific procedures and requirements for the movement of merchandise to a CES for purposes of examination. It is further noted that part 151 of the Customs Regulations (19 CFR part 151) concerns the examination, sampling and testing of merchandise and, in subpart A thereof, sets forth certain basic requirements and procedures for the examination of merchandise which are equally applicable in a CES context. In order to ensure consistency of context and better proximity as between related provisions, proposed subpart C of part 118 has been transferred in this document to subpart A of part 151 as one new § 151.15 (with paragraphs (a)–(d) thereof corresponding to proposed §§ 118.21–118.24 respectively), and the following conforming changes to other regulatory provisions have been made as set forth below to reflect this transfer: (1) Adding a sentence to § 118.0 (Scope) to clarify that the procedures governing the transfer of merchandise to a CES are set forth in part 151; (2) renumbering proposed §§ 118.31–118.34 as §§ 118.21–118.24 and redesignating proposed subpart D as subpart C; (3) modifying the first sentence of § 151.6 to include a reference to examination required or authorized under § 151.15; and (4) modifying the first sentence of § 151.7 to include a reference to examination at a CES as provided in § 151.15. For ease of reference within this document, where submitted comments concern aspects of proposed §§ 118.21–118.24 and result in changes to the proposed texts, the agreed changes are described in the relevant discussion as changes appearing in new § 151.15 as set forth in this document.

Customs agrees with the comment regarding clarification of the definition of a CES as a place not in the charge of a Customs officer, and the first sentence of § 118.1 as set forth below has been modified accordingly. In addition, the introductory text of § 151.15(b) as set forth below has been modified to expressly prohibit non-bonded transfers as one commenter suggested and to also improve the clarity of the text. Customs also agrees that a broker, if acting as importer of record, should be allowed to obligate his importation and entry bond for the transfer of cargo to a CES, and § 151.15(b)(4) as set forth below has been modified to clarify that liability is under the bond of the importer of record who may be the actual importer or an agent of the importer.

Customs does not agree with the suggestion regarding the need to set a specific minimum of $1 million liability insurance. Customs is of the view that a specific regulatory minimum level would be inappropriate because the necessary level would depend on the overall number and type of examinations performed within the port and at the particular CES facility.

Customs also disagrees with the suggestion that the operator's liability insurance should cover all damage to merchandise stored in the CES. Such insurance is intended to compensate the owner of merchandise for loss, theft, or damage occurring while the merchandise is in the operator's control and resulting from actions or negligence on the part of the operator or his employees. On the other hand, the CES operator should not be required to carry liability insurance to cover damage occurring outside the operator's control as, for example, when Customs causes damage to merchandise in connection with an examination to determine whether contraband is concealed within that merchandise.

Customs does not agree that the CES operator should be made solely liable for any duties and taxes on lost or stolen merchandise. The CES operator's liability for duties and taxes exists only during the period when the merchandise is covered by the operator's custodial bond and not when the loss or theft occurs during coverage of the merchandise by another bond such as an importer's entry bond or a cartman's custodial bond.

Finally, Customs agrees that the "performance bond" reference in § 118.4(g) is confusing because it can only have reference to a Customs custodial bond covering the CES operation (which, under § 118.11(e), must be in existence when an applicant is selected as a CES operator). In order to address this point, § 118.4(g) as set forth below has been modified by removing from the first sentence the words "and further agrees to its application as a performance bond to the CES operation" which are redundant in this context. In this way a clear and proper relationship will exist between possession of a custodial bond for selection purposes as required by § 118.11 and continued maintenance of that bond during operation of the CES as required by § 118.4.

Comment: A large number of comments was received on subpart D (redesignated in this document as subpart C as discussed above) relating to the immediate or proposed revocation of selection and cancellation of the agreement to operate a CES. Several commenters raised a number of procedural issues, arguing in favor of longer appeal periods, more extensive appeal rights, and specific provision for a formal hearing and for judicial review as is done in the regulations applicable to Customs bonded warehouses and licensed cartmen. Two commenters suggested that these regulations should not cover existing CESs. One commenter wanted clarification that a CFS operator also operating a CES would have revocation procedures concerning the CFS operation covered by the appropriate regulations in part 19 of the Customs Regulations. One commenter believed it was unreasonable to propose revocation and cancellation for not following a single order of a Customs officer, and another commenter argued that immediate revocation and cancellation for commission of criminal acts should not be permitted in the absence of either an actual conviction or an admission by the alleged violator that the act occurred. One commenter suggested adding offering or giving a gratuity to a Customs officer as grounds for immediate revocation and cancellation. Another commenter suggested adding the following circumstances as grounds for proposed revocation and cancellation: (1) When a CES operator charges, or proposes to charge, excessive fees for services; and (2) when the CES committee requests the district director to take such action.

Customs response: Customs does not agree with the proposals to extend the appeal time limits and to provide for formal hearings and for appeal rights beyond the level of the Commissioner of Customs. The appeal time limits are restricted in each case to a 10-day period because a longer period would be extremely disruptive to the cargo operation of any district due to the relatively small number of CESs in operation there. A more extended appeal procedure would have a detrimental effect on the delivery of cargo to many importers and would have a negative impact on the efficient use of Customs personnel by increasing Customs costs and reducing Customs ability to detect contraband.

With regard to the comments in favor of formal hearings and more extended appeal rights, Customs notes that there is a fundamental operational distinction between CESs and the bonded warehouses and licensed cartmen mentioned by the commenters: Whereas use of a CES occurs only as a result of a case-by-case Customs determination to examine particular merchandise (and in some cases to use a particular CES), in the majority of cases use of a bonded warehouse or cartman occurs at the instigation of the importer or the importer's agent and without the initial involvement of Customs. Moreover, Customs is not required under the law to provide formal hearings or more extended appeal rights in connection with an administrative procedure such as a CES revocation and cancellation action. In light of these factors, and given the extensive due process protection reflected in the CES regulations, Customs does not believe that it is necessary to precisely track the procedures used for bonded warehouses and cartmen. Finally, it should be noted that the presence or absence of a specific reference to judicial appeal in the Customs Regulations has no legal effect on the right of a party to seek review of an administrative action in any court of competent jurisdiction.

Customs does not agree with the proposal to existing CESs from these regulations. It would be inappropriate to treat two CES operations in a different manner when the purpose behind the revocation and cancellation procedure (to ensure that CESs are operated properly) clearly applies to all CES operations. Accordingly, Customs cannot accede to the enforcement loophole which this comment appears to suggest. On the other hand, and assuming that an existing CES otherwise operates in conformity with the regulatory requirements, Customs will honor any existing agreement as regards the duration of the CES operation and the security and other physical requirements needed at the CES.

A CFS operator continues to be subject to the provisions in part 19 concerning suspension or revocation of the privilege to operate a CFS. The CES regulations do not supersede or otherwise affect the CFS regulations in this regard.

Customs believes that proposing revocation because a CES operator failed to follow a Customs order is reasonable because in the appeal process the operator will be given the opportunity to show, for example, that he did comply with the order, that the order was not correctly communicated by Customs, or that the order was, in fact, improper.

Customs does not agree with the suggestion that immediate revocation and cancellation for a criminal act be limited to cases involving an actual conviction or admission. The only criminal offenses which will result in an immediate revocation and cancellation are those which involve theft, smuggling, or a theft-connected crime. These specific offenses were included in the regulation in question because they are of overriding concern to Customs given the threat that a perpetrator of such offenses could pose to a CES operation and to the merchandise under the control thereof. In view of the fact that significant procedural and other delays often occur in the criminal justice system before conviction or acquittal results and since admissions of guilt are comparatively rare, these special concerns militate strongly against basing an immediate revocation and cancellation only on an actual conviction or admission.

Customs does not believe that it is necessary or appropriate to list the giving or offering of a gratuity as one of the offenses which will be grounds for immediate revocation and cancellation. While bribery is a serious offense, it is usually committed in conjunction with smuggling or theft which are already grounds for immediate revocation and cancellation. Moreover, since the giving of a gratuity does not intrinsically involve a threat to the revenue or to the merchandise stored at a CES, Customs believes that if the gratuity is offered or given by an employee of the CES rather than by the operator himself, the CES operator should first be given an opportunity to demonstrate that he had no prior knowledge of, and involvement in, the improper action of his employee.

Customs does not agree that charging or proposing to charge excessive fees should be grounds for revocation and cancellation because (1) all fee schedules and changes thereto must be approved by the district director and (2) a failure to abide by the fees as approved by the district director is already a ground for revocation and cancellation. Finally, in view of the decision not to employ the CES committee concept as discussed above, the suggested ground for proposed revocation and cancellation based on a request made by a CES committee has become moot.

Comment: A number of commenters made the following suggestions regarding the fees charged by a CES operator: That any proposed fee changes be reviewed by a CES committee; that Customs audit operator's records; that each CES applicant include a detailed operating budget, including profit margin, in the application; that a new user fee be assessed on all importers, or that the existing merchandise processing fee (MPF) be used, to cover examination costs in place of the CES operator fees; that the notice period for proposed fee changes in § 118.4(c) be shortened from 90 days to 30 days; that

§ 118.4(c) be amended to refer to "reasonable" service fees; and that the regulations be amended to define reasonable fees as fees which are "comparable to fees for similar services in the community", as was stated in regard to the selection process outlined in the Directive implementing the CES program.

Customs response: Before responding to the above comment, two issues regarding changes to approved fee schedules must be discussed and resolved.

The first issue is both organizational and procedural in nature, and in this regard Customs notes that whereas the first sentence of proposed § 118.4(c) requires that fees be assessed as outlined in the fee schedule included in the approved application, the remaining sentences thereof concern the procedures for subsequent changes to an approved fee schedule. On further reflection, Customs does not believe it is appropriate to include fee change procedures within § 118.4 which is only intended to outline the basic responsibilities of a CES operator and thus more properly in paragraph (c) should only cover the responsibility to abide by the approved fee schedule (including any subsequent changes thereto). Accordingly, this document incorporates the following changes: (1) A new § 118.5 has been added to cover procedures for changes to a fee schedule; and (2) paragraph (c) of § 118.4 has been modified to reflect only the first sentence of the paragraph as proposed and with the addition of a reference to fee changes approved under § 118.5. Consistent with the principle of allowing input from the public during the decision-making process without utilizing the CES committee concept as discussed above in connection with the CES operator application process, new § 118.5 as set forth below provides for (1) publication of a notice of the proposed fee schedule changes with the solicitation of comments from the general public, with a cross-reference to § 118.2 as regards the procedures for dissemination of the notice and for submission of the public comments, and (2) publication of a notice of the new fee schedule if the proposed changes are approved by the district director. In addition, new § 118.5 refers to the intention of a CES operator to "increase, add to or otherwise change" the service fees (in order to clarify that the section applies to any change to the fee schedule, including an increase of an existing fee amount, the addition of a new fee, or the reduction or elimination of an existing fee), requires written justification also for the addition of a new fee (which is akin to a fee increase for which written justification was specified in proposed § 118.4(c)), and provides for written notice to the CES operator of the district director's decision on the proposed fee change.

The second issue concerns the relationship between the obligation of a CES operator to abide by a changed fee schedule and the sanctions that may be imposed if the operator fails to do so. It is noted in this regard that whereas proposed § 118.31(b)(1) (renumbered in this document as § 118.21(b)(1) as discussed above) provided that the district director may propose revocation and cancellation if the CES operator "* * * fails to operate in accordance with the terms of his agreement", a changed fee schedule in effect replaces the fee schedule approved as part of the CES operator application process but does not become part of the agreement itself. Thus a potential anomaly could arise whereby sanctions could be taken for failure to follow the original fee schedule but not for failure to follow a changed one. In order to avoid such an unintended and inappropriate result, § 118.21(b)(1) as set forth below has been modified by adding at the end a general reference to § 118.4 so that the obligation to follow a changed fee schedule (as provided in modified § 118.4(c) discussed above) will be treated the same as the obligation to follow an original fee schedule for purposed of a proposed revocation and cancellation action.

Customs does not agree with those commenters who argued that Customs should audit an operator's records and that each applicant should provide a detailed operating budget including profit margin. Neither an applicant's operating budget nor a CES operator's general business records are matters over which Customs should exercise direct control or oversight by audit or otherwise. Although Customs is directly concerned with the nature of the fees charged (as further discussed below) and the manner in which the operator makes merchandise available for examination and thus may have occasion to look into complaints affecting those areas, Customs has no intention of routinely auditing or otherwise controlling each and every aspect of a CES operation.

Customs lacks the authority to impose a new user fee in this situation. As regards use of the present MPF in place of CES operator fees, Customs does not agree with this suggestion for two related reasons: (1) Contrary to the case of the MPF, CES fees are not paid to Customs for services provided by Customs to the importer (rather, they are paid to the CES operator for services provided by that operator to the importer); and (2) CES fees cover, among other things, the maintenance and operating costs of the CES and thus they do not relate to Customs costs for examining the merchandise (which, in terms of salary and expenses of the Customs inspector performing the examination, would normally be covered by the MPF). Customs further notes that under a longstanding principle established in an opinion of the Attorney General (35 O.A.G. 431 (1928)) and reflected in §§ 151.6 and 151.7 of the Customs Regulations, the expenses incurred in making merchandise available to Customs for purposes of examination are to be borne by the importer rather than by Customs (except when the examination takes place at the public stores); this principle was reaffirmed in T.D. 84–152 (49 FR 29372) which amended §§ 151.6 and 151.7 to limit the use of public stores as places for the examination of merchandise. The legal responsibility of importers to cover expenses in connection with the examination of merchandise is based on legal authority totally separate from the user fee statute (19 U.S.C. 58c), and the importer's payment of a fee to a CES operator for his services is nothing more than an alternative means for the importer to carry out that legal responsibility.

Customs does not agree with the suggestion that the notice period regarding a proposed fee schedule change be reduced from 90 to 30 days. In view of the changes to the regulatory texts to provide public notice and comment procedures on fee schedule changes (which will include a 30-day public comment period under new § 118.5 and modified § 118.2) as discussed above, the 90-day period must be retained in order to ensure sufficient time for all required procedures.

As regards the comment that § 118.4(c) should refer to "reasonable" service fees, Customs agrees that some type of standard should apply to fees charged by a CES operator because the limited number of CESs established in a given area could otherwise give rise to monopolistic fee levels. However, Customs does not believe that a mere reference to "reasonable" fees would be useful because this would impose a requirement without providing any meaningful definition or standard. The better approach, as suggested by one of the commenters, would be to refer to fees that are "comparable to fees for similar services" in the area in which the CES is located, and Customs believes that the appropriate place for such a standard would be § 118.11(c) (rather than § 118.4(c)) so that the standard is properly applied at the very beginning in connection with the application approval process. Accordingly, § 118.11(c) as set forth below has been modified to refer to service fees comparable to fees for similar services in the area to be served by the CES, but with the qualification that this comparability requirement may be affected by special costs borne by the applicant such as facility modifications to meet specific cargo handling or storage requirements or Customs security needs. However, it should be noted that since the fee schedule is one of the criteria used to judge an application, proposing a higher-than-normal fee schedule in order to recover such costs could have an adverse effect on an applicant's candidacy (particularly if another otherwise equal applicant does not have to modify his facility and thus proposes a lower fee schedule). Finally, a reference to this principle of comparability has been included in § 118.5 to ensure consistency in the context of fee schedule changes.

Comment: Several commenters stated that the regulatory criteria for selection were too general. In this regard, they recommended providing specific standards concerning location and physical and security requirements (for example, maximum distance from the unloading facility, minimum square footage, number of bay doors, alarm system, sprinkler system) and concerning required experience or training for CES employees, with these specific criteria to be supplemented as necessary by any special local criteria set forth in the notice to the public in connection with the application process.

Customs response: Customs does not agree that such detailed standards should be included in the regulations because operational and physical requirements too often vary from one CES to another even within the same district or port of entry. For example, the operation of an airport CES where much cargo is loose or on pallets (and thus more easily examined) is different from a seaport CES where most cargo is containerized. Moreover, as compared to CESs in large seaports, CESs at land border points and at inland ports often handle less varied types of cargo and have lower examination volumes and thus often have to meet less stringent requirements regarding floor space, bay doors, machinery or handling equipment and other physical factors. Accordingly, in order to retain sufficient flexibility to meet local needs, Customs believes that specific criteria are inappropriate for the regulations but rather should be applied on a case-by-case basis by setting them out in connection with the notice by the district director that applications to operate a CES are being accepted.

Comment: Two commenters recommended language prohibiting any CES operations at airports.

Customs response: The need for a CES is based on two principal factors: The cargo activity in a port of entry and the demands placed on the Customs resources needed to examine that cargo so as to ensure compliance with the law. Thus, the regulations neither mandate nor preclude CES operations based on the particular type of location because the central issue in establishing a CES is the workload level in the area to be serviced by the CES. If cargo activity increases significantly at an airport (particularly in terms of the number of cargo receivers) so as to put a strain on Customs examination resources, it would be in the interest of both Customs and importers to establish a CES. Accordingly, Customs believes it would be inconsistent with the purpose of the CES program to exclude airports as CES locations.

Comment: One commenter suggested requiring applicants to commit to participation in the Automated Manifest System (AMS).

Customs response: Customs does not believe it would be appropriate to impose such a requirement because at this time there is no provision for CES participation as a receiver or transmitter of information through AMS.

Comment: One commenter suggested listing types of cargo that cannot be sent to a CES.

Customs response: Customs notes that certain types of merchandise (for example, heavy machinery) probably could not be transported to or handled at a CES and that other types of merchandise (for example, explosives and other dangerous products) would rarely, if ever, be designated for examination at a CES. However, Customs does not believe that it would be appropriate to include such an exclusionary list in the regulations because there will also be cases in which a special cargo (for example, frozen fish) could be handled at one CES but not at another. Since Customs makes the determination as to whether merchandise is to be sent to a CES for examination, it would be preferable to deal with such issues on a case-by-case basis so that, when special types of merchandise require examination, arrangements can be made to perform the examination at the best suited location.

Comment: Several commenters argued that the cargo owner or broker, and not the district director, should designate the CES to which merchandise is to be sent.

Customs response: Although under § 151.15(a) as set forth below the entry filer normally designates the CES to be used, the district director has authority under § 151.15(d) to override the entry filer's designation, consistent with the authority of a Customs officer to designate the place of examination under 19 U.S.C. 1499. Customs believes that the authority reflected in § 151.15(d) should be retained because (1) as previously noted, Customs controls the entire process starting with the decision to examine the merchandise, (2) Customs must ensure that the CES is compatible with the type of merchandise to be examined, and (3) the availability of Customs officers at a particular CES at a particular time may affect the selection of the CES to be used.

Comment: One commenter said that § 118.22 (§ 151.15(b) as set forth below) should state exactly how the importer or broker selects the specific movement method among the four methods listed.

Customs response: Customs does not agree that § 151.15(b) should be modified as suggested, because the movement method and resulting custodial bond liability is more properly a private, nonregulatory matter that should be resolved among the affected parties (importing carrier, importer, broker, bonded carrier, CES operator).

Comment: One commenter suggested adding language stating that the CES operator will make every effort to reload a container and will notify the carrier if he cannot. Another commenter stated that the principle of an "appointed" examination time should be added to § 118.4(b) (which only refers to service provided on a "first come-first served" basis) to reflect the fact that Customs often sends a particular cargo specialist to a CES to examine specific merchandise at a prearranged time.

Customs response: Since under the basic CES operating principle the CES operator renders services on behalf of the importer rather than for the benefit of the carrier, Customs cannot require in the regulations that the CES operator provide notice of reloading problems to the carrier; however, there is nothing to prevent a CES operator and a carrier from making their own private arrangements in this regard. As regards an appointed time for an examination, this procedure is not generally used in the case of CESs and therefore § 118.4(b) should not be modified as suggested.

Comment: The Food and Drug Administration (FDA) recommended adding general references to "other government agencies" or "other government agency personnel" to various regulatory provisions regarding office space availability, making merchandise available for inspection, selection of a CES operator who will best meet examination needs, and authority to order merchandise to a CES and to designate the CES to be used.

Customs response: Customs agrees in principle that, as a general rule, it is desirable for other government agencies to examine merchandise at a CES because it will generally save time and money for the importer to have all interested agencies examine his goods at one place. However, Customs does not believe that the suggested regulatory changes should be made at this time because publication of specific proposals by Customs and the other interested agencies, with opportunity for public comment, would be necessary before such substantive changes could be implemented. Customs will, of course, continue to coordinate with other government agencies to the greatest extent possible in arranging examinations at CESs to ensure compliance with laws administered by those agencies.

Comment: One commenter questioned the propriety of these regulations based on the argument that the CES selection process is actually a contracting process subject to Federal procurement regulatory procedures.

Customs response: Customs does not agree. The CES selection process does not involve a procurement (that is, a purchase and sale) between Customs and the CES operator and thus there is no contract within the meaning of the Federal procurement regulations.

Comment: One commenter recommended (1) amending § 118.11(f) to require that a CES applicant identify in the employee list any employee known to have had a felony conviction and (2) amending § 118.4(f) to require that a CES operator provide the same information as part of keeping the list of employees current, similar to what is required of Customs brokers in § 111.53(e) of the Customs Regulations. This commenter also stated that providing an employee's social security number should be mandatory as is the case with Customs brokers.

Cutoms response: Customs does not agree that the regulations should require that an applicant identify, or that an operator update the employee list regarding, any employee known to have had a felony conviction. Customs notes in this regard that the commenter's reliance on § 111.53(e) of the broker regulations in the present context is misplaced for the following reasons: (1) The cited broker regulation is based directly on a statutory provision (19 U.S.C. 1641(d)(1)(E)); (2) the broker statutory/regulatory provision is a ground for disciplinary proceedings (for knowingly employing a felon) but is not a substantive reporting requirement; and (3) the sensitivity issue as regards employment of a felon is clearer in the case of brokers because not all aspects of a broker's business are covered by a Customs bond and liability insurance. As concerns the voluntary providing of social security numbers, Customs notes that § 118.11(f) conforms to the requirements of the Privacy Act of 1974 (5 U.S.C. 552a) in this regard.

Additional Changes to the Proposed Regulatory Texts

In addition to the changes discussed above in connection with the comment analysis, the regulatory texts as set forth below incorporate further editorial or other non-substantive changes to the proposed regulations in order to improve the clarity, readability or organization of the texts. The following principal changes are noted in this regard:

Section 118.3

The second sentence has been changed to state that failure to execute the agreement "may result in" tentative selection of another applicant "or republication of the notice soliciting applications", to clarify that certain circumstances (for example, the absence of another suitable applicant) may make another selection impracticable at that time.

Section 118.4

The introductory text has been changed by adding a reference to "commencing operation" of a CES, because certain requirements set forth in the section (for example, abiding by a fee schedule change adopted under § 118.5) may not be directly reflected in the agreement. In addition, paragraph (h) has been reworded and rearranged to clarify that record retention and availability to Customs both have reference to the basic provisions contained in part 162.

Section 118.11

Paragraph (e) has been modified to clarify that where Customs Form 301 is submitted for approval with the application, approval of the custodial bond is a prerequisite to selection.

Section 118.21

In paragraph (a), the introductory test has been changed to state that the district director "shall" immediately revoke the selection and cancel the agreement, to more clearly reflect the mandatory nature of the provision. In addition, in paragraph (a)(2) the second sentence has been redrafted for clarity.

Sections 118.22–118.24

These sections have been modified to more clearly distinguish between an immediate action and a proposed action, to refer to a "notice" of the action in each case, and to simplify the references to a written decision on an appeal. In addition, in § 118.23, the second sentence has been amplified to clarify that a proposed revocation and cancellation does not take effect until the administrative appeal process has been concluded with a decision adverse to the operator.

Section 151.15

Paragraph (a) has been modified by adding a qualification at the end to reflect the authority of the district director under paragraph (d) to designate the CES to be used, and a qualification has similarly been added at the end of the introductory text of paragraph (b) as regards the district director's authority under paragraph (d) to specify the bonded movement to be used; in addition, in order to ensure a proper record of either action by the district director, paragraph (d) has been modified to provide for notation of the action on the Customs Form 3461 or 3461 (ALT) or attachment thereto. Finally, paragraphs (b) (1)–(4) have been modified to refer to the specific bond and the nature of the bond obligation involved, paragraph (b)(2) has been further modified by removing the unnecessary qualifier "formally" before "receipted", and paragraph (b)(4) has been further modified to refer to an importer or agent who "transfers" the merchandise to the CES (to clarify that the bond liability relates to the party who performs the transfer) and to refer at the end to receipt by the CES operator as is done in paragraphs (b) (1) and (2).

Conclusion

Accordingly, based on the comments received and the analysis of those comments as set forth above, Customs believes that the proposed centralized examination station regulations should be adopted as a final rule with certain changes thereto as discussed above. In addition, part 178 of the Customs Regulations (19 CFR part 178) is being amended to indicate the OMB-assigned control number for the information collection contained in this final rule.

Executive Order 12291

This document does not meet the criteria for a "major rule" as specified in E.O. 12291. Accordingly, no regulatory impact analysis has been prepared.

Regulatory Flexibility Act

Pursuant to the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), it is certified that the regulations will not have a significant economic impact on a substantial number of small entities. Importers are required under present law to bear the costs incurred in making imported merchandise available to Customs for examination, and the regulations, by streamlining examination procedures, should reduce those costs and improve the overall importation/entry process. Accordingly, the regulations are not subject to the regulatory analysis or other requirements of 5 U.S.C. 603 and 604.

Paperwork Reduction Act

The collection of information in these final regulations, contained in § 118.11, has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3507(h)) under control number 1515–0183. The estimated average annual burden associated with this collection is 2 hours per respondent or recordkeeper. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the U.S. Customs Service, Paperwork Management Branch, room 6316, 1301 Constitution Avenue NW., Washington, DC 20229, or the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Drafting Information

The principal author of this document was Francis W. Foote, Regulations Branch, U.S. Customs Service. However, personnel from other offices participated in its development.

List of Subjects

19 CFR Part 118

Customs duties and inspection, Imports, Centralized examination stations.

19 CFR Part 151

Customs duties and inspection, Imports, Examination, Sampling and testing.

19 CFR Part 178

Reporting and recordkeeping requirements, Paperwork requirements, Collections of information.

Amendments to the Regulations

For the reasons set forth above, chapter I of title 19, Code of Federal Regulations (19 CFR ch. I), is amended by adding part 118 and amending parts 151 and 178 as set forth below.

PART 118—CENTRALIZED EXAMINATION STATIONS

Authority: 19 U.S.C. 66, 1499, 1623, 1624.

§ 118.0 Scope.

This part sets forth regulations providing for the making of agreements between Customs and person desiring to operate a centralized examination station (CES). It covers the application process, the responsibilities of the person or entity selected to be a CES operator, the CES operator's agreement, the grounds and procedures for revoking a selection and cancelling an agreement, and the procedures for challenging a revocation and cancellation action. Procedures and requirements for the transfer of merchandise to a CES are set forth in part 151 of this chapter.

Subpart A—General Provisions

§ 118.1 Definition.

A centralized examination station (CES) is a privately operated facility, not in the charge of a Customs officer, at which imported merchandise is made available to Customs officers for physical examination. A CES may be established in any port or any portion of a port, or any other area under the jurisdiction of a district director.

§ 118.2 Establishment of a CES.

When a district director makes a preliminary determination that a new CES should be established, or when the term of an existing CES is about to expire and the district director believes that the need for a CES still exists, he will announce, by written notice posted at the customhouse and by any other written methods he may consider appropriate (such as normal district information distribution channels, trade bulletins or local newspapers), that applications to operate a CES are being accepted. This notice will include the general criteria together with any local criteria that applicants must meet (see § 118.11 of this part), and will invite the public to submit any relevant written comments on whether a new CES should be established or on whether there is still a need for a CES. Applications will be accepted only in response to the district notice and must be received within 60 calendar days from the date of the notice. Public comments must be received within 30 calendar days from the date of the notice.

§ 118.3 Written agreement.

The applicant tentatively selected to operate a CES must sign a written agreement with Customs before commencing operations. Failure to execute a written agreement with Customs in a timely manner will result in the revocation of that applicant's tentative selection and may result in tentative selection of another applicant or republication of the notice soliciting applications. In addition to the provisions described elsewhere in this part, the agreement will specify the duration of the authority to operate the CES. That duration will be not less than three years nor more than six years. Such agreements cannot be transferred, sold, inherited, or conveyed in any manner. At the expiration of the agreement, an operator wishing to reapply may do so pursuant to this part and his application will be considered de novo.

§ 118.4 Responsibilities of a CES Operator.

By signing the agreement and commencing operation of a CES, an operator agrees to:

(a) Maintain the facility designated as the CES in conformity with the security standards as outlined in the approved application;

(b) Provide adequate personnel and equipment to ensure reliable service for the opening, presentation for inspection, and closing of all types of cargo designated for examination by Customs.

Such service must be provided on a "first come-first served" basis;

(c) Assess service fees as outlined in the fee schedule included in the approved application or as changed under § 118.5 of this part and bill users directly for services rendered;

(d) Assume responsibility for any charges or expenses incurred in connection with the operation of the CES;

(e) Maintain, at his own expense, adequate liability insurance with respect to the property within his control and with respect to persons having access to the CES;

(f) Keep current the list filed with the district director pursuant to § 118.11(f) of this part. Additions to or deletions from the list must be submitted in writing to the district director within 10 calendar days of the commencement or termination of employement;

(g) Maintain a Customs custodial bond in an amount set by the district director. The operator also agrees to increase the amount of the bond if deemed appropriate by the district director;

(h) Maintain and make available for Customs examination all records connected with the operation of the CES in accordance with part 162 of this chapter and retain such records for a period of not less than five years from the date of the transaction or examination conducted pursuant to the agreement to operate the CES;

(i) Submit, if requested by Customs, the fingerprints of all employees involved in the CES operation;

(j) Provide office space, parking spaces, appropriate sanitary facilities, and potable water to Customs personnel at no charge or a charge of $1 per year; and

(k) Perform in accordance with any other reasonable requirements imposed by the district director.

§ 118.5 Procedures for changes to a fee schedule.

Whenever a CES operator intends to increase, add to or otherwise change the service fees set forth in the fee schedule referred to in § 118.4(c) of this part, the operator shall provide 90 calendar days advance written notice to the district director of such proposed fee schedule change and shall include in the notice a justification for any increased or additional fee. Following receipt of this written notice, the district director will advise the public of the proposed fee schedule change and invite comments thereon under the public notice and comment procedures set forth in § 118.2 of this part. After a review of the proposed fee schedule change and any public comments thereon, and based on the principle of comparability set forth in § 118.11(c) of this part, the district director will decide whether to approve the change, will notify the CES operator in writing of his decision, and will notify the public of any approved fee schedule change by the same methods that were used to provide the public with notice of the proposed change. A CES operator shall remain bound by the existing fee schedule and shall not implement any fee schedule change prior to receipt of written approval of the change from the district director.

Subpart B—Application To Establish a CES

§ 118.11 Contents of application.

Each application to operate a CES shall consist of the following information, any application not providing all of the specified information will not be considered, and the responses to paragraphs (b), (c), (d), (g) and (h) of this section shall constitute the criteria used to judge the application:

(a) The name and address of the facility to be operated as the CES, the names of all principals or corporate officers, and the name and telephone number of an individual to be contacted for further information;

(b) A description of the CES's accessibility within the port or other location, and a floor plan of the facility actually dedicated to the CES operation showing bay doors, office space, exterior features, security features, and staging and work space. Where a significant capital expenditure would be required in order for an existing facility to meet security or other physical or equipment requirements necessary for the CES operation, the applicant may request in the application, and the district director may allow, up to an additional 30 calendar days after tentative selection to conform the facility to such requirements, but in such a case the agreement referred to in § 118.3 of this part shall not be executed until those requirements are met;

(c) A schedule of fees clearly showing what the applicant will charge for each type of service. Subject to any special costs incurred by the applicant such as facility modifications to meet specific cargo handling or storage requirements or to meet Customs security standards, the fees set forth in the schedule shall be comparable to fees charged for similar services in the area to be served by the CES;

(d) A detailed list of equipment showing that the applicant can make a diverse variety of cargo available for examination in an efficient and timely manner;

(e) A copy of an approved custodial bond on Customs Form 301. If the applicant does not possess such a bond, a completed Customs Form 301 must be included with the application for approval as a prerequisite to selection

(f) A list of all employees involved in the CES operation setting forth their names, dates of birth, and social security numbers. (Providing social security numbers is voluntary; however, failure to provide the number may hinder the investigation process.);

(g) Any information showing the applicant's experience in international cargo operations and knowledge of Customs procedures and regulations, or a commitment to acquire that knowledge; and

(h) Any other information to address any local criteria that the district director considers essential to the selection process based on port conditions.

§ 118.12 Action on application.

Following submission of all applications in accordance with §§ 118.2 and 118.11 of this part, the district director will advise the public of the applications received and invite comments thereon under the public notice and comment procedures set forth in § 118.2; with regard to each application, the notice will set forth the name of the applicant, the address of the facility proposed to be operated as the CES, the proposed fee schedule, the list of equipment at the facility, and the number of employees to be involved in the CES operation. The district director, based on a review of all applications under the criteria set forth in § 118.11 and any public comments submitted under § 118.2 or this section, shall determine whether a CES operator should be selected and, if a CES operator is to be selected, shall select the applicant that will best meet the examination needs of Customs and facilitate the movement of imported merchandise.

§ 118.13 Notification of selection or nonselection.

The applicant selected to operate a CES will be notified in writing by the district director of his tentative selection. The selection shall become final upon execution of the written agreement between Customs and the applicant under § 118.3 of this part, and the district director will advise the public of the final selection and of the date on which the CES will commence operation under the agreement in accordance with the notice procedures set forth in § 118.2 of this part. Each applicant not selected to be a CES operator will be so notified in writing and with a statement of the reason of nonselection.

Subpart C—Terminations of a CES

§ 118.21 Revocation of selection and cancellation of agreement to operate a CES.

(a) *Immediate revocation and cancellation.* The district director shall immediately revoke a selection as operator and cancel an agreement to operate a CES if:

(1) The selection and agreement were obtained through fraud or the misstatement of a material fact; or

(2) The CES operator or an officer of a corporation which is a CES operator is convicted of, or has committed acts which would constitute, a felony or a misdemeanor involving theft, smuggling, or a theft-connected crime, and the conviction resulted from, or the subject acts were in fact committed as part of, his official duties or operator or corporate officer. Any change in the employment status of a corporate officer (for example, discharge, resignation, demotion, or promotion) prior to his conviction for a felony or misdemeanor involving theft, smuggling, or a theft-connected crime will not preclude application of this paragraph if the conviction resulted from an act or acts committed in his official capacity as corporate officer.

(b) *Proposed revocation and cancellation.* The district director may propose to revoke the selection as operator and cancel the agreement to operate a CES if:

(1) The CES operator refuses or otherwise fails to follow any proper order of a Customs officer or any Customs order, rule, or regulation relative to the operation of a CES, or fails to operate in accordance with the terms of his agreement or the provisions of § 118.4 of this part;

(2) The CES operator fails to retain merchandise which has been designated for examination;

(3) The CES operator does not provide secure facilities or properly safeguard merchandise within the CES;

(4) The CES operator fails to furnish a current list of names, addresses and other information required by § 118.4 of this part; or

(5) The custodial bond required by § 118.4 of this part is determined to be insufficient in amount or lacking sufficient sureties, and a satisfactory new bond with good and sufficient sureties is not furnished within a reasonable time.

§ 118.22 Notice of revocation and cancellation.

The district director shall immediately revoke the selection as operator and cancel the agreement to operate a CES, or propose to revoke such selection and cancel such agreement, by serving notice in writing on the operator. The notice shall be in the form of a statement specifically setting forth the grounds for immediate revocation and cancellation or proposed revocation and cancellation and shall inform the operator of his right to appeal.

§ 118.23 Appeal procedure.

An operator wishing to appeal an immediate revocation and cancellation or to show cause why a proposed revocation and cancellation should not occur may, within 10 calendar days of receipt of the written notice of the immediate or proposed action, file a written appeal with the Regional Commissioner having jurisdiction over the district director who signed the notice. A revocation and cancellation pursuant to § 118.21(a) of this part shall remain in effect during any appeal, but a revocation and cancellation pursuant to § 118.21(b) of this part shall not take effect until the appeal process under this paragraph and under § 118.24 of this part has been concluded with a decision adverse to the operator. The appeal shall be filed in duplicate and shall set forth the response of the CES operator to the statements of the district director. The Regional Commissioner shall render a written decision to the operator, stating the reasons for the decision, by letter mailed within 30 working days following receipt of the appeal unless the period for decision is extended with due notification to the operator.

§ 118.24 Appeal from the Regional Commissioner's decision.

Upon a decision by the Regional Commissioner affirming the immediate revocation of selection and cancellation of an agreement to operate a CES or agreeing that a proposed revocation and cancellation should take effect, the operator may file with the Commissioner of Customs a written appeal requesting such additional review as the Commissioner or his delegate deems appropriate. This request must be received by the Commissioner within 10 calendar days of the operator's receipt of the Regional Commissioner's decision. The Commissioner or his delegate shall render a written decision to the operator, stating the reasons for the decision, by letter mailed within 30 working days following receipt of the appeal unless the period for decision is extended with due notification to the operator.

PART 151—EXAMINATION, SAMPLING, AND TESTING OF MERCHANDISE

1. The authority citation for part 151 continues to read in part as follows:

Authority: 19 U.S.C. 66, 1202 (General Notes 8 and 9, Harmonized Tariff Schedule of the United States), 1624. Subpart A also issued under 19 U.S.C. 1499. * * *

* * * * *

2. Section 151.6 is amended by revising the first sentence to read as follows:

§ 151.6 Place of examination.

All merchandise will be examined at the place of arrival, unless examination at another place is required or authorized by the district director in accordance with § 151.7 or § 151.15 of this part.* * *

3. Section 151.7, introductory text, is amended by revising the first sentence to read as follows:

§ 151.7 Examination elsewhere than at place of arrival or public stores.

The district director may require or authorize examination at a place other than the place of arrival or the public stores, such as at the importer's premises or at a centralized examination station under § 151.15 of this part. * * *

* * * * *

4. Section 151.15 is added to read as follows:

§ 151.15 Movement of merchandise to a centralized examination station.

(a) *Permission to transfer merchandise for examination.* When a shipment requires examination at a centralized examination station (CES), Customs Form 3461, or Customs Form 3461 (ALT) for land border cargo, or an attachment to either, may be used to request permission to transfer the merchandise to a CES. The entry filer must write, type or stamp the following lines on the form or attachment, and must supply the information called for on the first three lines:

Containers to be transferred: _____All or,
Container #'s _____, _____, _____♦
To CES____________________♦
Approved by: U.S. Customs Inspector_____♦
Date____________________♦

Unless the district director exercises his authority pursuant to paragraph (d) of this section, the reviewing inspector will initial and date the form or attachment being used, or stamp one copy of the Customs Form 3461 or 3461 (ALT) if required by the district director. A copy of this document will act as notification and authorization to the entry filer that the merchandise must be transferred to the importer-designated CES unless another CES is designated by the district director under paragraph (d) of this section.

(b) *Assumption of liability during transfer.* Merchandise designated for examination may be transferred from the importing carrier's point of unlading or from a bonded facility, to a CES, only if the transfer takes place under bond. The entry filer shall select one of the following bonded movements for the transfer to the CES unless the type of bonded movement to be used is specified by the district director under paragraph (d) of this section:

(1) If the merchandise is tranferred directly to a CES by an importing carrier, the importing carrier shall remain liable under the terms of its international carrier bond for the proper safekeeping and delivery of the merc handise until it is receipted for by the CES operator.

(2) If the merchandise is transferred directly from a bonded carrier's facility to a CES or is delivered directly to the CES by a bonded carrier, the bonded carrier shall remain liable under the terms of its custodial bond for the proper safekeeping and delivery of the merchandise until it is receipted for by the CES operator.

(3) If containerized cargo, including excess loose cargo that is part of the containerized cargo, is transferred to a CES operator's own facility using his own vehicles, the CES operator shall be liable under the terms of his custodial bond for the proper safekeeping and delivery of the merchandise to the CES facility.

(4) If the importer or his agent acting as importer of record transfers the merchandise to a CES, that importer or agent shall assume liability under his importation and entry bond (see § 151.7(d) of this part) for the proper transfer of the merchandise until it is receipted for by the CES operator.

(c) *Annual blanket transfer.* District directors may institute an annual blanket transfer application procedure to facilitate any of the bonded movements described in paragraph (b) of this section.

(d) *Designation of bonded movement and CES to be used.* In the event the district director deems it necessary, he may direct the type of bonded movement to be used to transfer merchandise to a CES and may designate the CES at which examination must take place. In either case the district director's action will be noted on the Customs Form 3461 or 3461 (ALT) or attachment thereto.

PART 178—APPROVAL OF INFORMATION COLLECTION REQUIREMENTS

1. The authority citation for part 178 continues to read as follows:

Authority: 5 U.S.C. 301, 19 U.S.C. 1624, 44 U.S.C. 3501 *et seq.*

2. Section 178.2 is amended by inserting the following in the appropriate numerical sequence according to the section number under the column indicated:

19 CFR section	Description	OMB control No.
§ 118.11	Application to establish a centralized examination station.	1515–0183

Michael H. Lane,
Acting Commissioner of Customs.

Approved: December 8, 1992.

Peter K. Nunez,
Assistant Secretary of the Treasury.

[FR Doc. 93–1494 Filed 1–21–93; 8:45 am]

BILLING CODE 4820–02–M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 510 and 520

Animal Drugs, Feeds, and Related Products; Change of Sponsor

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect a change of sponsor for a new animal drug application (NADA) from Abbott Laboratories to Mid-Continent Agrimarketing, Inc.

EFFECTIVE DATE: January 22, 1993.

FOR FURTHER INFORMATION CONTACT: Benjamin Puyot, Center for Veterinary Medicine (HFV–130), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 301–295–8646.

SUPPLEMENTARY INFORMATION: Abbott Laboratories, North Chicago, IL 60064, has informed FDA that it has transferred ownership of, and all rights and interests in, NADA 9–252 for Bicyclohexylammonium fumagillin to Mid-Continent Agrimarketing, Inc., 8833 Quivira Rd., Overland Park, KS 66214. Accordingly, the agency is amending the regulations in 21 CFR 510.600(c)(1) and (c)(2) and in 21 CFR 520.182(b) to reflect the change of sponsor.

List of Subjects

21 CFR Part 510

Administrative practice and procedure, Animal drugs, Labeling, Reporting and recordkeeping requirements.

21 CFR Part 520

Animal drugs.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs and redelegated to the Center for Veterinary Medicine, 21 CFR parts 510 and 520 are amended as follows:

PART 510—NEW ANIMAL DRUGS

1. The authority citation for 21 CFR part 510 continues to read as follows:

Authority: Secs. 201, 301, 501, 502, 503, 512, 701, 706 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321, 331, 351, 352, 353, 360b, 371, 376).

2. Section 510.600 is amended in the table in paragraph (c)(1) by alphabetically adding a new entry for "Mid-Continent Agrimarketing, Inc.," and in the table in paragraph (c)(2) by numerically adding a new entry for "059620" to read as follows:

§ 510.600 Names, addresses, and drug labeler codes of sponsors of approved applications.

* * * * *

(c) * * *

(1) * * *

Drug labeler code	Firm name and address
* * *	* *
059620	Mid-Continent Agrimarketing, Inc., 8833 Quivira Rd., Overland Park, KS 66214
* *	* * *

(2) * * *

Drug labeler code	Firm name and address
* * *	* *
059620	Mid-Continent Agrimarketing, Inc., 8833 Quivira Rd., Overland Park, KS 66214
* *	* * *

PART 520—ORAL DOSAGE FORM NEW ANIMAL DRUGS

1. The authority citation for 21 CFR part 520 continues to read as follows:

Authority: Sec. 512 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 360b).