

ENERGIZING THE WORLD
ONE BTU **AT A TIME**

Peabody

**Meeting with the
CFTC on the
Implementation
of the
Dodd-Frank Act**

November 15, 2010



Table of Contents



<u>Topics</u>	<u>Slide</u>
Dodd-Frank Legislative Background	3
Peabody Background	5
Peabody's Hedging Activities	7
Dodd-Frank Issues for Discussion	9
Major Swap Categories	10
Swap Dealers	11
Major Swap Participants	13
Potential Impacts and Summary	14
Appendix	15

Peabody thanks the Commission for the opportunity to discuss the use of swaps in the coal industry

- Peabody Energy Corporation is a producer and supplier of coal and an End User of swaps to hedge commercial risks
- Peabody supports Congress's goal of preventing systemic risk
- Peabody hopes that its information will be of assistance to the Commission and its Staff in their efforts to develop rules that will achieve the legislative objectives of the Dodd-Frank financial reform legislation



Dodd-Frank's primary purpose with respect to derivatives is to reduce systemic risk in the financial markets, increase transparency and promote market integrity

- Dodd-Frank principally focuses on establishing a regulatory regime for major swap participants and swap dealers
- Congress also carefully crafted the law so that it should not diminish or impede the current ability of commercial businesses to use swaps to hedge and mitigate their commercial risks

Peabody Energy: 127 Years Strong



- The world's largest private-sector coal company supplying the world's thermal and steel markets
- Headquartered in St. Louis, Missouri
- Majority interest holder in 28 coal mining operations located in the U.S. and Australia
- Currently controls approximately 9 billion tons of coal reserve
- Customers on six continents
- Employs approximately 5,600 in U.S.; 7,000 globally
- Known for safety, productivity and environmental excellence
- Coal mining business dates back to 1883

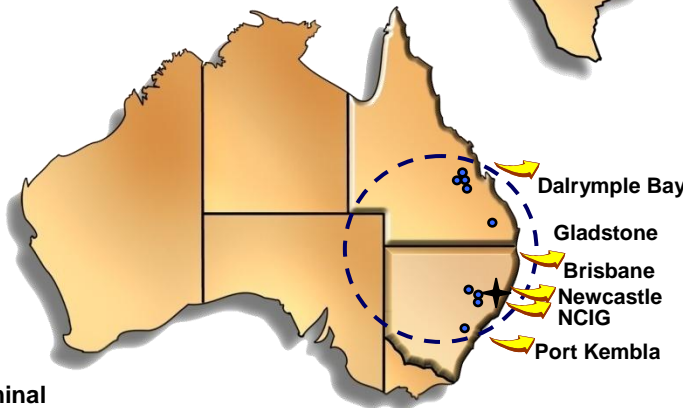
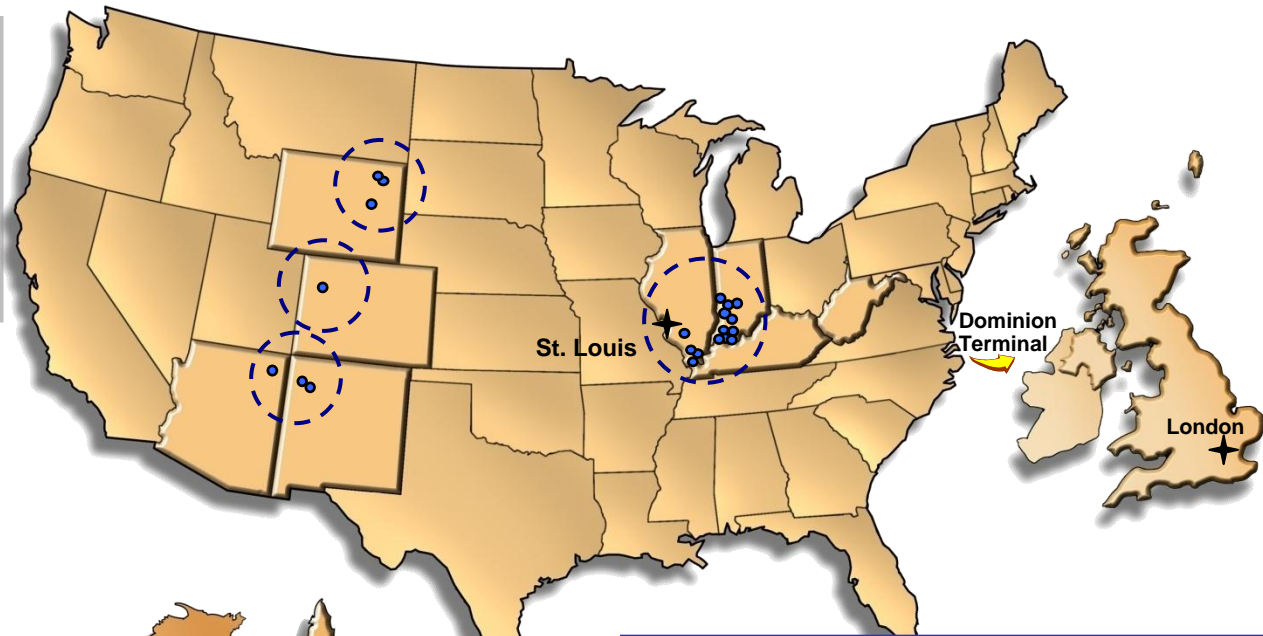


Peabody's Global Portfolio



Peabody's business operates in 3 primary segments: U.S. mining, Australian mining, and coal trading

Trading/Business Development Offices	
Brisbane	St. Louis
Newcastle	Beijing
London	Singapore
Ulaanbaatar	Jakarta



Mining Operations			
	Position	Sales	Reserves
Wyoming PRB	#1	137	3,015
Midwest	#1	32	3,566
Colorado	#1	8	240
Southwest	#1	15	1,120
Australia	#5	22	1,074

Export terminal

Tons in millions. 2009 sales volumes for consolidated results. Reserves are 2009 proven and probable.

Peabody, like other producers and manufacturers, is an End User and hedges its revenue opportunities and production costs with futures, options, and swaps

- Peabody uses futures, options, and swaps to hedge the commercial risks associated with its principal business of coal production including:
 - Coal and transportation price risks
 - Coal derivatives
 - Freight derivatives
 - Fuel price risks associated with mining
 - U.S. domestic crude and diesel derivatives
 - Singapore diesel and heavy oil derivatives
 - Production mining costs associated with explosives
 - U.S. natural gas derivatives
 - Foreign exchange risks associated with Australian production costs
 - Foreign exchange derivatives
 - Interest rates
 - Interest rate derivatives

Peabody's coal trading primarily uses futures, options, and swaps to manage commercial risks associated with buying, selling, and delivery of coal

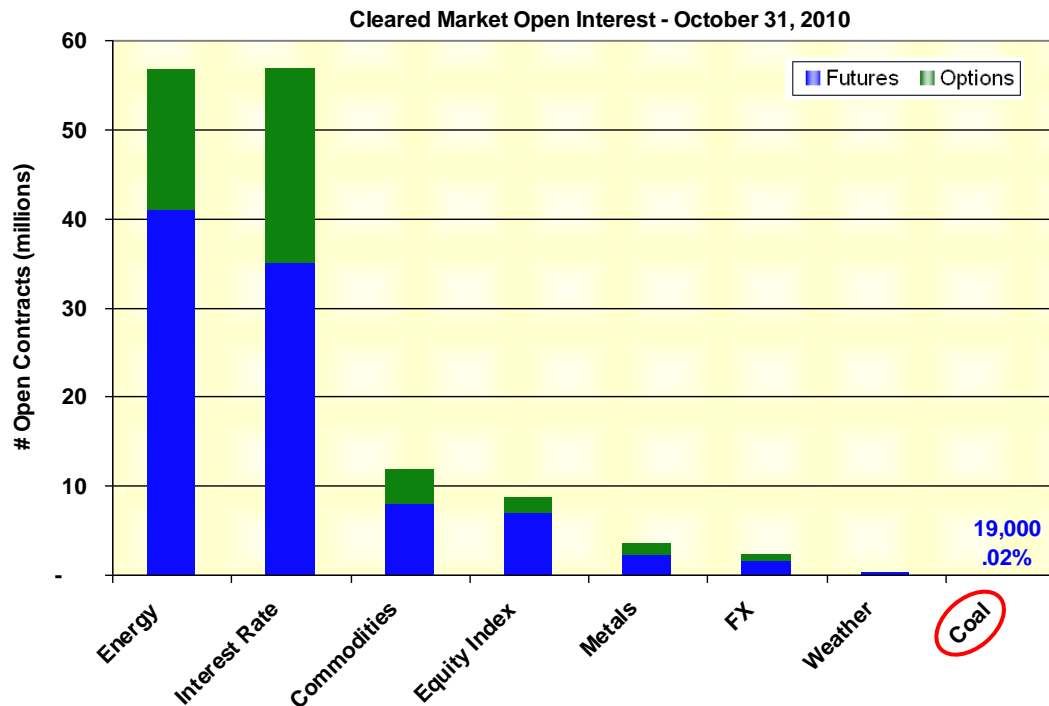
- Peabody trades physical coal and derivatives domestically and internationally by:
 - Purchase and resale of physical coal from and to 3rd parties
 - Purchase and sale of coal futures, options, and swaps contracts to manage price risk
 - Purchase and sale of ocean-going freight and related freight futures and swaps to manage transportation cost risks
- Peabody's U.S. based coal trading business uses physical and financial contracts
 - U.S. based traders transact against U.S. market indices
 - Counterparties are other coal producers, electric utilities, financial institutions, and large trading firms
 - Currently, all futures and swaps with non-affiliates are cleared
- Peabody's International based coal trading business uses physical and financial contracts
 - Traders based outside of U.S. transact against international indices
 - Counterparties are coal producers, electric utilities, financial institutions, and large trading firms
 - Currently, the vast majority of futures and swaps with non-affiliates are cleared

Peabody does not act as an intermediary for financial derivatives

- Coal is primarily a long term fixed price physical market with de minimis financial swap trading and therefore is not a Major Swap Category
- Define Major Swap Participants and Swap Dealers to distinguish them from commercial producers, recognizing that such commercial producers:
 - Use swaps to hedge and mitigate commercial risks, and
 - Are in commodity markets that pose no threat to the U.S. Financial System
- Provide End User exemption from margining for hedging activity

Coal is not a Major Swap Category

- The financial coal markets are de minimis as evident by the sum total of coal futures, options, and swaps representing:
 - Less than **.001%** of the notional \$600+ trillion OTC derivative market
 - Less than **.01%** of contract volume of the cleared futures, options, and swaps market
 - Less than **.02%** of contract open interest of the cleared futures, options and swaps market
 - Less than **.05%** of contract interest of the cleared energy futures, options and swaps market



Coal futures, options, and swap trading activities are not material enough to impact the U.S. Financial System

Almost all actively traded domestic coal swaps are cleared

Entities that use swaps to actively manage price risks associated with production, sales, and transportation logistics of their businesses can often be active in markets. However, that alone should not elevate them to a “Swap Dealer.”

Characteristics	Swap Peabody Dealers	
Actively participates in swap markets	✓	✓
Uses swaps to manage price risk	✓	
Holds itself out as a market maker/professional intermediary for swaps		✓
Runs a business to make money from the bid/ask spread through matched swap books		✓
Creates, designs, or sells swap products		✓
Advises others with respect to swaps		✓

- The definition of “Swap Dealer” should exclude an End User’s swap activity for itself or an affiliated entity:
 - For the purpose of hedging or mitigating commercial risks associated with the use, purchase, sale, growth, mining, extraction, transporting, processing, storage, merchandizing or production of non-financial commodities, or
 - That constitutes a de minimis quantity of swap dealing, i.e., 10% or less of the notional value of its swap transactions per swap category

***We respectfully submit a proposed definition of
“Swap Dealer” in the Appendix***

Major Swap Participant



Dodd-Frank defines “Major Swap Participant” as a person who maintains a substantial position in a Major Swap Category AND whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S.

Characteristics	Peabody	Major Swap Participant
Actively participates in swap markets	✓	✓
Is not a Swap Dealer	✓	✓
Uses swaps to manage price risk	✓	✓
Maintains a substantial position in a Major Swap Category		✓
Creates substantial counterparty exposure that could have serious adverse effects on the U.S. financial stability		✓

We respectfully submit a proposed definition of “Major Swap Participant” in the Appendix

POTENTIAL IMPACTS OF OVER-INCLUSIVE DEFINITIONS

- Additional margining, clearing, and reporting requirements for swaps used by Peabody and those like it to hedge commercial risk may:
 - Allocate scarce capital and resources away from re-investment in the coal mining business
 - Slow job creation in the energy industry and related services

IN SUMMARY

- Coal is primarily a long term fixed price physical market with de minimis financial swap trading and therefore is not a Major Swap Category
- Peabody and others that actively participate in swap markets (i) but are not market makers, (ii) do not run matched swap books, (iii) do not advise others on swaps, (iv) nor design swap products for others are not Swap Dealers
- Those whose positions in case of default that do not rise to the level of severely impacting U.S. Financial Markets are not Major Swap Participants
- End User exemption should protect companies that use swaps to hedge commercial risk because End Users do not pose a systemic risk

We ask the CFTC to consider Peabody's proposed definitions for Major Swap Category, Swap Dealers, and Major Swap Participants set out in the Appendix

Proposed Definitions for Major Swap Category, Swap Dealer, Major Swap Participant

Definition of “Major Swap Category”



“Major swap category” as used in the definition of “Major Swap Participant” in Section 1a(33) of the Act is defined to mean each swap based upon or involving any of the following specific categories of commodities:

1. Interest rates,
2. Credit risk or measures,
3. Security or security indices,
4. Index or measure of inflation,
5. Macroeconomic index or measure,
6. Gold,
7. Silver,
8. Crude oil,
9. Natural Gas,
10. Gasoline, and
11. Electric Power.

Definition of “Swap Dealer”



- (1) Any person who, as a discrete and primary line of business—
- (i) holds itself out as a dealer in swaps;
 - (ii) regularly makes a market in swaps, that is, simultaneously and continuously at all times makes bids to buy and offers to sell the same swap or swaps for the principal purpose of profiting from the prevailing bid/ask spread and with the intention of promptly offsetting risk exposure from any executed transactions;
 - (iii) regularly enters into swaps for its own account on behalf of or for the benefit of non-affiliated counterparties as an ordinary course of business; or
 - (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps,
- provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.
- (2) INCLUSIONScope.—A person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.
- (3) EXCEPTIONExceptions.—The term ‘swap dealer’ does not include a person that—
- (i) enters into swaps for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business,
 - (ii) engages in a de minimis quantity of swap dealing (where such constitutes 10% or less of the notional value of its swap transactions in any swap category), or
 - (iii) enters into swaps for such person’s own account, either individually or for an affiliated entity, in order to manage commercial risks associated with the use, purchase, sale, growth, mining, extraction, transporting, processing, storage, merchandizing or production of non-financial commodities.

Definition of “Major Swap Participant”



The term ‘major swap participant’ means any person who is not a swap dealer, and:

- (1) ~~Maintains a substantial position in swaps for any of the major swap categories as determined by the Commission defined in [insert reference to regulation defining major swap categories]-, and whose outstanding swaps create substantial counterparty exposure that would create a risk of serious adverse effects on the financial stability of the United States banking system or financial markets if the person were to default, after giving effect to any applicable notice requirement or grace period, in making any payment on or delivery due under all of such swaps on the same day and such default resulted in a liquidation of, an acceleration of obligations under, or an early termination of, all transactions under the documentation applicable to all such swaps; provided that the substantial position for purposes of this paragraph () (1) shall exclude—~~
 - (i) Positions held for hedging or mitigating commercial risk; and
 - (ii) Positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; or
 - ~~(ii) Whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or~~
- (2)(i) Is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and
 - (ii) Maintains a substantial position in outstanding swaps in any major swap category as ~~determined by the Commission defined in [insert reference to regulation defining major swap categories].~~
- ~~(B) DEFINITION OF SUBSTANTIAL POSITION.— For purposes of subparagraph (A), the Commission shall define by rule or regulation the term ‘substantial position’ at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States.— In setting the definition under this subparagraph, the Commission shall consider the person’s relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.~~
- (3) ~~SCOPE OF DESIGNATION~~ Scope.—~~For purposes of subparagraph (A), a~~ person may be designated as a major swap participant for 1 or more categories of swaps without being classified as a major swap participant for all classes of swaps.
- (4) EXCLUSIONS—The definition under this paragraph (xxx) shall not include an entity =
 - (i) ~~w~~ Whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company; or
 - (ii) enters into swaps for such person’s own account, either individually or from an affiliated entity, in order to manage commercial risks associated with the use, purchase, sale, growth, mining, extraction, transporting, processing, storage, merchandizing or production of non-financial commodities.

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