10-002
COMMENT
CL-08388

From: Anita Herrera <herrera@nodalexchange.com>
Sent: Monday, April 26, 2010 5:08 PM
To: secretary <secretary@CFTC.gov>
Cc: Paul Cusenza <cusenza@nodalexchange.com>
Subject: Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations
Attach: Nodal Exchange Position Limit Comments.pdf

Mr. Stawick:

Attached are the comments by Nodal Exchange regarding the Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations.

Regards,

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April 26, 2010

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

Re: Comments on Proposed Federal Speculative Position Limits on Referenced Energy Contracts

Dear Mr. Stawick:

Nodal Exchange, LLC appreciates the opportunity to comment on the Commodity Futures Trading Commission's proposed rulemaking on federal speculative position limits for referenced emergy contracts. Nodal Exchange Exchange applauds the Commission's efforts to mitigate the negative impact of excessive speculation creating unreasonable fluctuations in the price of a commodity.

As introduction, Nodal Exchange is the first independent electronic commodities exchange dedicated to offering locational (nodal) futures contracts and related services to participants in the organized North American electric power markets. Nodal Exchange provides these power trading markets with a non-discriminatory forum for trading locational power in an anonymous auction format. The Nodal Exchange platform also accepts over-the-counter (OTC) transactions submitted by participants for clearing through a derivatives clearing organization. Nodal Exchange builds on the success of the existing Regional Transmission Organization/Independent System Operator (RTO/ISO) Day Ahead and Real Time markets by offering cash-settled futures contracts in a cleared market enabling Nodal Exchange participants to effectively manage basis and credit risk. Daily auctions are held on 72 key locations and weekly auctions on all approximately 1,800 hubs, zones and nodes. Nodal Exchange is an independent, privately held company and employs approximately thirty people directly and more indirectly.

The Commission acknowledged Nodal Exchange in March 2009 as an "exempt commercial market" (ECM). On April 8, 2009, Nodal Exchange launched to provide transparency and liquidity in many contracts previously only available through customized over-the-counter (OTC) derivatives. A year later, Nodal Exchange continues to offer contracts to participants in the organized North American power markets based on the existing RTO/ISO Day Ahead and Real Time markets. Nodal Exchange does not offer any of the referenced energy commodities that are the subject of the proposed rulemaking. However, Nodal Exchange is commenting at this time because if the proposed rulemaking is implemented, the Commission may subsequently decide to expand its application to include additional contracts determined by the Commission to provide a "significant price discovery" function (SPDCs). Although the Commission has yet to determined that any of Nodal Exchange's contracts are SPDCs, upon the eventual SPDC determination, the proposed rulemaking could impact its more heavily traded contracts that significantly contribute towards the success of Nodal Exchange.

In accordance with Section 4a(a) of the Commodity Exchange Act, the Commission proposes to impose position limits on speculation that causes "sudden or unreasonable fluctuations or unwarranted changes in the price" of energy commodities. This represents a change from the existing framework for position limits on energy commodities established by the individual exchanges, displacing it with the regime the Commission currently uses for agricultural commodities. For the stated purpose of preventing excessive speculation and to mitigate its ensuing burden on interstate commerce, the Commission proposes to set position limits for the referenced futures and option contracts in major energy markets currently traded on NYMEX and ICE. The proposed rulemaking would not apply to the non-reporting OTC markets. Therefore, the benefits of trading on an exchange could be offset by the burden of position limits causing traders to transfer their positions to the OTC or foreign markets.

Nodal Exchange believes that appropriate regulation applied on an unbiased basis builds confidence in our markets and promotes more market participation. Energy contracts are traded broadly across on- and off-exchange markets, which establishes the basis for setting position limits on an aggregate basis that includes the OTC markets not currently addressed in the proposed rulemaking. Appropriate market-wide regulations enable innovative markets, such as Nodal Exchange, to provide transparency through cleared standardized contracts. However, within the current environment of uncertainty in derivatives legislation, implementation of the Commission's new position limit regime could result in the migration of trading from the transparent reporting markets to the opaque OTC and foreign markets beyond the scope of the Commission's jurisdiction.

This outcome is not without precedent. In 2007, the Senate report on "Excessive Speculation in the Natural Gas Market"[1] reported that a trader holding large positions on NYMEX, upon notice by NYMEX to reduce its positions, shifted

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[1] "Excessive Speculation in the Natural Gas Markets", U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Sen. Carl Levin, Chairman, June 25, 2007.

those positions to ICE. ICE is an ECM where no limits or CFTC oversight used to exist. At that time, trading activities on ECMs, such as ICE, were invisible to regulators. While holding large concentration of these positions on ICE, a period of extreme price volatility resulted in the collapse of one of the largest hedge funds in the natural gas market and liquidation of their entire portfolio of $8 billion. The Senate report concluded that the large concentrated positions held at ICE caused significant price movements and inflated prices. This disparity in the regulation between NYMEX and ICE has since been addressed by legislation requiring the regular reporting of trading activity on ECMs, such as Nodal Exchange, to the CFTC.[2] Accordingly, the proposed rulemaking needs to include the OTC markets because market-wide position limits reduce the potential for concentrated markets.

Separately, the single exchange limits in proposed Section 151.2(b)(2) could create a bias towards larger exchanges. A separate position limit for a single exchange may limit a new exchange's ability to build a market, and may prevent new entrants. For example, in a heavily traded market it is possible for a participant on a small exchange to hold over 5,000 contracts or 1% of the aggregated open interest and exceed the 30% single exchange position limit on the small exchange when a larger position on a larger exchange would not be limited. Traders would migrate to large exchanges to avoid the position limitations on the smaller exchanges. We do not see how this helps the marketplace from excessive speculation, but do see how it is a competitive disadvantage to smaller exchanges. We recognize and appreciate the Commission's effort to address the challenges of smaller exchanges through the proposed regulation section 151.2(c), however this does not eliminate the harm from the single exchange limit of 30%. We hope that the Commission will review this carefully and reconsider the single exchange position limits which only seems to serve the competitive interests of larger exchanges. Market participants will quickly close price differences between exchanges through arbitrage.

In addition, it is unclear what the beneift is of Section 151.3(2)(ii) placing additional restriction for single exchange position limitations on a gross basis for a single month. It is the net position of excess speculation that should be of concern, a gross position is not relavent to speculation and could be zero (no market view at all) yet be comprised of a high gross volume. Market makers may often trade in and out of a position and there is no risk from excessive speculation in a large gross position that has no net position. We suggest there not be separate single exchange position limits for the reasons previously stated, and we suggest position limits should be properly reviewed only a net basis.

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[2] Food, Conservation, and Energy Act of 2008, P.L. 110-246, June 18, 2008.

Nodal Exchange Exchange supports the view that position limits established across all markets and participants enhances efficiency and market integrity, which promotes transparency. Nodal Exchange Exchange commends the Commission for seeking input from the public on how the proposed rulemaking could impact the energy markets.

Sincerely,

Paul Cusenza
Chief Executive Officer