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

VIA ELECTRONIC MAIL

RE: Advanced Notice of Proposed Rulemaking on Antidisruptive Practices Authority, RIN 3038-AD26

Dear Secretary Stawick:

I. INTRODUCTION.

In accordance with the Commodity Futures Trading Commission's (the "CFTC" or the "Commission") Advanced Notice of Proposed Rulemaking, *Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act* ("*Advanced NOPR*") issued pursuant to Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"),[1] and published in the *Federal Register* on November 2, 2010,[2] the Working Group of Commercial Energy Firms (the "Working Group") hereby submits comments on the Commission's proposed antidisruptive practices rules pursuant to Section 4c(a) of the Commodity Exchange Act ("CEA"), as amended by the Act.

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers and utilities. The Working Group considers and responds to requests for public comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[2] Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301 (Nov. 2, 2010).

II. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.

A. The Commission Should Clarify the Scope and Applicability of its New Authority.[3]

1. The Commission Should Identify the Market Activities it is Seeking to Address.

The Working Group respectfully requests the Commission to specify the objectives and goals it seeks to accomplish pursuant to this new statutory authority regarding disruptive trading practices."[4] In particular, the Commission must provide additional guidance as to the nature of the disruptive trading conduct prohibited in new CEA Section 4c(a)(5)(A)-(C). Numerous terms included in these provisions are vague, making it impossible for market participants to provide reasoned comments in this proceeding. Similarly, the Commission should identify the market practices or activities the Commission hopes to address or eliminate pursuant to this new authority. Without a better understanding of the Commission's objectives and the practices potentially subject to any final rule, affected stakeholders will be unable to participate fully in this proceeding.

2. The Commission Should Clarify that its New Authority is Limited to Activities Subject to the Rules of Registered Entities.

New CEA Section 4c(a)(5) expressly limits the Commission's new disruptive trading practices authority to activities "on or subject to the rules of a registered entity." While new CEA Section 4c(a)(6) does not expressly include this limitation, it is clear that subsection (6) is intended to effectuate the Commission's implementation of subsection (5). The Commission must therefore clarify that new CEA Section 4c(a)(6) is also limited to activities "on or subject to the rules of a registered entity." Moreover, the Working Group respectfully submits that the term "registered entities," for purposes of new CEA Section 4c(a)(5)-(7), should be limited to swap execution facilities ("SEFs") and designated contract markets ("DCMs").

3. The Commission Should Clarify that Violation of New Section 4c(a)(5)(A) Requires Specific Intent.

New CEA Section 4c(a)(5)(A) provides that it is unlawful for any person to engage in any practice subject to the rules of a registered entity that "violates bids or offers." The provision does not, however, specify the scienter necessary to constitute a violation. In the absence of an intent standard, the Working Group recommends that the Commission interpret new CEA Section 4c(a)(5)(A) as requiring a specific intent to disrupt the market. To do

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[3] Part II.A of the Working Group's comments is intended to respond, in part, to the Commission's Question No. 1 relating to the nature of the conduct prohibited by new CEA Sections 4c(a)(5)(A)-(C).

[4] *See* Section 747 of the Act, which adds new CEA Subsection 4c(a)(5) "Disruptive Practices"; *see also* Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301 (Nov. 2, 2010), which was issued pursuant to Section 747 of the Act.

otherwise, such as evaluating violations pursuant to a general intent or recklessness standard, would result in the overbroad application of this provision to the detriment of otherwise legitimate business activities.[5]

B. The Commission Should Provide Additional Guidance Regarding the Nature of Prohibited Activity After a Thorough Study of Swap Markets.

The Working Group is concerned that if proposed rules prohibiting disruptive trading practices are applied in isolation, and without sufficient knowledge of business practices in swap markets, they could inadvertently capture legitimate business practices and chill liquidity in swap markets. As such, prior to implementing final rules prohibiting disruptive trading practices in swap markets, the Commission should conduct a thorough and extensive study of such markets.

Upon completion of such study, the Working Group recommends the Commission to issue additional guidance on the nature of prohibited activity. Such guidance, however, must not be overly prescriptive and should reflect the differences between various markets, as the recommended study would illustrate. The Commission should provide flexibility to ensure that it does not chill legitimate and economic market practices or impair market liquidity. Any practice that is not in violation of a Commission regulation, order, or applicable market rule should not be prosecuted as a disruptive trading practice. Furthermore, if the Commission identifies conduct that is potentially concerning, but otherwise legal, the Working Group recommends that the Commission issue a notice and request public comment regarding whether such conduct should be prohibited as a disruptive trading practice.

C. The Commission Should Adopt Clear and Enforceable Rules Prohibiting Disruptive Trading Practices.[6]

1. The Commission Should Clarify the Role of Executing Brokers and Other Intermediaries.[7]

The Commission solicits comment with respect to whether executing brokers should have an obligation to ensure that customer trades are not disruptive trading practices. The Working

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[5] In contrast to new CEA Section 4c(a)(5)(A), new subsection (5)(B) includes an express recklessness standard. Had Congress intended for subsection (5)(A) to also include a recklessness standard it would have specifically done so. *See Keene Corp. v. United States,* 508 U.S. 200, 208 (1993) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)) ("Where Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.").

[6] The Working Group further recommends that the Commission adopt new enforcement and compliance policy statements to ensure that the activities subject to this new authority are clearly defined, thus providing market participants sufficient guidance for compliance purposes. The Working Group will expand on this recommendation in response to other CFTC rulemakings.

[7] Part II.C.1 of the Working Group's comments is intended to respond, in part, to the Commission's Question No. 7 relating to the role of execution brokers.

Group respectfully submits that executing brokers, futures commission merchants ("FCMs"), clearing brokers, and other intermediaries should not be obligated to ensure that customer trades do not violate rules prohibiting disruptive trading practices. Such entities can make assessments and set guidelines for disruptive trading practices, as well as play a role in helping to identify such practices, but they cannot be the final arbiter of the appropriateness of a final trade. Because traders use multiple executing brokers and other intermediaries, such entities are often only privy to a small piece of a trader's book, without having sufficient knowledge, if any, of a trader's other activities. Thus, intermediaries are not in a position to make a determination as to the appropriateness of a final trade. Any determination of whether a trade has a legitimate business purpose must be made by the regulator, not the intermediary.

2. The Commission Should Clarify or Further Define Key Terms.

a. "Fair and Equitable Trading"[8]

The Commission should clarify what the phrase "fair and equitable trading" in new CEA Section 4c(a)(6) means. This phrase should be interpreted narrowly, as a broad interpretation could effectively create a new and far-reaching standard by which the Commission could evaluate and regulate trading practices. The Working Group respectfully submits that the Commission's interpretation and application of the term "fair and equitable trading" should be guided by the following non-exhaustive principles:

- the sophistication of the parties[9];
- the markets involved;
- the size of the markets involved;
- whether the parties involved operate pursuant to, and within, the rules of an exchange;
- the activity constitutes a practice (*i.e.*, an activity occurring more than once or having the intention of occurring more than once); and
- there is not an intent to create sudden and dramatic changes in market conditions.

The Working Group agrees that all market participants are entitled to a level playing field. As such, all Commission rules should be applied in a fair and non-discriminatory manner. However, the Commission should carefully study affected markets, particularly swap markets, to ensure that it does not issue rules that are so prescriptive that they identify conduct as a disruptive trading practice that inherently advantages a specific sector of the market over another. In this light, the Commission should not, at this time, designate additional practices that are considered disruptive to fair and equitable trading.

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[8] Part II.C.2.a of the Working Group's comments is intended to respond, in part, to the Commission's Question No. 13 relating to fair and equitable trading.

[9] The term "fair and equitable trading" should not be applied by the Commission when evaluating transactions between two equally sophisticated eligible contract participants ("ECPs"). ECPs are assumed to be sophisticated parties engaging in arms-length bilateral negotiations, and thus application of a fair and equitable standard to such transactions would be unnecessary and misplaced.

b. "Spoofing"[10]

In defining the term "spoofing," the Commission should take into account that, practically speaking, the trading practices identified in Question No. 9(a)-(c) of the *Advanced NOPR* do not occur regularly when trades are manually entered and executed. From an operational perspective, therefore, spoofing should be limited to algorithmic or high-frequency trading practices. As such, the Commission should not at this time separately specify and prohibit the practices identified in Question No. 9(a)-(c), nor should such activities be considered a form of spoofing. The Working Group believes the exchanges are in the best position to develop rules with respect to these practices, and, if there is a dispute over them, the Commission could then decide if or how the exchange implements the rule.[11]

The Working Group submits that where an order is exposed to the market for a period of time that would allow it to be executed upon by another party, it is not spoofing. Indeed, it is irrelevant whether there is a partial fill or no fill at all, so long as the order is properly shown to the market, thus exposing the offeror to sufficient risk. In addition, any fill of an order, partial or otherwise, is unequivocal proof that it was not spoofing. Finally, the Commission should clarify that rules applicable to spoofing are not applicable to block trades or large notional value trades. Again, the Commission should allow the exchanges to develop rules, if necessary, with respect to disruptive trading practices impacting block trades or large notional value trades.

c. "Orderly Execution"[12]

The term "orderly execution" in new CEA Section 4c(a)(5)(B) has no context. That is, activities in one market that are considered orderly, may be viewed as disorderly in another market. Indeed, the Commission will face difficulty in distinguishing between orderly and disorderly trading given the differences between the markets that the Commission oversees and the dynamic conditions that each of these markets experience. Due to these market differences, the Commission must also avoid applying a "one size fits all" definition for orderly execution.

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[10] Part II.C.2.b of the Working Group's comments is intended to respond, in part, to the Commission's Question Nos. 8-12 relating to spoofing.

[11] In addition, the Working Groups submits that the term "spoofing" should be defined using a specific intent standard. The issue also draws into focus the issue of an intent standard around the particular practices identified in Question No. 9(a)-(c). Each of these activities imply that the entity involved intended to "overload the quotation system," or to "cause a material price movement" through "submitting or cancelling multiple bids or offers," or "creating an appearance of market depth that is false." If a market participant "intentionally" engaged in these behaviors, such activities could be addressed under the Commission's market manipulation standards. There is a difference between cancelling a bid before execution, as there may be a legitimate business reason for doing so, and an intent to "overload," for example.

[12] Part II.C.2.c of the Working Group's comments is intended to respond, in part, to the Commission's Question Nos. 3-4 relating to orderly execution.

d. "Closing Period"[13]

The Commission's disruptive trading practice authority in new CEA Section 4c(a)(5)(B) is limited to transactions during the "closing period." The Commission solicits comment as to whether it should recognize certain conduct outside of the closing period as actionable under its new authority. The Working Group believes the Commission should refrain from looking at trading practices outside of the closing period. Trying to connect trading practices outside of the closing period to impacts within the closing period is far too tenuous. Moreover, the activities occurring during the closing period are vitally important given their substantial impact on the market. As such, the Commission should focus its efforts on those practices occurring within the closing period, rather than those activities outside the closing period. Finally, the Working Group does not believe that the closing period should apply to consummated transactions.

D. The Commission Should Rely Upon the Expertise of Exchanges and Delegate Monitoring of Disruptive Trading Practices to Exchanges as Appropriate.

Exchanges have rules and guidelines which are known and understood by market participants. The Commission should therefore look to such rules and guidelines when developing its proposed rules in this proceeding. Indeed, many exchanges already have rules that govern the type of practices identified in new CEA Section 4c(a)(5)(A)-(C) that could serve as models for the Commission.[14] In doing so, the Commission should justify and support any deviations from applicable exchange rules. The Commission should also consider delegating the monitoring of disruptive trading practices to exchanges as much as possible.[15] Doing so would conserve valuable agency resources, while allowing market participants to operate pursuant to familiar rules and guidelines.

E. Issues related to Algorithmic Trading and Automated Trading Systems.[16]

The Working Group believes that rules proposed or adopted by the Commission with respect to algorithmic trading should have the same foundation as rules related to other trading. The Commission could require market participants to monitor the activities of their personnel or

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[13] Part II.C.2.d of the Working Group's comments is intended to respond, in part, to the Commission's Question Nos. 5-6 relating to closing periods.

[14] *See, e.g.*, NYMEX Rulebook, *Ch. 5: Trading Qualifications and Practices*, § 514 (prohibiting certain trading infractions, including a bid or offer out of line with the market, a trade through the existing bid or offer, etc.); ICE OTC Regulatory Rulebook for Significant Price Discovery Contracts (Annex L), *Ch. 5: Trading Standards* (outlining standards prohibiting certain practices, including "acts detrimental to ICE's welfare"); *see also* ICE Participant Agreement, *Annex H: Participant Code of Conduct* (Nov. 1, 2010) (requiring ICE participants to act in accordance with "sound trading practices" prohibiting wash trades and misrepresentative trading).

[15] The Commission has previously delegated monitoring responsibilities to exchanges. *See, e.g.*, 17 C.F.R. § 36, Appendix B (requiring trading facilities to monitor trading of significant price discovery contracts); 17 C.F.R. § 38, Appendix B (requiring boards of trade to monitor and enforce compliance with the rules of the contract market).

[16] Part II.E of the Working Group's comments is intended to respond, in part, to the Commission's Question Nos. 15-19 relating to algorithmic or automated trading systems.

machines placing bids or offers onto an exchange, and, within a reasonable period of time, respond to any activities that may be disruptive to the market.

With respect to rules to regulate the design of algorithmic or automated trading systems to prevent disruptive trading practices, the Working Group submits that developing such rules will prove difficult unless the Commission takes a principles-based approach. The Working Group recommends that, prior to developing rules to regulate the design of algorithmic or automated trading systems, the Commission should convene a roundtable of experts to discuss what such design rules might look like. The same holds true should the Commission consider promulgating rules to regulate the supervision and monitoring of algorithmic or automated trading systems.

The Working Group further submits that algorithmic traders should only be held accountable upon a showing that they intentionally disrupted the market for the purpose of improving their financial position. Finally, the Working Group seeks clarification as to how algorithmic trading could be monitored so that the inadvertent actions of a computer system do not trigger a massive amount of market activity.

III. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the energy swap markets in the United States. The Working Group appreciates the balance the CFTC must strike between effective regulation and avoidance of hindering the energy swap markets. The Working Group respectfully submits that the Commission consider its comments set forth herein regarding the *Advanced NOPR*. If you have any questions, please contact the undersigned.

Respectfully submitted,

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