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Anthony M. Mansfield  
Attorney at Law  
amansfield@mwe.com  
+1 202 756 8232

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## VIA ELECTRONIC SUBMISSION

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

**Re: Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act (RIN Number 3038-AD26)**

Dear Mr. Stawick:

On behalf of Hess Energy Trading Company, LLC on its own and on behalf of its wholly-owned subsidiaries (collectively "HETCO"), we hereby submit comments on the Advance Notice of Proposed Rulemaking ("Advance Notice")<sup>1</sup> issued by the U.S. Commodity Futures Trading Commission ("Commission" or "CFTC") regarding the antidisruptive practices authority provided under Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").<sup>2</sup> HETCO appreciates the opportunity to provide the Commission with comments regarding the potential regulation of trade practices on or subject to the rules of a registered entity.

### **I. DESCRIPTION OF HESS ENERGY TRADING COMPANY AND ITS INTEREST IN THE ADVANCE NOTICE**

HETCO is a Delaware limited liability company established in 1997. HETCO recently organized branches in Paris and the Dubai International Financial Center and operates with three United Kingdom corporations, two of which are registered with the Financial Services Authority, a Cayman Islands exempted company, and a corporation organized in Singapore. All of these entities are used in the continually evolving development and implementation of a worldwide energy trading strategy effectuated by a series of spot and forward purchase and sales agreements, equity, foreign exchange, physical oil storage and chartered vessel transactions from

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<sup>1</sup> 75 Fed. Reg. 67,301.

<sup>2</sup> Pub. L. No. 111-203 (2010).

time to time, swaps and other derivative transactions in crude oil, petroleum products, natural gas, and power, and freight transactions.

## II. COMMENTS ON THE REGULATION OF DISRUPTIVE PRACTICES

### A. Section 747 – Disruptive Practices

Section 747 of the Dodd-Frank Act amends Section 4c(a) of the Commodity Exchange Act, as amended (“CEA”), to make it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—

- (A) violates bids or offers;
- (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
- (C) is, is of the character of, or is commonly known to the trade as, “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution).<sup>3</sup>

Section 747 provides the Commission with the authority to “make and promulgate such rules and regulations as, in [its] judgment... are *reasonably necessary* to prohibit the trading practices described [above] and any other trading practice that is disruptive of fair and equitable trading.”<sup>4</sup>

The authority provided in Section 747 complements other provisions of the Dodd-Frank Act that supplement the CFTC’s enforcement authority, including amendments expanding the CEA’s anti-manipulation provisions and adding new prohibitions on insider trading.<sup>5</sup> Together, these amendments provide the CFTC with authority to promote the integrity of the commodity and derivatives markets, and the security of the broader financial system. HETCO supports the stated purpose of these amendments and the Commission’s continued efforts to ensure that commodity markets are open, competitive, efficient, and transparent.

### B. Market Participants Need Legal Certainty.

HETCO believes that the Commission can further overall transparency, in this instance, by providing market participants with legal certainty about the contours of the disruptive practices provisions and practical guidance as to how the agency intends to implement and enforce these prohibitions. In order for the CFTC’s new enforcement authority to be effective and fair, HETCO believes that the Commission should clarify the types of behavior these provisions will prohibit. This is particularly true with respect to the prohibition on market practices the Commission determines to be “disruptive to fair and equitable trading,” whether

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<sup>3</sup> Dodd-Frank Act § 747 (to be codified as CEA § 4c(a)(5)).

<sup>4</sup> Dodd-Frank Act § 747 (to be codified as CEA § 4c(a)(6)) (emphasis added).

<sup>5</sup> Dodd-Frank Act § 746 (to be codified as CEA § 4c(a)(3) & 4c(a)(4)) (new insider trading provision); Dodd-Frank Act § 753 (to be codified as CEA § 6(c), 6(d) & 22(a)(1)) (new anti-manipulation authority).

because they are executed in a disorderly manner during the “closing period,” or because they constitute “spoofing”. Without adequate guidance, market participants will not know what activity is permissible and what activity is prohibited. The resulting uncertainty will not only discourage a significant volume of legitimate and beneficial market activity in exchange-traded products, particularly during the closing period, which could impair the soundness of the settlement process, but may also lead to unpredictable and potentially unfair enforcement actions. Such a result ultimately undermines the integrity of the commodity and derivatives markets and is, therefore, inconsistent with the purposes that Congress intended Section 747 and the Dodd-Frank Act as a whole to serve.<sup>6</sup>

**C. Market Participants Cannot Comply with Section 747 Until the Commission Provides Notice About the Trading Practices it Considers to be “Disruptive”.**

1. *The Commission Should Explain What Constitutes “Disregard for the Orderly Execution of Transactions During the Closing Period.”*

Section 4c(a)(5)(B) of the CEA, as amended by Section 747 of the Dodd-Frank Act, prohibits any trading that “demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period.”<sup>7</sup> However, nowhere in the CEA or the CFTC’s regulations that HETCO is aware of has “orderly execution” ever been meaningfully defined, and there is no commonly understood meaning of this term in the marketplace at large.

The plain meaning of “orderly” as it is used in Section 4c(a)(5)(B) provides little clarity as to which trading practices are permissible and which are not. Indeed, the CFTC’s website does not define this term and a search of the glossaries of terms provided by various registered entities yields no further insights. “Orderly” is commonly understood to refer to a process that is governed by an established system or method.<sup>8</sup> Under this definition, trading arguably is orderly under Section 4c(a)(5)(B) only if transactions are executed according to a predefined strategy or schedule. Although traders often rely on models and strategies when executing trades, all markets are dynamic and traders routinely modify (or even abandon) their original plans in response to rapidly changing market conditions. This may be particularly true during the closing period on an exchange-listed contract because of the fixed time constraints. From HETCO’s perspective, trading cannot be deemed “disruptive” simply because the execution of, or an attempt to execute, a legitimate strategy failed to go according to plan. **A party must always be able to change its mind to react to rapidly changing market conditions.**

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<sup>6</sup> Section 747 of the Dodd-Frank Act “amended the CEA to expressly prohibit certain trading practices that it determined were disruptive of fair and equitable trading.” 75 Fed. Reg. 67,301. The Dodd-Frank Act, as a whole, was enacted to “reduce risk, increase transparency, and promote market integrity within the financial system by, among other things... enhancing the Commission’s rulemaking and enforcement authorities with respect to... all registered entities and intermediaries subject to the Commission’s oversight.” *Id.*

<sup>7</sup> Dodd-Frank Act § 747 (to be codified as CEA § 4c(a)(5)).

<sup>8</sup> Definition of Orderly, Dictionary.com, <http://dictionary.reference.com/browse/orderly>.

Congress included the prohibitions on disruptive trading, including Section 4c(a)(5)(B), in response to specific requests from the CFTC for new enforcement authority.<sup>9</sup> It is, therefore, reasonable to assume that *before* Congress proposed new legislative language, the Commission identified specific market practices that it considered to be “disruptive of fair and equitable trading,” but that were not already prohibited by the CEA or the CFTC’s regulations.

The Commission should resolve the ambiguity in Section 4c(a)(5) by articulating the specific types of disruptive practices that prompted it to request the new enforcement authority in Section 747. And to the extent that the Commission determines that it is “reasonably necessary” to promulgate rules to prohibit such activities, it should include in the proposed regulations examples of past trading activity that it believes demonstrate intentional or reckless disregard for orderly execution during the closing period. These examples, even if only framed in hypothetical terms, will provide tangible guide posts for market participants to follow to ensure that their trading remains “orderly” and non-disruptive. Without such guidance, it will be difficult for market participants to understand *prospectively* how the relevant legal standards may have changed and what activity may now be prohibited.

The version of the Dodd-Frank Act passed by the U.S. House of Representatives on December 2, 2009 included a provision that is similar to Section 4c(a)(5)(B), but was more concrete to the extent that it referred to conduct for which the CFTC previously had initiated enforcement actions.<sup>10</sup> That version provided, in relevant part:

It shall be unlawful for any person to engage in any trading or practice on or subject to the rules of a registered entity that... is, is of the character of, or is commonly known to the trade as ‘marking the close’ (bidding or offering during or near the market’s closing period with the intent to influence the settlement price).<sup>11</sup>

The concepts of “marking” or “banging the close” are themselves the subject of some confusion among market participants. However, at least the CFTC’s numerous enforcement actions alleging that a trader manipulated a market by marking the close have put market participants on notice that the Commission considers this particular conduct, whatever it is, to be disruptive. The Commission has not, however, provided comparable notice as to what *other* types of trading activity that occurs in the closing period of an exchange traded contract it considers to be disruptive. Because Section 4c(a)(5)(B) is written in general terms that potentially include a

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<sup>9</sup> 156 Cong. Rec. S5922 (daily ed. Jul. 15, 2010) (statement of Sen. Lincoln) (“The CFTC requested, and received, enforcement authority with respect to... disruptive trading practices.”).

<sup>10</sup> See, e.g., *In the Matter of Anthony J. DiPlacido*, CFTC Docket No. 01-23 (Nov. 5, 2008) (finding that DiPlacido manipulated settlement prices by placing large orders for NYMEX Western U.S. electricity futures contracts on the options expiration days); *CFTC v. Amaranth Advisors, LLC*, 554 F. Supp. 2d 523 (S.D.N.Y. 2007) (alleging that Amaranth attempted to manipulate the price of natural gas futures contracts by deliberately waiting to sell a substantial number of those contracts in the final minutes before the close of trading); *CFTC v. Moore Capital Management, LLP*, CFTC Docket No. 10-09 (Apr. 29, 2010) (alleging that Moore Capital attempted to manipulate the platinum and palladium futures markets by engaging in the practice known as “banging the close” by attempting to exert upward pressure on the settlement prices of the platinum and palladium futures contracts).

<sup>11</sup> H.R. 4173, 111th Cong. § 3118 (2009).

wide range of otherwise legitimate market activity, market participants need practical guidance from the Commission as to what practices the new provisions actually prohibit.

It would be consistent with the Commission's precedent in enforcement cases and the legislative history of the Dodd-Frank Act to interpret Section 4c(a)(5)(B) as only prohibiting marking the close or similar trading activity. If this is the Commission's interpretation of Section 4c(a)(5)(B), a rulemaking may not be necessary. In Section 4c(a)(6), Congress authorized the Commission to "make and promulgate" rules *only* to the extent that they are "*reasonably necessary* to prohibit the trading practices described in [Section 4c(5)]."<sup>12</sup> If Section 4c(a)(5)(B) only prohibits activity that was already prohibited under the anti-manipulation provisions of the pre-Dodd-Frank Act CEA (e.g., marking the close), new regulations are unnecessary and inappropriate. Alternatively, if there are gaps in the Commission's ability to pursue other types of disorderly trading, it should identify those gaps and promulgate rules that make the prohibitions on such behavior explicit. Without rules that specifically describe what constitutes disorderly trading, market participants will not be able to understand fully what behavior is prohibited.

2. *If the Commission does not Promulgate Rules that Clearly Distinguish Between Permissible and Prohibited Trading Practices, Section 4c(a)(5)(B) may be Unconstitutionally Vague and Unenforceable.*

If the Commission does not promulgate regulations that clarify what trading practices it considers to be disruptive under Section 4c(a)(5)(B), the legal standard will be uncertain and the prohibition itself could be unconstitutionally vague and, therefore, unenforceable. The Supreme Court has held that a statute is unconstitutionally vague if it either: (1) fails to provide adequate notice to enable ordinary people to understand what conduct is prohibited; or (2) has the potential to authorize or to encourage arbitrary and discriminatory enforcement.<sup>13</sup> In other words, a statute that imposes potentially criminal liability must provide "fair notice" to the public as to the type of conduct that it prohibits.<sup>14</sup> Without appropriate guidelines as to what behavior is permissible and prohibited, entities subject to the law are at risk of being unfairly penalized for activity that they reasonably believed to be legitimate. Similarly, without those same guidelines, there will be no meaningful boundary between permissible market activity and trading that is labeled as disorderly merely because it results in a settlement price that certain market participants do not like.

Currently, marking the close is the *only* conduct that market participants can reasonably anticipate that the CFTC will prosecute as a form of disruptive trading that is prohibited under Section 4c(a)(5)(B). Absent detailed regulations that prohibit (or permit) other specific types of trading activity, market participants will only learn what the CFTC considers to be disorderly by following and analyzing each subsequent enforcement action. Such a case-by-case construction

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<sup>12</sup> Dodd-Frank Act § 747 (to be codified as CEA § 4c(a)(6) (emphasis added).

<sup>13</sup> *City of Chicago v. Morales*, 527 U.S. 41, 56 (1999).

<sup>14</sup> *U.S. v. Valencia*, 2003 U.S. Dist. LEXIS 15264 (S.D. Tex. 2003).

of an important legal standard may eventually yield some degree of clarity, but in the interim the process will be fundamentally unfair for the market participants who become the targets of an enforcement action even though they could not possibly have known how their conduct was prohibited.

**D. Clear Guidelines Regarding Closing Periods are Necessary to Preserve and Promote Beneficial and Legitimate Market Activity.**

1. *Participants' Concerns About Potential Accusations of Disruptive Trading may Chill Legitimate Trading Activity, Particularly During Market Closing Periods.*

Historically, traders have relied on futures markets' closing periods to conduct their trading for a number of legitimate trading objectives. Typically, traders rely on the closing period, whether several minutes or one-half hour long, as a period with greater liquidity than occurs during other times of the trading day. In part due to greater liquidity, the closing period also is commonly characterized by prices that more efficiently reflect market fundamentals, including tighter bid-ask spreads. Therefore, those who need to execute a large order or those who need to offset a position before the end of the session, such as day traders, may wait until the closing period because they have the greatest ability to execute their trades reliably and economically during this time. Because of this, market-on-close or "MOC" orders have been a long-accepted, common order type used in futures and equities markets.

In addition, transactions executed during the closing period determine the daily settlement price. Because more conservative market participants want to trade at a price approximating the average price, many over-the-counter and cash market commodity transactions are priced based on futures market settlement prices. Market participants who are opposite those transactions have exposure to the settlement price. Therefore, traders who need to hedge those transactions do so by trading during the closing period with the goal of transacting at an average price as close to the settlement price as possible.

Market participants understand the risks associated with transacting during the close. For example, trading during the close may be more volatile, especially during trading on the expiration of a futures contract with a physical delivery obligation. Natural tightness can occur when liquidity evaporates because some long position holders may intend to take delivery, but not all short position holders can or want to make delivery. Similarly, a trader may need to execute a large series of trades to hedge a recently established position in the cash market. In either scenario, the trader's ability to execute trades in a balanced and ratable manner may be limited by market forces beyond its control. When this occurs, traders must become price takers in order to offset their positions before the end of the trading day. Their supply or demand may be reflected in rapid and significant price increases or decreases. However, under Section 4c(a)(5)(B) this trading activity now may be construed as unlawful "disruptive trading". Upon consideration of this enforcement risk, market participants may choose not to execute during the closing period, which could reduce trade volume, cause illiquidity, and provide fewer transaction prices from which to derive the daily settlement price.

2. *The Commission Should not Expand the Definition of Closing Period to Include Time Periods Used to Establish Indices or Pricing References.*

In its request for comments, the Commission asked how the closing period should be defined and whether it should include “trading periods used to establish indices or pricing references.” HETCO urges the Commission to refrain from applying the prohibition against disruptive trading to an overly broad trading time period, which HETCO believes would be the result should the Commission so extend the definition of closing period.

Commodities market publications assemble price data from market participants using different methodologies and criteria. For example, some may collect prices transacted in a discrete time period during the trading day, such as Market on Close, while others may collect data from market participants who transacted throughout the trading day. Platts reports daily crude oil prices that reflect the posted prices at 5:30 p.m. of ChevronTexaco, ConocoPhillips, Valero, Link, Shell, ExxonMobil, Koch, Murphy, Plains, and Sunoco. Platts also reports an assessment of bids, offers, and prices that represent arms-length, openly negotiated transactions executed during the market-on-close window at 3:15 p.m. daily. In contrast, Argus seeks to represent the entire trading day in its assessments of crude oil prices executed between 7:00 a.m. and 3:00 p.m. Central Time. Similarly, in natural gas, both Platts and Argus assemble daily day-ahead prices to calculate day-ahead indexes. They utilize all prices transacted during the last five business days of each month (bidweek) for gas deliveries the next month to calculate the monthly bidweek price indices. Platts also assembles all balance-of-month and forward market natural gas prices for all locations that it reports.

Therefore, broadening the definition of closing period as the Advance Notice suggests the Commission is considering doing, could result in a substantial portion of all exchange and off-exchange trading through the entire trading day and over weeks at a time being subjected to the “orderly execution” requirement. However, the manner in which trading occurs across markets, particularly in many of the physical markets in which price indices are compiled, varies greatly. Thus, what may constitute “orderly execution” in one market may not be applicable in another market or unrealistic given how the market currently operates. For this reason, imposing this heightened standard, rather than preventing disruptive practices may, in fact, interfere with the orderly flow of transactions.

**E. The Commission Should Explain With Specificity What Constitutes (and What Does Not Constitute) “Spoofing”.**

Section 4c(a)(5)(C) of the CEA, as amended by Section 747 of the Dodd-Frank Act, prohibits any trading that “is, is of the character of, or is commonly known to the trade as, “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution).”<sup>15</sup> The Commission should describe, with specificity, what trade practices constitute spoofing, particularly where this is not a concept familiar to the markets for commodities and derivatives.

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<sup>15</sup> Dodd-Frank Act § 747 (to be codified as CEA § 4c(a)(5)).

In response to the Commission's questions on spoofing, HETCO respectfully submits that each of the following trade practices may harm market integrity and, therefore, should be prohibited:

- (1) Submitting or cancelling bids or offers with the specific intent to overload the quotation system of a registered entity, or to delay the execution of another market participant's trades;
- (2) Submitting or cancelling multiple bids or offers with the specific intent to cause a price movement that is materially misleading; or
- (3) Submitting or cancelling multiple bids or offers with the specific intent to create the appearance of, or lack of, market depth that is materially misleading.

Moreover, a partial fill of an order or series of orders should *not* exempt the activity described above from being defined as "spoofing," if there is a specific intent to disrupt the markets. On the contrary, the intent of trader should be dispositive. A trader that specifically intends to achieve any of the disruptive trading strategies in any of these enumerated ways should be held accountable. A trader that has no intent to harm the integrity of the market should be free to execute any legitimate trading strategy without risk of inadvertently disrupting the market.

The Commission also should consider regulating the positing of orders that cannot be traded in reality, whether due to credit or operational issues. Each of these topics should be addressed by the Commission whether trades are manually executed or are executed on electronic trading platforms with pre-determined order-matching algorithms. Indeed, the Commission, in conjunction with each respective exchange, should promulgate rules to regulate the use of algorithmic or automated trading systems to prevent disruptive trading practices and hold algorithmic traders accountable if they intentionally disrupt fair and equitable markets.

### III. CONCLUSION

HETCO welcomes the opportunity to discuss these issues further with the Commission and its Staff. Please contact us at (202) 756-8000 if you have any questions regarding HETCO's comments.

Respectfully submitted,



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Anthony M. Mansfield  
Jonathan H. Flynn  
McDermott Will & Emery LLP  
600 Thirteenth Street, N.W.  
Washington, D.C. 20005  
*Counsel for HETCO*