

February 22, 2011

**Via Online Submission**

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

Re: COMMENTS OF EXELON CORPORATION - Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, RIN No. 3038-AD25.

Dear Mr. Stawick:

Exelon Corporation ("Exelon") offers its comments on the Notice of Proposed Rulemaking issued by the Commodity Futures Trading Commission ("CFTC" or the "Commission") on December 22, 2010 regarding Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties (the "NOPR").<sup>1</sup> The NOPR proposes specific requirements for interactions between Swap Dealers and Major Swap Participants (collectively, "SD/MSPs") and their swaps counterparties in order to implement new section 4s(h) of the Commodity Exchange Act ("CEA") pursuant to § 731 of Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>2</sup>

### **Introduction**

Exelon and its affiliates operate in the generation, transmission, and distribution sections of the electric utility industry and the distribution section of the natural gas industry. As such, Exelon and its affiliates participate in the over-the-counter (OTC) bilateral market for swaps as end-users in order to hedge commercial risk associated with their businesses, and execute swaps transactions with entities that may be characterized as SD/MSPs.

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<sup>1</sup> 75 Fed. Reg. 80638 (December 22, 2010).

<sup>2</sup> Public Law No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

Exelon understands that under the CEA, SD/MSPs are subject to CFTC oversight. Business conduct standards are an appropriate way to provide structure to that oversight. However, as proposed, Exelon is concerned that several of the business conduct standards proposed in the NOPR will chill communication and increase costs to SD/MSPs (which will be passed on to end-users). Thus, while Exelon does not below suggest specific changes to the NOPR (as it presumes that SD/MSPs will do so), it provides the following comments which are designed to ensure that the standards do not have the unintended consequence of interfering with, rather than improving, the execution of swaps with end-users.

### **The Commission Should Tailor Business Conduct Standards to the Commodities Markets as Opposed to the Securities Markets**

Much of the NOPR seems to be modeled on a securities law (or futures broker) paradigm. Under the proposed regulations, SD/MSPs are not viewed as counterparties, but rather, as broker-dealers in many respects.<sup>3</sup> They must, for example, make securities-like risk and other disclosures and are subject to "best execution" requirements.<sup>4</sup> Under the execution standards in proposed section 155.7, SD/MSPs would be required in certain instances to execute a swap on terms that have a "reasonable relationship" to the best terms available, and to make certain other disclosures concerning the execution facilities on which the swap is available for trading.<sup>5</sup> The Commission explicitly notes that these standards would apply whether the SD/MSP was acting as agent or principal in a given transaction, "consistent with existing duties for broker-dealers under the Federal securities laws."<sup>6</sup> In the OTC bilateral swaps marketplace, SD/MSPs are counterparties executing trades with sophisticated institutions who are often looking to manage commercial risk; they are not broker-dealers.

The Federal securities laws are essentially disclosure statutes.<sup>7</sup> Their fundamental purpose is to "provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails . . . ."<sup>8</sup> Unlike the securities markets regulated by the Federal securities laws, the commodity-based swaps markets are *caveat emptor* markets where the value of a commodity on which the swap is dependent derives from external factors such as supply, demand, and location. In a previously issued Notice of Proposed Rulemaking implementing another section of Dodd-Frank, the Commission recognized that its own proposed

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<sup>3</sup> See, e.g., NOPR at 80643 (discussing required disclosures of material risks, characteristics, material incentives and conflicts of interest regarding a swap).

<sup>4</sup> See *id.* at 80643 (disclosure of material risks); 80644 (required scenario analyses); 80648 (proposed execution standards).

<sup>5</sup> *Id.* at 80648; 80662.

<sup>6</sup> *Id.* at fn. 86.

<sup>7</sup> Charles J. Johnson, Jr. and Joseph McLaughlin, *Corporate Finance and the Securities Laws* 3 (3d ed. 2004).

<sup>8</sup> *Id.*

rule modeled after SEC Rule 10b-5<sup>9</sup> was necessarily modified "to reflect the CFTC's distinct regulatory mission and responsibilities."<sup>10</sup>

The Commission should take care to implement rules that are suited for the commodities market. Unlike securities, commodity swaps are not unique to a given issuer. They are derivative of an underlying physical market. The information regarding that market is not the type of data that is susceptible to insider trading or other issuer or broker-dealer abuses that the Federal securities law are designed to prevent. SD/MSPs in this market are counterparties that are entering into contracts with other counterparties and are not acting in any capacity that is analogous to that of agents or brokers.

The disclosures proposed by the NOPR will, among other things, address the nature and risks of a swap as well as explain its legal terms and conditions.<sup>11</sup> Since these disclosures would be meaningful regulatory obligations, with failure to strictly adhere to them resulting in regulatory violations (as well as potential civil litigation), SD/MSP compliance staff will need to "control communication" with swaps counterparties to ensure proper compliance. As proposed in the NOPR, the disclosure requirements are likely to result in "canned" disclosures and approved scripts for SD/MSP staff to use when interacting with potential end-user counterparties. If the NOPR's regulations are implemented as proposed, such canned and scripted statements will be the core of communication with SD/MSP counterparties since unsupervised communication could trigger the need for further disclosure or risk a violation and litigation. This is not how the OTC swaps market works today, and such misplaced broker-dealer obligations will clearly chill the open interaction that occurs between counterparties in a competitive commodity swaps market.

Further, the above-referenced disclosure components of the NOPR, together with other aspects such as institutional suitability and best execution requirements, will only cause SD/MSPs to put their compliance staffs in charge of the interface with counterparties. Because the compliance and litigation stakes will be significantly raised by the proposals in the NOPR, the costs for SD/MSP compliance will rise and communication will be chilled. These increased costs will be passed on to end-users. Beyond increased costs, the limitations on communication will impact the ability of end-users to engage in the type of robust dialogue that is held today in which multiple SD/MSPs can be made to compete to provide the best pricing for a swap. Open communication with counterparties and potential counterparties with regard to prices, market conditions, and real-time changes in each is imperative to allow end-users to obtain the most advantageous terms in swaps transactions used to hedge risk. Disclosure requirements such as those proposed in the NOPR,<sup>12</sup> if implemented, could detract from these counterparties' ability to hedge commercial risk by interfering with the commercial process.

Exelon does not object to other principles in the NOPR that assure fair dealing and transparency.<sup>13</sup> Exelon believes that holding SD/MSPs to standards that require fair dealing,

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<sup>9</sup> 18 C.F.R. § 240.10b-5 (2011).

<sup>10</sup> Prohibition of Market Manipulation, 75 Fed. Reg. 67657, 67658 (November 3, 2010).

<sup>11</sup> NOPR at 80643; 80658.

<sup>12</sup> *See id.* at 80643-80644.

<sup>13</sup> *See id.* at 80659 (§ 23.433 – Communications – fair dealing).

mandate disclosure of conflicts of interest, and prohibit manipulation/fraud by SD/MSPs are appropriate as long as these principles are properly applied to commodity swap markets. The same is true for aspects of the NOPR that increase transparency.<sup>14</sup> Thus, the provision of a daily mark (on a portfolio basis);<sup>15</sup> some level of scenario analysis for complex swaps,<sup>16</sup> and information regarding clearing<sup>17</sup> are all elements of the NOPR which could work in favor of market participants if properly implemented in the commodity swap market context. Further, good business practices such as the "know your counterparty" requirements are appropriate for any dealer/counterparty relationship.<sup>18</sup>

Therefore, Exelon recommends that the Commission re-examine the NOPR to better tailor the rules to the commodity swap market. It should not utilize the securities/futures market broker-dealer paradigm. The swap market features bilateral interactions between counterparties. In no event should the Commission implement rules that will raise costs to end-users or chill the robust communications they currently have with the SD/MSPs competing to trade with them.

### Conclusion

Accordingly, the Commission should refocus its rules for SD/MSP Business Conduct Standards to address the OTC commodity swaps market, not the securities market or a futures broker role. The Commission should take care not to adopt rules that will increase costs or chill commerce between Exelon and similarly situated entities and their counterparties. In implementing rules intended to benefit and protect the swap counterparties of SD/MSPs, the Commission should not adopt restrictions that will detract from the ability of end-users to hedge risk through swap transactions.

Respectfully submitted,

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<sup>14</sup> See, e.g., *id.* at 80658 (§ 23.431 – Disclosures of material information).

<sup>15</sup> *Id.* at 80645; 80659.

<sup>16</sup> *Id.* at 80644; 80658.

<sup>17</sup> *Id.* at 80646; 80659.

<sup>18</sup> *Id.* at 80641; 80657.