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

Re: Comment Letter on Proposed Rulemaking: Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (December 22, 2010)

Dear Mr. Stawick:

Nodal Exchange, LLC (Nodal Exchange or Exchange) appreciates the opportunity to submit comments with respect to the Commodity Futures Trading Commission's (CFTC or Commission) proposed rulemaking published in the Federal Register on December 22, 2010 (Release). In the Release, the Commission seeks comments on the proposed rules to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) proposing new rules and amending guidance and acceptable practices on designated contract markets (DCMs).

As introduction, Nodal Exchange is an exempt commercial market (ECM) that launched in April 2009 to serve the electricity markets by offering cash settled contracts for power in North America. All Nodal Exchange contracts ("Nodal Contracts") are for monthly terms and are central counterparty cleared by LCH.Clearnet. Nodal Exchange also offers natural gas contracts for the benefit of being able to cross-margin power and natural gas open positions. The electric power markets are not like typical commodity markets because electricity cannot be stored economically. Since variations in supply, demand and transmission constraints lead to price variances by location, it is important to be able to hedge with contracts for the price of power at specific locations, leading to a very high number of required contracts. Nodal Contracts enable market participants to hedge their risks with central counterparty clearing at over 1,800 locations at the hubs, zones, and generation nodes. Nodal Exchange has become a vital market distinguished by its granularity and is the only cleared market for over 1,750 locations in the United States.

Nodal Exchange has two platforms: 1) a multiple to multiple trading platform that conducts a "blind" auction during a set time each trading day and 2) an over-the-counter platform that permits participants and voice brokers to submit negotiated transactions, or block trades, for clearing. The block trades are often very large complex deals, but are solely comprised of standardized Nodal Contracts. The two platforms complement each

other in that the auction platform provides price discovery on the large number of contracts traded while the over-the-counter platform permits many complex hedging deals to be submitted for central counterparty clearing. Participants are then margined based on their open positions as one portfolio, regardless of the platform source.

Since Dodd-Frank eliminates ECMs, Nodal Exchange must transition to a registered DCM or swap execution facility (SEF) by no later than July 15, 2012 (Nodal Exchange filed a petition for grandfather relief). Nodal Exchange is closely monitoring the proposed rules implementing Dodd-Frank that may impact the decision regarding the transition from ECM to DCM and/or SEF.

The following text provides comments and proposals regarding: Core Principle 9, Part 38.3 and Part 38.253(b).

Core Principle 9 – Minimum Centralized Market Requirement

Nodal Exchange currently complies with DCM Core Principle 9 as written in the Dodd-Frank Act:

“(9) EXECUTION OF TRANSACTIONS.—

“(A) IN GENERAL.—The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.

“(B) RULES.—The rules of the board of trade may authorize, for bona fide business purposes—

“(i) transfer trades or office trades;

“(ii) an exchange of—

“(I) futures in connection with a cash commodity transaction;

“(II) futures for cash commodities; or

“(III) futures for swaps; or

“(iii) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

Nodal Exchange was planning to become a DCM¹, however, the proposed rules for Core

¹ The proposed rules for SEFs also may disqualify Nodal Exchange from becoming a SEF because the Nodal Exchange blind auction platform does not display pre-trade executable bids and offers accessible by the entire market. See Part 37.9, 76 FR 1240-1 (January 7, 2011).

Principle 9 would disqualify us, even though the Dodd-Frank Act as written does not. Proposed rules for Core Principle 9 establish a minimum trading threshold that 85 percent of trading must be executed on the exchange. However, a minimum centralized market trading percentage requirement is neither required in Dodd-Frank nor was it the intent of Congress to create a one-size-fits-all required mechanism “that protects the price discovery process of trading in the centralized market of the board of trade.” To the contrary, Dodd-Frank explicitly permits DCMs to authorize off exchange transactions, i.e., block trades, for bona fide business purposes, and contains no provision calling for volume limitations in off-exchange trading.

Nodal Exchange is currently achieving the purpose of Core Principle 9 to protect “the price discovery process of trading in the centralized market of the board of trade.” The Nodal Exchange blind auction is a multiple participant to multiple participant trading platform that is critical to determining settlement prices required by LCH.Clearnet to clear all trades. Nodal Exchange also permits participants to submit block trades on Nodal Contracts. These transactions are usually significantly larger than the auction trades because the participants negotiate these transactions to accomplish their unique hedging needs. Just a few bilateral transactions would cause Nodal Exchange to violate the 85% minimum on-exchange trading threshold and extinguish a viable DCM market. Inflexible thresholds discourage innovative markets like Nodal Exchange that address legitimate market needs and accomplish the objectives of Core Principle 9 as written by Congress.

Nodal Exchange notes that Commission staff recognizes that certain newly-listed contracts may fail to meet the minimum on-exchange threshold; however, the proposed rules specifically require such contracts to have achieved an average of at least 50% trading volume over the previous 12 months with the likelihood of attaining the 85% minimum on-exchange trading threshold within the following 12 months. The purpose of these blunt thresholds is unproven and does not accommodate for the unique qualities of commodity markets like power that have been evolving over the past decade, not just 12 months. Setting any threshold discourages the formation of new DCMs.

There are numerous types of commodities markets that have developed and have continued to evolve in recent years, especially in energy. These markets can change over the short term and most markets change over the long term so that hard, fast requirements may fail to protect the price discovery process while providing false safe harbors to DCMs. Instead of protecting the price discovery process, the inflexibility of threshold requirements may precipitate failures during market disruptions when unforeseen circumstances alter the trading environment within a given industry. Nodal Exchange urges the Commission to establish a process for permitting DCM markets that protect “the price discovery process of trading” consistent with the Dodd-Frank Act to exist without established minimum trading thresholds.

Part 38.3 – Procedures for designation

The proposed rules do not address how a DCM applicant that is an ECM remains

compliant while operating as an ECM pursuant to petitioned grandfather relief. The Dodd-Frank Act permitted ECMs to petition the Commission for grandfather relief to continue to operate as an ECM for one year after the effective date of the Dodd-Frank Act, i.e., July 15, 2012. The Commission's order grants relief subject to conditions including the requirement that the ECM file a formal application for registration as a DCM or SEF within 60 days after the effective date of final regulations implementing the DCM or SEF regulations, whichever is applicable.² ECM entities like Nodal Exchange must examine the impact of both DCM and SEF final rules before making a determination. Unless the rules for DCMs and SEFs become effective simultaneously, the 60 day decision window will be curtailed resulting in less than optimal decision making. A hasty decision at this time will likely impede an efficient application review and registration process.

Furthermore, the proposed rules prescribe how a DCM applicant must comply with the core principles in order to obtain and maintain the designation as a DCM, which implies that the applicant must be Dodd-Frank compliant at the time of the DCM application. Sixty days after the rules are effective will not be sufficient time to achieve Dodd-Frank compliance. Even assuming that the DCM and SEF rules are finalized simultaneously, a 60 day application deadline is an unnecessarily harsh timeframe for an existing business to transform its operations and demand changes from its support providers. Besides the implementation of the regulatory requirements at Nodal Exchange, there are also entities that support Nodal Exchange's operations with certain services that may now require registration pursuant to Dodd-Frank, such as clearing members.³ The function of clearing members is crucial to the operations of Nodal Exchange because Nodal Exchange clears all transactions using LCH.Clearnet through their clearing members who are not otherwise required to be registered as futures commission merchants. These clearing members are typically large financial institutions. While addressing the more immediate requirements of Dodd-Frank compliance and the demands of institutional registrants, these clearing members are extremely unlikely to be able to fulfill the regulatory needs of Nodal Exchange within 60 days. Nodal Exchange, as a smaller new exchange, will be particularly disadvantaged by short compliance time frames because its supporting external parties are also facing numerous other compliance requirements and will likely prioritize compliance obligations in order to be responsive to the largest exchanges first.

Nodal Exchange recommends that the Commission revise Part 38.3 to address the DCM registration process for ECMs subject to petitioned grandfather relief as follows:

- (1) requires the ECM to apply for registration as a DCM or SEF within 90 days after the effective date of final regulations implementing the regulations for

² Pursuant to Dodd-Frank Act Section 723(c), ECMs could petition the Commission to continue to operate as an ECM for a "grandfather period" of up to one year after the July 15, 2011 effective date of the Dodd-Frank Act subject to applicable conditions set forth in the Commission's order. See 75 FR 56513 at 56515 (September 16, 2010).

³ See Section 724(a) of Dodd-Frank requiring registration as futures commission merchants.

- DCM or SEF, whichever is later, and
- (2) defers DCM or SEF compliance, whichever is applicable, until registration requirements may be fulfilled as follows:
- a. staggered compliance coordinated with the applicant during the application review process in order to achieve full compliance prior to the expiration of the one-year grandfather relief extension; or
 - b. completed compliance at the time of registration on a date certain no later than the expiration of the grandfather relief.

In the rule making for Part 38.3, the Commission proposes eliminating the expedited approval procedures for DCM applications, so that the timing of such reviews will be governed by the 180-day statutory review period rather than the prior 90-day expedited review period. The Commission notes that the 90-day accelerated review process is inefficient and impracticable because it results in incomplete applications. We support the Commission's proposal on eliminating expedited approval procedures for DCMs.

Part 38.253(b) – Additional requirements for cash-settled contracts

The proposed rules, referenced above, require DCMs offering contracts settled by reference to the price of a contract traded on another venue to have an information sharing agreement with the other venue. Nodal Exchange believes that being a party to an industry agreement, such as the International Information Sharing Memorandum of Understanding & Agreement (MOU) dated March 15, 1996 should satisfy this information sharing requirement. This MOU is executed by multiple financial institutions and exchanges throughout the world that recognize the efficiency of assisting each other in implementing their respective regulatory duties by sharing specific information in respect of common and inter-related members and employees. Since the MOU parties agree to provide financial information and positions per specific requests in accordance with the MOU, Nodal Exchange expects the MOU to meet the requirements of Part 38.253(b). However, to avoid any unnecessary potential confusion, Nodal Exchange proposes that the last sentence of Part 38.253(b) be revised as follows:

“In the alternative, the DCM may have an information sharing agreement with the other venue or designated contract market, or a multi-party information sharing agreement executed by the relevant parties.”

Nodal Exchange appreciates the opportunity to comment on this rulemaking and welcomes any questions from the Commission.

Sincerely,



Paul Cusenza
Chief Executive Officer