



8065 Leesburg Pike, 7<sup>th</sup> Floor  
Vienna, VA 22182  
**Phone** (703) 962 9800  
**Fax** (703) 962 9850  
[www.nodalexchange.com](http://www.nodalexchange.com)

March 8, 2011

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

Re: Comment Letter on Proposed Rulemaking: Core Principles and Other  
Requirements for Swap Execution Facilities, 76 FR 1214 (January 7, 2011)

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 January 7, 2011 (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 swap execution facilities (SEFs).

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 designated contract market (DCM) or SEF by no later than July 15, 2012 (Nodal Exchange filed a petition for grandfather relief)<sup>1</sup>. 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. Nodal Exchange hereby submits comments on Part 37.9, Part 37.3, and Part 37.403(b).

### **Part 37.9 – Pre-trade price transparency**

Nodal Exchange generally supports the Commission’s efforts to implement Congress’ goal “to promote the trading of swaps on SEFs and to promote pre-trade price transparency in the swaps market.”<sup>2</sup> However, the Commission’s proposed rules focus on “to promote pre-trade price transparency” without adequately balancing for the desired goal of promoting the on-exchange trading of swaps through trading facilities that achieve nondiscriminatory pricing for all participants.

The proposed rules seek to achieve “pre-trade price transparency” by requiring that SEFs offer trading services by displaying executable bids and offers on a centralized electronic system that is accessible by the entire market, which limits swaps trading to screen based trading formats. This approach may be appropriate for much of the traditional over-the-counter market for bilaterally negotiated swaps. However, entities offering certain auction platforms to market participants on an impartial basis will promote the trading of swaps for multiple parties with the “ability to execute or trade swaps by accepting bids and offers made by multiple participants”<sup>3</sup> without the posting of bids and offers on a pre-trade basis, while still providing nondiscriminatory pricing.

Nodal Exchange operates a blind auction platform, which is a multiple to multiple participant trading platform that is critical to determining settlement prices required by LCH.Clearnet to clear all trades. Participants submit bids and offers on Nodal Exchange without knowing what other participants may be bidding or even who is bidding. The results of each auction produce transparent prices available to all participants. Auction volume is awarded to participants at the same price for each expiry and at a price equal to or better than the participant’s auction order. Such a blind auction virtually eliminates the opportunity for collusion among participants. The blind auction execution

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<sup>1</sup> 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).

<sup>2</sup> See CEA Section 5h(e).

<sup>3</sup> See 76 FR 1214 at 1219 under Commission staff’s discussion of the SEF definition and registration requirements.

methodology is important for a market in which frequently few participants are interested in each location and pre-trade bidding information may negatively impact competitive orders. Nodal Exchange is able to offer standardized contracts on over 50,000 expiries with all contracts central counterparty cleared because it conducts daily blind auctions. This type of blind auction trading platform is permissible on DCMs, which defies the reasoning for its prohibition on SEFs.

Nodal Exchange's blind auction model also satisfies the statutory definition of a SEF that requires the trading facility enable multiple participants to execute trades "by accepting bids and offers made by multiple participants."<sup>4</sup> In certain industries like energy, the terms of certain bids or offers may be sufficient to disclose the bidder's identity, which can be detrimental to the bidder and consequently destroy the price efficiency of the transaction. In Nodal Exchange's blind auction, multiple participants "blindly" submit binding bids and offers into the auction without disclosure to other participants. The auction algorithmically processes the bids and offers to match participants efficiently. At the conclusion of the auction, the executed auction prices are disclosed to participants. In this manner, Nodal Exchange protects the price discovery process especially in markets with fewer participants that can be identified by their consistent trading requirements. Without a blind auction, some markets may not achieve price efficiency.

Nodal Exchange recommends that the Commission explicitly include the blind auction model of execution for SEFs especially for certain trading environments such as markets within the energy industry. This model promotes the trading of swaps on SEFs, consistent with Congress' goal.

### **Part 37.9 – Indicative quotes**

The Release requires SEFs to offer an "indicative quotes" system<sup>5</sup>; indicative quotes are described as firm bids or offers that are not immediately available for execution by a participant. It is unclear how "indicative quotes" could be used by all market participants seeking to trade a swap transaction. "Indicative quotes" may not be useful in all markets because the specified terms of the transactions may obviate the need for "indicative quotes" systems, especially in certain energy trading environments.

It appears that the Commission views "indicative quotes" as a mechanism that is necessary to obtain information from liquidity providers, especially to price transactions that lack certain specific terms. Although "indicative quotes" may be necessary to be able to price customized swap transactions, this is not true for certain energy markets such as Nodal Exchange that only offer standardized contracts with specified contract terms. The "indicative quote" requirement would be detrimental to Nodal Exchange because "indicative quotes" could be used for manipulative purposes. Unless traders are

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<sup>4</sup> CEA Section 1a(50).

<sup>5</sup> See Part 37.9(b)(2), which requires SEFs to provide the ability to post both firm and indicative quotes on a centralized electronic system that is accessible to all of the SEF's market participants.

obligated to execute transactions based on their posted firm bids and offers, false price transparency may result. Nodal Exchange is also concerned that “indicative quotes” could also enable forms of price signaling. Therefore, Nodal Exchange requests that the Commission issue rules that do not require “indicative quotes” systems at SEFs meeting certain criteria, such as standardized contracts.

### **Part 37.3 – Requirements for registration**

The Release requires that a SEF application certify that the applicant believes that while it operates under temporary grandfather relief, it will meet the requirements of Part 37. This provision refers to exempt commercial markets (ECMs), pursuant to the exemptive provisions of Section 2(h)(3)-(7) of the Commodity Exchange Act, that petitioned for grandfather relief to continue to operate as an ECM for a limited period up to a year subsequent to the July 15, 2011 effective date of the Dodd-Frank Act.

The proposed rules require ECMs to apply as a SEF, including certification of compliance with Part 37, within sixty days after the effective date of final SEF regulations. Sixty days after the rules are effective will not be sufficient time to achieve Dodd-Frank compliance. 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.

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.<sup>6</sup> 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 37.3 to address the SEF registration process for ECMs subject to petitioned grandfather relief as follows:

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<sup>6</sup> See Section 724(a) of Dodd-Frank requiring registration as futures commission merchants.

- (1) requires the ECM to apply for registration as a SEF or DCM within 90 days after the effective date of final regulations implementing the regulations for SEF or DCM, whichever is later, and
- (2) defers SEF or DCM 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.

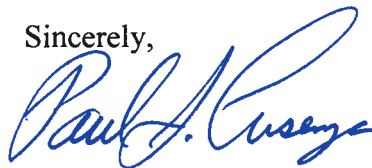
**Part 37.403(b) – Additional requirements for cash-settled swaps.**

The Release requires SEFs 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 37.403(b). However, to avoid any unnecessary potential confusion, Nodal Exchange proposes that the last sentence of Part 37.403(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