NODAL EXCHANGE

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March 21, 2011

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

Re: Comment Letter on Proposed Rulemaking: Risk Management Requirements for Derivatives Clearing Organization 76 FR 3698 (January 20, 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 20, 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 that establish risk management requirements for derivatives clearing organizations (DCOs).

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, a registered DCO. 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.

Since Dodd-Frank eliminates ECMs, Nodal Exchange must transition to a registered designated contract market (DCM) or swap execution facility (SEF) by no later than July

15, 2012 (Nodal Exchange filed a petition for grandfather relief)[1]. 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 39.13(g)(2)(ii).

Part 39.13(g)(2)(ii) – Margin requirements; Methodology and coverage

Nodal Exchange supports the Commission's efforts to strengthen the financial integrity of the futures and swaps markets. The Release proposes regulations that require DCOs to implement risk management practices to monitor and manage the range of risk exposures in connection with the clearing of swaps. However, Nodal Exchange is concerned that the Commission is prescribing initial margin methodology requirements based solely on the swap's execution venue rather than the swap's inherent risk characteristics.

The Release requires that DCOs "use a liquidation time that is a minimum of five business days for cleared swaps that are not executed on a DCM." Otherwise, the DCO would use a liquidation time that is a minimum of one business day for all other contracts that it clears. The proposed rules do not explain why this disparity should exist, and simply assume that swaps and futures traded on a DCM are inherently less risky than those traded on a SEF. In short, the proposed rule discriminates against swaps executed on SEFs.

It is anticipated that some SEFs will offer standardized swaps that settle on a DCM contract, thus economically equivalent to the related DCM futures contract commonly referred to as "futures look-alike" contracts. In addition, the currently proposed rules for DCM's Core Principle 9 establish a minimum trading threshold that requires 85 percent of trading be executed on the exchange, which will force the block trades of futures contracts on DCMs to be executed on SEFs further compounding this issue if that proposed rule remains. Therefore, it would not seem appropriate to require a minimum five day liquidation period for the economically equivalent SEF product when the related DCM futures contract would only be subject to a minimum one day hold period.

It appears that the Commission views that all swaps are inherently customized and lack the standard terms and conditions of futures contracts, necessitating a longer liquidation period. Although this may be true for many financial swaps, the needs of the evolving energy markets have produced both contracts that settle financially against futures contracts on energy commodities traded on DCMs, and contracts that are listed on both DCMs and ECMs (which could transition to SEFs) with identical terms including settlement price.[2] These swaps are standardized with the same terms and conditions as

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1 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).

2 Unlike "futures look-alikes" that settle against a DCM traded futures contract, power contracts typically settle against a price generated by a Regional Transmission Operator

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the futures contracts traded on the DCM. The proposed rule would unduly discriminate against the SEF traded contracts and potentially create a detrimental arbitrage environment as an unintended consequence.

Nodal Exchange recommends that the Commission revise Part 39.13(g)(2)(ii) to require the use of a minimum one day liquidation period for all swaps and futures contracts subject to the same terms and conditions that are traded on either a DCM or SEF. Nodal Exchange agrees with the Release that if appropriate, the DCO may be required to use longer liquidation periods based on the unique characteristics of the particular products or portfolios.

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

Sincerely,

Paul Cusenza
Chief Executive Officer

(RTO) or Independent System Operator (ISO). Thus, several exchanges, including DCMs, list such power contracts with identical terms that settle against the RTO/ISO price.

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