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

VIA ELECTRONIC SUBMISSION

RE: *Proposed Interpretive Order on Antidisruptive Practices Authority*

Dear Secretary Stawick:

I. INTRODUCTION.

On behalf of the Working Group of Commercial Energy Firms (the "Working Group"), Hunton & Williams LLP hereby submits these comments in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Proposed Interpretive Order, *Antidisruptive Practices Authority* ("Proposed Interpretive Order"), published in the *Federal Register* on March 18, 2011,[1] which provides market participants and the public with guidance on the scope of the statutory prohibitions set forth in new Sections 4c(a)(5) and 4c(a)(6) of the Commodity Exchange Act ("CEA"), as adopted in Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").[2]

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers, and utilities. The Working Group considers and responds to requests for public comment regarding regulatory and legislative developments with respect to

[1] *Antidisruptive Practices Authority*, Proposed Interpretive Order, 76 Fed. Reg. 14,943 (Mar. 18, 2011) (hereinafter "Proposed Interpretive Order").

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

II. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.

The Working Group supports the goals of the Act to enhance transparency and reduce systemic risk in the swap markets and appreciates the opportunity to provide the comments set forth herein below. While the Commission's regulations exempt interpretive orders or rules from the public rulemaking process, the Working Group appreciates the Commission's efforts to treat this as a *proposed* interpretive order and request comment from market participants. To that end, the Working Group hopes that the comments filed in response to the Proposed Interpretive Order will be treated analogously by the Commission to those received in proposed rulemaking proceedings.

Without formal regulations implementing new CEA Sections 4c(a)(5) and 4c(a)(6), the issuance of a Final Interpretive Order addressing the comments provided in response to the Proposed Interpretive Order will provide the guidance and certainty necessary to effectively aid market participants in their efforts to comply with these new statutory requirements. Accordingly, the Working Group hopes that the Commission will (i) consider all comments submitted by interested parties in this proceeding, (ii) create a formal record, and (iii) specifically identify and address the comments submitted by interested parties.

A. VIOLATING BIDS AND OFFERS.

New CEA Section 4c(a)(5)(A) provides that it is unlawful for any person to engage in any practice subject to the rules of a registered entity that "violates bids or offers." The Proposed Interpretive Order interprets new CEA Section 4c(a)(5)(A) as "prohibiting any person from buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price."[3]

The Proposed Interpretative Order declines to interpret new CEA Section 4c(a)(5)(A) using an intent standard and instead states that the violation of bids or offers is a *per se* offense. As a consequence, the Commission would not be required to show that a person accused of an alleged violation of bids or offers acted with any intent to disrupt fair and equitable trading.

[3] Proposed Interpretive Order at 14,946.

Such a strict application of new CEA Section 4c(a)(5)(A) is not reasonable and could have a chilling effect on liquidity in swap markets. Specifically, a *per se* offense standard would effectively eliminate any defense for good faith, inadvertent errors that can occur from time to time in the manual execution of trades. Additionally, the adoption of a *per se* offense standard would have the unintended consequence of penalizing market participants that do not trade at the lowest available offer or highest bid when legitimate, verifiable business reasons support such conduct.[4]

For example, in light of various new requirements imposed by Title VII of the Act, it cannot be the Commission's intent to require a market participant (Party A) to transact with a counterparty (Party B) proposing the lowest available offer or highest bid if Party A does not have the required documentation, including credit support arrangements, in place with Party B or has other legitimate, verifiable business reasons for not transacting with Party B. The Working Group believes that a market participant should retain the ability and discretion to **not** transact with a particular counterparty if that counterparty does not meet applicable internal credit risk management standards. Further, market participants should not be penalized for not transacting at lowest available offers or highest bids when responding to requests for quotes or requests for proposals where price is an important, but not the only critical term.

The Working Group strongly recommends that the Commission interpret new CEA Section 4c(a)(5)(A) as requiring an intent to disrupt the market.[5] This approach would avoid (i) unintended consequences, such as those discussed above, associated with using a *per se* offense standard, and (ii) the uncertainty that it could create in swap markets. The use of an intent standard would provide market participants with a reasonable, but limited, degree of flexibility to address errors or otherwise justify legitimate business conduct that was not intended to harm the market but results in technical violations of bids and offers. Finally, interpreting new CEA Section 4c(a)(5)(A) as if it contained an intent standard would in no way diminish the Commission's ability to investigate bid and offer violations by market participants that appear to be systemic in nature or demonstrate an institutional lack of compliance with the requirements of new CEA Section 4c(a)(5)(A).

B. FAIR AND EQUITABLE TRADING.

New CEA Section 4c(a)(6) gives the Commission authority to make and promulgate rules that are reasonably necessary to prohibit trading practices that are disruptive of "fair and

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[4] The Working Group believes that if transactions in equivalent contracts are occurring on multiple exchanges, a party should not be held accountable if its bid on one exchange crosses an offer on another, and vice versa. In addition, prices in bilaterally negotiated contracts should not be compared to a party's contemporaneous bids and offers on an exchange. Thus, the Working Group supports the Commission's statement—"section 4c(a)(5)(A) does not create any sort of best execution standard across multiple trading platforms and markets; rather, a person's obligation to not violate bids or offers is confined to the specific trading venue which he or she is utilizing at a particular time—and strongly recommends that such interpretation of new CEA Section 4c(a)(5)(A) be adopted in any final interpretive order.

[5] The Working Group believes that a general intent or recklessness standard could result in an overbroad application of new CEA Section 4c(a)(5)(A).

equitable trading." The Working Group respectfully requests that the Commission clarify the term "fair and equitable trading" and provide further guidance to market participants and CFTC staff who otherwise may adopt conflicting interpretations of such phrase.

The Working Group respectfully submits that this term should be interpreted narrowly. A broad interpretation of "fair and equitable trading" could effectively create a new and far-reaching standard by which the Commission could evaluate and regulate trading practices. In this regard, the term "fair and equitable trading" should not be applied by the Commission when evaluating transactions between two equally sophisticated market participants (*i.e.*, eligible contract participants ("ECPs")).[6] Further, the Working Group recommends that the Commission's interpretation and application of the term "fair and equitable trading" be guided by the following non-exhaustive principles:

- the relevant markets;
- the size of the relevant markets;
- whether the relevant parties operate pursuant to, and within, the rules of an exchange;
- the activity constitutes a practice (*i.e.*, an activity occurring more than once or having the intention of occurring more than once); and
- lack of intent to create sudden and dramatic changes in market conditions.

C. THE COMMISSION SHOULD RELY UPON THE EXPERTISE OF EXCHANGES TO IDENTIFY DISRUPTIVE TRADING PRACTICES.

As noted in the Working Group's comments submitted in response to the Commission's Advanced Notice of Proposed Rulemaking, *Antidisruptive Practices Authority*, exchanges have rules and guidelines that are known and understood by market participants.[7] Indeed, many exchanges already have rules that govern the type of practices identified in new CEA Section 4c(a)(5)(A)-(C).[8] Any guidance set forth in a final interpretative order issued by the Commission in this proceeding should be consistent with applicable exchange rules. This will promote certainty and help ensure the efficient operation of swap markets. To the extent that the

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[6] ECPs are assumed to be sophisticated parties engaging in arms-length bilateral negotiations, and thus, application of a fair and equitable standard to such transactions would be unnecessary and misplaced.

[7] *See Working Group of Commercial Energy Firms*, Comment Letter at Part II.C.2.b. (Jan. 3, 2011).

[8] *See, e.g.*, NYMEX Rulebook, *Ch. 5: Trading Qualifications and Practices* § 514 (prohibiting certain trading infractions, including a bid or offer out of line with the market, a trade through the existing bid or offer, etc.); ICE OTC Regulatory Rulebook for Significant Price Discovery Contracts (Annex L), *Ch. 5: Trading Standards* (outlining standards prohibiting certain practices, including "acts detrimental to ICE's welfare"); *see also* ICE Participant Agreement, *Annex H: Participant Code of Conduct* (Nov. 1, 2010) (requiring ICE participants to act in accordance with "sound trading practices" prohibiting wash trades and misrepresentative trading).

Commission adopts guidance that deviates from applicable exchange rules, such deviations should be clearly identified and explained.

III. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the energy swap markets in the United States. The Working Group respectfully submits that the Commission consider its comments set forth herein regarding the Proposed Interpretive Order.

The Working Group expressly reserves the right to supplement these comments as deemed necessary and appropriate.

If you have any questions, please contact the undersigned.

Respectfully submitted,

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