Dominion Resources Services, Inc.
120 Tredegar Street, Clearinghouse Building, Richmond, VA 23219

January 17, 2012

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street N.W.
Washington, DC 20581

Re: **Comments of Dominion Resources, Inc. to Final Rule and Interim Final Rule on "Position Limits for Futures and Swaps" (RIN 3038–AD17) under the Dodd-Frank Wall Street Reform and Consumer Protection Act.**

Dear Mr. Stawick:

Dominion Resources, Inc. ("Dominion") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") Final Rule and Interim Final Rule on "Position Limits for Futures and Swaps" ("Interim Final Rule"),[1] which implements the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Dodd-Frank").[2]

I. *Introduction*

Dominion is one of the nation's largest producers and transporters of energy, with a portfolio of more than 27,600 megawatts of generation, 12,000 miles of natural gas transmission, gathering and storage pipeline, and 6,000 miles of electric transmission lines. Dominion operates the nation's largest natural gas storage system, with 942 billion cubic feet of storage capacity and serves retail energy customers in 13 states. Dominion enters into swap agreements to reduce exposure to market shifts in prices received and paid for electricity, natural gas and other commodities. Dominion clearly is an end user under the intent of Congress and the Dodd-Frank Act.[3]

The energy activities constituting Dominion's core business were found to be vested with the public interest under the Federal Power Act of 1935 and the Natural Gas Act of 1938 and thus are subject to intense regulation by the Federal Energy Regulatory Commission ("FERC"), as well as state utilities. Dominion's formation and growth as an energy company has been with an understanding of the importance of regulation and market oversight in the protection of consumer interest, which it believes has been effectively safeguarded by FERC. Dominion participates in the swaps market as an end user hedging its commercial risks in the physical

[1] Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (Nov.18, 2011).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

[3] *See* 156 Cong. Rec. H5248 (daily ed. June 30, 2010) (letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Collin Peterson); 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (statements of Sen. Blanche Lincoln).

energy markets. Its hedging activities that mitigate its exposure to market risks ultimately benefit the consumer interests in the natural gas and power markets it serves. As an end user using futures and swaps for hedging purposes, Dominion had expected to be minimally affected by the Interim Final Rule concerning position limits for futures and swaps. Unfortunately, as described below, the rules as adopted by the Commission may impose significant costs on energy market participants like Dominion and restrict the ability of such market participants to hedge their commercial risks.

The Interim Final Rule implements Section 737 of Dodd-Frank, which, among other things, amends CEA Section 4a to extend the authority of the Commission to set position limits for swaps. In relevant part, CEA Section 4a(a)(1) states that the Commission shall fix position limits where "necessary to diminish, eliminate, or prevent" the burden of "excessive speculation" in the markets it oversees. CEA Section 4a(a)(3) specifically directs that the levels are to be set:

(i) To diminish, eliminate or prevent *excessive speculation* as described under this section;

(ii) To deter and prevent *market manipulation, squeezes and corners*;

(iii) To ensure sufficient *market liquidity* for *bona fide* hedgers; and

(iv) To ensure that the *price discovery function* of the underlying market is not disrupted.

Regulations adopted pursuant to Dodd-Frank and the CEA should be developed with recognition of the integrated design of these statutory provisions for the protection of the national public interest, while also mitigating the regulatory impact on commercial end users from redundant and duplicative regulatory processes. CEA Section 3 provides an architecture for an integrated regulatory structure designed to protect the national public interest against systemic risk. CEA Section 3's statement of purpose defines the national public interest by the presence of certain factors that link all of the various consumer protectionist provisions of the CEA as amended by Dodd-Frank.[4] The italicized factors in the language above link CEA Section 4a(a)(3) to the CEA's overall purpose. Position limit regulations that restrict the legitimate risk management activities of end users and hinder transactions from qualifying as bona fide hedges are inconsistent with the protection of the national public interest and the integrated regulatory scheme intended by the CEA. Such overreach has the potential to reduce market liquidity for bona fide hedgers, contrary to the statutory requirement, without advancing the national public interest. In the end, overly restrictive position limit regulations do harm to markets and cause end users to assume greater commercial risks in their core business or to restrict legitimate

[4] *See* Commodity Exchange Act, ch. 545, § 2, 49 Stat. 1491, 1491 (1936) (current version at CEA § 3, 7 U.S.C. § 5) (setting forth the need to regulate futures transactions as they were affected with a "national public interest," "carried on in *large volume* by the public generally" with prices that were "*generally quoted and disseminated* throughout the United States . . . as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof," and "*susceptible to speculation, manipulation, and control* . . . render[ing] regulation imperative for the *protection of such commerce and the national public interest*" (emphasis added)).

expansion of their core business, because the tools by which they manage their commercial risks are ineffective or unavailable.

The Interim Final Rule sets spot-month position limits to be imposed on certain futures and swap contracts. The Commission has asked whether the Interim Final Rule maximizes the objectives enumerated in CEA Section 4a(a)(3). However, the Interim Final Rule does not present any record evidence supporting any relationship between the position limits as adopted and the CEA Section 4a(a)(3) objectives. Without a rational relationship between the proposed position limits and these four objectives, which are hallmarks of the national public interest under CEA Section 3, the Interim Final Rule does not serve the CEA public interest purpose. Accordingly, Dominion believes that any subsequent review of the Interim Final Rule resulting from the Commission's request for comments should be consistent with the CEA's integrated regulatory structure and supported by data, analysis or other record evidence demonstrating a need to protect the public interest under CEA Section 3. The Commission should consider further tailoring the Interim Final Rule to minimize the impact of the final regulations on energy market end users, particularly where the impact cannot be justified by a need to protect the national public interest.[5]

II. *Relationship Between Initial Position Limit and Deliverable Supply for Natural Gas Contracts*

The Commission has established spot-month position limits for twenty-eight physical-delivery Core Referenced Futures Contracts, including the NYMEX Henry Hub Natural Gas ("NG") futures contract,[6] a contract that has significance for energy companies like Dominion. The Henry Hub NG contract is characterized by factors relating to price discovery and market liquidity functions, making its listing appropriate for position limits. Under the Interim Final Rule, the spot-month position limits for physical-delivery contracts will be based on 25% of the estimated deliverable supply, as determined by the Commission in consultation with DCMs. The deliverable supply determination would be updated every two years, starting, for energy contracts such as the Henry Hub NG contract, as early as August 2014.[7] Position limits for cash-settled referenced contracts would be set based on a one-to-one ratio to the relevant physical-delivery contract, with the exception of the Henry Hub NG contract, which the Commission sets at a five-to-one ratio on an interim basis.[8] This five-times limit applicable to cash-settled

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[5] *See* Letter from Dominion Resources, Inc. to the Honorable Scott D. O'Malia (Sept. 22, 2011), attached as Attachment A (which discusses how the integrated regulatory structure as conceived in the CEA for the protection of the national public interest against system risks to swap markets should instruct the design of specific regulations under the CEA's individual statutory provisions, specifically regarding real-time reporting, position limits and mandatory clearing).

[6] *See* 17 C.F.R. § 151.2 (listing the various Core Referenced Futures Contracts).

[7] *See* 17 C.F.R. § 151.4(d)(2). The adjustment process will commence on "January 1st of the second calendar year after the term 'swap' is further defined" under Dodd-Frank. *See id.* § 151.4(d)(2)(i). Energy contracts will be the first category revised, with deliverable supply data due March 31, 2014, revised limits published by May 31, 2014, and an effective date of August 1, 2014. *See id.* § 151.4(d)(2)(iii)(B), (vi)(B), (e)(1)(ii). Thereafter, energy spot-month limits will be revised biennially. *See id.* § 151.4(d)(2)(vi)(B).

[8] *See* Position Limits for Derivatives, 76 Fed. Reg. 4757, 4758 (Jan. 26, 2011) ("Proposed Rules"). The one-to-one ratio of spot-month physical limits (25% of deliverable supply) and cash-settled limits (25% of deliverable supply)

equivalents of the Henry Hub NG contracts is an aggregate limit applicable to combined physical delivery and cash-settled contracts, meaning that a firm may not exceed the five-times limit when counting all of its cash-settled and physical-delivery positions.[9]

Although the Commission found that spot-month limits are to be set based on the deliverable supply determination, it nevertheless adopted *initial* spot-month position limits pending the collection and analysis of relevant data regarding deliverable supply on which to base the biennial adjustment of spot-month position limits. For the Henry Hub NG physical-delivery contract, the initial spot-month limit is 1,000 contracts, which necessarily sets, in accordance with the Commission's five-to-one ratio, the spot-month limit for cash-settled natural gas contracts at 5,000 contracts, as well as an aggregate limit of 5,000 contracts for both physical-delivery and cash-settled contracts.[10] The Commission is implementing these spot-month position regulations on an interim final basis and invites comments on how the spot-month position limits are set, e.g., whether deliverable supply and the proposed ratio between cash-settled contracts to physical-delivery contracts are appropriate metrics.

The Interim Final Rules do not adequately support or justify setting a position limit of 1,000 contracts for physical-delivery Henry Hub NG contracts on an initial, interim basis. Since the Commission's own methodology provides for changes to the limits based on deliverable supply calculations, at a minimum the initial, interim limits should have some rational relationship to the current deliverable supply at Henry Hub. A limit of 1,000 contracts would appear on its face to be severely restrictive in light of the physical delivery capacity at the Henry Hub interconnection that is published to be 1.8 bcf/day of gas, not including significant new storage facilities tied to the Hub. Since no record evidence was presented in this proceeding or discussed in the Interim Final Order regarding the capacity currently deliverable at Henry Hub, there is no evidence that a 1,000 contract limit bears any rational relationship to the deliverable supply formula now required under the Commission's regulations. Likewise, there is no evidence contained in the record indicating that the strict 1,000 physical-delivery contract limit is needed to advance the four goals of position limits, namely: to prevent excessive speculation; to deter and prevent market manipulation, squeezes and corners; to safeguard sufficient market liquidity for bona fide hedgers; and to ensure that the price discovery function of the underlying market is not disrupted.[11]

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is a departure from the Proposed Rules, which had provided for a cash-settled limit for *all referenced* contracts of five times the physical limit (subject to certain conditions), not just the Henry Hub NG contract (emphasis added).

[9] 17 C.F.R. § 151.4(a)(2)(ii); *see also* 76 Fed. Reg. at 71,636-37.

[10] 76 Fed. Reg. at 71,695 (Appendix A).

[11] During the open meeting discussing these final rules, Commissioner Sommers observed that it was a "problem" that the deliverable supply calculations had not been updated since 2005 for the agricultural contracts and may not be updated again until at least 2014. *See* Transcript of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act, October 18, 2011, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission7_101811-trans.pdf, at 161.

With respect to the cash-settled limit, Dominion notes that the interim 5,000 contract limit for Henry Hub NG must also advance the four goals of position limits.[12] Without record evidence regarding deliverable supply, Dominion cannot assess whether to support a five-to-one ratio of cash-settled contract limits to physically settled limits. An appropriate cash-settled contract limit is particularly important to energy companies, who rely on the Henry Hub NG contract and related swaps to hedge price risk associated with their operations. Dominion submits that the Commission cannot make a reasoned decision about the appropriate ratio until the deliverable supply calculation is updated and the spot-month limit for physical-delivery natural gas contracts is appropriately set. This calculation should be a part of the record in this proceeding, as well as the historical performance of the Henry Hub NG contract relative to its efficiency in serving the price discovery function and its market liquidity, which is "very active."[13] As part of its review of the Interim Final Rule regarding deliverable supply and the ratio of cash-settled contracts to physical-delivery contracts, the Commission should thus reconsider the legitimacy of the initial position limits set forth in Appendix A to the Final Interim Rule, particularly with respect to NYMEX Henry Hub NG contracts.

It is critically important that the initial position limits are set correctly right from the start, as companies will have to invest significant time and expense to update their business practices and data systems accordingly to manage the risk of non-compliance with the initial position limits for a two-year period. The Commission acknowledges in the Interim Final Rule that the "the spot-month limits on cash-settled natural gas contracts will be more restrictive than the current natural gas conditional spot-month limits."[14] In fact, it notes that the interim limit of 5,000 contracts is effectively half of the combined cash-settled limits currently applied to both the NYMEX cash-settled natural gas futures contract and the ICE Henry HUB LD1 contract.[15] This 5,000 limit becomes even more restrictive where the limit applies to the aggregate of positions across an entity's affiliates and across all platforms. The Commission provides no record evidence that would justify imposing this stricter, 5,000 contract limit, nor provides any discussion of the costs of compliance or the benefits of imposing new, albeit interim, restrictive limits. The Commission recognizes that the Interim Final Rules should advance the public

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[12] The Commission notes that the "the existing conditional limits on cash-settled natural gas contracts have not materially diminished the price discovery function of physical-delivery contracts." 76 Fed. Reg. at 71,636. However, it also acknowledges that the new, interim final limits cut these limits in half or even more, since the new limits apply in the aggregate to contracts traded on all platforms and bilaterally. *See id.* at 71,637. Nowhere does the Commission show that the new, narrower, interim final limits, will not diminish price discovery of the Henry Hub NG contract.

[13] 76 Fed. Reg. at 71,636. The Commission has recognized that there is a difference between physical-delivery and cash-settled contracts with respect to setting position limits consistent with the four goals. For example, Core Principle 5(b)(2) of the current rules for designated contract markets provides that, "[i]n general, position limits are not necessary for markets where the threat of excessive speculation or manipulation is nonexistent or very low. Thus, contract markets do not need to adopt speculative position limits for . . . contracts specifying cash settlement where the potential for distortion of such price is negligible." 17 C.F.R. § 38, Appendix B. Nothing in the current record has changed such a finding. Hence, before setting a limit on cash-settled Henry Hub NG contracts, even on an interim basis, the Commission should examine how the level of the limit relates to the four goals, including the potential for price distortions.

[14] 76 Fed. Reg. at 71,637.

[15] *Id.*

interest factors discussed earlier and included in CEA Section 4a(a)(3) and asks for comments regarding whether the Interim Final Rule maximizes those objectives. But that begs the question of whether the position limits are set beyond the need to achieve those objectives. Not only should the position limits be adopted to prevent excessive speculation and price manipulation and protect market liquidity and the contract's price discovery function, position limits also should be established at levels no higher than needed to provide these protections. The overly strict limits proposed by the Interim Rule for natural gas contracts not only appear inconsistent with the Commission's deliverable supply criteria but also fail to advance the objectives of Section 4a(a)(3), and thus fail to contribute to the protection of the national public interest of CEA Section 3.

Setting an overly restrictive initial spot-month limit of 1,000/5,000 contracts is additionally troublesome where the Final Rules also place significant new restrictions and burdens on end users seeking to apply for the bona fide hedge exemption and where they impose a greatly expanded, and much more difficult to administer, intraday requirement, discussed in more detail below. The Commission's cost and benefit analysis fails to consider the costs of the bona fide hedge and intraday requirements, especially in the context of the new, more restrictive, interim spot-month limits. Likewise, the Commission fails to consider how the bona fide hedge and intraday requirements comply with CEA Section 4a(a)(3) when applied in conjunction with the new position limits. For the reasons discussed above and in the following sections, Dominion submits that, at a minimum, if the Commission imposes strict, interim position limits, it provide more reasonable and less burdensome bona fide hedge and end-of-day compliance rules.

III. *Implication of Intraday Compliance and the Bona Fide Hedge Exemption Under Overly Strict Position Limits*

Establishing an appropriate initial and subsequently adjusted spot-month position limit is particularly critical for end users where position limits are administered in the context of stricter intraday compliance and bona fide hedge regulations. The Interim Final Rule must be considered in its entirety to properly assess its cost and benefits. Consequently, in considering comments regarding the appropriate interim spot-month position limits, particularly for natural gas, the Commission should also take into consideration the impact on energy end users who face increased risks of exceeding limits and fewer options to manage their commercial risks, and who now must implement a costly real-time monitoring system and/or satisfy burdensome bona fide hedge exemption application and reporting regulations. The Commission proposes that for "the majority of participants, the 25 percent of deliverable supply formula is estimated to impose limits that are sufficiently high, so as not to affect their hedging or speculative activity."[16] It is difficult for Dominion and other energy swap end users to comment on the relative accuracy of this presumption because there is no record evidence as to what that deliverable supply may actually be. As noted above, the initial cash-settled limit is almost half the limit with which energy end users must now comply under the combined cash-settled limits currently imposed on both the NYMEX cash-settled natural gas futures contract and the ICE Henry Hub LD1 contract.

[16] *Id.* at 71,668.

This new, lower, aggregate limit does not appear "sufficiently high, so as not to affect" hedging or speculative activities, and certainly the final rules provide no support for this proposition. In any event, the proposed 1,000 contract position limit for physical-delivery natural gas is not correlated to this deliverable supply formula. As a result, energy end users, such as Dominion, will have less margin for error in complying with these limits, particularly where the Interim Final Rule has increased the operational requirements to manage transactions that might otherwise qualify for a bona fide hedge exemption.

A. Intraday Compliance

The Commission's cost discussion in the Interim Final Rule regarding position limits completely fails to take into consideration the cost implications of intraday compliance that would require real-time calculation and monitoring in order to avoid penalties. It states that the Core Referenced Futures Contracts "have some form of spot-month position limits currently in place by their respective DCMs and thus market participants with very large positions . . . should be currently incurring costs (or foregoing benefits) associated with those limits . . . and that a certain level of costs is already necessary to comply with the Congressional mandate."[17] With respect to to intraday compliance in particular, the Interim Final Rule states that such "intraday compliance would constitute a marginal compliance cost and not be overly-burdensome."[18] The Commission also asserts its belief that firms can manage intraday compliance through use of internally imposed limits on individual traders and affiliated entities. The Commission's assertions entirely ignore the costs related to the swap activity of end users, who have not had to manage this type of intraday compliance risk previously on the scale required in the Interim Final Rule. Dominion's current cost estimate for designing and implementing a real-time position monitoring system, associated with position limit compliance, is approximately $1.5 million. In its rulemaking, the Commission further estimates that the position limits could affect 85 traders in energy Referenced Contracts, based on the number of traders holding hedge exemptions for existing DCM, ECM, or FBOT spot-month position limits for Referenced Contracts.[19] The overall industry cost implications for real-time compliance systems, based only on the Commission's expected number of affected entities, greatly exceeds what would generally be considered marginal costs. The requirement to manage intraday compliance within strict limits is burdensome per se. However, when those stricter limits are not justified by excessive speculation and potential for price manipulation, then the intraday compliance requirement becomes overly-burdensome.

If the Commission determines not to reevaluate the initial 1,000/5,000 contract position limits for Henry Hub NG contracts, Dominion respectfully suggests that before imposing intraday compliance, the Commission consider gathering information as to the frequency of intraday non-compliance of energy market end users by allowing each company to look back over the relevant day to assess whether it had exceeded its position limit and at what time during the day. Any non-compliance and the related timing could be reported to the Commission

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[17] *Id.* at 71,669.

[18] *Id.* at 71,643.

[19] *Id.* at 71,668.

consistent with the reporting requirements, but such intraday non-compliance, when infrequent and when corrected by the end of day, would not be subject to penalties without prior notice from the Commission that further non-compliance would be sanctioned. This process would provide the Commission with information on which to base a finding concerning the need for intraday compliance and would permit the Commission to consider whether intraday compliance by end users could be sufficiently monitored via a look-back over the relevant day, rather than real-time monitoring, and still accomplish position limits statutory objectives. Few system changes would be required for Dominion to be able to report to the Commission as required by the Interim Final Rule any transactions that exceeded its position limit and the relevant time of day. Costly system changes and additions are required only where Dominion must monitor intraday positions on a real-time basis, risking penalties for exceeding intraday limits.

B. Bona Fide Hedge Exemptions

The Interim Final Rule will have a significant impact on the ability of end users to rely on the bona fide hedge exemption, increasing their susceptibility to position limits that could affect their ability to mitigate their commercial risk exposure. While the definition of bona fide hedging transactions adopted by the Interim Final Rule generally follow the language used in CEA Section 4a(c) as amended by Section 737 of Dodd-Frank, the Commission, on its own, further narrows the definition by requiring that the relevant hedge qualify as one of eight enumerated hedges set forth in 17 CFR §151.5(a)(2).[20] In comments to the proposed regulations, numerous parties voiced concerns that the proposed regulations adopted under this Interim Final Rule were overly restrictive and "would unnecessarily limit the ability of many market participants to engage in 'many well-established risk reducing activities.'"[21] In addition, the documentation required in order to claim the bona fide hedge exemption for a transaction over the life of such transaction is so onerous that it makes it administratively burdensome and inefficient to utilize the bona fide hedge exemption to avoid exceeding position limits. Under the new regulations, business processes and systems would be required that can distinguish between hedges that are bona fide and therefore exempt from position limits and those transactions that

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[20] *Id.* at 71,644. Neither the CEA nor Dodd-Frank requires the Commission to establish "enumerated" hedges. Since the Commission's decision to (i) create enumerated hedges and (ii) require hedgers to satisfy one of the eight enumerated hedges is discretionary, it should justify such regulations based on record evidence and consistent with the advancement of the four statutory goals cited above. However, the Commission presents no record evidence to support limiting bona fide hedges to eight enumerated hedges. Similarly, the Commission has not justified, based on the record, the definition of "bona fide hedge" as applied to swaps compared to futures. Once again, the Commission has discretion to define "bona fide hedge" in a manner that makes sense for swaps. *See Proposed Rules*, 76 Fed. Reg. at 4760 (noting that Dodd-Frank "places no restriction on the Commission's ability to define bona fide hedging for swaps."). However, it chose simply to use the same definition as that required for futures. This definition, however, is substantially the same as that created in 1977 in the context of agricultural contracts. The swaps markets have expanded greatly since that time. *See, e.g.*, Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations (September 2008) at 10 (discussing the development of swap markets especially since 1980). The Commission should reconsider its definition of "bona fide hedge" for purposes of swaps in a way that conforms to the reality of current swaps markets and in a manner that makes sense for energy and other end users. As noted above, the Commission effectively narrows the availability of the bona fide hedge exemption at a time when it also imposes stricter spot-month limits, including on an interim basis. The combination of these actions harm end users and make risk reduction more difficult.

[21] 76 Fed. Reg. at 71,644.

would count toward position limits, and to further distinguish when a hedge may no longer qualify for the exemption.

The bona fide hedge exemption is a significant tool for end users and serves to mitigate the otherwise intrusive impact that position limits will have on energy companies' core commercial businesses. Yet, as drafted, end users, such as Dominion, are now forced to elect whether to expend the significant financial costs and resources necessary to claim bona fide hedge exemptions and maintain the onerous application and recordkeeping requirements, on the one hand, or to forgo claiming any bona fide hedge exemptions entirely and thus be subject to position limit risks, on the other hand. While Dominion believes that the shackles imposed on end users in their legitimate management of commercial risks as a result of the narrowing of the bona fide hedge exemption was not the intent of Congress when enacting Section 737 of Dodd-Frank, it also had hoped that concerns arising from the limited availability of the exemption would, at least practically, be moot because of reasonable position limits. In reviewing comments to this Interim Final Rule and reevaluating initial position limits, the Commission may wish to weigh the cost and benefits associated with stricter position limits against the cost and benefits of a narrower bona fide hedge exemption. If the position limits initially adopted by the Interim Final Rule, particularly for Henry Hub NG contracts, are found by the Commission to be rational in the protection of market participants and the general national public interest, the Commission should consider the negative impact on end users from what has been acknowledged by the Commission itself as more restrictive limits and reconsider changes to the bona fide hedge exemption rules to mitigate their harm to end users as earlier described in these comments.

IV. *Conclusion*

Dominion appreciates the opportunity to submit comments and respectfully encourages the Commission to reconsider the interim final position limit of 1,000/5,000 contracts for Henry Hub NG contracts. To provide useful comments on the 25% of deliverable supply formula requires more data and information on NYMEX Henry Hub NG contracts than has been provided and made available to the public in this proceeding. However, should the Commission find that 1,000 contracts is consistent with its 25% of deliverable supply formula, then Dominion submits that 25% would not appear to be a reasonable percentage of deliverable supply for purposes of setting position limits. Dominion would further encourage the Commission, for purposes of establishing rational position limits, to take into consideration the aggregate negative effect of all the regulations proposed and adopted in this Interim Final Rule on end users' ability to manage the commercial risks associated with their core businesses. The Commission should incorporate into its decisionmaking and cost-benefit analysis the substantial additional costs to end users to comply with the rules and regulations, which Congress intended should have a minimal impact on them, particularly where the benefit to consumers and the national public interest are not commensurate with those costs and burdens. If the Commission affirms its proposed initial position limits, Dominion further respectfully requests that the Commission consider amendments to the regulations requiring intraday compliance by end users and to the definition of bona fide hedge so that the overall regulatory impact does not arbitrarily discriminate against end users while providing little incremental protection against excessive speculation and price manipulation, and ultimately systemic risk.

Dominion respectfully requests that the Commission consider these comments in its consideration of position limits under the Interim Final Rule. Position limit regulations will have a significant impact on how end users conduct their businesses and manage their commercial risks. If you have any questions, or if we may be of further assistance, Dominion is willing to discuss these issues further with the Commission or its Staff at your convenience.

Respectfully,

/S/ David C. Holden

David C. Holden
Vice President
Enterprise Risk Management

ATTACHMENT A

To Comments of Dominion Resources, Inc.

Final Rule and Interim Final Rule on "Position Limits for Futures and Swaps"
(RIN 3038–AD17)

Dominion Resources, Inc.
120 Tredegar Street, Richmond, VA 23219

Dominion

September 22, 2011

The Honorable Scott D. O'Malia
Commissioner
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Review of Swaps for Mandatory Clearing Under Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

Dear Commissioner O'Malia:

Thank you for your invitation to the public to provide comments directly to you for consideration regarding the Commission's review of swaps for mandatory clearing under section 723 of Dodd-Frank. Dominion Resources, Inc. ("Dominion") has stated in other comments that, as a commercial end user, it supports the consumer protections intended by Dodd-Frank and the Commission's efforts to implement those protections in the swap markets. Dominion recognizes mandatory clearing as one of the building blocks Dodd-Frank has provided the Commission to use in constructing a regulatory infrastructure to guard against systemic risks of financial failures and market participants' insolvency. However, after much consideration, it became clear that the answers to the questions you posed are best approached by answering the larger question of how mandatory clearing should be considered within the consumer protection framework of the Commodity Exchange Act ("CEA"). While the comments in this letter provide expanded discussion of Dominion's answer to this larger question, Dominion has attached to this letter a one-page abbreviated answer for your convenience.

Dominion is one of the nation's largest producers and transporters of energy, with a portfolio of more than 27,600 megawatts of generation, 12,000 miles of natural gas transmission, gathering and storage pipeline and 6,000 miles of electric transmission lines. Dominion operates the nation's largest natural gas storage system with 942 billion cubic feet of storage capacity and serves retail energy customers in 13 states. Dominion enters into swap agreements to reduce exposure to market shifts in prices received and paid for electricity, natural gas and other commodities. Dominion is clearly an end user contemplated under Dodd-Frank, as reflected in the legislative history and correspondence by various members of Congress.[1]

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[1] *See* 156 Cong. Rec. H5245 (daily ed. June 30, 2010) (statement of Rep. Colin Peterson); *see also* 156 Cong. Rec. H5248 (daily ed. June 30, 2010) (Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Collin Peterson); 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (statements of Sen. Blanche Lincoln). The Senate version of Dodd-Frank was more restrictive than the House version with respect to which

The energy activities constituting Dominion's core business were found to be vested with the public interest under the Federal Power Act of 1935 and the Natural Gas Act of 1938 and thus are subject to intense regulation by the Federal Energy Regulatory Commission ("FERC"), as well as state utilities. Dominion's formation and growth as an energy company has been with an understanding of the importance of regulation and market oversight in the protection of consumer interest, which it believes has been effectively safeguarded by FERC. Its participation in the swap market as an end user to hedge its commercial risks in the physical energy markets ultimately benefits the consumer interests that its physical activities serve. Thus, Dominion generally supports the regulatory structure that the Commission is developing and implementing under the Dodd-Frank amendments to the CEA that is designed to achieve consumer protection for end users of swap products, such as Dominion, and the public generally.

I. INTRODUCTION

Margining is a core building block in the regulatory structure being designed by the Commission to implement Dodd-Frank. CEA Section 2(h), as amended by section 723 of Dodd-Frank, establishes the clearing requirements for swaps, with subsection (2)(D)(ii) setting forth the factors to be used by the Commission to determine which swaps should be subject to mandatory clearing. You have asked how the factors listed there should be considered by the Commission. Among those listed in CEA Section 2(h)(2)(D)(ii) are fundamental factors that become the mortar binding the building blocks of the various CEA sections into an integrated regulatory structure to carry out the consumer protection objective of the CEA. Those factors include price dissemination and/or a price discovery function; market liquidity; notional volume; susceptibility to manipulation and price disruption; and systemic risk. The role these factors play in determining the need for mandatory clearing cannot be defined in the isolated context of section 2(h) without first defining the role they play throughout the other requirements under the CEA.

When Congress first passed the CEA in 1936, Congress set out its finding and its purpose for regulating transactions that were affected with a national public interest in section 3.[2] Section 3 defined the national public interest in terms of price dissemination and price discovery functions; market liquidity and size, and the market's susceptibility to manipulation and price disruption; and systemic risk. While Congress amended the language of section 3 in 2000, it

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entities could qualify for the end-user exception. *See* CRS Report R41398, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title VII, Derivatives* 9 (Aug. 30, 2010).

[2] *See* Commodity Exchange Act, ch. 545, § 2, 49 Stat. 1491, 1491 (1936) (current version at CEA § 3, 7 U.S.C. § 5) (setting forth the need to regulate futures transactions as they were affected with a "national public interest," "carried on in *large volume* by the public generally" with prices that were "*generally quoted and disseminated* throughout the United States . . . as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof," and "*susceptible to speculation, manipulation, and control* . . . render[ing] regulation imperative for the *protection of such commerce and the national public interest*" (emphasis added)).

retained these core factors,[3] which the Dodd-Frank amendments to the CEA left intact. Rather, Dodd-Frank relied on these factors as the defining characteristics of the national public interest that attaches to swaps characterized by these factors.

Three of the primary building blocks of Dodd -Frank for protecting the national public interest are: (1) real-time reporting and public dissemination of swap transactions; (2) positions limits in swap trading; and (3) mandatory clearing of swaps. These comments describe how these three building blocks should be considered as an integrated structure relative to these core factors so that the principle consumer protection objective of the CEA is advanced while also mitigating the regulatory impact from Dodd-Frank on commercial end-users from redundant and duplicative regulatory processes. As set forth in more detail below, the price discovery function should be the determining factor relative to real-time reporting and public dissemination. Assuring that transactional data for swaps serving a price discovery function is available to the Commission and the public in real time allows the Commission to assess a swap market as to its liquidity and notional volume. These factors are carried forth as primary factors in determining and applying position limits to swaps where the presence of those factors indicate a national public interest. Position limits are designed to protect the liquidity and overall integrity of a swap market. Consequently, when designed properly, position limits should result in a lower number of swaps requiring mandatory clearing for the protection of the national public interest.

In the suite of protections provided by Dodd-Frank, mandatory margining is the more intensive and intrusive form of protection. Consequently, it should only apply when systemic risk is clearly determinable and at a magnitude measurable by the significant impact of these core factors found both at the heart of CEA Section 3 statement of purpose and CEA Section 2(h)(2)(D)(ii). Limiting the application of a margining requirement to that smaller number of swaps at risk of systemic failure will not increase the overall risks to the public where the public is afforded protections first by the requirements for real-time reporting and public dissemination of pricing information and then by position limits. The weight ascribed to each of these factors in the clearing determination should recognize the role of mandatory margining within the whole consumer protection regulatory structure that includes public reporting and position limits, as well as other Dodd-Frank provisions. An overly broad cautionary application of mandatory clearing could have a detrimental effect in decreasing liquidity and increasing market concentration at the risk of the national public interest.

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[3] The 2000 amendments to the CEA retained the core factors, stating the need to regulate transactions that are "affected with a national public interest by providing a means for managing and assuming *price risks, discovering prices, or disseminating pricing information* through trading in *liquid*, fair and financially secure trading facilities," and to protect this "national public interest" by deterring "*price manipulation [and] disruptions to market integrity*," ensuring the financial integrity of transactions subject to the CEA, and avoiding "*systemic risk*." *See* Commodity Futures Modernization Act, Pub. L. 106-554, § 1(a)(5), 114 Stat. 2763, 2763A-383 (2000) (enacting current CEA § 3, 7 U.S.C. § 5) (emphasis added).

II. An Integrated Approach to Reporting, Position Limits & Mandatory Clearing

1. Price Discovery and Public Dissemination Factors for Determining Reporting Requirements

The express purpose of Section 2(a)(13) of the CEA, as amended by section 727 of Dodd-Frank, "is to authorize the Commission to make swap transaction and pricing data available *to the public* in such form and at such times as the Commission determines appropriate to enhance *price discovery*," addressing the stalwart factors of price dissemination and discovery included in Congress' statement of purpose in CEA Section 3 (emphasis added). Congress has made it clear that price discovery should be a core factor in the Commission's deliberations regarding requirements for real-time reporting and public dissemination of swap information. Reporting and public dissemination requirements will assure the availability of adequate pricing data where the liquidity of a market warrants further regulatory oversight, whether pursuant to position limits or mandatory clearing rules. Accordingly, the Commission expressly sought in its notice of proposed rulemaking, Real-Time Public Reporting of Swap Transaction Data (the "Real-Time NOPR"), specific comments "on the scope of transactions covered by this part."[4] In addition, the Commission requested "specific comment on which parties to a swap should be covered by the reporting requirements in this part *in order to enhance price discovery*" (emphasis added).[5]

Underlying the CEA is a presumption of the correlation between the national public interest and liquidity of the relevant market, as evidenced in CEA Section 3's statement of purpose. Price transparency contributes to the competitive and economic efficiency of a liquid market. Liquidity is associated with markets that trade homogeneous products. Price discovery has relevance only to markets of such homogeneous products that are sufficiently liquid that they are susceptible to price manipulation, disruption of market integrity and systemic risk. These are the markets that should be subject to public dissemination and real-time reporting.

In many cases, however, swaps involving two end users, and off-facility swaps entered into between end users and regulated entities, are likely to be customized products, be designed to hedge certain specific assets or otherwise represent specific and illiquid transactions tailored to the specific needs of the end user. This is especially the case for those entities hedging energy assets, such as Dominion. The real-time reporting of such swaps does not advance the goal of transparency and price discovery precisely because the swaps are not comprised of sufficiently liquid products or located at sufficiently liquid locations to provide the market with meaningful price discovery information. The less homogenous and more customized a product, the less it informs the market and serves a price discovery function. Because of the uniqueness of these

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[4] Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140, 76,143 (Dec. 7, 2010).

[5] *Id.*

transactions, there is limited ability, if any, to manipulate prices or disrupt the market, let alone subject the market to systemic risks – the factors that make the CEA relevant to the swap under Section 3. Customized products and transactions in illiquid markets affect the national public interest minimally, if at all.

In answer to the question raised by the Commission in the Real-Time NOPR regarding the scope of transactions and which entities should be subject to real-time reporting and public dissemination requirements, these requirements should be applicable to those swaps vested with the national public interest because they serve a "significant price discovery" function. Accordingly, Dominion urged the Commission, in its response to the Real-Time NOPR, to modify its rules to allow an exclusion from public disclosure of data concerning any transaction between either two end users or an end user and a regulated entity with respect to any swaps that do not serve a significant price discovery function. It further proposed that, for all swaps under CEA Section 2(a)(13)(C)(iii) and end-user swaps under CEA Section 2(a)(13)(C)(i) that are clearable but not cleared at registered DCOs, the swap should serve some form of price discovery function before requiring public dissemination of such swaps.

A process for making a specific finding regarding which swaps serve a significant price discovery function and thus should be subject to the reporting requirements and public dissemination already exists within the Commission. Dominion proposed in its response that the Commission utilize the process that it had previously established for findings of swaps that perform a "significant price discovery" ("SPD") function under the now-repealed section 2(h) of the CEA. Use of the SPD standard for determining the swap data to be made publicly available achieves the balance between the national public interest and the commercial interest of the end user envisioned by Dodd-Frank. Moreover, the SPD mechanism provides a clear and readily available means to indentify the end-user swaps to be reported in real time, and satisfies the mandates of CEA Section 2(a)(13).

The analogy to SPDs is particularly apt to the issue of whether the above-referenced end-user swaps should be publicly disseminated. First, the standards used for determining a SPD contract – (i) price linkage, (ii) arbitrage, (iii) material price reference, (iv) material liquidity and (v) other material factors – tie directly to the purpose in section 727 of Dodd-Frank that reported swap data "enhance price discovery." That is, if a swap does not meet the standards of a SPD swap, it does not serve a price discovery function, and therefore public dissemination of its data does not serve to protect the broader national public interest from systemic risk, which is a paramount factor in CEA Section 3, as well as a core objective of Dodd-Frank. Second, the entire point of incorporating the SPD framework of the repealed CEA Section 2(h) into section 737 of Dodd-Frank is to permit the Commission to set limits for swaps "not traded on or subject

to the rules of a designated contract market or a swap execution facility."[6] In this case, end-user swaps that are traded on registered swap facilities and those that are subject to mandatory clearing and cleared at registered DCOs will continue to be made publicly available in real time, but other end-user swaps would not be publicly disseminated unless an SPD determination can be made.[7] Applying the concept of SPDs to determining which end-user swaps will be subject to being reported in the time frames proposed by the Commission for corresponding public dissemination is well within the Commission's discretion and meets the goals of Dodd-Frank.[8] A SPD process will ensure that the Commission and the market have "adequate price data" in order to ensure that higher levels of protection are applied to swaps warranting greater protections, whether through position limits or finally, mandatory clearing.

2. *Liquidity, Price Discovery and Prevention of Market Manipulation Factors for Determining Position Limits*

CEA Section 4a(a)(1), as amended by Dodd-Frank, extended the authority of the Commission to set position limits to swaps that the Commission finds "are necessary to diminish, eliminate, or prevent" the burden of "excessive speculation" in the market it oversees. CEA Section 4a(a)(3) directs that the levels are to be set:

> (i) To diminish, eliminate or prevent excessive speculation as described under this section;
>
> (ii) To deter and prevent *market manipulation, squeezes and corners*;
>
> (iii) To ensure sufficient *market liquidity* for *bona fide* hedgers; and
>
> (iv) To ensure that the *price discovery function* of the underlying market is not disrupted (emphasis added).

These objectives that are to be the guiding factors for where the position limits should be set incorporate the integrating factors stated in CEA Section 3.

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[6] *See* Dodd-Frank § 737.

[7] The number of end-user swaps that would otherwise come under subsection (i) of CEA § 2(a)(13) but for no SPD finding would most likely be a limited number as swaps mandated to be cleared have already been evaluated for some of the same price discovery and liquidity criteria that would be used for a SPD finding. It could be presumed that swaps mandated to be cleared would therefore correspond with SPD swaps, but that may not necessarily be the fact as the criteria for mandatory clearing under CEA § 2(h)(2)(D) includes other criteria and serves differing public policy objectives.

[8] Where a SPD determination is not made, and therefore the non-SPD swap is excluded from public dissemination, the need to report in the narrow timeframe to allow for real-time public availability no longer has purpose. Therefore, in order to meet the reporting requirement of section 727 of Dodd-Frank, Dominion asked the Commission to use its discretion under CEA Section 2(a)(13)(F) to prescribe rules under which such non-SPD end-user swaps would be found in compliance with CEA Section 2(a)(13) if reported as part of the daily state or snapshot reporting pursuant to the final rules adopted under section 728 of Dodd-Frank.

CEA Section 4a(a)(5), as amended by Dodd-Frank, extends the applicability of position limits to swaps that are economically equivalent to designated contract market ("DCM") futures and option contracts that are already subject to limits. In implementing this section, the Commission proposed a new regulation, Rule 151.2 that lists 28 core physical delivery DCM futures contracts that would be subject to the Commission's proposed position-limit framework.[9] In proposing the list, the Commission stated:

> Generally, the 151.2-listed contracts were selected either because such contracts have high levels of open interest and significant notional value or because they otherwise may provide a reference price for a significant number of cash market transactions.[10]

The criteria for listing contracts that would be subject to position limits mirrors the factors of notional exposure and price reference included among the factors to be considered in the clearing review of a swap. The Commission very specifically described the risks that position limits were to protect against:

> Large concentrated positions in the physical commodity markets can potentially facilitate price distortions given that the capacity of any market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market and the market's structure and is, therefore, not unlimited. Concentration of large positions in one or a few traders' accounts can also create the unwarranted appearance of appreciable liquidity and market depth which, in fact, may not exist. Trading under such conditions can result in sudden changes to commodity prices that would otherwise not prevail if traders' positions were more evenly distributed among market participants. Position limits address these risks through ensuring the participation of a minimum number of traders that are independent of each other and have different trading objectives and strategies.[11]

The risks described here by the Commission are broader and more generalized risks relative to market integrity than the financial credit risks underlying mandatory clearing requirements. Consequently, swaps subject to position limits should be a broader group than those subject to mandatory clearing. In fact, in delineating those swaps subject to position limits, Dodd-Frank specifies swaps traded on DCMs and swap execution facilities ("SEF"), not just those cleared through derivative clearing organizations ("DCOs").

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[9] Position Limits for Derivatives, 76 Fed. Reg. 4,752, 4,768–69 (Jan. 26, 2011).

[10] *Id.*

[11] *Id.* at 4,755.

CEA Section 4a(a)(1), as amended by section 737 of Dodd-Frank, also authorizes the Commission to establish position limits for swaps that are not traded on a DCM or SEF but that perform a significant price discovery function. The factors for determining which swaps perform significant price discovery functions for purposes of CEA Section 4a(a)(1) are the same factors previously used for identifying significant price discovery functions under the repealed CEA Section 2(h): (i) the linkage between the settlement price of a swap to the price of another contract traded on a regulated market based on the same underlying commodity; (ii) the extent to which the linkage between the two contracts permit market participants to arbitrage between the markets for the two contracts; (iii) the recurring extent that market participants use the swap price as a reference price; and (iv) the material liquidity of the swaps being traded, in addition to any other factor the Commission finds is relevant to determining the significant price discovery function of the specific swap market. These factors correspond to the factors used for clearing determinations. However, since swaps should at least serve a significant price discovery function before position limits are imposed, the availability of adequate pricing data should have already been qualified for purposes of a mandatory clearing review. As to the weight ascribed to the other factors, as discussed above, if the broader protections afforded by position limits are already available to the national public interest, then a more logical and practical interpretation of congressional intent is that the national public interest must continue to be, even after position limits are imposed, at risk significantly and systemically before mandatory clearing is implicated.

3. *Notional Exposure, Liquidity and Pricing Availability Factors for Determining Mandatory Clearing*

CEA Section 2(h)(2)(D)(ii) states that in reviewing a swap to determine whether it should be subject to a mandatory clearing requirement, the Commission will take into account the following factors:

> (i) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data;
>
> (ii) The availability of rule framework, capacity, operational expertise and resources and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;
>
> (iii) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract;
>
> (iv) The effect on competition, including appropriate fees and charges applied to clearing; and

(v) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

These factors fall into two groups. One group addresses the creditworthiness and security of the clearing organizations available to clear the swap. The second group includes those factors that are, as discussed in the introduction, also determinative in applying other means of protection, including, but not limited to swap reporting and public dissemination requirements and position limits. These means of protection are, however, less intrusive in the end user's business management of commercial risks than mandatory clearing. Therefore, the character of the swap being reviewed should raise the stakes that the national public interest has in such swaps before clearing becomes mandatory. The level of systemic risk related to a particular swap (or swap class, type, or group) should be the paramount factor in determining the need for a mandate to clear.

The factor that should be weighted the least for purposes of mandatory clearing is adequate pricing data. The availability of pricing data should be substantially less important at this level of protection where, as demonstrated in the sections above, a price discovery function should be the crucial driver for implementing protection through requirements for real-time reporting and public dissemination of swap information.

III. Conclusion

The Commission has proposed that its rules relating to the real-time collection and public dissemination of swap transactions be applied, without further consideration, to all swaps required to be cleared through a DCO and those that would have been required to be cleared but for the non-financial end-user exemption.[12] Position limits apply beyond mandated cleared swaps to those traded on a DCM or a SEF without further determination by the Commission. Consequently, the factors required for real-time public reporting and for position limits should have already been found present for swaps that are being considered by the Commission for mandatory clearing. Where those factors under CEA Section 3 define the national public interest and provides the measurement of systemic risk to which the national public interest is exposed, the degree of liquidity and notional exposure for purposes of a clearing mandate should be at a much higher magnitude than the magnitude used for determinations regarding position limits and real-time reporting.

[12] The Commission's proposed rules are consistent with CEA Section 2(a)(13)(C)(i), as amended by section 727 of Dodd-Frank.

The integrated process Dominion proposes here balances the public interest with the policy goal of mitigating the regulatory burden on non-regulated entities such as end users. The public interest in a swap market is first assessed under the real-time reporting and public dissemination requirements. That interest correlates, as discussed above, with the SPD function of a particular swap. On the other end, the public interest is subject to the greatest magnitude of risks, justifying the intrusive mandate for clearing that effectively also mandates full collateralization to address the credit risks perceived to be the trigger of potential financial meltdown. Dominion believes that the proposed processes included here – both the use of the SPD process for determining applicability of reporting and public dissemination requirements to end-user swaps and the weighting of factors for determining mandatory clearing for swaps – promote the "policy choice made by Congress in Dodd-Frank to place lesser burdens on non-SD/MSP counterparties to swaps, where this can be done without damage to the fundamental systemic risk mitigation, transparency, standardization, and market integrity purposes of the legislation."[13]

A federal mandate to clear should be the last line of defense of the national public interest against the systemic risk associated with a swap market. Voluntary clearing should be left to end users as one tool among others that they can elect to use in managing their market exposure and credit risks. Regulatory over-subscription to clearing as a save-all remedy to financial risk would be to compromise end users' established and proven risk management policy that they have developed consistent with best practices for their particular form and level of commercial risks. The strength of the consumer protection under the CEA, as amended by Dodd-Frank, comes from its integrated regulatory structure composed of not only clearing but also the imposition of real-time reporting and public dissemination of swap information and position limits that ensures price transparency and market integrity. Those swaps not covered by the clearing requirement that are still vested with a public interest due to their liquid markets and the price discovery function that is associated with liquidity will not escape Commission oversight under reporting and public dissemination requirements and position limits established consistent with the Commission's SPD process already available and with which the Commission has historical experience.

Dominion appreciates the additional opportunity for commenting that you have provided in your invitation to submit responses on these important questions directly to your office. Dominion's goal, in its comments filed with the various Dodd-Frank proceedings, has been to encourage a workable, common-sense framework for swap regulation that meets the policy objectives of the statute and represents a reasonable weighing of costs versus benefits. If you have any questions, or if we may be of further assistance, Dominion is willing to discuss these issues further with you or your staff at your convenience.

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[13] Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574, 76,579 (Dec. 8, 2010).

Respectfully,

/S/ David C. Holden

David C. Holden
Vice President
Enterprise Risk Management

Attachment

cc: The Honorable Gary Gensler, Chairman
The Honorable Michael Dunn, Commissioner
The Honorable Jill E. Sommers, Commissioner
The Honorable Bart Chilton, Commissioner

Review of Swaps for Mandatory Clearing

Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

In reviewing a swap, group of swaps, or class of swaps pursuant to subparagraph (A) or a submission made under subparagraph (B), the Commission shall take into account the following factors:

(I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

(II) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

(III) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract.

(IV) The effect on competition, including appropriate fees and charges applied to clearing.

(V) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

How should the factors included in Section 723 be considered by the Commission?

The answer to this question is best approached by answering the larger question of how mandatory clearing should be considered within the CEA's consumer protection framework.

1. CEA §3 – Defining the Factors Constituting the National Public Interest

CEA §3 set out Congress' findings and purpose for enacting the CEA for the regulation of transactions that were affected with a national public interest. It defines the national public interest by the presence of core factors that include price dissemination and price discovery functions; market liquidity and size, and the market's susceptibility to manipulation and price disruption; and systemic risk.

2. Integrated Regulatory Approach to Protecting the National Public Interest under Dodd-Frank

Three of the primary building blocks of Dodd-Frank for protecting the national public interest are (1) real-time reporting and public dissemination of swap transactions; (2) positions limits in swap trading; and (3) mandatory clearing of swaps.

These three building blocks should be considered as an integrated structure bound together by the core factors of CEA §3.

(a) *Real-time Public Reporting:* The price discovery function should determine the need for real-time reporting and public dissemination of swap data. This provides the first level of protection as the Commission distinguishes between (i) end-users' customized swaps which do not inform the public as to swap prices or supply and demand and (ii) those swaps affected by national public interest as measured by the price discovery factor under CEA §3. Assuring that data relative to swaps serving this price discovery function is available to the Commission and the public in real time allows the Commission to assess a swap market as to its liquidity and notional volume, which are determining factors for position limits. Commission could utilize the process previously established under the now-repealed CEA §2(h) for identifying swaps that perform a "significant price discovery" ("SPD") function to determine which swaps should be publicly reported in real-time consistent with the national public interest served by this factor. A SPD process will ensure that the Commission and the market have "adequate price data" in order to ensure that higher levels of protection are applied to swaps warranting greater protections, whether through position limits or finally, mandatory clearing.

(b) *Position Limits:* Market liquidity and notional exposure are the primary factors in determining and applying position limits to swaps where the presence of those factors indicate a national public interest. This provides the next level of protection after public reporting. Large concentrated positions in a swap market could potentially facilitate price distortions given that the capacity of a swap market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market and the market's structure and is, therefore, not unlimited. Position limits mitigate the risks associated with such large concentrated positions. If position limits accomplish such mitigation of notional exposure for these swaps or if a swap does not warrant position limits, then neither of these groups of swaps should warrant mandatory clearing. Accordingly, a logical and practical interpretation of congressional intent regarding mandatory clearing is that, even after position limits are imposed, the national public interest must continue to be at risk significantly and systemically before mandatory clearing is implicated.

(c) *Mandatory Clearing:* Mandatory clearing is the more intensive and intrusive form of protection. Consequently, it should only apply when systemic risk is at a magnitude measurable by the significant impact of the core factors at the heart of CEA §3 and Dodd-Frank §723. These factors and their associated risks are managed under the above means of protections - which is appropriate where those means are less intrusive in the end user's business management of commercial risks than mandatory clearing. Therefore, the character of the swap being reviewed should raise the stakes that the national public interest has in such swaps before clearing becomes mandatory. The level of systemic risk related to a particular swap (or swap class, type, or group) should be the paramount factor in determining the need for a mandate to clear.

DOMINION RESOURCES, INC.
ALTERNATIVE RULE PROPOSAL

CEA § 3. Findings and Purpose.

(a) FINDINGS -- The transactions subject to this chapter . . . are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.

(b) PURPOSE – To foster these public interests, it is further the purpose of this chapter to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk

WHEREAS: For the Real-Time Reporting of Swap Transaction Data NOPR

The finding and purpose of CEA regulation presumes a correlation between the national public interest and liquidity of the relevant market. Price transparency contributes to the competitive and economic efficiency of a liquid market. Liquidity is associated with markets that trade homogeneous products. The timely availability of price references in a market enhances its liquidity. In contrast, the less homogenous and more customized a product, the less it informs the market and serves a price reference function. Customized swaps have limited ability, if any, to manipulate prices or disrupt the market. Illiquid markets are not subject to systemic risk. Thus, customized swaps and illiquid markets affect the national public interest minimally, if at all.

WHEREAS:

The NOPR seeks guidance "on the scope of transactions covered by this part" and "on which parties to a swap should be covered by the reporting requirements in this part *in order to enhance price discovery?*" Furthermore, the Commission's stated goal in proposing to include price changing events in the definition of a reportable swap under proposed § 43.2(x) is to "enhance the *transparency and price discovery* attributes of swaps trading."

THEREFORE:

Dominion proposes that

- ***Only those end-user swaps for which a specific price discovery finding has been made should be required to be publicly available in real time unless cleared at a registered DCO as contemplated under CEA §§2(a)(13)(i) and (ii).***
- ***Commission should use the existing regulatory framework previously established to find which swaps perform a "significant price discovery" ("SPD") function under former §2(h) of the CEA, now included in §737 of the Dodd-Frank Act.***
- ***Such swaps for which no SPD finding has been made should not be required to be reported publicly in real time unless otherwise cleared on a registered DCO.***

RESULT: Use of the SPD standard for determining swap data to be made publicly available achieves the balance between the national public interest and the commercial interest of the end user envisioned by Dodd-Frank.

Executive Order & State of the Union Address

President Obama's Charge to Federal Agencies:

take into account the costs of cumulative regulations
tailor regulations to impose the least burden on society
select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits

WHEREAS: For the Swap Data Recordkeeping & Reporting Requirements NOPR

Proposed rules require a market participant to report data concerning the same swap four different times during the day of its transaction: (i) 5 minutes after transacted; (ii) again 15 minutes after transacted; (iii) then 15 minutes after confirmation, and (iv) an end of day state report, with an obligation to refresh the data to capture any changes to the swap and its evaluation throughout the continuation of the swap until expiration. This creates tremendous administrative burden and duplicative tasks all to report essentially the same data information with no additional benefit to the CFTC, the market or the public.

THEREFORE:

Dominion proposes that the CTC accept real-time reporting under CEA § 2(a)(13) as satisfying the creation (primary economic data) requirement; eliminate the confirmation reporting; and accept and utilize the State Data Snapshot report for monitoring the swap market.

RESULT:

There is no regulatory need that additional creation and/or confirmation reporting requirements would serve that would not be met by an end-of-the-day reporting requirement. By eliminating the creation and confirmation reporting, the Commission and the public forfeits no benefits but the market and the public saves significant costs for otherwise redundant reporting.