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

VIA ELECTRONIC SUBMISSION

Re: *Proposed Rule on Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade,* RIN 3038-AD18

Dear Secretary Stawick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "Working Group"), Sutherland Asbill & Brennan 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") Further Notice of Proposed Rulemaking, *Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade.*[1]

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 the trading of energy commodities, including derivatives and other contracts that reference energy commodities. The Working Group appreciates the opportunity to provide the comments set forth herein and respectfully requests the Commission's consideration of such comments.

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[1] *See Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade*, Further Notice of Proposed Rulemaking, 76 Fed. Reg. 77,728 (Dec. 14, 2011) ("Proposed Rule").

II. COMMENTS OF THE WORKING GROUP.

A. RELATIONSHIP TO MANDATORY CLEARING DETERMINATION.

Section 2(h)(8) of the Commodity Exchange Act (the "CEA") requires a swap subject to mandatory clearing to be executed on a swap execution facility ("SEF") or designated contract market ("DCM"), unless no SEF or DCM makes that swap "available to trade." The Working Group appreciates Congress making the "available to trade" determination a separate and distinct process from the determination of whether a contract should be subject to mandatory central clearing. A determination as to whether a contract should be subject to mandatory central clearing should not lead to an automatic conclusion or even a presumption that a contract is appropriate for an "available to trade" designation. While both determinations will rely on similar information and factors, the analysis of such information and factors will be different as one process seeks to determine whether a contract can and should be required to be centrally cleared and the other process seeks to determine whether a contract is appropriate for mandatory DCM or SEF execution. The level of liquidity and degree of standardization within a particular product necessary to safely centrally clear a swap is markedly different than the level of liquidity and standardization necessary to make mandatory on-facility execution viable. There are many examples of futures contracts that can be centrally cleared, but have failed to reach the level of liquidity necessary to make mandatory DCM or SEF execution viable.[2]

These processes should remain separate and should not occur in conjunction with one another. Not only are they distinct, but a mandatory clearing determination may have significant positive or negative consequences for the liquidity of a contract. The effect of such a determination should be apparent before a contract is subject to mandatory on-facility execution.

B. MARKET PARTICIPANTS SHOULD BE GUARANTEED NOTICE AND COMMENT.

Under the Proposed Rule, there is little to no guaranteed opportunity for public comment on a SEF or DCM's determination that a swap should be made "available to trade." Only if a submission is made by a SEF or DCM under Section 40.6 of the Commission's regulations, and only then if the Commission issues a stay with regards to the submission, is the public afforded the opportunity to comment on whether a swap should be made "available to trade." SEFs and DCMs will have an understandable business interest in making many or all of the swaps that they list that are subject to Section 2(h)'s mandatory clearing requirement "available to trade". Such a requirement will have a significant impact on market participants and market liquidity as discussed below. Given the potential impacts, SEFs, DCMs, and the Commission should provide market participants the opportunity to comment on whether any swap should be made "available to trade".

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[2] NYMEX's attempts to introduce electricity futures contract following reforms in the structure of the Pennsylvania-New Jersey-Maryland Interconnection (PJM) and other regional electric markets in the mid-1990s are illustrative. NYMEX introduced a host of electricity futures contracts, aimed at luring volumes from the over-the-counter market. Those contracts were ultimately delisted in 2002. NYMEX's decision was attributed to "lack of interest" in those contracts. See "NYMEX pulls the plug on electricity futures, relaunch soon," Reuters News, 15 February, 2002.

Accordingly, the Working Group believes that the rule approval processes set forth in Sections 40.5 and 40.6 of the Commission's regulations are not the appropriate processes for making an "available to trade" determination. *First,* Sections 40.5 and 40.6 are appropriate for rules or rule amendments that apply to a particular SEF or DCM. By definition, those requests apply only to the requesting SEF or DCM. In the event that market participants do not agree with such a rule change, they can choose to transact elsewhere. However, the implications of an "available to trade" determination are more far reaching. An "available to trade" determination binds not only the requesting SEF or DCM, but the entire market as well because an "available to trade" determination will require a move of the bilateral market for a swap onto SEFs and DCMs that list the contract. As such, market participants should have the opportunity to provide the Commission with comments regarding the appropriateness of the requested determination.

Second, one of many advantages of the processes set forth in Sections 40.5 and 40.6 is that they provide a timely and definite approval process for SEF and DCM rules. However, in the case of an "available to trade" determination, a quick resolution is not of paramount importance as the question at hand is not whether a SEF or DCM can list a contract for trading. The question is whether transactions in a contract subject to mandatory clearing can continue to be bilaterally executed. That question should be subject to a process that values diligence and inclusion rather than expediency. Therefore, the Working Group requests that the Commission amend the Proposed Rule to require that any "available to trade" determination be automatically subject to a notice and comment period.

Lastly, the Commission lists several criteria in the Proposed Rule that a SEF or DCM should consider when making an "available to trade" determination. Included in that list is any factor that a SEF or DCM may consider relevant.[3] The Proposed Rule also permits a SEF or DCM to disregard any of the listed criteria if it does not believe such criteria to be relevant to the determination. Effectively, a SEF or DCM is able to make an "available to trade" determination based solely on criteria it deems relevant while ignoring the explicit criteria set forth in the Proposed Rule. That ability introduces uncertainty and variability into the "available to trade" designation process. In short, as drafted, the Proposed Rule does not establish mandatory criteria that must be considered.

The Working Group submits that a SEF or DCM should be required to consider all of the specific criteria in proposed CFTC Regulations 37.10(b) and 38.12(b) respectively. If a SEF or DCM does not believe that certain of the specific criteria are applicable to a particular determination, it should provide an explanation to the Commission as to why it reached such conclusion and public comment should be permitted with regards to that conclusion.

C. DETERMINATION ON A SWAP-BY-SWAP BASIS.

The Commission requests comment as to whether it should allow a SEF or DCM to submit its "available to trade" determination with respect to a group, category, type, or class of

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[3] *See* Proposed CFTC Rules 37.10(b)(8) and 38.12(b)(8).

swaps. The Working Group recommends that "available to trade" determinations be made on a swap-by-swap basis. With respect to energy commodities, designating an entire group or class of swaps (*e.g.*, all Henry Hub Natural Gas swaps) as "available to trade" will have a negative impact on liquidity and ignores the important variation not only among the different swaps in a class, but also across the various forms of a particular swap.

If a contract is illiquid or thinly traded, a firm runs the risk of being "front run" as execution "on-facility" can telegraph a person's position in the market and trading strategy.[4] In short, if there is inadequate liquidity in specific contracts within a class, market participants may be forced to choose between paying inordinately high prices to hedge on a SEF or DCM, choosing a less efficient hedging strategy or forgoing hedging altogether for a particular risk. By requiring "available to trade" determinations to be made on a swap-by-swap basis, and providing opportunity for public comment, SEFs, DCMs and the Commission will have the opportunity to carefully examine the impacts such a determination may have on liquidity.

i. Variation Across a Group or Class

Making an "available to trade" determination, or even allowing a DCM or SEF to apply for an "available to trade" determination, for a group or class of swaps is inappropriate. The variation within a particular group of swaps will likely be considerable. Certain products within that group may have characteristics that may make an "available to trade" designation appropriate while others may not.

For example, the Henry Financial LD1 Fixed Swap, which is traded on the InterContinental Exchange's ("ICE") over-the-counter market has a contract size of 2,500 MMBtu per lot and the longest possible term on such contract is, at a minimum, eight calendar years. On the other hand, ICE's Henry Financial LD4 Fixed Swap has the same contract size, but a maximum duration of 24 calendar months, while ICE's Physical Basis LD1 has a contract size of 100 MMBtus and available terms of three months, six quarters, five seasons or three calendar years. Each of these swaps is unique and economically distinguishable from the others. They have their own uses and liquidity characteristics. As such, the determination of whether each of these swaps should be "available to trade" should be a separate undertaking for each swap.

If an "available to trade" determination is made at the level of group or class, it is likely that in the process of capturing one contract that should be "available to trade," other economically similar contracts that do not have the requisite characteristics to support an "available to trade" determination will be swept in as well.[5] The consequences for such contracts

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[4] This issue may be further exacerbated if voice brokers do not qualify as SEFs. The use of voice brokers allows many commercial firms to seek counterparties to transactions while not giving away details about a firm's position which may prevent such firm from obtaining the best market price for the transaction. Voice brokers are especially useful in this regard when conducting block trades.

[5] The Working Group notes that in order for swaps within a group or class to be part of an "available to trade" determination, they must first be subject to Section 2(h)'s mandatory central clearing requirement.

could include an evaporation in liquidity as market participants are forced to move away from the bilateral market and do not trade in the contract on a SEF or DCM because they are unable able to hedge the risk at issue in an economical manner.

ii. Differences Within a Particular Swap

Even within a singular product, not all variations of a swap may be appropriate for an "available to trade" designation. Many energy derivatives listed for trading are liquid in the front month, but increasingly less liquid for each month further away from the delivery date. For example, NYMEX's Henry Hub Physical futures contract, one of the most liquid energy contracts available, recently had an open interest of 235,110 contracts and daily trading volume of 173,688 trades for the front month, but the contract for delivery in 24 months had an open interest of 828 contracts and a daily trading volume of 3 contracts.[6] This stark difference in liquidity will likely be the case for other energy-based derivatives as well. As such, the Working Group requests that the Commission require SEFs and DCMs to limit the application of "available to trade" determinations to the front-month of a contract and should be required to consider the implications of subjecting all tenors of a contract to when making an application for an "available to trade" designation.[7]

iii. Definition of Economically Equivalent

The Working Group respectfully suggests that the Commission remove the economically equivalent concept from the Proposed Rule. If the Commission is concerned that market participants will intentionally structure contracts to avoid mandatory SEF or DCM execution, then it can exercise its anti-evasion authority to address the issue. The Commission should not attempt to prevent evasion of Section 2(h)(8) of the CEA, through the economically equivalent concept, at the expense of real economic activity. If the Commission decides to retain the economically equivalent concept, which is not a statutory requirement, as it moves forward, the Working Group recommends it do so with the following concise definition of the economic equivalency: two swaps are economically equivalent if their respective payoffs are equal in all states of the world.

The issues with regards to the definition of "economically equivalent" are similar to those presented by making "available to trade" determinations by group or class. A broad definition of "economically equivalent," such as the definition in the Commission's proposed rule on Position Reports for Physical Commodity Swaps, which equated Henry Hub to Transco Zone 6,[8] will

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[6] *See* CME Group's 2012 Daily Information Bulletin for Energy Futures Products for February 8, 2012. Available at: http://www.cmegroup.com/dailybulletin.

[7] The Working Group requests that the Commission confirm that both the mandatory on-facility execution requirement as well as the mandatory clearing requirement apply only at execution. Said another way, if the mandatory on-facility execution requirement or mandatory clearing requirement applies only to the front month of a swap, then market participants will not have to centrally clear or move their longer duration trades onto a SEF or DCM once that position moves into the front month.

[8] 75 Fed. Reg. 67,258 (Nov. 2, 2010) at 67,261.

force many swaps that are appropriate for mandatory clearing, but not for mandatory SEF or DCM execution, out of the bilateral markets. Those contracts provide valuable risk mitigation tools for the market participants that use them, but may not have the necessary liquidity for them to continue to function as a valuable risk mitigation tool if they are required to be executed on a SEF or DCM as market participants will be forced to take inaccurate prices or, in the alternative, to hedge through other less efficient methods.

Finally, if the Commission retains the economically equivalent concept, the determination as to whether a contract is economically equivalent to a contract which is "available to trade" should be made by the CFTC. That determination would bind the entire market place, and given the economic motivations a SEF or DCM may have to find that a contract is economically equivalent, it is appropriate for the Commission, with input from market participants, and not an interested party, to make that determination.

D. COMMISSION APPROVAL OF DETERMINATIONS.

Under the Proposed Rule, a SEF or DCM that makes a determination that a swap is "available to trade" must submit the determination pursuant to Sections 40.5 or 40.6. While Section 40.5 requires an affirmative approval of a submission, 40.6 does not. In the event that the Commission does allow SEFs and DCMs to submit "available to trade" determinations under Sections 40.5 or 40.6, the Working Group submits that affirmative Commission approval should be required for all "available to trade" determinations, whether submitted under Section 40.5 or 40.6. Again, the Working Group submits that such an action may have a severe impact on liquidity. Given the importance of this determination, the Working Group believes an affirmative act by the Commission is warranted.

III. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the swap markets in the United States. The Working Group appreciates this opportunity to provide comments on the Interim Final Rule and respectfully requests that the Commission consider the comments set forth herein as it develops a final rule in this proceeding.

If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ David T. McIndoe
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