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2

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January 23, 2004

Commodity Futures Trading
Commission
Att'n: Office of the Secretariat
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

RE: Proposed Rules for Exempt Commercial Markets

Dear Sir or Madam:

These comments are provided to you on the Commission's proposed changes to its Regulation §36.3 as set forth in its *Federal Register* release dated November 25, 2003.¹ Our client, Natural Gas Exchange Inc. ("NGX"), gave notice to the Commission dated November 5, 2002 of its operation of an "exempt commercial market" ("ECM") under section 2(h)(3) of the Commodity Exchange Act, 7 U.S.C. §2, and it welcomes this opportunity to assist the Commission in its formulation of policy on that subject.

Changes to "Required Information" under Regulation §36.3(b).

Fundamentally, the Commission's new proposal reflects a concern that the ECM transactional data to which it presently has access may not be as effective or as efficient as possible in order for the Commission to perform its duty to monitor these markets against price manipulation and other market distortions. At the present time, NGX provides such data to the Commission via electronic access and, to its knowledge, makes available through these means information regarding *all* transactions conducted there.

¹ 68 F.R. 66032-66040 (November 25, 2003).

The Commission proposes that ECMs should segregate transactions that are subject to its exclusive jurisdiction (principally futures contracts and nonsecurity options) from those which are not, such as commercial physical sales of the underlying exempt commodity. Then, the ECM should report or provide access to the Commission with respect *only* to futures and options data, filtering out all other transactions. NGX urges the Commission to reconsider this approach for each of the following reasons:

First, the Commission *needs* all of the market data it is receiving because the Commission's authority with respect to the prevention and punishment of commodity price manipulations is not limited to futures contracts and options. Section 9(a)(2) of the Act, which remains applicable to ECM operations, explicitly renders it unlawful (indeed, felonious) for "any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, *or* for future delivery . . . or to corner or attempt to corner any such commodity . . ." (emphasis added).

At the present time, the Commission's Division of Enforcement has dozens of active investigations into possible manipulations of natural gas prices involving transactions that are neither futures contracts nor options, and has settled several of them with substantial civil penalties. Accordingly, the Commission's responsibilities transcend futures and options and, as a result, the entire stream of transactional data received today by the Commission from an ECM is both "relevant and useful" to the Commission (68 F.R. at 66033).

Second, the proposal infers that only *some* ECM transactions (principally futures and options) are covered by section 2(h)(3): "a report . . . showing . . . each transaction executed on the facility *in reliance on the exemption* set forth in section 2(h)(3)" (emphasis added). But the exemption provided in section 2(h)(3) of the Act applies to *every* "agreement, contract, or transaction in an exempt commodity." Therefore, regardless of what classification might otherwise be ascribed to an instrument, the intent of section 2(h)(3) is to extend its benefits to all forms of transaction.

Third, the Commission is keenly familiar with the litigation and debates of the past over demarcation lines between "futures contracts," "options" and a plethora of other commercial or financially engineered instruments having both subtle similarities to and differences from the products over which it exercises exclusive jurisdiction. NGX believes that the decision of the Congress to adopt the phrase "agreement, contract, or transaction" in section 2(h)(3) as well as in other provisions of the Act was an acknowledgement that regulation by product differentiation had engendered confusion and controversy including substantial legal

uncertainty which was not in the best interests of the markets or their participants. The current proposal would restore that uncertainty.

Fourth, the current proposals contemplate a formal duty by ECMs to confine their data streams to the Commission only to futures contracts and options, while also mandating that such data — once culled — be complete and accurate. The palpable uncertainty over where the line should be drawn between a number of similar products could generate a high error rate both by including transactions that the Commission does not wish to review and by overlooking transactions of interest to the Commission. In addition to degrading the quality of information received by the Commission, ECMs that provide data to the Commission using their own judgement as to relevancy must also be mindful that section 9(a)(3) of the Act carries harsh penalties for knowingly submitting or failing to submit to the Commission any "material fact" where a reporting duty exists.

Ambiguity as to public disclosure protections.

The Commission also proposes to clarify the *elements* of information for each transaction that it seeks to obtain. Generally, those elements fall within what is regarded as contract specifications or normal market activity reports, and most of those data should already be available to the Commission. NGX has no objection to providing the Commission with the specifically enumerated elements of each transaction. However, NGX urges the Commission to reconsider its open-ended proposal to include "such other information as the Commission may determine" for each of the following reasons:

First, the quoted phrase would authorize the Commission to demand the routine (indeed, daily) collection of information about the transactions of specific, identified market participants, including all such participants. The Commission is keenly aware of the high level of sensitivity that trader identification creates even on the most heavily regulated markets; participants on ECMs share that same concern. Collection of trader identity information "for each business day" as might occur pursuant to proposed Regulation §36.3(b)(1)(ii)(A) or (B) would have a chilling effect on market usage. At a minimum, in NGX's opinion, the policy with respect to ECM participants should be no more invasive than for futures traders under Part 18 of the Regulations, namely, combining trading activity with trader identification *only* "after a special call upon such trader by the Commission." 17 C.F.R. §18.00.

Either the Commission's existing "special call" rights under section 2(h)(B)(iii) of the Act, or a moderate adaptation, would give ECM participants a status parallel to traders under Part 18 of the Regulations, and NGX urges the

Commission to take a more measured approach to the collection of sensitive commercial and financial information about traders than what has been proposed.

Second, the principal exemption provided by section 2(h) of the Act is to allow certain classes of "eligible contract participants" to bypass Commission-regulated markets and other trading facilities in order to transact business in exempt commodities among themselves on a bilateral basis. Note that the Commission's duties with respect to market manipulation extend to these transactions as well. If a fear of unwarranted disclosure of trader information under proposed Regulation §36.3(b)(1)(ii)(A) and (B) were to provoke an exodus of activity from ECMs and the substitution of private dealings in its place, the Commission's dilemma would become complete because it would remain responsible for market disruptions while having *no* meaningful access to useful information that it now obtains from ECMs.

Third, in any event, the Commission should make very clear its policy on the public disclosure of data with respect to the activity of specific ECM participants. Section 8(a) of the Act provides that "the Commission may not publish data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers . . ." except in connection with certain enumerated proceedings. U.S.C. §12(a). On its face, that provision should foreclose the Commission from releasing such data to the public (including competitors of the identified trader) under other programs such as the Freedom of Information Act ("FOIA"). However, the trader-specific reports made possible by proposed Regulation §36.3(b)(ii)(A) and (B), unlike reports filed under Part 18 of the Regulations by futures market traders, are not explicitly classified as "nonpublic" under the Commission's FOIA Regulations. (*Cf.*, 17 C.F.R. §145.5(d)(iii) and (iv)). The Commission should not raise the possibility of gathering information, especially on a regularized basis, about the activities of specific ECM participants until it makes a definitive decision to afford such data a level of confidentiality at least as broad as under Part 18 of the Regulations.

The foregoing comments of NGX reflect its principal concerns about the proposed amendments to Regulation §36.3. NGX would be pleased to work with the Commission on this or any other matter pertaining to ECMs.

Sincerely,



Philip M. Johnson

Commodity Futures Trading Commission
January 23, 2004
Page 5

cc: Nancy E. Yanofsky, Esq.
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