

COMMENT

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UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

In the matter of: )  
 )  
Significant Price Discovery Contracts ) 17 CFR Parts 15 – 19,  
On Exempt Commercial Markets ) 21, 36 and 40

2/11/09

COMMENTS OF THE AIR TRANSPORT ASSOCIATION  
OF AMERICA, INC.

The Air Transport Association of America, Inc. ("ATA") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed rules<sup>1</sup> to implement the CFTC Reauthorization Act of 2008 ("Reauthorization Act" or "Act"). ATA supports the proposed rule, which brings much-needed regulatory oversight and reform to exempt commercial markets ("ECMs"). In addition, we urge the Commission to vigorously execute and enforce these regulations once finalized.

I. ATA's INTEREST

ATA is the nation's oldest and largest airline trade association and its members account for more than 90 percent of the passenger and cargo traffic carried by U.S. airlines.<sup>2</sup> Since its founding in 1936, ATA has played a major role in the regulatory arena by encouraging governmental policy decisions that foster a financially stable U.S. airline industry capable of meeting the nation's travel and shipping needs while withstanding the inherently cyclical nature of this industry.

<sup>1</sup> 73 Fed.Reg. 75888 (December 12, 2008).

<sup>2</sup> ATA serves as the principal trade and service organization of the major air carriers – both passenger and cargo – in North America. ATA member airlines are: ABX Air; AirTran Airways; Alaska Airlines; American Airlines; ASTAR Air Cargo.; Atlas Air; Continental Airlines.; Delta Air Lines; Evergreen International Airlines, Federal Express Corporation.; Hawaiian Airlines; JetBlue Airways; Midwest Airlines; Southwest Airlines; United Airlines; UPS Airlines and US Airways; associate members are: Air Canada; Air Jamaica and Mexicana.

The U.S. airline industry continues to face many challenges in returning to financial stability. Primary among those challenges is the high cost of jet fuel, whose price is closely tied to the price of crude oil. In 2008, crude oil and jet fuel prices reached all-time highs with significant negative ramifications for air service.<sup>3</sup> It is now generally accepted that 2008's meteoric price rise to unprecedented levels was due largely to excessive speculation in energy futures. The oil price implosion in the Fall/Winter of 2008 is another indicator that prices had become, and perhaps still are, disconnected from supply and demand principles.

Airlines consume the fuel they purchase and cannot easily pass on that cost in what is a highly competitive marketplace. Because the airline industry is a substantial consumer of jet fuel, and because individual airlines rely on strategic hedging to manage the financial risk associated with that consumption, ATA and its members have a significant interest in healthy and properly functioning energy commodity markets and the CFTC's oversight of those markets. In June, 2008, we urged Congress to enact common-sense measures to ensure transparency and reign in excessive speculation in the energy futures markets. The proposed rules are an important step on the road to accomplishing these objectives.

## **II. SPECIFIC COMMENTS**

While ATA would have preferred Congress to enact a more direct and comprehensive regulatory structure for energy markets, including ECMs but also

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<sup>3</sup> U.S. airlines spent nearly \$58 billion on jet fuel in 2008, \$16 billion more than in 2007, and jet fuel surpassed labor as the largest cost category for most airlines.

OTC and other transactions,<sup>4</sup> nevertheless the Reauthorization Act goes a long way towards closing the so-called “Enron loophole”<sup>5</sup> by bringing a degree of regulatory oversight to ECMs. The absence of regulatory oversight over ECMs enabled excessive speculation in energy futures contracts that, ultimately, led to oil prices becoming disconnected from underlying supply and demand fundamentals and the price “bubble” during the spring and summer of 2008. As we know now, those oil prices could not be sustained and the bubble burst.

*Identifying Covered Contracts.* As the NPRM notes, Congress has directed the CFTC to extend its regulatory oversight to ECMS with significant price discovery contracts (“SPDCs”) and to treat the ECMS, in essence, as designated contract markets (“DCMs”) with respect to SPDCs. To accomplish this, ECMS would be required to submit quarterly reports containing information about the terms and conditions, and related information, for all contracts traded. In addition, the NPRM sets forth conditions under which ECMs will be required to notify the Commission of possible SPDCs. ATA supports both of these measures as they are critical to ensuring much needed transparency into ECMs and allowing the CFTC to exercise its oversight authority. ATA also supports the requirement in proposed rule 36.3(b)(3), which calls for ECMs with SPDCs to comply with the daily reporting and publication requirements of regulation 16.01.

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<sup>4</sup> Large speculative positions transacted OTC are not reportable since they are masked behind the commercial position of the market maker. For this reason, aggregate position limits are preferable as a means to curtail excessive speculation.

<sup>5</sup> In the Commodity Futures Modernization Act of 2000 (“Mod Act”), Congress revised longstanding law and policy by allowing energy commodities to be traded, for the first time, on markets other than regulated exchanges – specifically, ECMs. This is the so-called Enron loophole. ATA supports complete repeal of the Enron loophole.

Section (b)(7)(B) of the Act sets forth the criteria the Commission is to consider in determining whether an agreement, contract or transaction constitutes an SPDC; that is, whether a contract performs a significant price discovery function. The NPRM adopts the statutory language, proposed section 36.3(c), and in the preamble notes that Congress did not prioritize or weight these criteria, instead leaving it to the Commission to exercise its judgment and discretion in applying them to a particular contract or market. To give ECMs and the public guidance as to how the Commission will apply the criteria, Appendix A to the NPRM explains how the Commission expects to apply the criteria in making determinations.

*Procedures for Determining SPDCs.* The determination of SPDCs is fundamental to the success of the regulatory structure and Congress' goal of closing the Enron loophole. Consequently, it is critically important that the Commission exercise its authority aggressively and broadly to achieve this goal. The benefits to the public from ECM oversight mandated by Congress flow from the identification of SPDCs. For these reasons, it is incumbent on the Commission to construe its authority broadly and to aggressively exercise its discretion to ensure transparency and oversight over SPDCs and ECMs. Furthermore, the Commission should act swiftly to identify and regulate specific contracts and ECMs. The case-by-case nature of the regulatory structure established by the Reauthorization Act should not be allowed to become an obstacle to achieving the Act's overriding purpose of restoring regulatory oversight to ECMs. The Commission should use its authority and discretion to

create a streamlined and speedy process, and rely on existing data and studies in addition to new information reported pursuant to these regulations, to identify SPDCs. In this case, delay will only harm markets, consumers and legitimate energy hedgers. Accordingly, ATA urges the Commission to revise proposed regulation 36.3(c)(3) to provide 14 calendar days notice, not 30, of its intention to designate a contract as an SPDC. The regulation also should state that the Commission will issue its final determination no later than 14 days after the comment period closes.

Likewise, proposed regulation 36.3(c)(4) should be modified to reduce from 90 days to 60 days the time allowed ECMS to demonstrate initial compliance with the nine core principles. The success (or failure) of the oversight regulatory structure hinges in large part on ECM conformance to the Act's core principles, which the proposed regulations amplify. ECMs are sophisticated entities that will have had ample warning that a contract is likely to be determined to be an SPDC, based not only on the CFTC's published notice but also on their own knowledge of transactions occurring on their platforms. A 90 day grace period is excessive under these circumstances.

The trader grace period to reach a position limit<sup>6</sup> likewise should be reduced to 60 days. A 90 day grace period does little to deter traders who are intent on engaging in speculative trading from "gaming the system" until "caught." On the other hand, large positions can often have a highly deleterious effect on the markets and these impacts need to be mitigated at the earliest feasible time. Accumulating excessive positions should carry a risk over and above normal

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<sup>6</sup> Core principle IV directs ECMs to establish position and monitoring limits.

market risks for traders, and the swift imposition of position limits and the potential for forced liquidation of contracts provides that additional risk.<sup>7</sup> By creating a deterrent to accumulating excessive positions, the Commission furthers the goals of the Reauthorization Act.

*Core Principles and Compliance.* The Act sets forth the core principles that ECMs must satisfy if the Commission identifies one or more SPDCs. Appendix B to the proposed regulations provides guidance for traders on complying with the core principles. Although ATA generally supports Appendix B, we offer the following specific comments.

- *CFTC Enforcement Reviews.* The NPRM states that the Commission will conduct “regular enforcement reviews” to evaluate compliance with the nine core principles. Consistent with our earlier comments, such reviews should be rigorous and frequent. Lax monitoring and enforcement will encourage non-compliance by ECMs and, ultimately, traders, thereby frustrating Congress’ purpose in passing the Reauthorization Act.
- *Core Principle II.* The NPRM states that monitoring by ECMs with SPDCs is intended to “prevent market manipulation” and deter “trading and participation abuses.” 73 Fed.Reg. 75894. This statement falls short by failing to expressly include excessive speculation. When it promulgates the final rule, the Commission should make clear that it is intended to prevent excessive speculation. This is an important point that bears on the implementation of Core Principle IV and the effectiveness of the final

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<sup>7</sup> A quicker reduction in positions will not typically work a significant hardship on traders but the added risk should affect their behavior.

rule. Failure to expressly include excessive speculation will impair the final rule's reach and deterrent effect.

- *Core Principle III.* As noted, ATA has advocated transparency for these markets. ATA supports the authority granted to ECMs to obtain information necessary to perform their monitoring and oversight responsibilities under the core principles. Consistent with our earlier comments, the Commission should exercise its own authority liberally to encourage ECMs to collect such information and monitor traders and transactions.
- *Core Principle IV – Position and Monitoring/Accountability Limits.*<sup>8</sup> ATA recommends more stringent standards for position and accountability limits in order to prevent or deter excessive speculative trading. While we agree that this principle should prevent market manipulation, it should also prevent excessive speculation, which drove the oil prices to unsustainable highs in 2008, followed by dramatic lows after the bubble burst. These regulations should seek to prevent such volatility that is disconnected from market fundamentals. We also recommend a shorter grace period for traders to comply with these limits. The risk of having to quickly liquidate contracts determined to exceed position or accountability limits will deter traders from attempting to game the system.

We also note our disagreement with the Commission's assertion that position limits should not be required for uncleared contracts. We

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<sup>8</sup> Position accountability, while a positive step forward, falls short of the benefits to markets and consumers of position limits. For most markets, firm position limits should be required.

recommend that firm limits be established for all contracts traded on the ECM, whether cleared or uncleared, and that position taken by traders in like contracts off the exchange should be reported.

- *Principles VI, VII and VIII.* ATA supports the Commission's guidance regarding these principles. Avoiding conflicts of interest (Principle VIII) is particularly important, and ECMs must have the tools to detect compliance with this, and other, rules.
- *Principle IX.* ATA agrees that ECMs must avoid anticompetitive conduct and supports the guidance on this point.

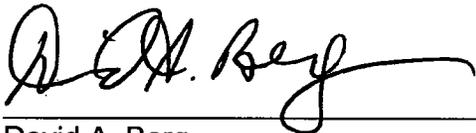
*Market, Transaction and Large Trader Reporting Rules.* ATA supports the Commission's determination that its reporting rules can be applied to SPDCs traded on ECMs. 73 Fed.Reg. 75897-88. In particular, we agree with the reach of proposed section 16.01 to ECM clearing members clearing SPDCs, regardless of their registration status with the Commission or their status as domestic or foreign persons, for large SPDC position held in accounts carried by such brokers when customer positions exceed the contract reporting levels of regulation 15.03(b). This is consistent with the Reauthorization Act's purpose of preventing excessive speculation and market manipulation. We also support proposed section 16.02 to access transaction information and trader identifications to enforce position limits and to monitor large positions.

### III. Conclusion

The NPRM brings sorely needed regulatory oversight and transparency to ECMs even though it is limited by the framework established by Congress in the Reauthorization Act. To overcome these inherent limitations, at least in part, we urge the Commission to modify the proposed regulations to expressly prevent and deter excessive speculation, articulate the policy that it will construe its authority broadly and liberally to prevent excessive speculation and volatility, and vigorously enforce these regulations.

Respectfully submitted,

AIR TRANSPORT ASSOCIATION OF AMERICA, INC.

A handwritten signature in black ink, appearing to read "D. A. Berg", written over a horizontal line.

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