From: Sweeney, R. Michael <rsweeney@hunton.com>
Sent: Friday, November 19, 2010 2:24 PM
To: SEFRules <SEFRules@CFTC.gov>
Cc: Menezes, Mark W. <mmenezes@hunton.com>; McIndoe, David <dmcindoe@hunton.com>; Holtan, Alexander S. <AHoltan@hunton.com>; Currier, Patrick T. <pcurrier@hunton.com>; Thomas, Matthew C. <MThomas3@hunton.com>
Subject: Rulemakings for Swap Execution Facilities under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act
Attach: SEF pre-comment letter_final.pdf

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms (the "Working Group"), Hunton & Williams LLP respectfully submits the attached pre-rulemaking comments to the Commodity Futures Trading Commission ("CFTC") regarding the proposed regulation of Swap Execution Facilities ("SEF") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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 legislative and regulatory 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 submit these pre-rulemaking comments and looks forward to working with the CFTC to further define the scope and application of the term SEF as part of the formal rulemaking process for implementing this and other key definitions contained in Title VII.

Please let me know if you have any questions or require additional information.

Respectfully submitted,
R. Michael Sweeney, Jr.
David T. McIndoe
Mark W. Menezes

Counsel for the Working Group of Commercial Energy Firms

<<SEF pre-comment letter_final.pdf>>

R. MICHAEL SWEENEY, JR.

HUNTON & WILLIAMS LLP

1900 K STREET, N.W.

SUITE 1200

WASHINGTON, D.C.

(202) 955-1944

RSWEENEY@HUNTON.COM

HUNTON & WILLIAMS

HUNTON & WILLIAMS LLP
1900 K STREET, N.W.
WASHINGTON, D.C. 20006-1109

TEL 202 • 955 • 1500
FAX 202 • 778 • 2201

FILE NO: 76142.2

November 19, 2010

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

VIA ELECTRONIC MAIL

Re: *Rulemakings for Swap Execution Facilities under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act*

Dear Secretary Stawick:

I. INTRODUCTION.

On behalf of the Working Group of Commercial Energy Firms (the "Working Group"), Hunton & Williams LLP respectfully submits the following pre-rulemaking comments to the Commodity Futures Trading Commission ("CFTC") regarding the proposed regulation of Swap Execution Facilities ("SEF") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").

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 legislative and regulatory developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

The comments herein specifically address the definition of SEF set forth in new Section 1a(50) of the Commodity Exchange Act ("CEA") and provisions regulating the operation of SEFs under new CEA Section 5h. The Working Group appreciates the opportunity to submit these comments and looks forward to working with the CFTC to further define the scope and application of the term SEF as part of the formal rulemaking process for implementing this and other key definitions contained in Title VII.

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

A. GENERAL COMMENTS.

The Working Group respectfully submits that the CFTC should adopt a rule that permits a broad array of many-to-many execution methodologies. In particular, the Working Group believes that the CFTC needs to preserve the role of voice brokers in the energy swaps market. At the present time, that role is integral to market liquidity for the reasons described herein. The role of the voice broker is consistent with the policy goals underlying new CEA Section 5h, as voice brokers function as many-to-many execution conduits that, when coupled with the real-time reporting requirements set forth in Section 727 of the Act, will provide both pre- and post-trade price transparency.[1]

Moreover, interpreting the definition of SEF to include voice brokers and other many-to-many execution platforms and systems provides market participants, particularly those in the energy sector, with the optionality to execute Swap transactions on different types of platforms given the nature and characteristic of the transaction at issue. Specifically, classifying a variety of execution methods as SEFs will give individual markets, with their varying degrees of specialization, liquidity, and volume, and their participants, the flexibility to select the type of SEF that functions best within a market given that market's unique characteristics. This variety of execution methods is particularly important in less liquid markets where platforms that provide counterparties with the ability to find a counterparty willing to execute - as opposed to shopping the market - are essential.

B. CONGRESS INTENDS SEFS TO SUPPORT A DIVERSITY OF MANY-TO-MANY EXECUTION PLATFORMS AND SYSTEMS.

The plain language of the SEF definition clearly reflects Congress' intent that SEFs encompass a diversity of many-to-many execution systems or platforms, including voice brokers. Specifically, new CEA Section 1(a)(50) defines the term SEF as:

> [A] trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, *through any means of interstate commerce*, including any trading facility, that:
>
> (A) facilitates the execution of Swaps between persons; and
>
> (B) is not a designated contract market.

(Emphasis added).

---

[1] Section 727 of the Act states that "the purpose of this section is 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."

The language makes plainly clear that SEFs are intended to support a platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple other participants. In other words, a many-to-many execution platform.[2]

Importantly, in addition to intending that SEFs support many-to-many platforms and systems, Congress also intended that the CFTC utilize a diverse range of many-to-many options, such as voice brokers. Indeed, inclusion of the phrase "*through any means of interstate commerce*" is an important addition to the SEF definition, as its clearly shows that Congress intends for the CFTC, when evaluating proposed SEFs, to approve many-to-many platforms utilizing an array of Swap execution methodologies.[3]

This intent is further reflected by the fact that Congress chose not to use verbatim the existing CEA definition of "trading facility" when establishing the definition of SEF.[4] The CEA definition of "trading facility" is more restrictive than the SEF definition in that it limits the means of execution to physical or electronic facilities or systems. In contrast, the definition of SEF is broader, contemplating instead "any means of interstate commerce" to effectuate Swap transactions, in addition to the physical or electronic methodologies of a "trading facility."

In this respect, the Working Group submits that, based on the plain language of the definition of SEF, and the fact that Congress chose not to use verbatim the existing definition of "trading facility," the term must be interpreted as including a range of many-to-many execution systems or platforms, including voice brokers.

---

[2] CFTC Chairman Gary Gensler recently explained that an SEF "is not a facility where many buyers have access to only one dealer," *i.e.*, a one-to-many platform or facility. *See* "Remarks of Chairman Gary Gensler at the Swap Execution Facility Conference" (Oct. 4, 2010).

[3] This specific phrase of "through any means of interstate commerce" is meant to be broad, not restrictive, and can only mean what it says. "Any means" clearly includes more than electronic systems or platforms. "Interstate commerce" indicates the recognition that execution systems and platforms affect markets throughout the United States.

[4] The term "trading facility" is defined in CEA § 1(a)(34), in part, as:

> [A] person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions—
>
> > (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system . . . .

7 U.S.C. § 1a(34).

See also CFTC Glossary of Terms, available at http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm (defining the term "trading facility" as "[a] person or group of persons that provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions by accepting bids and offers made by other participants in the facility or system.").

C. VOICE BROKERS MEET THE MANY-TO-MANY REQUIREMENT OF SEFS.

Voice brokers function purely as a trading and execution platform, *i.e.*, a platform where multiple market participants can come to trade and execute Swap transactions. Specifically, voice brokers are open to receiving orders from multiple market participants, and upon receiving an order from a market participant, the voice broker solicits bids and offers from multiple participants. Voice brokers are thus open to all market participants and provide an important vehicle through which market participants can identify and solicit select counterparties in a manner that is consistent with the policy objectives of new CEA Section 5h. Accordingly, voice brokers function as many-to-many execution conduits that, when coupled with the real-time reporting requirements set forth in Section 727 of the Act, will provide both pre- and post-trade price transparency.

D. PRACTICAL IMPLICATIONS OF A NARROW INTERPRETATION OF SEF.

1. An Interpretation of SEF that Does Not Include Voice Brokers Would Significantly Impede Energy Markets.

Voice brokers play a critical role in over-the-counter derivatives markets for energy commodities, functioning as key trading and execution platforms. The following examples illustrate situations in which the benefits of using voice brokers cannot be replicated through the use of an electronic trading facility, underscoring the integral role voice brokers play in Swap markets:

- Commercial firms often enter into a physical contract coupled with a Swap. A voice broker is able to intermediate the negotiation of both sides of the transaction. However, if this transaction needed to be executed on an exchange-like platform, a counterparty could not be assured of getting the two legs at a price certain, and thus would be forced to take execution (or "slippage") risk that is unnecessary and costly.

- Given the variety of delivery locations in energy markets and the presence of long-dated trades, many energy Swap markets tend to be less liquid. In such markets, a voice broker can "shop" an order and solicit interest, assisting liquidity where it is most needed. This is also true in markets where there is "episodic liquidity" (*i.e.*, sometimes it is there and sometimes it is not). In these markets, voice brokers provide more accurate pricing information than quotes on an electronic platform.

- Having a voice broker intermediate in less liquid markets has the added advantage of a live market. Traders are certain that potential interested parties are engaged, rather than posting a bid or offer and "hoping" others are watching as the initial trader changes the components of its bid/offer (*i.e.*, price or quantity). In these less liquid markets, the pre-trade price information provided by a voice broker is more accurate than those posted on an electronic platform. In short, when using a voice broker there is immediate accurate feedback (liquidity) on both sides.

Furthermore, voice brokers serve as a third party check in the price/volatility validation process. In this capacity, voice brokers help counterparties validate the mark-to-market value of their transactions. Without voice brokers, the energy industry would lose a key source of information routinely used to support FAS 157 (Fair Value Measurement) disclosures. The accurate price information provided by voice brokers, especially in less liquid markets, is necessary to calculate relative exposures to determine when collateral must be delivered. Such exposure determinations will be integral to the efficient operation of the margin and capital regimes that the CFTC must adopt under Section 731 of the Act.

2. Electronic Trading Platforms are Ill-Suited for All Markets.

Voice brokers exist because some markets simply do not work electronically. Take, by analogy, the New York Board of Trade's Cocoa market. When the IntercontinentalExchange, Inc. purchased the New York Board of Trade in 2007, it converted the market from a trading pit to an electronic platform. The result was a sharp decline in liquidity and a sharp increase in both volatility and prices, the cost of which caused end users, such as confectioneries, to raise their prices or curtail production.[5]

Moreover, the NYMEX options markets remain open outcry markets despite the general trend toward electronic trading platforms because there are too many instruments (*e.g.*, strikes, months, puts and calls) dividing liquidity and making individual contracts too illiquid (or episodically liquid) to trade electronically. In addition, option trading strategies are complex, often involving more than a single instrument (*e.g.*, other options, futures, forwards, swaps, physicals), and "packaging" the trade is too complicated for an electronic market.

As markets evolve more markets will likely shift to electronic trading platforms. But as the above suggests, electronic trading is presently ill-suited for certain markets. In the interim, the CFTC should interpret the term SEF to include voice brokers.

III. OPEN COMMENT PERIOD.

Given the complexity and interconnectedness of all of the rulemakings under Title VII of the Act, and given that the Act and the rules promulgated thereunder entirely restructure over-the-counter derivatives markets, the Working Group respectfully requests that the CFTC hold open the comment period on all rules promulgated under Title VII of the Act until such time as each and every rule required to be promulgated has been proposed. Market participants will be able to consider the entire new market structure and the interconnection between all proposed rules when drafting comments on proposed rules. The resulting comprehensive comments will allow the CFTC to better understand how their proposed rules will impact Swap markets.

---

5 *See* Carolyn Cui, Electronic Era Zings Cocoa Market, Wall Street Journal (Nov. 18, 2009), available at http://online.wsj.com/article/SB10001424052748704533904574544052903125742.html?KEYWORDS=cocoa+ice.

IV. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the energy Swap markets in the United States. We appreciate the balance the CFTC must strike between effective regulation and not hindering the energy Swap markets. The Working Group offers its advice and experience to assist the CFTC in implementing the Act. Please let us know if you have any questions or would like additional information.

Respectfully submitted,

/s/ R. Michael Sweeney, Jr.

R. Michael Sweeney, Jr.
Mark W. Menezes
David T. McIndoe

Counsel for the
Working Group of Commercial Energy Firms