

HUNTON &
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C.F.T.C.
OFFICE OF THE SECRETARIAT
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HUNTON & WILLIAMS LLP
1900 K STREET, N.W.
WASHINGTON, D.C. 20006-1109

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

MARK W. MENEZES
DAVID T. MCINDOE
R. MICHAEL SWEENEY, JR.
EMAIL: mmenezes@hunton.com
dmcindoe@hunton.com
rsweeney@hunton.com

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

VIA ELECTRONIC MAIL

COMMENT

Re: *Significant Price Discovery Contract Proceeding, Fuel Oil-180 Singapore Swap Contract*, Comment File 9-030

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms (the "Working Group"), Hunton & Williams LLP submits the following comments in response to the request for public comment set forth in the Notice of Intent ("NOI") issued by the Commodity Futures Trading Commission ("CFTC" or "Commission") and published in the *Federal Register* on October 6, 2009,¹ addressing whether the Fuel Oil-180 Singapore Swap Contract ("SZS Contract") offered for trading on the IntercontinentalExchange, Inc. ("ICE") performs a significant price discovery function.

The Working Group is a diverse group of commercial firms in the domestic energy industry whose primary business activity is the physical delivery of one or more energy commodities to customers, including industrial, commercial and residential consumers. Members of the Working Group consist of 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.

¹ *Notice of Intent, Pursuant to the Authority in Section 2(h)(7) of the Commodity Exchange Act and Commission Rule 36.3(c)(3), to Undertake a Determination Whether the Fuel Oil-180 Singapore Swap Contract, Offered for Trading on the IntercontinentalExchange, Inc., Performs a Significant Price Discovery Function*, 74 Fed. Reg. 53,728 (Oct. 20, 2009).

As discussed further in these comments, the Working Group does not believe that the SZS Contract serves a significant price discovery function and should not be designated as a significant price discovery contract (“SPDC”) at this time.

I. COMMISSION AUTHORITY AND DISCRETION TO DESIGNATE CONTRACTS AS SPDCs.

In 2000, Congress enacted the Commodity Futures Modernization Act (“CFMA”),² which amended the Commodity Exchange Act (“CEA”), 7 U.S.C. §§ 1 *et seq.*, to create a tiered approach to the regulation of futures and derivatives markets to replace the CEA’s then-existing “one size fits all” regulatory framework. As part of this tiered approach, the CFMA created exempt commercial markets (“ECMs”). ECMs are principal-to-principal electronic trading platforms designed to encourage electronic trading of derivatives by sophisticated market participants. ECMs were subject to limited Commission regulation and oversight under the CFMA amendments to the CEA.

In June 2008, Title XIII of the Food, Conservation and Energy Act of 2008³ was enacted and, in relevant part, amended the CEA to include new Section 2(h)(7). CEA Section 2(h)(7) expanded the Commission’s limited authority over ECMs to identify and list contracts that serve a significant price discovery function.⁴ Specifically, this provision sets forth enumerated factors that the Commission must consider when determining whether a contract performs a significant price discovery function: (1) Price Linkage; (2) Arbitrage; (3) Material Price Reference; (4) Material Liquidity; and (5) Other Factors.

The purpose of new CEA Section 2(h)(7) is to make the regulation of certain contracts traded on ECMs similar to the Commission’s regulation of those contracts traded on designated contract markets (“DCMs”). Accordingly, in situations where the Commission determines that ECM contracts serve a significant price discovery function similar to contracts traded on a DCM, those contracts are subject to comparable regulation.

On March 23, 2009, the Commission issued a final rule implementing the provisions of new CEA Section 2(h)(7) subjecting ECMs with SPDCs to self-regulatory and reporting requirements, as well as certain Commission oversight authorities, with respect to those contracts.⁵ The SPDC Final Rule became effective on April 22, 2009. Among other things,

² Incorporated as Appendix E of the Consolidated Appropriations Act of 2001, Pub. L. No. 106-554, 114 Stat. 2763 (Dec. 21, 2000).

³ Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, 122 Stat. 1623 (June 18, 2008) (the “Reauthorization Act”).

⁴ Section 13204(c) of the Reauthorization Act requires the Commission to identify contracts that it deems appropriate for designation as SPDCs within 180 days after issuing rules implementing new CEA Section 2(h)(7).

⁵ See *Significant Price Discovery Contracts on Exempt Commercial Markets*, 74 Fed. Reg. 12,178 (Mar. 23, 2009) (“SPDC Final Rule”); 17 C.F.R. § 36.3 (2009).

the Commission adopted regulations establishing the procedures and the standards by which it will determine whether an ECM contract performs a significant price discovery function and provided guidance with respect to compliance with nine statutory core principles applicable to ECMs.⁶

The Commission has broad discretion when determining whether to designate a contract as a SPDC. Importantly, not all of the various statutory factors must be present to support a determination that a contract performs a significant price discovery function. In this regard, CEA Section 2(h)(7) neither prioritizes nor specifies the degree to which a contract must conform to the various factors.

II. PROPOSED DESIGNATION OF THE SZS CONTRACT AS AN SPDC.

The SZS Contract specifies 1,000 metric tons of 180 CentiStokes (cst) Singapore high-sulfur fuel oil (“HSFO”). The contract is cash-settled based on the arithmetic average of the means between the daily high and low price quotations for “HSFO 180 CST” delivered in the specified calendar month, published under the “Singapore” heading within Platts’ *Asia-Pacific/Arab Gulf Marketscan* (“Platts’ *Marketscan*”). The SZS Contract is listed for up to 60 consecutive calendar months beginning with the next calendar month. The NOI states that the SZS Contract appears to satisfy the Material Liquidity and Material Price Reference factors required for SPDC designation.⁷

The Working Group fully supports the Commission’s efforts to exercise in a disciplined and deliberate manner its statutory obligations under the Reauthorization Act to designate contracts traded on ECMs that meet the statutory criteria set forth in CEA Section 2(h)(7) as SPDCs. However, as discussed below, it is not clear that the SZS Contract satisfies either the Material Price Reference or Material Liquidity factors. Accordingly, the Working Group respectfully submits that the Commission should refrain from designating the SZS Contract as an SPDC.

A. MATERIAL PRICE REFERENCE.

The NOI states that the SZS Contract may perform a significant price discovery function as it appears to satisfy the Material Price Reference factor. The Commission’s apparent determination the SZS Contract meets the Material Price Reference factor is based solely on general statements made by market participants contained in its October 2007 *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* (“ECM Study”) that ICE functions as a “price discovery market for

⁶ *Id.* at § 36.3(c)(3).

⁷ NOI at p. 53,729.

certain energy contracts.”⁸ Although the Commission has the discretion to consider such general statements as part of the SPDC determination process, the Working Group respectfully submits that these statements are not sufficient as a matter of law or fact to satisfy the Material Price Reference factor.⁹

CEA Section 2(h)(7)(B)(iii) requires the Commission to consider “the extent to which, on a frequent and recurring basis, bids, offers, or transactions in a commodity are directly based on, or are determined by referencing, the prices generated” by the ECM.¹⁰ Guidance set forth in Appendix A to Section 36 of the Commission’s regulations states that the Commission will rely on one of two sources of evidence, direct or indirect, that the contract is a Material Price Reference.¹¹ A direct reference would be whether the cash market quotes the ECM contract.¹² An indirect reference would be whether an industry publication quotes the ECM contract’s price.¹³ As discussed below, the SZS Contract does not meet either of these standards.

1. Direct Reference.

There are no other related contracts traded in any market that settle to, or reference, the SZS Contract. This point is not contradicted by the NOI. Specifically, the NOI fails to identify any contracts which serve a significant price discovery function and settle to, or reference, the SZS Contract. The material price reference for the SZS Contract itself is the settlement price of the underlying physical market as determined by *Platts’ Marketscan*. Although the SZS Contract is influenced by the *Platts’ Marketscan* settlement price, it cannot influence the physical markets upon which such settlement prices are based or any other contract traded in an ECM, designated contract market (“DCM”) or over-the-counter (“OTC”) market.

2. Indirect Reference.

As to the indirect reference regarding whether an industry publication quotes the ECM contract’s price, the only publication to which the CFTC refers is the “East Oil End of Day”

⁸ See NOI at 53,729 (citing the ECM Study at the following URL link: http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf).

⁹ To the extent that the Commission formally concludes that the SZS Contract meets the Material Price Reference factor, the Working Group respectfully requests that it expressly provide the rationale and quantitative factual support addressing how general statements made by market participants in the ECM Study that ICE performs a price discovery function for “certain energy contracts” are sufficient as a matter of law and fact to satisfy the Material Price Reference factor for the SZS Contract.

¹⁰ 7 U.S.C. § 2(h)(7)(B)(iii).

¹¹ 17 C.F.R. Part 36, Appendix A (2009) (Guidance on Significant Price Discovery Contracts).

¹² *Id.*

¹³ *Id.*

ICE publication. It is logical that ICE would publish the prices of its own contracts, as would any other contract market. However, the fact that ICE publishes the settlement prices of its own contracts does not constitute sufficient evidence of a Material Price Reference necessary to satisfy the requirements of CEA Section 2(h)(7)(B)(iii). As noted above, the only price reference that market participants rely on are the physical prices published by *Platts' Marketscan*. There is no evidence whatsoever that a contract in any market is tied directly or indirectly to the settlement price of the SZS Contract.

B. MATERIAL LIQUIDITY.

To meet the Material Liquidity test, CEA Section 2(h)(7)(B)(iv) requires that the contract traded on the ECM must trade with sufficient volume “to have a material effect on other agreements, contracts, or transactions listed for trading . . . on a designated contract market” or ECM.¹⁴ The Commission also states “[l]iquidity is a broad concept that captures the ability to transact immediately with little or no price concession.”¹⁵ As demonstrated below, the SZS Contract lacks both (a) a material effect on other contracts and (b) sufficient liquidity to perform a significant price discovery function.

1. No Material Effect on Other Contracts Listed for Trading.

As noted in Section II.A., above, there is no evidence of other related contracts traded in any market that settle to, or reference, the SZS Contract. As a consequence, trading in the SZS Contract has no effect whatsoever on any contract listed for trading on a DCM, ECM or even in the OTC market. Although the SZS Contract is influenced by underlying physical prices as published by the *Platt's Marketscan*, it cannot influence such underlying physical prices.

2. Liquidity in the SZS Contract Is Insufficient for Designation as an SPDC.

Guidance set forth in Appendix A to Section 36 of the Commission's regulations states, in relevant part, that “in markets where material liquidity exists, a more or less continuous stream of prices can be observed and the prices should be similar,” for example, to “a market where trades occur multiple times per minute.” The quoted language indicates two factors that can show liquidity: (a) a narrow bid/ask spread, and (b) a trade frequency of multiple trades per minute.¹⁶ The NOI does not address either of these factors. Rather, it

¹⁴ 7 U.S.C. § 2(h)(7)(B)(iv).

¹⁵ 17 C.F.R. Part 36, Appendix A (2009).

¹⁶ Because the NOI does not expressly address how the SZS Contract satisfies the guidance in Appendix A of the Commission's regulation for Material Liquidity (*i.e.*, narrow bid/ask spread and trade frequency of multiple trades per minute), the Working Group respectfully requests that the Commission expressly identify the criteria supporting its view that the SZS Contract appears to meet the Material Liquidity factor.

states that the SZS Contract was transacted on an average daily basis of 30.6 times.¹⁷ Based on the average daily trade data set forth in the NOI, the trade frequency of the SZS Contract in terms of multiple trades per minute is very low. Because neither factor is presented by the SZS Contract, trading in this contract fails to meet this standard.

III. CONCLUSION.

The Working Group appreciates this opportunity to comment, and requests that the Commission consider these comments as it develops a final rule in this proceeding. Given the limited time provided for public comment, the Working Group expressly reserves the right to supplement these comments as deemed necessary and appropriate.

Respectfully Submitted,

/s/ Mark W. Menezes

Mark W. Menezes

David T. McIndoe

R. Michael Sweeney, Jr.

Counsel for the

Working Group of Commercial Energy Firms

¹⁷ The Commission should clearly identify whether the average daily trading volume of the SZS Contract identified in the NOI is based solely on transactions executed on ICE itself or whether this figure includes privately negotiated transactions that are executed off of the ICE platform and submitted to ICE for clearing. The Working Group believes that any determination on whether the SZS Contract performs a significant price discovery function should be based solely on daily trading volume on ICE and should not include privately negotiated transactions submitted to ICE for clearing.