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January 26, 2003

Via E-mail and Federal Express

Ms. Jean Webb,
Secretary,
Commodity Futures Trading Commission,
1155 21st Street, N.W.,
Washington, D.C. 20581.

COMMENT

Re: Proposed Rules for Exempt Commercial Markets

Dear Ms. Webb,

On behalf of IntercontinentalExchange, Inc. ("ICE"), we are pleased to comment on the Commission's proposed rules (the "Proposed Rules"), 68 Fed. Reg. 66032 (November 25, 2004), with respect to the operation of exempt commercial markets ("ECMs") under the Commodity Exchange Act (the "CEA"). ICE is a Delaware corporation that operates an electronic platform (the "Platform") for the trading of physical commodities and derivative products on such commodities among eligible commercial entities ("ECEs"). The Platform is the principal ECM in the energy market and is operated as an ECM pursuant to section 2(h)(3) of the CEA.

We note initially that Section 2(h)(3) of the CEA is framed as a broad exemptive provision that places ECMs outside the regulatory scheme. In amending the CEA through the Commodity Futures Modernization Act ("CFMA") to, among other things, authorize the operation of ECMs, Congress clearly intended that, as the name suggests, such entities be exempt from Commission regulation, rather than simply being subjected to a "lighter" system of regulation. Indeed, other types of trading facilities – such as "Derivatives Transaction Execution Facilities" – were created by the CFMA and were designed to be regulated by the Commission, although not to the same extent as designated contract markets. ECMs, in contrast, were intended to be outside the regulatory structure. For this reason, the CEA expressly states that an ECM may not "represent to any person that the facility is registered with, or designated, recognized, licensed or approved by the Commission". CEA, §2(h)(5)(F).

Accordingly, Section 2(h)(3) of the CEA provides that, with limited specific exceptions, "nothing in this Act shall apply" to transactions executed on an

ECM. The exceptions include provisions stating that (1) the Commission may prescribe regulations regarding "timely dissemination" by an ECM of certain information, "if the Commission determines that the electronic trading facility performs a significant price discovery function . . ."; (2) an ECM must either provide the Commission with access to its trading facility or submit certain reports of trading activity, but only at the request of the Commission; and (3) an ECM must maintain certain information related to data entry and transaction details. CEA, §§2(h)(4)and (5). We recognize that these provisions grant the Commission limited jurisdiction to obtain information from ECMs. However, the CEA does not provide the Commission with ongoing regulatory jurisdiction over ECMs. In its release announcing the Proposed Rules, the Commission notes that designated contract markets and derivatives transaction execution facilities are "subject to a greater degree of regulatory oversight than ECMs" and "are required to provide more frequent and detailed transaction data". This comparison, which suggests that ECMs are subject to regulation, but at a reduced level, is, in our view, inconsistent with the clear language of the CEA. For example, we do not believe that the CEA provides the Commission with the authority to require ECMs to maintain specific records or to submit prescribed reports, except to the limited extent set forth above. In particular, if the ECM provides the Commission with access to its trading facility (e.g., "view only" access), the CEA does not give the Commission the authority to require that the ECM submit reports to the Commission. CEA, §2(h)(5)(B)(i). We therefore believe that the Commission should reconsider those respects in which the Proposed Rules go beyond the clear direction of the CEA and subject ECMs to ongoing regulatory oversight or requirements.

We also have the following specific comments on the Proposed Rules.

I. Information Access Provisions

Section II of the Proposed Rules, "Information Access Provisions", proposes to require an ECM to provide the Commission with a notice identifying those transactions executed on the ECM with respect to which it intends to rely on the 2(h)(3) exemption. The Proposed Rules would also require an ECM to provide the Commission either with weekly reports in a specified form of those transactions executed on the ECM for which it is relying on Section 2(h)(3), or with electronic access to such transactions in a manner that would enable the Commission to compile the information that would otherwise be submitted in the weekly reports. In addition, the Proposed Rules would require an ECM to amend its notice regarding the transactions for which it is relying on Section 2(h)(3), should a new agreement, contract or transaction be added on the Platform, or an existing one amended, that would be traded in reliance on the 2(h)(3) exemption.

In our view, it will be unnecessarily burdensome for an ECM to identify all transactions for which it is relying on Section 2(h)(3). We also do not believe that this identification will be useful to the Commission unless the transactions are in a market with respect to which the ECM performs a significant price discovery function. We therefore recommend that the Commission require reports on, or the provision of

electronic access to, specific transactions only in those markets with respect to which the ECM performs a significant price discovery function. The Commission has the authority to require ECMs to maintain and report certain information on transactions executed in these markets, and it is these transactions that are likely to be of greatest interest to the Commission. Of course, the Commission would still have electronic access to (or would receive reports of) all transactions executed on an ECM, even in those markets for which the ECM does not serve a significant price discovery function, as is currently the case. We therefore do not believe that any changes are required to the current practice with respect to non-price discovery markets. The approach suggested herein, however, would obviate the need for the ECM to identify specifically those transactions that are covered by Section 2(h)(3), with the exception of those executed in a market for which the ECM performs a price discovery function.

In addition, we recommend that the Commission delete from the Proposed Rules the requirement that an ECM amend its notice to reflect the addition of, or amendments to, products traded in reliance on Section 2(h)(3). This requirement will be burdensome and inconsistent with the approach to ECMs taken by the CFMA. One of the defining characteristics of an ECM is the ease and speed with which products or transactions can be made available for trading or can be modified. Indeed, ECMs often add a new product whenever a sufficient number of participants express interest in trading that product. An ECM may also define its "products" differently than organized exchanges. ICE, for example, treats each expiration or delivery month as a separate product. Similarly, because transactions available for trading on an ECM are generally not the same type of standardized products traded on exchanges, it may be difficult to determine whether modifications made to an existing product transform it into a new product. In this respect as well, we believe that the CFMA intended to require ECMs only to provide the Commission with information in their possession, not to generate new information or make affirmative evaluations of products for purposes of filing notices. If the Commission has access to the ECM's system, or receives reports, it will clearly have the information it needs to determine if new products have been added. The frequent filings that will be necessitated by this proposal are inconsistent with the CEA and are unwarranted. We therefore recommend that they not be adopted.

II. Price Discovery

The CFMA authorizes the Commission to adopt rules regarding the timely dissemination of certain transactional information by an ECM "if the Commission determines that the electronic trading facility performs a significant price discovery function" in the relevant markets. CEA, §2(h)(4)(D). The statute, however, does not define the term "significant price discovery function". The Proposed Rules would require the dissemination of information by an ECM if (1) transactions in the relevant cash market are "directly based on, or quoted at a differential to, the prices generated on the market [the ECM] on a more than occasional basis", or (2) the ECM's prices are "routinely disseminated in a widely distributed industry publication and are consulted by the industry on more than an occasional basis for pricing cash market transactions". In

our view, the second of these tests is inappropriate in the context of ECMs and is in any event unnecessary in light of the first test.

First, the term "consulted" is inherently vague and potentially all-encompassing. Any information that is published is potentially "consulted" by market participants on more than an occasional basis for pricing purposes, but might not be the principal component of pricing decisions or even have any direct impact on such decisions. Indeed, traders typically "consult" any news or information that is available to them on a regular basis, including information regarding interest rates, exchange rates or global political events, and could be construed to do so "for pricing cash market transactions". However, this should not be a basis for a determination that an ECM performs a significant price discovery function. Moreover, the second test is circular and, as a practical matter, adds nothing to the first test. Specifically, the second test is met only if information is already widely disseminated by the ECM. Using this as a basis for subsequently determining whether the ECM should be required to widely disseminate the information is illogical and not particularly helpful. We therefore recommend that the Commission delete the second test and rely on the first test in determining whether an ECM "performs a significant price discovery function".

III. Provision of Market Data

In Section III. C. of the release accompanying the Proposed Rules, which is headed "Information to be Disseminated by a Price Discovery Market", the Commission describes the types of market data that would be required to be made public by those ECMs that are found to perform a significant price discovery function. In this context,

> the Commission notes that the Act does not appear to require publication of real-time price data. The Commission also notes that many exchanges charge fees for real-time market data (usually bids, offers and transaction prices), and that such fees can be an important source of exchange revenues. The exchanges also make certain market summary data freely available to the public on a delayed basis (where the delay can be as little as 10 minutes). This delayed market information generally includes opening and closing prices or price ranges, daily high and low prices, settlement prices, daily trading volume and open interest. The Commission interprets the Act as allowing exempt commercial markets to reap gains from the sale of real-time market data, but also to require these markets to publish the required market summary information noted above without charge to the marketplace on a delayed basis.

68 Fed. Reg. at 66038.

The Commission's intentions in this regard with respect to the obligations of ECMs, and how those obligations compare to those of designated contract markets ("DCMs" or "exchanges"), are unclear and we respectfully request that the Commission clarify its statement in several respects. First, we are unclear as to the basis on which the Commission "interprets the Act . . . to require" ECMs to disseminate delayed information without charge. The CEA refers only to "timely dissemination" of information by an ECM that performs a significant price discovery function and does not refer to, or place any limits on, the extent to which an ECM may charge for such dissemination. CEA, §2(h)(4)(D). In contrast, the CEA expressly requires DCMs to make specified information public on a daily basis and the Commission's "core principles" for DCMs state that exchanges must make this information available to the public "on a fair, equitable and timely basis". Commission Rules, Part 38, Appendix B. To the extent that the CEA and the Commission's regulations address the dissemination of information, therefore, they clearly impose more stringent requirements on DCMs. The Commission observes in its release that exchanges make price and volume information "freely available to the public on a delayed basis." In fact, we understand that the exchanges universally follow this practice because they interpret the CEA and CFTC regulations to require it, based on the obligation to disseminate information on a "fair, equitable and timely basis". However, we are not aware of any statements by the Commission expressly imposing such a requirement and the only mention of this requirement in the release accompanying the Proposed Rules relates to ECMs. The Commission should therefore clarify that, to the extent that ECMs are required to make delayed information publicly available without charge, DCMs are subject to the same requirement. It would be anomalous -- and directly contrary to the clear intent of the CFMA -- if ECMs were subject to a more stringent requirement than exchanges with respect to publication of information.

Second, if the Commission does intend to impose an express requirement on ECMs to make delayed data available free of charge, will this requirement be included in the final version of the Proposed Rules? If so, will the Commission provide guidance as to the meaning of the term "delayed," as well as the means by which ECMs must make the information available and the circumstances under which ECMs can charge for their expenses in providing the information?

Third, we respectfully request that the Commission clarify that its statement regarding publication of delayed information by ECMs without charge applies only to information on markets for which an ECM performs a significant price discovery function. The statement appears only in the section of the release regarding price discovery markets. In addition, the Commission's authority to require publication of information only extends to these markets and the Commission cannot require ECMs that do not perform a price discovery function to publish information at all. We therefore do not believe that the Commission intended to impose this requirement on all markets traded by ECMs. However, we suggest that the issue be clarified.

Depending on the content of the clarifications provided by the Commission on the foregoing issues, we may need to consider further the statement that ECMs will be required to make delayed information available without charge. ICE therefore reserves the right to provide additional comments on this portion of the release accompanying the Proposed Rules.

IV. Reporting of Complaints

Section II of the Proposed Rules, "Information Access Provisions", would require an ECM to provide the Commission with a copy of each substantive complaint concerning instances of suspected fraud or manipulation received by the ECM no later than three days after the complaint is received. This proposal, in our view, is overly broad in several respects and should be modified.

First, ECMs such as ICE from time to time receive communications that could be construed as complaints, although many of these communications are not bona fide or are easily resolved. As provided by Proposed Rule 36.3(b)(1)(iii), ECMs would be required to maintain records of all such communications. ICE has no objection to a requirement that it maintain such records. However, a requirement that an ECM also report each such communication to the Commission after only three days is unnecessarily burdensome and will serve only to inundate the Commission with communications that are not bona fide complaints. The required early reporting of complaints that are not bona fide, and the potential for CFTC investigations of such complaints, could be used to intimidate traders from participating on an ECM, motivating them to continue to trade through voice brokers or directly with counterparties and, in either case, outside of the Commission's reporting system. Instead, ECMs should be afforded an adequate opportunity to conduct their own due diligence investigation of a complaint before submitting it to the Commission. We recommend that the Proposed Rules be amended to allow ECMs thirty days to determine whether a complaint is bona fide before being required to submit it to the Commission.

Second, the meaning of the term "substantive" in the Proposed Rules is vague and its use in this context is potentially problematic. We assume that the Commission intended this term to refer to complaints that are found to be bona fide and to have merit. As drafted, however, the Proposed Rules could be construed to apply to every complaint, regardless of how frivolous, provided that the complaint relates to substantive, and not procedural, aspects of the ECM's operation. This could result in ECMs forwarding all complaints to the Commission, which would serve to inundate the Commission with documentation and would actually undermine the Commission's realization of its objectives by making it difficult or impossible to identify and, if necessary, act upon legitimate complaints. This approach would also be unduly burdensome for ECMs. The proposal should be modified to make it clear that only those complaints that are bona fide and have merit are subject to the reporting requirement.

Third, the Commission should not, in our view, be concerned about complaints received by an ECM that relate to markets other than those in which the ECM performs a significant price discovery function. It is only with respect to these markets that the CFMA gives the Commission broader authority and we question whether the statute even permits the Commission to require the filing of reports on complaints regarding other markets. Moreover, as a practical matter, it is unlikely that the Commission will require, or find useful, information on complaints made in connection with such other markets. The Proposed Rules, therefore, will serve only to burden ECMs and the Commission, without any enhancement of the Commission's ability to address actual problems in the markets.

We urge the Commission to modify the Proposed Rules in the foregoing respects.

V. Roles of Other Market Participants

Finally, although the Commission has not expressly requested comment on the issue, we believe it is important for the Commission to consider the roles of other market participants, particularly voice brokers and index publishers, in determining whether to adopt the Proposed Rules as well as the content of such Rules. We recognize that the Commission may have limited jurisdiction, or in some cases no jurisdiction, over these entities. To the extent that it does have jurisdiction, the Commission should consider the applicability of its Proposed Rules to such entities. To the extent that it has no jurisdiction over these entities, the Commission should nevertheless consider their activities in fashioning its rules.

Voice brokers allow participants in the markets for physical commodities and over-the-counter derivatives on such commodities to identify potential counterparties to desired transactions and to execute transactions with such counterparties. Accordingly, voice brokers perform a function that is virtually identical to that of ECMs. In fact, ICE is essentially an electronic voice broker that provides market participants with a more efficient means of identifying counterparties and executing transactions. However, the Proposed Rules apply only to ECMs and do not encompass or address voice brokers in any respect. Voice brokers, like ECMs, generate and obtain data regarding executed transactions, trading volumes and other matters that is substantially identical to the data generated by ECMs. Nevertheless, voice brokers are not required under the Proposed Rules to provide the Commission with access to information, to file reports or to make data available to the public. This deprives the Commission and the market of information regarding a significant portion of the transactions executed by the same market participants trading on ECMs. Moreover, the additional burdens imposed by the Proposed Rules add to the cost of ECMs and the burdens imposed on their participants, to the competitive disadvantage of ECMs versus voice brokers. We urge the Commission to consider the role of voice brokers in connection with its adoption of any rules regarding ECMs.

Data publishers similarly obtain and disseminate information regarding market transactions -- including, in some cases, those executed on ECMs -- and may also be involved in the execution of transactions. As a result, data publishers have as much, if not more, of an ability to influence pricing decisions in the cash and derivatives markets as ECMs. The Commission should therefore take into account the activities of voice brokers and data publishers and their roles in the market, and consider the competitive burdens that would be placed on ECMs, in determining the final form of the Proposed Rules.

We appreciate the opportunity to comment upon the Proposed Rules. Please call the undersigned at (212) 558-4675 if you would like to discuss these issues further or if you require additional information.

Sincerely,

Kenneth Raisler/FSL

Kenneth M. Raisler

cc: Charles Vice
(IntercontinentalExchange, Inc.)