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David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, D.C. 20581

COMMENT

2009 OCT 22 PM 4 42  
OFFICE OF THE SECRETARIAT  
C.F.T.C.

Re: Notice of Intent To Undertake a Determination Whether Certain Mid-C Contracts Offered for Trading on the IntercontinentalExchange, Inc., Perform Significant Price Discovery Functions

Dear Mr. Stawick:

The Edison Electric Institute (“EEI”) respectfully submits the following comments in response to the Commodity Futures Trading Commission’s (the “Commission” or “CFTC”) 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 Mid-C Financial Peak Contract; Mid-C Financial Peak Daily Contract; Mid-C Financial Off-Peak Contract; and Mid-C Financial Off-Peak Daily Contract Offered For Trading on the IntercontinentalExchange, Inc, Perform Significant Price Discovery Functions (“Notice of Intent”).<sup>1</sup>

**I. INTEREST OF EEI IN THE PROPOSED RULEMAKING**

EEI is the association of shareholder-owned electric companies, international affiliates and industry associates worldwide. Our U.S. members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. Many of EEI’s electric

<sup>1</sup> See “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 Mid-C Financial Peak Contract; Mid-C Financial Peak Daily Contract; Mid-C Financial Off-Peak Contract; and Mid-C Financial Off-Peak Daily Contract, Offered for Trading on the IntercontinentalExchange, Inc., Perform Significant Price Discovery Functions, Notice of action and request for comment”, 74 Fed. Reg. 51,261-51,264 (October 6, 2009) (the “Mid-C Notice of Intent”).

utility company members utilize financial instruments, like the contracts referenced by the Commission in its Notice of Intent, to hedge the price risks associated with buying and selling wholesale power supply. These tools are a key method used by utilities to provide reliable electric service to consumers at stable prices, and to protect electric customers from higher retail prices caused from time-to-time by volatile wholesale electricity prices. As a result, EEI and its member companies have a direct interest in the outcome of these proceedings.

## **II. OVERVIEW OF EEI'S COMMENTS**

EEI appreciates the opportunity to comment upon whether the ICE Mid-C contracts referenced in the Notice of Intent and traded on the IntercontinentalExchange, Inc. ("ICE") (collectively, the "ICE Contracts") perform significant price discovery functions.

At the outset, it is important to recognize that electric power markets are very complex, owing in part to the unique physical characteristics of electricity and the delivery and timing issues that result. Customers require electricity around the clock, and our modern economy depends upon having a reliable and steady supply of electricity. Electricity cannot be stored in significant quantities, however, which requires that it be generated and consumed almost instantaneously. Moreover, the supply and demand for electricity changes dramatically on a daily, weekly and seasonal basis as well as in response to specific weather patterns. In addition, wholesale electricity transactions generally are limited to regional markets because of technical, reliability and efficiency factors. For these reasons, electricity prices are among the most volatile of any commodity. To manage this volatility, market participants such as investor-owned utilities and power generators use a variety of financial instruments and tools to address

the specific physical characteristics of electricity, and the specific timing and delivery issues they face in providing service to retail customers. The ICE Contracts are an example of these very important price hedging and risk management tools.

In order to serve retail load, EEI members procure and sell substantial quantities of wholesale physical power. The contracts through which they procure and sell this power often provide for delivery not only in the spot month, but often for months or even years into the future.<sup>2</sup> EEI members use the ICE Contracts to hedge the price risk associated with their long and short physical power positions in the Pacific Northwest electricity markets. The ability of EEI members to hedge against price volatility by purchasing and selling the ICE Contracts helps reduce price volatility in the wholesale markets and, thereby, promotes a reliable flow of electricity to retail customers at more stable prices.

EEI submits the following general comments in response to the Commission's Notice of Intent: (1) the short amount of time provided by the Commission to respond to the Notice of Intent is insufficient to allow affected market participants to provide detailed information about whether the ICE Contracts meet the criteria of a significant price discovery contract ("SPDC"); (2) the ICE Contracts do not meet any of the criteria that the Commission is directed to consider in its SPDC Order;<sup>3</sup> and (3) the costs and

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<sup>2</sup> Under the Federal Power Act, all sales of electric energy at wholesale must be made at prices that are "just and reasonable." In addition, all persons who sell physical power in the interstate wholesale markets are subject to the regulation of the Federal Energy Regulatory Commission.

<sup>3</sup> "Significant Price Discovery Contracts on Exempt Commercial Markets; Final Rules," 74 Fed. Reg. 12,178, 12,203 (23 March 2009) (the "SPDC Order").

risks associated with designating the ICE Contracts as SPDCs significantly outweigh any potential benefit.<sup>4</sup>

### III. **THE COMMISSION HAS NOT PROVIDED A SUFFICIENT OPPORTUNITY FOR COMMENT**

The Notices of Intent provide only a 15-day window for providing comments on the Commission's proposals to designate the ICE Contracts as SPDCs. EEI respectfully submits that this limited time period for providing comments is insufficient to give the numerous entities that could be impacted an opportunity to provide detailed information that will assist the Commission in reaching a sound and well-reasoned determination. As noted above, the markets for electricity-related products are exceedingly complex. A full understanding of the particular facts surrounding each power contract is needed in order to fully analyze what effect a change in regulation may have on the underlying wholesale power markets. In addition, the Commission has simultaneously announced its intent to designate several energy-related contracts as SPDCs.<sup>5</sup> This requires users of these contracts to provide details on multiple contracts, in response to multiple Notices of Intent, all within a compressed time period.

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<sup>4</sup> 17 CFR Parts 15, 16 and 17 (March 23, 2009).

<sup>5</sup> *See, e.g.*, "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 SP-15 Financial Day-Ahead LMP Peak Contract; SP-15 Financial Day-Ahead LMP Peak Daily Contract; SP-15 Financial Day-Ahead LMP Off-Peak Daily Contract; SP-15 Financial Swap Real Time LMP--Peak Daily Contract; SP-15 Financial Day-Ahead LMP Off-Peak Contract; NP-15 Financial Day-Ahead LMP Peak Daily Contract. *See also* NP-15 Financial Day-Ahead LMP Off-Peak Daily Contract, Offered for Trading on the IntercontinentalExchange, Inc., Perform Significant Price Discovery Functions, Notice of action and request for comment," 74 Fed. Reg. 51,264, 51,268 (October 6, 2009). *See also* "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 Henry Financial Swing Contract; Henry Financial Basis Contract; and Henry Financial Index Contract, Offered for Trading on the IntercontinentalExchange, Inc., Perform Significant Price Discovery Functions, Notice of action and request for comment," 74 Federal Register 53,720, 53722 (October 20, 2009).

Given the unique characteristics of the evolving electricity trading markets, coupled with the fact that the process for designating SPDCs is still new for both the Commission and the affected public (with only one contract designated to date), the Commission should provide an adequate process that allows for a thorough analysis of whether the ICE Contracts meet the SPDC criteria, and the potential consequences of designating them as SPDCs. In order to give affected entities a sufficient opportunity to provide detailed comments on the Notices of Intent, the Commission should either extend the comment period for 30 days, or establish public hearing procedures to provide further opportunity for comment.<sup>6</sup>

#### **IV. THE ICE CONTRACTS DO NOT MEET ANY OF THE SPDC DETERMINATION CRITERIA**

EEI respectfully submits that none of the ICE Contracts meets any of the SPDC determination criteria set forth in the Commission's regulations, which require the Commission to consider factors such as price linkage, arbitrage, material price reference and material liquidity in making its determination.<sup>7</sup>

##### **A. There Is No Price Linkage Between The ICE Contracts And The Corresponding NYMEX Contracts.**

Although the Commission does not specify the exchange-traded contracts to which it is comparing the ICE Contracts, the Commission's analysis should focus on power contracts listed on the New York Mercantile Exchange ("NYMEX") (a designated contract market) that correspond to the ICE Contracts (*e.g.*, Dow Jones Mid-Columbia Electricity Price Index Swap Contract). The remaining comments provided herein

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<sup>6</sup> Mid-C Notice of Intent at n. 3, (stating: "[w]here appropriate, the Commission may choose to interview market participants regarding their impressions of a particular contract.")

<sup>7</sup> SPDC Order at 12,181.

assume that the Commission intends to focus on these corresponding NYMEX power contracts. None of the ICE Contracts has the requisite price linkage to the NYMEX contracts that the Commission must find in order to determine that they are SPDCs.<sup>8</sup>

The Commission can take official notice that the Mid-C contracts, for example, settle based on different price indices than those used to settle the NYMEX equivalent contract. The prices of the two contracts, therefore, do not bear a direct relationship to each other.

B. There Is No Effective Arbitrage Between The ICE Contracts And The Corresponding NYMEX Contracts

The Commission's Notice of Intent does not provide either real world or hypothetical examples illustrating how arbitrage would occur between the ICE and NYMEX markets. The NYMEX Dow Jones Mid-Columbia Electricity Price Index Swap Contract is considerably less liquid than the ICE Contracts.<sup>9</sup> Notwithstanding any similarities in the referenced prices used to settle the contracts, EEI members and other market participants cannot effectively arbitrage between these markets because they cannot execute simultaneous trades or liquidate positions in the contracts on a sufficiently frequent basis to protect themselves against exposure to unacceptably high price risk. As a result, the ICE Contracts do not "permit market participants to effectively arbitrage

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<sup>8</sup> *Id.*

<sup>9</sup> A brief review of available statistical information related to recent trading activity on the Mid-C contract shows either no open interest or activity, or the trading of only very small amounts of contracts. *See, e.g.*, <<[http://www.cmegroup.com/daily\\_bulletin/Section02C\\_Summary\\_Volume\\_And\\_Open\\_Interest\\_\(Excludes%20TRAKRS\)\\_Energy\\_Futures\\_And\\_Options\\_2009202.pdf](http://www.cmegroup.com/daily_bulletin/Section02C_Summary_Volume_And_Open_Interest_(Excludes%20TRAKRS)_Energy_Futures_And_Options_2009202.pdf) and [http://www.cmegroup.com/market-data/files/NYMEX\\_Monthly\\_volumes-2009.pdf](http://www.cmegroup.com/market-data/files/NYMEX_Monthly_volumes-2009.pdf)>>.

between the markets by simultaneously maintaining positions or executing trades in the contracts on a frequent and recurring basis.”<sup>10</sup>

C. No Material Price Reference

The Commission’s Notice of Intent references its study of exempt commercial markets (“ECM Study”), which found only generally that “market participants view the ICE as a price discovery market for certain electricity contracts”.<sup>11</sup> However, the Notice of Intent also acknowledges that the ECM Study “did not specifically address the power contracts under review.”<sup>12</sup> A more in depth analysis of the specific contracts reveals that there is no material price reference as defined by the Commission.<sup>13</sup> As noted above, the ICE Mid-C contracts settle based on the day-ahead index price (or calendar-month average prices) for the Mid-Columbia hub published in the settlement month by the ICE for the specified day (or month). The index price is derived from physical transactions. Thus, the ICE Mid-C contract settles based on the price of the underlying physical transactions; not the other way around. The bids, offers, or transactions in physical electric power are not primarily “based on,” or “determined by referencing, the prices generated by” any of the ICE Contracts, as the Commission’s regulations require.<sup>14</sup>

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<sup>10</sup> “Order Finding That the ICE Henry Financial LD1 Fixed Price Contract Traded on the IntercontinentalExchange, Inc., Performs a Significant Price Discovery Function, Final Order” 74 Federal Register 37,989 (30 July 2009) (the “ICE Henry Financial SPDC Order”).

<sup>11</sup> See CFTC, *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets*, Oct. 2007. See also Mid-C Notice of Intent at 51,262, 51,264.

<sup>12</sup> Mid-C Notice of Intent at 51,262, 51,264.

<sup>13</sup> ICE Henry Financial SPDC Order at 37,989.

<sup>14</sup> See 17 CFR § 36.3(c)(1)(iii).

D. No Material Liquidity

The Notice of Intent concluded that the ICE Contracts may satisfy the material liquidity provision outlined in the SPDC Order apparently based solely on the average number of daily contracts and the average number of separate transactions for each of the relevant ICE Contracts.<sup>15</sup> However, the material liquidity criterion that the Commission is directed to consider in Rule 36.3(c)(1)(iv) requires the Commission to consider whether the trading volume of the ICE Contracts is “sufficient to have a material effect” on exchange-traded contracts such as the NYMEX contracts listed above.<sup>16</sup> As noted above, there is no *direct* price linkage between the ICE Contracts and the corresponding NYMEX contracts. Thus, the ICE Contracts cannot have a direct material effect on the NYMEX contracts. Moreover, as also discussed above, potential arbitrage between the contracts is hindered by the lack of liquidity in the NYMEX contracts. Because trading in the ICE Contracts cannot have a direct “material effect” on the corresponding NYMEX contracts, the material liquidity criterion in the Commission’s regulations is not satisfied.<sup>17</sup>

V. **THE COSTS AND RISKS THAT WOULD RESULT FROM DESIGNATING THE ICE CONTRACTS AS SPDCS SIGNIFICANTLY OUTWEIGH ANY POTENTIAL BENEFIT**

EEI members and other market participants in U.S. physical power markets rely on the ability to hedge their price risks by purchasing and selling the ICE Contracts.

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<sup>15</sup> See Mid-C Notice of Intent at 51,262, 51,264.

<sup>16</sup> See ICE Henry Financial SPDC Order at 37989.

<sup>17</sup> See ICE Henry Financial SPDC Order at 37989 (in which the Commission explained that material liquidity means “the extent to which the volume of agreements, contracts or transactions in a commodity being traded on the electronic trading facility is sufficient to have a material effect on other agreements, contracts or transactions listed for trading on or subject to the rules of a DCM, DTEF or electronic trading facility operating in reliance on the exemption in section 2(h)(3).”)

Setting position limits for the ICE Contracts could adversely affect the underlying physical power markets by limiting the ability of market participants (including electric utilities with obligations to serve consumers) to adequately hedge against volatile physical power prices and deliver a reliable source of power to consumers at stable prices. The resulting reduced liquidity would also harm the ability of the market to generate accurate price signals, which are essential to maintaining efficient wholesale markets.

The critical role that these contracts play in ensuring a steady flow of power to retail consumers at reasonably stable prices, coupled with the fact that the SPDC determination criteria weigh against designating the contracts as SPDCs, should give the CFTC significant pause. In addition to the known risks discussed above, there is still the potential for unintended consequences that may result from the application of the Commission's comprehensive regulatory program to these contracts. To date, the Commission has no experience with respect to what effect SPDC designation may have on the contracts or the related physical transactions. The first contract to be deemed an SPDC, the ICE Henry Financial LD1 Fixed Price Contract, was identified in July of 2009 and the ICE has not yet completed its implementation of the Commission's regulatory requirements.

As discussed above, in the absence of providing additional time for public comment, the Commission should make a finding that the ICE Contracts are not SPDCs, based on the application of the specific facts associated with these contracts to the criteria for determining SPDCs set forth in the Commission's regulations. If the Commission does not make such a finding, it should delay making a determination as to whether the

ICE Contracts are SPDCs until further research can be done on the long-term and marketwide effects such designation may have. In the alternative, the Commission should limit any SPDC designation to a finite number of contracts. If the Commission chooses to do this, it should then study the effect such designation has on those contracts and the underlying physical markets prior to taking any action with respect to the other ICE Contracts.

Finally, to the extent that the ICE Contracts are designated as SPDCs and position limits are imposed, the limits should be set high enough to allow for hedging of transactions in physical markets at current levels well forward on the price curve and allow automatic position increases as a result of load growth or new generation. Additionally, the Commission should provide for the opportunity to reassess any determination that the ICE Contracts are SPDCs, and to reassess any position limits imposed, based on actual experience.

## VI. CONCLUSION

For the foregoing reasons, EEI respectfully recommends that the Commission not designate the ICE Contracts as SPDCs. If you have any questions regarding these comments, please do not hesitate to contact Richard F. McMahon, Jr., Executive Director, at (202) 508-5571, or Jeff Dennis, Director, Federal Regulatory Affairs, at (202) 508-5098.

Respectfully Submitted,

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