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October 21, 2009

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

COMMENT

RE: Determination whether the Carbon Financial Instrument Contract serves a Significant Price Discovery Function

Dear Mr. Stawick:

IntercontinentalExchange, Inc. ("ICE") welcomes the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") notice of intent ("notice") to determine whether the following contracts serve a significant price discovery function:

- SP-15 Financial Day-Ahead LMP Peak ("SPM") contract, SP-15 Financial Day-Ahead LMP Peak Daily ("SDP") contract, SP-15 Financial Day-Ahead LMP Off-Peak Daily ("SQP") contract, SP-15 Financial Swap Real Time LMP - Peak Daily ("SRP") contract, SP-15 Financial Day-Ahead LMP Off-Peak ("OFP") contract (collectively the SP-15 contracts).
- NP-15 Financial Day-Ahead LMP Peak Daily ("DPN") contract, NP-15 Financial Day-Ahead LMP Off-Peak Daily ("UNP") (collectively, the NP-15 contracts)
- Mid-C Financial Peak contract ("MDC"), Mid-C Financial Peak Daily ("MPD"), Mid-C Financial Off-Peak ("OMC") contract, Mid-C Financial Off-Peak Daily ("MXO") Mid-C contract (collectively, the Mid-C contracts)

ICE believes that these contracts do not serve a significant price discovery function, and that the Commission may exceed its jurisdiction if it determines that these contracts serve as a significant price discovery contracts ("SPDC"). In addition to the absence of minimum liquidity thresholds, the existence of pricing regimes established under the Federal Energy Regulatory Commission, which include locational marginal pricing and independent systems operators further precludes many of these contracts from a significant price discovery role.

Background

In 2000, the Commodity Futures Modernization Act ("CFMA") created a system of tiered regulation to replace a "one size fits all" regulatory scheme. As part of the tiered regulatory scheme, Congress created exempt commercial markets ("ECMs"), which are principle to principle electronic trading platforms that serve sophisticated

IntercontinentalExchange
2100 RiverEdge Parkway
Suite 500
Atlanta, GA 30328
phone 770 857 4700
fax 770 951 1307
online www.theice.com

market participants. ECMs were designed to encourage electronic trading of derivatives. Given the sophisticated status of the participants, ECMs were subject to light touch regulation by the CFTC. The CFTC Reauthorization Act of 2008[1] expanded the CFTC's authority over ECMs that list contracts that serve a significant price discovery function. Congress directed the Commission to consider five criteria when making the significant price discovery determination: (1) Price Linkage; (2) Arbitrage; (3) Material Price Reference; (4) Material Liquidity; and (5) Other Factors. It is important to note that Congress gave the CFTC this authority over ECMs to capture two types of contracts: (1) contracts that trade with enough volume to impact trading on a designated contract market ("DCM"); or (2) contracts that trade with enough volume to be quoted as an independent price reference by the public.[2] It is clear that - by giving the CFTC tailored authority - Congress intended to keep the CFMA's tiered regulatory structure.

It is against this backdrop that the Commission makes its determination whether the NP-15, SP-15, and Mid-C contracts serve a significant price discovery function.

The NP-15, SP-15, and Mid-C Contracts

ICE was formed as an electronic platform to increase the transparency and liquidity in the wholesale power and natural gas markets. Over the years, ICE has been an innovator in the power markets, including screen-based trading to provide more visibility into formerly opaque markets, as well as the development of the first cleared power swaps, bringing needed risk management practices including daily mark-to-market and reduction in counterparty risk. In addition to these enhancements, the power markets have evolved significantly over the past decade as a result of regulation. Following the passage of the Federal Energy Policy Act of 1992, the Federal Energy Regulatory Commission has encouraged the formation of Independent System Operators ("ISO") to ensure the safe and reliable transportation of electricity. In California, the ISO, CAISO, operates the "physical market" and determines locational marginal pricing ("LMP") in an effort to maximize the efficient use of the power grid. Following the CAISO Market Redesign and Technology Upgrade ("MRTU"), the ICE contracts for NP-15 and SP-15 were designed to settle on the LMP price as determined by CAISO. Both contracts are cash-settled and neither plays a role in determining the LMP.

The Mid-Columbia contract, or Mid-C, is also a cash-settled contract, but rather than settling on a price determined by an ISO, it settles on the prices published in the "ICE Day Ahead Power Price Report". The ICE Day Ahead Power Price Report is an index of the physical trades in Mid-C reported independently to ICE by market

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[1] Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, 122 Stat. 1623 (June 18, 2008).

[2] The Joint Explanatory Statement of the Committee of Agriculture Conference, H.R. Rep. No. 1110 627, 110 Cong., 2nd Sess. at 978-86 (2008).

participants. The Mid-C contract thus reflects the physically-settled market, and does not play a role in establishing the price upon which it settles.

The CFTC's Analysis

The CFTC believes that the NP-15, SP-15, and Mid-C could potentially serve a significant price discovery function based upon two factors: (1) the NP-15, SP-15, and Mid-C contracts are materially liquid; and (2) the NP-15, SP-15, and Mid-C contracts serve as a material price reference. ICE believes that these contracts do not meet either test.

To prove material liquidity, the Commission needs to determine 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. There are no comparable power contracts listed for trading on another ECM or DCM that trade with any liquidity, thus the NP-15, SP-15, and Mid-C contracts must be decided on their merits. The Commission has issued guidelines stating "[l]iquidity is a broad concept that captures the ability to transact immediately with little or no price concession". Further, "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, "a market where trades occur multiple times per minute".[3]

In the notice of intent, the CFTC seems to have adopted a five trade per day test for material liquidity. The CFTC's test includes trades made in all months, thus, just five trades spread out over, for example, a 110 month trading period would meet this test. This very low threshold is at odds with Congress's intent that the CFTC include "material liquidity" in its analysis for significant price discovery. At the very least, the CFTC should reconcile how five trades per day equate to a "more or less continuous steam of prices" as mentioned above.

In the analysis of the SP-15, NP-15, and Mid-C contracts, it should be noted that these contracts only trade on the ECM platform a couple of times per day. For example, the OMC contract trades roughly six trades per day. However, the analysis does not state that nearly 80% of these transactions are not executed on the ECM, but rather are executed off-exchange and blocked into ICE for clearing. Similarly, in the MDC contract only 35% of its trades are executed on the ECM, and in the SP-15 and NP-15 contracts, the majority of the SPM and OFP transactions are executed off-exchange and blocked in for clearing. For these contracts, position limits on trading would effectively be clearing limitations. Furthermore, with all of the contracts, a trade every couple of hours does not

[3] Appendix A to Part 36, 17 C.F.R. 36 (2009).

equate to the "ability to transact immediately" or "a more or less continuous stream of prices" and certainly not "a market where trades occur multiple times per minute".

The second basis for the Commission's determination is that the NP-15, SP-15 and Mid-C contracts serve as material price references. Congress instructed 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. The Commission elaborates on this by saying that it will rely on one of two sources of evidence, direct or indirect, that the contract is a material price reference. A direct reference would be whether the cash market quotes the ECM contract. An indirect reference would be whether an industry publication quotes the ECM's contract's price.

For the SP-15 and NP-15 contracts, the CAISO determines the price of the underlying cash market. This is explained in the CAISO MRTU. Therefore the cleared price of electricity in CAISO for each hour, the LMP, reflects natural forces of supply and demand for the physical commodity at each pricing point. The ICE swaps market does not, and cannot, influence the LMP in CAISO. The only factors CAISO takes into consideration in setting the LMP for each hour is the available supply of physical electricity and the available demand for physical electricity.

The Mid-C contracts settle on an ICE index of physical market trades. This is akin to an LMP determined by an ISO. The Mid-C cash-settled swaps reflect the physical market price, not vice versa and, like the SP-15 and NP-15 contracts, do not affect the price of the underlying cash market.

It is clear that the NP-15 and SP-15 do not serve as a material price reference as the CAISO sets the price of power independently of the financially-settled power swaps. Further, the Mid-C, NP-15, and SP-15 do not meet the Commission's own test for material liquidity. On this basis, the Commission should not deem these contracts as significant price discovery contracts.

Thank you for the opportunity to comment.

Sincerely,

R. Trabue Bland
Director of Regulatory Affairs
Assistant General Counsel