COMMENT

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EDISON ELECTRIC INSTITUTE

Received CFTC Records Section

11/3/09

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

Re: Notice of Intent To Undertake A Determination Of Whether Certain SP-15 and NP-15 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 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; and NP–15 Financial Day-Ahead LMP Off-Peak Daily Contract, Offered for Trading on the IntercontinentalExchange, Inc. Perform Significant Price Discovery Functions ("Notice of Intent").[1]

[1] *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 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; and 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 Federal Register 192 . Reg. 51,264, 51,268 (October 6, 2009) (the "SP-15 and NP-15 Notice of Intent").

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 utility company members utilize financial instruments, like the contracts referenced by the Commission in its Notices 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 SP-15 and NP-15 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.[2] EEI members use the ICE Contracts to hedge the price risk associated with their long and short physical power positions in the California 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 SPDC criteria; (2) the ICE Contracts do not meet any of the criteria that the Commission is directed to consider

[2] 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.

in its SPDC Order;[3] and (3) the costs and risks associated with designating the ICE Contracts as SPDCs significantly outweigh any potential benefit.[4]

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 contacts as SPDCs.[5] 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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[3] "Significant Price Discovery Contracts on Exempt Commercial Markets; Final Rules," 74 Fed. Reg. 12,178, 12,203 (March 23, 2009) (the "SPDC Order").

[4] 17 CFR Parts 15, 16, 17 et all (March 23, 2009).

[5] *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 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). *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 201, 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 as an SPDC 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.[6]

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.[7]

A. <u>There Is No Price Linkage Between The ICE Contracts And The Corresponding NYMEX Contracts</u>

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 the power contracts listed on the New York Mercantile Exchange ("NYMEX") (a designated contract market) that correspond to the ICE Contracts.[8] The remaining comments

[6] SP-15 and NP-15 Notice of Intent, at n. 4 (stating: "[w]here appropriate, the Commission may choose to interview market participants regarding their impressions of a particular contract.")
[7] SPDC Order at 12,181.
[8] References to the "corresponding NYMEX power Contracts" include the following: CAISO SP15 EZ Gen Hub 5 MW Peak Calendar-Month Real-Time LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW
(continued...)

provided herein 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.[9]

To the extent that both the ICE SP-15 and NP-15 contracts and the NYMEX SP-15 and NP-15 contracts settle at the same prices, it is solely because both sets of contracts reference the day-ahead or real-time hourly Locational Marginal Prices ("LMPs") set by physical power trading in the California Independent System Operator ("CAISO") markets. In the CAISO, LMPs settle based on physical factors such as weather, snow-pack, generation and transmission outages, factors which affect all markets regardless of the existence of the corresponding NYMEX contracts. Moreover, LMPs are regulated by the Federal Energy Regulatory Commission ("FERC"), which is charged with ensuring that LMP prices are just and reasonable. Thus, none of the ICE Contracts "uses or otherwise relies on a daily or final settlement price, or other major price parameter" of a

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Off-Peak Calendar-Month Real-Time LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Peak Calendar-Day Real-Time LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Off-Peak Calendar-Day Real-Time LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Peak Calendar-Month Day-Ahead LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Off-Peak Calendar-Month Day-Ahead LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Peak Calendar-Day Day-Ahead LMP Swap Futures, CAISO SP15 EZ Gen Hub 5 MW Off-Peak Calendar-Day Day-Ahead LMP Swap Futures, Dow Jones SP15 Electricity Price Index Swap Contract, CAISO NP15 EZ Gen Hub 5 MW Peak Calendar-Month Real-Time LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Off-Peak Calendar-Month Real-Time LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Peak Calendar-Day Real-Time LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Off-Peak Calendar-Day Real-Time LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Peak Calendar-Month Day-Ahead LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Off-Peak Calendar-Month Day-Ahead LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Peak Calendar-Day Day-Ahead LMP Swap Futures, CAISO NP15 EZ Gen Hub 5 MW Off-Peak Calendar-Day Day-Ahead LMP Swap Futures, and Dow Jones NP15 Electricity Price Index Swap Contract.

[9] SPDC Order at 12,181.

NYMEX contract "to value a position, transfer or convert a position, cash or financially settle a position, or close out a position."[10]

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 corresponding NYMEX power contracts are considerably less liquid than the ICE Contracts.[11] 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 between the markets by simultaneously maintaining positions or executing trades in the contracts on a frequent and recurring basis."[12]

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

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[10] *See* 17 CFR § 36.3(c)(1)(i).

[11] A brief review of available statistical information related to recent trading activity on the SP-15 and NP-15 contracts 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 and http://www.cmegroup.com/market-data/files/NYMEX_Monthly_volumes-2009.pdf>>.

[12] 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 (July 30, 2009) (the "ICE Henry Financial SPDC Order").

ICE as a price discovery market for certain electricity contracts".[13] However, the Notice of Intent also acknowledges that the ECM Study "did not specifically address the power contracts under review."[14] A more in-depth analysis of the specific contracts reveals that there is no material price reference as defined by the Commission.[15] As noted above, both the ICE SP-15 and NP-15 contracts settle at LMPs that are (1) determined by fundamental factors such as weather, snow-pack, generation and transmission outages, (2) regulated by FERC to insure that they are just and reasonable, and (3) set by physical power trading in the CAISO market. As such, 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.[16] In fact, the opposite is true: the ICE SP-15 and NP-15 contracts are priced primarily based on the results of physical commodity trading in the CAISO's markets.

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 daily contracts and the average separate transactions for each of the relevant ICE Contracts.[17] 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

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[13] *See* CFTC, *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* (Oct. 2007). *See also* SP and NP Notice of Intent at 51,264, 51,268.
[14] SP-15 and NP-15 Notice of Intent at 51,264, 51,268.
[15] ICE Henry Financial SPDC Order at 37,989.
[16] *See* 17 CFR § 36.3(c)(1)(iii).
[17] SP-15 and NP-15 Notice of Intent at 51,264, 51,268.

contracts such as the NYMEX contracts listed above.[18] As noted above, there is no direct price linkage between the ICE Contracts and the corresponding NYMEX contracts. Thus, they cannot have a 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 "material effect" on the corresponding NYMEX contracts, the material liquidity criterion in the Commission's regulations is not satisfied.[19]

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. 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.

[18] *See* ICE Henry Financial SPDC Order at 37989.

[19] *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).")

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 market-wide effects such designation may have. In the alternative, the Commission should limit the designation of ICE Contracts as SPDCs 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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