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11/30/09

November 27, 2009

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Via Electronic Mail: Secretary@CFTC.gov

Mr. David Stawick, Secretary  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

**COMMENT**

**Re:** ICE SP-15 Financial Day-Ahead LMP Peak (SPM) Contract;  
ICE SP-15 Financial Day-Ahead LMP Peak Daily (SDP) Contract;  
ICE SP-15 Financial Day-Ahead LMP Off-Peak Daily (SQP) Contract;  
ICE SP-15 Financial Swap Real Time LMP—Peak Daily (SRP) Contract;  
ICE SP-15 Financial Day-Ahead LMP Off-Peak (OPF) Contract;  
ICE NP-15 Financial Day-Ahead LMP Peak Daily (DPN) Contract;  
ICE NP-15 Financial Day-Ahead LMP Off-Peak Daily (UNP) Contract;  
ICE Mid-C Financial Peak (MDC) Contract;  
ICE Mid-C Financial Peak Daily (MPD) Contract;  
ICE Mid-C Financial Off-Peak (OMC) Contract; and  
ICE Mid-C Financial Off-Peak Daily (MXO) Contract

Mr. Stawick,

On October 21, 2009, the Financial Institutions Energy Group (“FIEG”) filed comments in the Commission’s rulemakings to determine whether any of the above-referenced contracts perform a significant price discovery function. In addition to its substantive comments, FIEG (and other interested persons) proposed that the Commission allow at least 30 days for public comment, as the Commission’s rules allow comments to be filed “within 30 calendar days of publication of notice in the Federal Register or within such other time specified by the Commission.”<sup>1</sup> On November 12, 2009, the Commission reopened and extended the comment period in each rulemaking. FIEG appreciates the extended comment period provided by the Commission and herein submits its expanded comments on the Commission’s significant price discovery contract (“SPDC”) proposals.

**Background**

FIEG is comprised of investment and commercial banks that provide a broad range of financial services to all segments of the U.S. and global economy. Its Members and their affiliates play a number of roles in the wholesale power and natural gas markets, including acting as marketers, lenders, underwriters of debt and equity securities, and proprietary investors. The Federal Energy Regulatory Commission (“FERC”) has authorized FIEG’s power-marketer Members to sell energy, capacity and ancillary

<sup>1</sup> *Procedure for Significant Price Discovery Determination*, 17 CFR § 36.3(c)(3) (2009).

services at market-based rates.<sup>2</sup> FIEG Members are active participants in the various organized electricity markets administered by independent system operators (“ISOs”) and regional transmission organizations (“RTOs”) in North America.

Electricity prices are among the most volatile of any commodity. This makes it critically important for market participants, including public power companies, investor-owned utilities and power marketers, to be able to adequately hedge their price risks. These market participants often use the above-referenced ICE SP-15, NP-15 and Mid-C contracts (the “ICE Contracts”) to hedge their long and short physical positions in the California and Pacific Northwest electric power markets. These underlying physical positions can be substantial and not only involve delivery in the spot month, but also often extend forward for months or even years as a result of the manner in which market participants procure and sell physical power. As a result, these companies’ long-term price exposures often require hedging beyond the spot month, for several months or years. FIEG is concerned that unwarranted constraints on market participants’ access to the ICE Contracts for legitimate short-term and long-term hedging purposes could harm the related California and Pacific Northwest electric power markets by diminishing the ability of market participants to hedge their physical positions.

### **The ICE Contracts Are Not SPDCs**

The ICE Contracts do not meet any of the four SPDC determination criteria described in the Commission’s March 23, 2009, SPDC Order.<sup>3</sup> Additionally, under the CEA it is the Commission’s burden to demonstrate through application of the four SPDC determination criteria that a contract performs a significant price discovery function.

Section 2(h)(7) of the CEA specifies four factors that the Commission *must* consider, as appropriate, in making a determination that a contract is performing a significant price discovery function. The four factors *prescribed by the statute* are: Price Linkage; Arbitrage; Material Price Reference; and Material Liquidity.<sup>4</sup>

FIEG respectfully submits that thus far the Commission has not met its burden with regard to any of the four designation criteria for any of the ICE Contracts; in the Commission’s original Federal Register notices (and in the comments submitted during

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<sup>2</sup> Under the Federal Power Act (“FPA”), 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 wholesale markets are subject to the regulation by the FERC.

<sup>3</sup> See, *Significant Price Discovery Contracts on Exempt Commercial Markets*, 74 Fed. Reg. 12178 (to be codified at 17 CFR. parts 15, 16, 17, 18, 19, 21, 36, 40.).

<sup>4</sup> *Appendix A to Part 36, Guidance on Significant Price Discovery Contracts*, 17 CFR part 36, Appendix A (2009) (emphasis added; hereinafter the “*SPDC Appendix*”). The inclusion of the four SPDC designation criteria in the CEA and Congress’ requirement that “in its discretion” the Commission “shall consider” them in making its determination, 7 USC § 2(h)(7)(A & B), strongly suggest that the Commission must reasonably find that at least some of the criteria are satisfied to make a valid determination that a contract performs a significant price discovery function.

the initial 15-day comment period) no information has been submitted that would substantively support a finding that any of the four SPDC factors are satisfied for any of the ICE Contracts. Barring the submission of new facts supporting a finding that any of the ICE Contracts is a SPDC, FIEG believes that the Commission is compelled under the procedure it promulgated for significant price discovery determination to find that none of the ICE Contracts are SPDCs.<sup>5</sup> FIEG's specific comments on each of the four SPDC factors are set forth below.

Three of the four SPDC factors require a nexus between the contract being considered for SPDC designation and a contract listed for trading on or subject to the rules of a designated contract market or derivatives transaction execution facility, or to another SPDC traded on an electronic trading facility ("ETF").<sup>6</sup> Although the Commission does not specify the exchange-traded contracts to which it will refer in making its SPDC determinations relating to the ICE Contracts, FIEG's comments below assume that the Commission's analyses will focus on one or more of the various NYMEX power contracts that reference prices at SP-15, NP-15 and Mid-C.<sup>7</sup>

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<sup>5</sup> "Before making a final price discovery determination under this paragraph, the Commission shall publish notice in the Federal Register that it intends to undertake a determination with respect to whether a particular agreement, contract or transaction performs a significant price discovery function and to receive *written data, views and arguments relevant to its determination* from the electronic trading facility and other interested persons. ... After *prompt consideration of all relevant information*, the Commission shall, within a reasonable period of time after the close of the comment period, issue an order explaining its determination whether the agreement, contract or transaction executed or traded by the electronic trading facility performs a significant price discovery function under the criteria specified in paragraph (c)(1)(i) through (v) of this section." 17 CFR § 36.3(c)(3) (2009). Based on this language, FIEG believes that "all relevant information" includes only "written data, views, and arguments," of the Commission, the ETF and other interested persons submitted in the course of the ICE Contracts' SPDC determinations. Further, FIEG believes procedural due process requires that the ETF and other interested persons have a reasonable opportunity to comment on any new data, views or arguments material to the Commission's determination introduced into the record by the Commission after the close of the extended comment period on November 27, 2009.

<sup>6</sup> See 17 CFR § 36.3(c)(1)(i, ii, & iv) (describing Price Linkage, Arbitrage, and Material Liquidity).

<sup>7</sup> Specifically, the NYMEX contracts for the SP-15, NP-15, and Mid-C delivery points are the: CAISO SP15 EZ Gen Hub 5 MW Peak Calendar-Month Real-Time LMP Swap Futures; CAISO SP15 EZ Gen Hub 5 MW 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; 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; Dow Jones NP15 Electricity Price Index Swap Contract; and Dow Jones Mid-Columbia Electricity Price Index Swap Contract.

## **No Material Liquidity**

In the Commission's Federal Register notices, Material Liquidity is the only factor for which the Commission provided data allegedly supporting a finding that the factor is present. However, to establish the criterion of Material Liquidity it is insufficient for the Commission solely to note that the trading volume of the ICE Contracts exceeds the numerical thresholds for the reporting requirements in 17 CFR § 36.3(c)(2) (2009). In the *SPDC Appendix*, the Commission states that in markets where Material Liquidity exists, "a more or less continuous stream of prices can be observed" and traders have to make little in the way of price concessions to execute their trades. In its Federal Register announcements for the instant SPDC determinations, the Commission does not show how any of the ICE Contracts fit this description. The Commission's relative reticence here is in stark contrast to the levels of liquidity the Commission showed in its determination that the ICE Henry Financial LD1 contract performs a significant price discovery function.

Instead of showing that trading volumes and open interest exceed a reporting requirement threshold, the material liquidity criterion in section 36.3(c)(1)(iv) of the Commission's regulations 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>8</sup> FIEG questions how even hypothetically high trading volumes in any of the ICE Contracts could have a material effect on any of the NYMEX contracts unless either Arbitrage or Price Linkage is also established. In the *SPDC Appendix*, the Commission states that Material Liquidity alone "would not be sufficient to make a determination that a contract is a significant price discovery contract, but combined with other factors it can serve as a guidepost indicating which contracts are functioning as significant price discovery contracts." The Commission then states that Material Liquidity "as reflected through the prices of linked or arbitrated contracts, will be a primary consideration in determining whether such contracts are significant price discovery contracts." As noted below, there is no price linkage between the ICE Contracts and the corresponding NYMEX contracts. Moreover, potential arbitrage between the ICE Contracts and any of the corresponding NYMEX 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, either through Price Linkage or Arbitrage, the material liquidity criterion is not satisfied.

## **No Price Linkage**

With respect to the ICE's Mid-C contracts, which settle based on the average of day-ahead prices as published in the 'ICE Day Ahead Power Price Report' for all peak or off-peak hours in the contract month, the equivalent NYMEX contract settles based on the average of all firm, day-ahead Mid-Columbia prices published by Dow Jones & Co. for all peak hours in the contract month. To the extent that both the ICE and the NYMEX SP-15 and NP-15 contracts settle at similar prices, it is solely because both sets of

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<sup>8</sup> See n.7, *supra*.

contracts reference the day-ahead or real-time hourly Locational Marginal Prices (“LMPs”) set by physical demand and supply in the California Independent System Operator (“CAISO”). In the CAISO, LMPs depend on physical factors such as weather, snow-pack, and generation and transmission outages. LMPs are regulated by the FERC, which is charged with ensuring that they are just and reasonable.<sup>9</sup> Thus, none of the ICE Contracts “uses or otherwise relies on a daily or final settlement price, or other major price parameter” of a NYMEX contract “to value a position, transfer or convert a position, cash or financially settle a position, or close out a position.”<sup>10</sup>

### No Arbitrage

The NYMEX contracts listed above<sup>11</sup> are considerably less liquid than the ICE Contracts. Compare the second quarter of 2009 open interest and trade volume information for the ICE Contracts cited by the Commission in its Federal Register announcements<sup>12</sup> to NYMEX open interest and trade volume information from the CME Group web site, which shows an open interest of only 120 contracts for the Dow Jones Mid-Columbia Electricity Price Index Swap Contract<sup>13</sup> and zero open interest on the Dow Jones SP-15, NP-15 and Mid-C contracts from January 2009 to June 2009.<sup>14</sup> None of the NYMEX CAISO LMP-based contracts are even listed in these NYMEX reports. Therefore, notwithstanding any alleged correlation between the ICE Contracts and the NYMEX contracts listed above,<sup>15</sup> it would be unrealistic to conclude that market participants can “effectively arbitrage between the markets by simultaneously maintaining positions or executing trades in the contracts on a frequent and recurring basis.”<sup>16</sup>

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<sup>9</sup> “All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.” 16 USC § 824d(a).

<sup>10</sup> 17 CFR § 36.3(c)(1)(i) (2009).

<sup>11</sup> See n.7, *supra*.

<sup>12</sup> 74 Fed. Reg. 51261 (Oct. 6, 2009); and 74 Fed. Reg. 51264 (Oct. 6, 2009).

<sup>13</sup> See *NYMEX/COMEX Exchange Open Interest Report – Monthly, September 2009*, <http://www.cmegroup.com/market-data/volume-open-interest/index.html>, p.2.

<sup>14</sup> See *NYMEX/COMEX Monthly RTH / CME Globex & NYMEX ClearPort Volume, June 2009 Volumes*, [http://www.cmegroup.com/wrappedpages/web\\_monthly\\_report/Web\\_OI\\_Report\\_NYMEX\\_COMEX.pdf](http://www.cmegroup.com/wrappedpages/web_monthly_report/Web_OI_Report_NYMEX_COMEX.pdf), p.10.

<sup>15</sup> In the *SPDC Appendix*, the Commission states that it would view correlated price movements between contracts as evidence that material liquidity exists and that SPDC designation is warranted. See *SPDC Appendix*, at section (C)(2). However, in examining any potential settlement price correlation between the SP-15/NP-15-related ICE Contracts and the corresponding NYMEX contracts, the Commission should also examine whether or not any such correlation is due solely to the contracts settling on the basis of the same CAISO LMP prices. Without this further examination, FIEG believes a correlation in price movements alone would not necessarily be evidence of material liquidity or that SPDC designation is warranted.

<sup>16</sup> 17 CFR § 36.3(c)(1)(ii) (2009).

## No Material Price Reference

As noted above, both the ICE SP-15 and NP-15 contracts settle at LMPs set by physical demand and supply in the CAISO. Thus, the bids, offers, or transactions in physical power at SP-15 and NP-15 are not “based on,” or “determined by referencing, the prices generated by” any of the ICE Contracts.<sup>17</sup> In fact, the opposite is true; the ICE SP-15 and NP-15 contracts are priced based on the results of physical demand and supply in the CAISO’s markets.<sup>18</sup>

## Other Material Factors

In its March 23, 2009, SPDC Order,<sup>19</sup> the Commission promulgated four substantive SPDC determination criteria and reserved § 36.3(c)(1)(v) of its regulations, entitled “Other material factors [Reserved],” ostensibly as a place keeper for SPDC determination factors that it may develop at a later time. The Commission’s Procedure for Significant Price Discovery Determination states that “the Commission shall ... issue an order explaining its determination whether the [contract] performs a significant price discovery function *under the criteria specified in paragraph (c)(1)(i) through (v) of this section.*”<sup>20</sup> FIEG believes this provision confines the Commission’s consideration of SPDC criteria in these rulemakings to those “specified in paragraph (c)(1)(i) through (v)” of the Commission’s current SPDC determination regulations.

## Policy Considerations

The Commission may also want to consider fundamental differences between power markets and other energy markets such as oil and natural gas as it debates the question of any potential position limits. Prices in the underlying physical power markets at SP-15 and NP-15 are generally not influenced by financial trading that occurs on platforms such as ICE and are calculated using physical supply and demand subject to market power mitigation rules under FERC’s “just and reasonable” standard. Access to liquid financial contracts offers physical generators and loads additional flexibility to hedge their

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<sup>17</sup> 17 CFR § 36.3(c)(1)(iii) (2009).

<sup>18</sup> In its Federal Register announcements for the ICE Contracts, the Commission refers to a general statement in the ECM Study that market participants view the ICE as a price discovery market for certain electricity contracts. This reference does not appear to fall within either the direct or indirect category of evidence of Material Price Reference described in the *SPDC Appendix*. Additionally, FIEG respectfully submits that publication and sale by the InterContinental Exchange of data packages that may include price data related to one or more of the LMP-based ICE Contracts should not be viewed as *prima facie* evidence of Material Price Reference as LMPs cannot be “directly based on” or “determined by referencing” prices in these ICE publications.

<sup>19</sup> 74 Fed. Reg. 12178.

<sup>20</sup> 17 CFR § 36.3(c)(3) (2009) (emphasis added).

physical positions.<sup>21</sup> The absence of adequate hedging is one of factors that in the past contributed to problems in physical power markets (e.g., in California in 2000-2001). Imposing position limits on financial trading in markets that do not currently face any known problems can run the risk of inadvertently harming the risk management and hedging opportunities available to physical market participants and should not be done without careful deliberation.

Considering the balance of known factors weighing against the designation of the ICE Contracts as SPDCs, the Commission should exercise extreme care; particularly in light of the yet unknown 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 an SPDC designation may have on the contracts or the related physical transactions. The first contract to be designated a SPDC, the ICE Henry Financial LD1 Fixed Price Contract, was designated in July of 2009 and the ICE has only recently completed its implementation of the Commission's regulatory requirements. Therefore, FIEG respectfully recommends that the Commission not designate the ICE Contracts as SPDCs or in the alternative, that it consider delaying its determination as to whether the ICE Contracts are SPDCs until it has fully reviewed the effects of its regulation on the ICE Henry Financial LD1 Fixed Price Contract.

FIEG appreciates the Commission's consideration of its comments.

Sincerely,

/s/ Catherine M. Krupka

Catherine M. Krupka  
Michael Brooks  
Sutherland Asbill & Brennan LLP  
1275 Pennsylvania Ave., NW  
Washington, DC 20004  
(202) 383-0248  
catherine.krupka@sutherland.com  
michael.brooks@sutherland.com

*Attorneys for the Financial Institutions Energy Group*

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<sup>21</sup> The financial hedging in power includes spot, monthly, quarterly and calendar year terms and have grown as physical power markets have developed, e.g., see Figure 29 in FERC's 2008 State of the Markets Report <http://www.ferc.gov/market-oversight/st-mkt-ovr/2008-som-final.pdf>.