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October 21, 2009

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 (OFP) 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,

The Financial Institutions Energy Group ("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 services at market-based rates. 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.

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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. Such 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 require delivery not only in the spot month, but often extend forward for months or even years as a result of the manner in which market participants procure and sell physical power.[1]

[1] 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 regulation by the FERC.

In addition to its general comments below, FIEG respectfully submits that the Commission's allowed time for public comment may be insufficient to allow some affected market participants to respond to the Commission's proposal, especially given the large number of power and natural gas contracts concurrently being proposed for significant price discovery contract ("SPDC") designation. The Commission's rules allow comments to be filed within 30 calendar days or such other time specified by the Commission.[2] FIEG proposes that the Commission allow at least 30 days for public comment.

FIEG respectfully submits that the ICE Contracts do not appear to meet the SPDC determination criteria set forth in the Commission's SPDC Order.[3] Although the Commission does not specify the exchange-traded contracts to which it is comparing the ICE Contracts, FIEG's comments below assume that the Commission's analysis will focus on NYMEX power contracts for SP-15, NP-15 and Mid-C.[4]

- *No price linkage to NYMEX contracts.* 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

[2] 17 CFR § 36.3(c)(3) (2009).

[3] Significant Price Discovery Contracts on Exempt Commercial Markets, 74 Fed. Reg. 12178 (March 23 2009) (to be codified at 17 CFR parts 15, 16, 17, 18, 19, 21, 36, 40).

[4] Three of the SPDC designation criteria compare agreements, contracts or transactions trading on an electronic trading facility ("ETF") under the exemption in section 2(h)(3) of the CEA to contracts listed for trading on or subject to the rules of a designated contract market or derivatives transaction execution facility, or to other significant price discovery contracts traded on an ETF. *See* 17 CFR § 36.3(c)(1)(i, ii, & iv). 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;
- 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;
- Dow Jones NP15 Electricity Price Index Swap Contract; and
- Dow Jones Mid-Columbia Electricity Price Index Swap Contract.

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 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 can depend on physical factors such as weather, snow-pack, and generation and transmission outages. Prices in physical power markets are regulated by the FERC, which is charged with ensuring that prices are just and reasonable.[5] 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." *See* 17 CFR § 36.3(c)(1)(i) (2009).

- *No arbitrage between ICE and NYMEX contracts.* The NYMEX contracts listed above appear to be considerably less liquid than the ICE Contracts.[6] Therefore, notwithstanding any similarities in the referenced prices used to settle the contracts, 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." *See* 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. *See* 17 CFR § 36.3(c)(1)(iii) (2009). 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.

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[5] "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 U.S.C. § 824d(a).

[6] 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, 74 Fed. Reg. 51261 (Oct. 6, 2009); and 74 Fed. Reg. 51264 (Oct. 6, 2009), to open interest and trade volume information from the CME Group web site, *NYMEX/COMEX Exchange Open Interest Report – Monthly, September 2009*, http://www.cmegroup.com/market-data/volume-open-interest/index.html, p.2 (showing open interest of 120 lots only for the Dow Jones Mid-Columbia Electricity Price Index Swap Contract); and *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, p.10 (showing zero open interest on the Dow Jones SP-15, NP-15 and Mid-C contracts from January 2009 to June 2009). None of the NYMEX CAISO LMP-based contracts are listed in these NYMEX reports.

- *No material liquidity.* To establish the criterion of "material liquidity" it is insufficient for the Commission to note that the trading volume of the ICE Contracts meets or exceeds numerical thresholds for the reporting requirements in 17 CFR § 36.3(c)(2) (2009). Instead, 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.[7] As noted, there is no *direct* price linkage between the ICE Contracts and most of the corresponding NYMEX contracts. Moreover, potential arbitrage between ICE and 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, the material liquidity criterion is not satisfied.

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 physical positions.[8] 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 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 not yet 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.

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[7] See n.4, *supra*.

[8] 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.

FIEG appreciates the opportunity to provide these comments.

Sincerely,

<u>/s/ Catherine M. Krupka</u>

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