09-10
(3)

ICE

Atlanta Calgary Chicago Houston London New York Singapore

September 4, 2009

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

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

Dear Mr. Stawick:

The 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 Carbon Financial Instrument Contract ("CFI") traded on the Chicago Climate Exchange serves a significant price discovery function. ICE believes that the CFI does not serve a significant price discovery function and that Commission may exceed its jurisdiction if it determines that the CFI serves as a significant price discovery contract ("SPDC").

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, which are principle to principle electronic trading platforms that serve sophisticated 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 or (2) contracts that trade with enough volume to be quoted as an independent price reference

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

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

by the public.[2] It is clear that by giving the CFTC tailored authority that Congress intended to keep the CFMA's tiered regulatory structure.

It is against this backdrop that the Commission makes its determination whether the CFI serves a significant price discovery function.

The CFI Contract

Even in the diverse swaps market, the CFI is a unique contract. The CFI is part of the CCX's innovative program to reduce carbon emissions through a voluntary offset program. The contract represents an offset of 1,000 metric tons of carbon dioxide. To create the CFI, CCX enters into contracts with participants to reduce carbon dioxide emissions through offset projects or technological improvements.

The physically-delivered CFI is neither a futures contract or a swap. First, and foremost, it is a spot contract. As the CFTC's notice points out, there is no open interest in the CFI. The CFI requires immediate delivery and payment on the following day. Second, the CFI doesn't "expire" like a futures contract or swap, CFI trades in dated "vintages" which recognize the carbon offset compliance year. The CCX does trade a futures product on its designated contract market, CCFE, which should not be confused with the spot contract listed on the ECM.

The CFTC's Analysis of the CFI Contract as a Potential SPDC

The CFTC believes that the CFI serves a significant price discovery function based upon two reasons: (1) the CFI contract is materially liquid and (2) the CFI serves as a material price reference. A reading of the Reauthorization Act and the Commission's SPDC rules demonstrates that the CFI contract meets neither of these tests.

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. Leaving aside the fact there is no comparable CFI contract listed for trading on another ECM or DCM, the CFI fails the Commission's test for material liquidity outlined in its rules.[3] The Commission states "[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."

---

[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).

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

ICE

The CFI contract traded, on average, 15 times per day in the second quarter of 2009. Presumably, this figure sums every vintage of the CFI contract (presently eight are listed on the CCX website).[4] Thus, each vintage may trade less than twice a day. Further, the CCX is open for 5½ hours per day. Therefore, a trade occurs on average every 2¾ hours. This certainly fails the Commission (and Congress') threshold for material liquidity. A trade every couple of hours does not 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 CFI serves as a material price reference. 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.

The Commission, in determining that the CFI serves a material price reference, relies on the fact that the CFI is a spot contract. The only "cash" market that uses the CFI as a price benchmark is the CCX. The only traders that refer to the CFI trade on CCX. Under the Commission's theory, any spot contract automatically serves as a material price reference, simply because the *contract references itself.* The Commission points out that the CCX is the only entity that lists a CFI contract. While that may be true, there are numerous carbon offset programs that are similar to the CFI.[5] In any event, sole listing alone of a contract is not and should not be a material price reference determinant.

It is clear that the CFI does not serve as a material price reference. Further, the CFI does not meet the Commission's own test for material liquidity. On this basis, the Commission should not deem the CFI contract a significant price discovery contract.

The CFI is a Spot Contract and Outside of CFTC Jurisdiction

The CFI, having no open interest and settling the next day, is a spot contract.[6] In asserting jurisdiction, the Commission relies on the "agreement, contract or transaction" language from Section 2(h)(7) of the Commodity Exchange Act, finding that the

---

4 www.chicagoclimatex.com

5 Currently, there are a number of regional carbon cap and trade programs, such as the Western Climate Initiative.

6 *See, e.g.,* CFTC v. Frankwell Bullion Ltd., 99 F.3d 299 (9th Cir. 1996), *aff'g* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) 26,222 (N.D. Cal. 1994).

language does not require the Commission to determine whether the potential SPDC is within the Commission's jurisdiction.[7] By making this determination, the Commission is broadly asserting jurisdiction over the spot market if the spot contract is electronically traded.

This finding could lead to adverse consequences for the Commission's market oversight, confuse long-held jurisdictional expectations, and duplicate regulation. For example, FERC regulates physical spot and forward natural gas and electricity markets, including Independent System Operators' (ISO) real-time and day-ahead electricity markets. The latter clearly meet material liquidity and price reference criteria for SPDCs. Though no ISO has registered as an ECM, many do offer financially-settled instruments, like transmission or congestion rights, for trading. Given that the language in 1a of the CEA defining "trading facility" uses the same "agreement, contract or transaction" wording, the Commission's interpretation may lead to unintended consequences. If an ISO in the electricity market allows users to trade congestion rights, the CFTC could also assert or be expected to assert jurisdiction over the ISO spot markets if they meet SPDC criteria.

Conclusion

The CFTC Reauthorization Act struck the appropriate balance between ECM and non-ECM (physical spot and forward markets) market oversight. If the Commission notifies a trading facility listing a spot contract that that contract is deemed an SPDC, we presume the trading facility would withdraw its ECM notification with regard to the spot contract in question.

Thank you for the opportunity to comment.

Sincerely,

R. Trabue Bland
Director of Regulatory Affairs
Assistant General Counsel

---

[7] 42 Fed. Reg 42052 at 42054 (August 20, 2009).