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**COMMENT**

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581  
Telefacsimile (202) 418-5521 and email [secretary@cftc.gov](mailto:secretary@cftc.gov)

Re: Comments to Commodity Futures Trading Commission ("Commission") Notice of Intent ("NOI"), 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 Carbon Financial Instrument Contract ("CFI") Offered for Trading on the Chicago Climate Exchange, Inc. ("CCX"), Performs a Significant Price Discovery Function (Document ID CFTC-2009-0066-0001)

Dear Mr. Stawick:

The Commission has by the above-referenced NOI sought comments on whether the CCX CFI contract "performs a significant price discovery function."

In evaluating whether an exchange-traded contract "performs a significant price discovery function," Commodities Exchange Act §2(h)(7) directs the Commission to consider four specific criteria, one of which is "material price reference." Material price reference means the extent to which, on a frequent and recurring basis, bids, offers or transactions in a commodity are based on or determined by referencing the contract being traded on the exchange on which the contract is traded.

CCX claims CFIs represent offsets (or "allowances"<sup>1</sup>) of CO<sub>2</sub>-equivalent emissions. The Commission recognizes that "the CFI market is solely a CCX-created entity."<sup>2</sup> However, CCX

<sup>1</sup> Although the NOI uses the term "allowance", there are as of yet no federal allowances for CO<sub>2</sub>, and much of what is permitted in CCX CFIs would in most forums be labeled "offsets" (and sometimes "credits"). For example, the NOI notes "the CCX's GHG reduction program allows for the creation of CFIs through offset projects." NOI at 6. Therefore, in referring to the CO<sub>2</sub>-emissions market, the term "offset" as used in this letter includes the aforesaid "allowances."

<sup>2</sup> NOI at 7.

promotes an alleged tie between CFIs and the broader market for transactions in Carbon offsets,<sup>3</sup> and therefore the Commission should consider whether transactions in the Carbon market at large, and not just in CCX's own proprietary CFI market, reference the CFI contract.

The CFI contract does not perform a significant price discovery function for the Carbon market because CFIs do not conform to the stringent additionality and leakage standards that are in the Carbon offset contracts that are accepted by the broader market. The lack of common standards between CFIs and transactions prevalent in the marketplace prevents market participants from using CFI contracts to compare prices across markets, arbitrage CFIs with other carbon contracts, and use CFIs to execute or settle other transactions.

There are key requirements that the broader Carbon market has adopted over the years in order to establish and maintain the legitimacy of the instruments in which it trades. A number of these "essential attributes of offsets"<sup>4</sup> were discussed by presenters at the Federal Trade Commission ("FTC") January 8, 2008, Workshop on Carbon Offsets.<sup>5</sup>

Foremost among these is a set of concepts that fall within the rubric of "additionality."<sup>6</sup> Additionality means that an action should not be given the bonus value of a Carbon offset if the activity would have occurred anyway, either because the activity was required by law, for example a law requiring all landfills to capture methane emissions, or because it was economically compelled, for example replacing an old appliance or smokestack.<sup>7</sup> Additionality has until today been perhaps the most fundamental, core concept for assuring Carbon market

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<sup>3</sup> "Chicago Climate Exchange® (CCX®) today welcomed a decision announced this week by the Commodity Futures Trading Commission to consider whether the Carbon Financial Instrument® (CFI®) contract traded on CCX performs a Significant Price Discovery Function. ... 'We look forward to working with the CFTC as it considers this designation and continues to prepare for growth in emissions trading,' said CCX Chairman and founder Richard L. Sandor. 'We think this reflects the increasing maturity of the carbon market and we welcome the critically important function that regulation and transparency plays in new and emerging markets of all kinds.'" CCX Press Release, *CCX Welcomes CFTC Consideration of Carbon Contract*, available at <http://www.chicagoclimatex.com/news.jsf?story=3172>.

<sup>4</sup> E.g., *Ensuring Real, Measurable Emission Reductions from GHG Mitigation Projects*, presentation by Maurice N. LeFranc, Jr., available at <http://www.ftc.gov/bcp/workshops/carbonoffsets/presentations/mlefranc.pdf>.

<sup>5</sup> Materials available at <http://www.ftc.gov/bcp/workshops/carbonoffsets/>

<sup>6</sup> A worthy example of the variety of uses to which the term "additionality" has been put in the course of negotiations concerning implement the United Nations Framework Convention on Climate Change Conferences of the Parties following the Kyoto Protocol is Ertel and Egelstrom, *COP 6 – big decisions or big disappointment*, Environmental Finance, June 2000 at 26, available at [http://www.emissions.org/publications/member\\_articles/ef6ema26.pdf](http://www.emissions.org/publications/member_articles/ef6ema26.pdf).

<sup>7</sup> "Additionality, then, is a tool used to separate the genuine from the opportunistic." Reynolds, *Do we need financial additionality*, Environmental Finance, March 2008 at 36, available at [http://www.environmentalmarkets.org/galleries/default-file/EF0308\\_Marketview.pdf](http://www.environmentalmarkets.org/galleries/default-file/EF0308_Marketview.pdf).

legitimacy.<sup>8</sup> As that legitimacy is conceived, it is additionality that makes an offset “real.” H.R.2454, the version of the American Clean Energy and Security Act of 2009, popularly known as Waxman-Markey, passed by the House of Representatives includes additionality as a firm requirement for Carbon offsets.<sup>9</sup>

The CCX’s General Offset Program Provisions<sup>10</sup> do not even mention the word “additionality”; nor do the CCX Rulebook provisions for CCX Exchange Offsets and Exchange Early Action Credits.<sup>11</sup> Neither use the word “additional” in the sense described above.<sup>12</sup>

Another core concept to ensure market legitimacy is “leakage.” If a forest is saved from being cut down for development, and an equivalent acreage of neighboring forest is cut down for that same development, there have been no net Carbon savings; rather, there has been “leakage.” Measuring and minimizing leakage is another way to ensure that a Carbon offset represents a real and legitimate saving of CO<sub>2</sub> emissions into the atmosphere. Several provisions of the Waxman-Markey address leakage.<sup>13</sup>

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<sup>8</sup> “The fact that additionality testing is difficult doesn’t mean we can simply ignore it. ... Crediting even a fraction of these billions of tons of non-additional reductions would undercut the environmental integrity of almost any emissions trading system.” Bloomgarden and Trexler. *Another look at additionality*. Environmental Finance. May 2008 at 17. available at [http://www.environmentalmarkets.org/policies/detail-file/EF0508\\_%20Marketview.pdf](http://www.environmentalmarkets.org/policies/detail-file/EF0508_%20Marketview.pdf).

<sup>9</sup> Section 732(b)(2) of Title VII of the Clean Air Act that would be added by H.R. 2454 requires that regulations implementing the offset program to be established “ensure that such offset credits represent verifiable and additional greenhouse gas emission reductions or avoidance, or increases in sequestration”. Section 734(a)(1) as added by H.R. 2454 requires “A standardized methodology for determining the additionality of greenhouse gas emission reductions or avoidance, or greenhouse gas sequestration, achieved by an offset project of that type. Such methodology shall ensure, at a minimum, that any greenhouse gas emission reduction or avoidance, or any greenhouse gas sequestration, is considered additional only to the extent that it results from activities that— (A) are not required by or undertaken to comply with any law, including any regulation or consent order; (B) ... were registered as of the date of enactment of this title under an offset program with respect to which the Administrator has made an affirmative determination ...; (C) are not receiving support under part E of this title or title IV, subtitle D ...; and (D) exceed the activity baseline established ... .”

<sup>10</sup> As updated to August 20, 2009, available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_General\\_Offset\\_Provisions\\_Final.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_General_Offset_Provisions_Final.pdf).

<sup>11</sup> Chapter 9, January 2004, available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_Rulebook\\_Chapter09\\_OffsetsAndEarlyActionCredits.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_Rulebook_Chapter09_OffsetsAndEarlyActionCredits.pdf).

<sup>12</sup> Using Google to search the Climate Action Registry website shows 116 documents that use the word “additionality”- [http://www.google.com/search?q=additionality+site:http://www.climateactionreserve.org&hl=en&lr=&client=firefox-a&rlz=1R1GGGL\\_en\\_US314&hs=IZh&filter=0](http://www.google.com/search?q=additionality+site:http://www.climateactionreserve.org&hl=en&lr=&client=firefox-a&rlz=1R1GGGL_en_US314&hs=IZh&filter=0) as opposed to only five documents using the word “additionality” on the CCX website: [http://www.google.com/search?hl=en&lr=&client=firefox-a&rlz=1R1GGGL\\_en\\_US314&hs=eE2&q=additionality+site%3Ahttp%3A%2F%2Fwww.chicagoclimatex.com%2F&aq=f&oq=&aqi=](http://www.google.com/search?hl=en&lr=&client=firefox-a&rlz=1R1GGGL_en_US314&hs=eE2&q=additionality+site%3Ahttp%3A%2F%2Fwww.chicagoclimatex.com%2F&aq=f&oq=&aqi=)

<sup>13</sup> Section 734(a)(4) of Title VII of the Clean Air Act that would be added by H.R. 2454 requires “A standardized methodology for accounting for and mitigating potential leakage, if any, from an offset project of that type, taking uncertainty into account.”

CCX Protocols appear specifically to disclaim leakage assessment; for example, the CCX coal mine methane protocol provides “no Project specific leakage assessment is required.”<sup>14</sup>

Instruments traded in the Carbon market at large include offsets developed under the rigorous protocols of the Climate Action Reserve,<sup>15</sup> successor to the California Climate Action Registry.<sup>16</sup> As one can see from exploring the detailed protocols posted with their long history of prior drafts and open stakeholder meetings and comments,<sup>17</sup> the essential concepts for market legitimacy, including additionality and leakage, were covered at length and in depth.<sup>18</sup>

In contrast, it is not at all clear that CCX CFIs require additionality or assess leakage, to mention just two of several concepts that are essential for any legitimate market in CO<sub>2</sub>-emission equivalents. Commodities Exchange Act §2(h)(7) does not include the desire of an exchange to have its contract regulated among the acceptable criteria for Commission determination of

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<sup>14</sup> *Chicago Climate Exchange Offset Project Protocol: Coal Mine Methane Collection & Combustion Offset Projects*, Aug. 20, 2009, p. 11, available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_Coal\\_Mine\\_Methane\\_Collection\\_and\\_Combustion\\_Final.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_Coal_Mine_Methane_Collection_and_Combustion_Final.pdf); “no Project-specific leakage assessment is required,” *Chicago Climate Exchange Offset Project Protocol: Small Scale Renewable Biogas*, p. 9, available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_Small\\_Scale\\_Renewable\\_Biogas\\_Final.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_Small_Scale_Renewable_Biogas_Final.pdf); “no Project-specific leakage assessment is required,” p. 11, available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_Avoided\\_Emissions\\_Organic\\_Waste\\_Disposal\\_Final.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_Avoided_Emissions_Organic_Waste_Disposal_Final.pdf); “no project specific leakage assessment is required,” *Chicago Climate Exchange Offset Project Protocol: Agricultural Best Management Practices – Continuous Conservation Tillage and Conversion to Grassland Soil Carbon Sequestration*, p. 16 available at [http://www.chicagoclimatex.com/docs/offsets/CCX\\_Conservation\\_Tillage\\_and\\_Grassland\\_Conversion\\_Protocol\\_Final.pdf](http://www.chicagoclimatex.com/docs/offsets/CCX_Conservation_Tillage_and_Grassland_Conversion_Protocol_Final.pdf). Using Google to search the Climate Action Registry website shows 94 documents that use the word “leakage”- [http://www.google.com/search?q=leakage+site:http://www.climateactionreserve.org&hl=en&lr=&client=firefox-a&rlz=1R1GGGL\\_en\\_US314&hs=xDO&filter=0](http://www.google.com/search?q=leakage+site:http://www.climateactionreserve.org&hl=en&lr=&client=firefox-a&rlz=1R1GGGL_en_US314&hs=xDO&filter=0) as opposed to only twelve documents using the word “leakage” on the CCX website: [http://www.google.com/search?hl=en&lr=&client=firefox-a&rlz=1R1GGGL\\_en\\_US314&q=leakage+site:http://www.chicagoclimatex.com/&start=0&sa=N&filter=0](http://www.google.com/search?hl=en&lr=&client=firefox-a&rlz=1R1GGGL_en_US314&q=leakage+site:http://www.chicagoclimatex.com/&start=0&sa=N&filter=0) There is a higher CAR:CCX use of the term “leakage” when compared to use of the term “additionality”, but it arises from the CCX protocol exclusions of leakage as a tool for determining whether the activity has offset CO<sub>2</sub>-equivalent emissions.

<sup>15</sup> <http://www.climateactionreserve.org/>.

<sup>16</sup> <http://www.climateactionreserve.org/>. The California Climate Action Registry is now a subsidiary of the Climate Action Reserve. See Climate Action Reserve Press Release at <http://www.climateactionreserve.org/resources/docs/press-releases/Climate%20Action%20Reserve%20becomes%20parent%20organization%20042009.pdf>.

<sup>17</sup> Available at <http://www.climateactionreserve.org/how/protocols/>.

<sup>18</sup> Accordingly, the Chicago Climate Futures Exchange (“CCFE”) CCAR-CRT (for Carbon Reduction Tonne) futures could serve a useful price discovery function once there is sufficient market depth. The CCFE data posted at [http://www.ccfex.com/mktdata\\_ccfe/futuresSummary.jsf?symbol=CCAR-CRT](http://www.ccfex.com/mktdata_ccfe/futuresSummary.jsf?symbol=CCAR-CRT) shows negligible open interest.

“significant price discovery function.” This is especially important to keep in mind when the exchange in question has already used this very NOI for its own marketing purposes.<sup>19</sup>

Accordingly, the CCX CFI contract is not a material price reference. The absence from the CCX CFI contract of the most essential requirements for commonality with other carbon offset contracts prevents market participants from using the CFI contracts for material price reference, arbitrage, and settlement and execution of transactions. In fact, the CFI is so significantly disconnected from what the marketplace and those federal and international regulators who have considered the issue accept as a “legitimate” Carbon offset that a Commission finding of the CFI as a “significant price discovery contract” could undermine the very market legitimacy that thousands of experts and stakeholders around the world have invested many years to develop. Because the CFI does not meet standards of the broader Carbon market, it in fact sends a false price signal and would sow even further confusion were it legitimized by a positive Commission determination. The Commission should rather await the development of liquidity in instruments that more accurately reflect the CO2 offset market from which to select a significant price discovery contract.

This letter represents solely my own personal opinion, and is not submitted on behalf of, nor is intended to represent the opinion of, any other person or entity.

Yours truly,

/s/

Jeremy D. Weinstein

cc: Gregory K. Price, [gprice@cftc.gov](mailto:gprice@cftc.gov)  
Susan Nathan, [snathan@cftc.gov](mailto:snathan@cftc.gov)

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<sup>19</sup> Google shows 4,030 instances of the CCX press release, *CCX Welcomes CFTC Consideration of Carbon Contract*, available at <http://www.chicagoclimatex.com/news.jsf?story=3172>, in news stories, twitters and blogs. <http://www.google.com/search?hl=en&q=%22CCX+Welcomes+CFTC+Consideration+of+Carbon+Contract%22>.