

enhancement permit 1493 for takes of endangered species.

**SUMMARY:** This notice advises the public that a scientific research permit to the Bonneville Power Administration (BPA) and the Confederated Tribes and Bands of the Yakama Nation, as their agent, pursuant to the Endangered Species Act of 1973 (ESA), has been issued and that the decision documents are available upon request.

**DATES:** Permit 1493 was issued on September 15, 2004, subject to certain conditions set forth therein. The permit expires on September 15, 2009.

**ADDRESSES:** Requests for copies of the decision documents or any of the other associated documents should be directed to the Salmon Recovery Division, NOAA Fisheries, 525 NE Oregon Street, Suite 510, Portland, Oregon 97232. The documents are also available on the Internet at [www.nwr.noaa.gov](http://www.nwr.noaa.gov).

**FOR FURTHER INFORMATION CONTACT:** Kristine Petersen, Portland, OR, at phone number: (503) 230-5409, e-mail: [Kristine.Petersen@noaa.gov](mailto:Kristine.Petersen@noaa.gov)

**SUPPLEMENTARY INFORMATION:** The following species and evolutionarily significant units (ESUs) are covered in the permit:

Steelhead (*Oncorhynchus mykiss*): endangered Upper Columbia River.

Chinook salmon (*O. tshawytscha*): endangered Upper Columbia River spring run.

Issuance of this permit, as required by the ESA, was based on a finding that such permits: (1) were applied for in good faith; (2) will not operate to the disadvantage of the listed species which are the subject of the permits; and (3) is consistent with the purposes and policies set forth in section 2 of the ESA. This permit was issued in accordance with, and is subject to, 50 CFR part 222, the NMFS regulations governing listed species permits.

Dated: November 9, 2004.

**Phil Williams,**

*Chief, Endangered Species Division, Office of Protected Resources, National Marine Fisheries Service.*

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## COMMODITY FUTURES TRADING COMMISSION

### In the Matter of the Intercontinental Exchange, Inc. Petition for Expansion of the Definition of an Eligible Commercial Entity Under Section 1a(11)(C) of the Commodity Exchange Act

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Order.

**SUMMARY:** In response to a petition from the Intercontinental Exchange, Inc. ("Intercontinental"), the Commodity Futures Trading Commission ("Commission" or "CFTC"), pursuant to section 1a(11)(C) of the Commodity Exchange Act ("Act"), is issuing an order that deems, subject to certain conditions, brokers and traders associated with the International Petroleum Exchange ("IPE"), a recognized investment exchange ("RIE") located in the United Kingdom ("U.K."), who are either authorized by the Financial Services Authority ("FSA") or registered with the IPE,<sup>1</sup> when acting in a proprietary trading capacity, to be an "eligible commercial entity" as defined in section 1a(11) of the Act.<sup>2</sup> Accordingly, subject to certain conditions as set forth in the Commission's order, IPE members authorized as commodity brokers by FSA or registered as local traders with IPE, when acting for their own accounts, are permitted to enter into transactions in exempt commodities on exempt commercial markets pursuant to section 2(h)(3) of the Act. In order to participate, the FSA-authorized broker or IPE-registered trader must either be an eligible contract participant, as that term is defined in section 1a(12) of the Act, or have its trades on the exempt commercial market guaranteed by a clearing member that is both a member of an FSA-recognized derivatives clearing organization and is an eligible contract participant.

<sup>1</sup> Registration with IPE is not registration with FSA or any other government entity. Criteria and procedures for obtaining membership or trading privileges on IPE are discussed below.

<sup>2</sup> The Commission previously determined to expand ECE eligibility to include, subject to certain conditions, Commission-registered floor brokers and floor traders. See 68 FR 2319 (January 16, 2003). That action applied to Commission-registered floor brokers and floor traders conducting business on electronic or open outcry markets. Similarly, this action applies to IPE brokers and local traders conducting business on IPE in either electronic or open outcry trading environments. As used in this **Federal Register** notice and in the prior **Federal Register** notice, the term proprietary trading means trading for one's own account.

**EFFECTIVE DATE:** This order is effective November 15, 2004.

**FOR FURTHER INFORMATION CONTACT:** Clarence Sanders, Special Counsel, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone: (202) 418-5068. Electronic mail: [csanders@cftc.gov](mailto:csanders@cftc.gov).

**SUPPLEMENTARY INFORMATION:**

#### I. Statutory Background

The Commodity Futures Modernization Act of 2000 ("CFMA"), Public Law No. 106-554, was signed into law on December 21, 2000. Under amendments implemented by the CFMA, section 2(h)(3) of the Act authorizes trading in an "exempt commodity"<sup>3</sup> on an exempt commercial market ("ECM") meeting the requirements of section 2(h)(3)-(5). Under those provisions, transactions between an eligible commercial entity ("ECE") in an exempt commodity on an ECM are exempt from all but certain limited requirements of the Act.<sup>4</sup>

Section 1a(11) of the Act lists those eligible contract participants ("ECP")<sup>5</sup>

<sup>3</sup> Section 1a(14) of the Act defines the term "exempt commodity" to mean a commodity that is not an excluded commodity or an agricultural commodity. Section 1a(13) defines the term "excluded commodity" to mean, among other things, an interest rate, exchange rate, currency, credit risk or measure, debt instrument, measure of inflation, or other macroeconomic index or measure. Although the term "agricultural commodity" is not defined in the Act, section 1a(4) enumerates a non-exclusive list of several agricultural-based commodities and products. The broadest type of commodities that fall into the exempt category are energy and metals products.

<sup>4</sup> Under section 2(h)(3), ECMs are markets that meet the requirements of section 2(h)(3)-(5) by notifying the Commission of their intention to operate a trading facility in reliance on the exemption and by limiting themselves to transactions: (1) In exempt commodities, (2) entered into on a principal-to-principal basis by ECEs, and (3) executed or traded on an electronic trading facility. An ECM is not a registered entity, but is required to notify the Commission of its intention to operate an electronic trading facility in reliance on the exemption set forth in section 2(h)(3). The notification of operation as an ECM must include several certifications and, pursuant to Commission regulation 36.3(c)(3), a representation that it will require each participant to comply with all applicable law and that it has a reasonable basis for believing that authorized participants are ECEs. Section 2(h)(4) reserves, with respect to transactions eligible for the 2(h)(3) exemption, certain provisions of the Act, including certain anti-fraud and anti-manipulation provisions.

<sup>5</sup> Section 1a(12) lists those entities and individuals included within the ECP category. Included generally as ECPs are financial institutions; insurance companies; and investment companies subject to regulation; commodity pools and employee benefit plans subject to regulation and asset requirements; other entities subject to asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; governmental entities; brokers,

P=65585' that are qualified to be ECEs.<sup>6</sup> As defined under section 1a(11), floor brokers and floor traders, even if determined to fall within the definition of an ECP, do not, as a category, fall within the statutory definition of an ECE. Thus, commodity brokers and traders, whether conducting business in either electronic or open outcry trading environments, are prohibited from entering into transactions on ECMs.

Section 1a(11)(C) of the Act, however, vests the Commission with discretion to expand the list of entities qualifying as an ECE. Specifically, under that provision, the definition of an ECE shall include "such other persons as the Commission shall determine appropriate and shall designate by rule, regulation, or order." Therefore, a Commission-determination recognizing that IPE brokers and traders, either authorized by FSA or registered with IPE, are considered to be ECEs would permit these entities to enter into exempt commodity transactions on ECMs pursuant to section 2(h)(3) of the Act.

## II. The Petition

### A. Scope of Request

By letter dated February 9, 2004, Intercontinental requested that the Commission issue an order pursuant to section 1a(11) of the Act that would expand the ECE category to include certain IPE brokers and local traders, who are either authorized by FSA or registered with IPE, thus permitting

dealers, and futures commission merchants ("FCM") subject to regulation and organized as other than natural persons or proprietorships; brokers, dealers, and FCMs subject to regulation and organized as natural persons or proprietorships subject to total asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; floor brokers or floor traders subject to regulation in connection with transactions that take place on or through the facilities of a registered entity or an exempt board of trade; individuals subject to total asset requirements; an investment adviser or commodity trading adviser acting as an investment manager or fiduciary for another ECP; and any other person that the Commission deems eligible in light of the financial or other qualifications of the person.

<sup>6</sup> Section 1a(11) defines the term ECE by listing those entities and individuals considered to be ECEs. Generally, an ECE is an ECP that (1) in connection with its business, demonstrates the ability to make or take delivery of the underlying commodity; incurs risk, in addition to price risk related to the commodity; or is a dealer that regularly provides risk management or hedging services to, or engages in market-making activities with, the foregoing entities with respect to the commodity or derivatives transactions in the commodity; or (2) is other than a natural person or government entity and regularly enters into transactions with respect to the commodity, subject to certain qualification or total asset requirements; or (3) such other persons as the Commission shall determine appropriate.

them to trade on ECMs.<sup>7</sup> Intercontinental operates a commodities trading platform for energy and metals (the "Intercontinental electronic platform") and is itself an ECM. Intercontinental also owns IPE, a U.K. futures exchange that trades energy futures products. The Intercontinental electronic platform is used by IPE for its electronic trading system. Intercontinental stated that including IPE brokers and local traders as ECEs would be consistent with the CFMA and would recognize their value as both liquidity providers and market makers.

As more fully described below, Intercontinental's request applies to certain IPE brokers and local traders conducting business on IPE in either electronic or open outcry trading environments.<sup>8</sup> Specifically, Intercontinental proposed that eligible IPE brokers must be located in the U.K., be authorized and regulated by the FSA, and be a member of the IPE. For IPE local traders, Intercontinental proposed that eligible local traders be located in the U.K., be outside the scope of the Financial Services and Markets Act of 2000 ("FSMA"), and be a member of, or registered to, the IPE. Additionally, for both brokers and local traders, Intercontinental proposed that they have, as a part of their business activities, the business of acting as a broker or local trader but need not have any connection or experience in the underlying physical commodity. Finally, Intercontinental proposed that an eligible IPE broker or local trader must be an ECP or, if not an ECP, then the IPE broker or local trader must have its trades on the ECM guaranteed by an

<sup>7</sup> Intercontinental submitted its notice of operation as an ECM to the Commission on December 27, 2001. Intercontinental is one of 11 ECMs that have submitted notices to the Commission to date.

<sup>8</sup> The two classes denominated as brokers or local traders encompass four separate types of holders of trading privileges on IPE. Within the broker class there are Floor Members and General Participants. Floor Members hold privileges to trade on the IPE floor, whereas General Participants may trade only through the IPE electronic trading system. After establishment by IPE of the General Participant class, Floor Members were eligible to be grandfathered as General Participants. Also new Floor Members can elect to qualify as General Participants. The class denominated as local traders by IPE can similarly be broken down into two separate trader types. These are called Local Members and Individual Participants. Local Members may trade on the IPE floor, but Individual Participants may trade solely through the IPE electronic trading system. During July 2003 IPE introduced a new "electronic" membership structure. FSA recognizes all four classes as "members," irrespective of whether the individual class is vested with equity or voting rights. See FSA Handbook Glossary at M8, 01/10/04, which defines a member as "a person who is entitled, under an arrangement or agreement between him and that body, to use that body's facilities."

entity that is both an ECP and a clearing member of a U.K. recognized clearing organization.

In its petition, Intercontinental noted that the Commission has previously expanded the eligibility criteria for ECE status to include Commission-registered floor brokers and floor traders when acting in a proprietary trading capacity. In this respect, Intercontinental commented that the relief it seeks for IPE brokers and local traders is an appropriate extension of the Commission's previous expansion of the ECE definition. Moreover, Intercontinental contends that the IPE brokers and local traders, much as the CFTC registered floor brokers and floor traders qualifying under the Commission's prior action, are commodity professionals supervised by a central regulator, the FSA, or the IPE. Intercontinental also notes that the IPE brokers and local traders regularly trade on the IPE as part of their business and would utilize ECMs in connection with their trading activities. Intercontinental also observes that the Commission's prior action effectively acknowledges that floor brokers and floor traders are sophisticated market participants who are subject to a comprehensive regulatory scheme, such as that provided under FSA and IPE regulations. Intercontinental concludes that IPE brokers and local traders satisfy similar criteria, including that of having their trades guaranteed by the arrangements put in place by an RIE, and should therefore be eligible for the same type of relief.<sup>9</sup>

### B. IPE Brokers

The petition requests that the ECE definition be expanded to include IPE brokers that are located in the UK when acting in a proprietary capacity. The IPE brokers include IPE Floor Members and IPE General Participants. IPE Floor Members may trade in either the open outcry or electronic markets; General Participants are restricted to the electronic market only.

As the petition describes, IPE brokers are firms authorized to transact business on behalf of customers or for the firm's proprietary account.<sup>10</sup> When acting on behalf of customers, the firm's business activities fall within the scope of the FSMA. Thus, a firm conducting such

<sup>9</sup> FSA recognition requirements place obligations on an RIE to put in place satisfactory arrangements for securing clearing and settlement services, which generally will be carried out by a Recognized Clearing House.

<sup>10</sup> Although IPE brokers have FSA authorization to conduct transactions on behalf of customers, any relief granted in response to the Intercontinental petition would be solely for their proprietary trading activities.

activities in the UK is subject to regulation by the FSA. Among other qualifying criteria, such firms must obtain FSA authorization prior to engaging in the commodity brokerage business.<sup>11</sup>

As there are two separate trading venues at IPE, conduct of business by IPE brokers may take two different forms. Each IPE floor-based broker (*i.e.*, Floor Members) is represented on the trading floor by one or more individual traders.<sup>12</sup>

General Participants are IPE brokers authorized to conduct business solely on the electronic trading platform. IPE-established eligibility requirements for this class of membership differ from those applicable to floor members. However, both classes of IPE brokers are authorized by FSA and therefore under FSA oversight. When operating on the IPE electronic trading platform, representatives of IPE General Participants are registered with the IPE as a Responsible Individual ("RI") or, alternatively, are registered with the FSA as an Approved Person linked to a particular General Participant.<sup>13</sup>

<sup>11</sup> Under the U.K. regulatory regime, FSA also is responsible for approving persons who perform certain "controlled functions" for an authorized person. The FSA has specified 27 separate controlled functions, which fall into two main groups. The first of these two groups is the "significant influence functions" group, which includes activities carried out by persons in positions having a significant influence over conduct of the firm, such as governing functions (a Board Director or Chief Executive) or required functions (Compliance Officer or Money-Laundering Reporting Officer). The other group is the "customer functions" group, which includes persons performing advisory functions or customer trading and investment management functions.

<sup>12</sup> In order to qualify for membership as a Floor member on IPE, an applicant also must meet a schedule of IPE eligibility requirements. Under this schedule, an applicant must (1) be a firm or company, (2) meet IPE requirements on record-keeping, training and fitness of staff and directors, and implement internal procedures to ensure compliance with regulations, (3) meet minimum IPE-established net worth requirements, (4) maintain a properly established office in an IPE-approved location for the conduct of business, (5) have a continuing interest in trading and maintain trading staff on the IPE floor, (6) be a clearing member of LCH.Clearnet or be a party to a clearing agreement with another firm that is a member of LCH.Clearnet, and (7) hold at least one seat on IPE, where the applicant wishes to self-execute transactions on the IPE floor.

<sup>13</sup> Under the applicable schedule of requirements, the applicant must (1) demonstrate fitness to be a member, (2) demonstrate sufficiency of controls and procedures to ensure that employees, agents, and representatives are fit and proper, suitably qualified and experienced, adequately trained, and properly supervised, (3) maintain a properly established office in an IPE-approved location for the conduct of business, (4) meet minimum IPE-established financial standing requirements, (5) be a party to an IPE-prescribed Platform User Agreement, (6) maintain access to the Trading Server via a front end application meeting IPE criteria, (7) be a clearing member of LCH.Clearnet or be a party to

### C. IPE Local Traders

The petition also requests that the ECE definition be expanded to include IPE local traders located in the UK. Under IPE rules, local traders are authorized to trade for their own account but are prohibited from engaging in customer brokerage. As noted above, IPE local traders as a class are composed of two separate types of holders of trading privileges. These are Local Members and Individual Participants.<sup>14</sup> Qualifying criteria for these two trader classes differ in some respects. Local Members hold privileges to trade on the IPE floor.<sup>15</sup> Individual Participants are authorized to trade solely on the electronic trading platform.<sup>16</sup>

Notably, both Local Members and Individual Participants are outside the scope of the FSMA and therefore need not be authorized by the FSA—either when trading on IPE on behalf of their own account or on behalf of other IPE members.<sup>17</sup> However, both Local Members and Individual Participants

a clearing agreement with another firm that is a member of LCH.Clearnet, (8) hold all necessary licenses, authorizations, and consents or qualifies for an exclusion permitting the conduct of business on the Platform in accordance with applicable law and regulation, and (9) identify the location of all RIs, along with related details and information on order routing, upon request from IPE.

<sup>14</sup> A third local trader class, Trade Participant membership, also exists but relief is not being sought for this class. Trade Participants are companies limited to trading for their own account.

<sup>15</sup> To qualify as an IPE Local Member an applicant must (1) demonstrate fitness as a member and an intention to comply with IPE regulations, (2) register with IPE and successfully pass the Registered Floor Trader examination, (3) demonstrate that the applicant will become a party to a clearing agreement with a clearing member of LCH.Clearnet, (4) demonstrate that the applicant is entitled, upon admission to membership, to acquire or lease a minimum of one seat on IPE, (5) demonstrate that the applicant is either a sole trader or a company where 90 percent of issued share capital is owned by the sole trader or 90 percent of voting rights of a non-share capital company is held by the sole trader, and (6) provide any other information or documents requested by IPE.

<sup>16</sup> To demonstrate eligibility an applicant as an Individual Participant must (1) demonstrate fitness as a member and an intention to comply with IPE regulations, (2) register with IPE as an RI and successfully pass the Registered Trader examination, (3) be a party to an IPE-prescribed Platform User Agreement, (4) maintain access to the Trading Server via a front end application meeting IPE criteria, (5) demonstrate that the applicant will become a party to a clearing agreement with a clearing member of LCH.Clearnet, and (6) demonstrate substantial experience trading on a UK futures exchanges, or otherwise meet the Intermediate Customer Standards found in FSA Conduct of Business Rule 4.1.9R.

<sup>17</sup> IPE Local Members and Individual Participants were determined to be outside the scope of FSMA by Order 2001. Local Members and Individual Participants may be individuals or corporations, although in the case of a corporation, 90 percent of the share capital or voting rights must be held by a single member.

must be members of, or registered with, the IPE, and must meet independent qualifying criteria established by IPE under an FSA-recognized regime.<sup>18</sup> The IPE actively monitors Local Member and Individual Participant trading activity, and has authority to impose sanctions for improper trading conduct.<sup>19</sup>

### D. Qualifying Experience for Individual Participants

IPE affirms that it will determine whether an applicant has substantial qualifying experience by applying the standards set out under the definition of an Intermediate Customer contained in FSA regulations. In particular, IPE represents that the standards defining an expert private client as an Intermediate Customer found in Rule 4.1.9R of the FSA Conduct of Business ("COB") sourcebook will be applied as the primary guide in determining the adequacy of an applicant's experience for this purpose.

COB Rule 4.1.9R imposes a two-tiered regulatory structure on financial services firms servicing accounts of expert private clients. This structure is divided between (1) procedural steps in establishing a client relationship with an expert private client and (2) objective steps in determining the adequacy of the expert private client's trading and business experience. More specifically, under FSA regulations, a financial intermediary is required to classify a client in one of three classifications: these are private ("retail") customer, intermediate customer, or market counterparty.<sup>20</sup> Provisions under COB Rule 4.1.9R, permit a financial services firm to classify a client who would otherwise be a private, or retail, customer as an Intermediate Customer only upon a determination that the client is an "expert" private client.

COB 4.1.9R requires a firm to assess the adequacy of a client's experience and knowledge as an expert private client.<sup>21</sup> In this respect, COB Rule

<sup>18</sup> FSA confirms that IPE regulations appear to meet the requirements in the FSA sourcebook on Recognized Investment Exchanges and Recognized Clearing Houses.

<sup>19</sup> All IPE members and holders of trading privileges must execute an IPE-prescribed agreement consenting to be bound by IPE rules. See IPE Rule B.1.4.

<sup>20</sup> See COB Rule 4.1.4, FSA Handbook, Release 034, September 2004.

<sup>21</sup> Under the first tier, which concerns the establishment of a client relationship, COB Rule 4.1.9R requires that a firm take reasonable care to determine that the client has sufficient experience and understanding, disclose in writing the regulatory protections waived by such classification, provide the client sufficient time to consider the determination, and obtain the client's written consent or otherwise demonstrate that informed consent has been given by the client.

4.1.9R requires that a firm inquire about the client's knowledge, understanding, and awareness of risks in the applicable investments and markets. The rule also requires a firm to consider the length of time the client has been active in the applicable markets, the frequency of dealings, and the extent to which the client has relied on advice. Finally, the rule instructs a firm to inquire about or consider the size and nature of any transactions undertaken for the client, and the client's financial standing, including where appropriate an assessment of the client's net worth and portfolio holdings.

Essentially, IPE has determined to adopt the COB Rule 4.1.9R standards as qualifying criteria for applicants as IPE Individual Participants. Thus, these standards, otherwise imposed upon financial services firms regulated by FSA, will also be part of IPE procedures and serve as a screening device for determining the sufficiency of an applicant's experience and knowledge for admission on the IPE as an Individual Participant. In this respect, IPE confirms that its application of the criteria found in Rule 4.1.9R, to assess experience and knowledge of Individual Participant applicants, will be part of an independent determination made by IPE management. Moreover, IPE represents that any prior status an applicant may have attained as a customer of a financial services firm would not be determinative of eligibility, but that IPE would undertake an independent assessment of the applicant's experience and knowledge under the standards of COB Rule 4.1.9R.

#### E. Comments

The Intercontinental petition was published in the **Federal Register** for a 15-day public comment period on March 22, 2004.<sup>22</sup> In addition, the **Federal Register** release includes a series of questions posed by the Commission regarding the petition. Those questions focus on whether the petition should be granted; what conditions if any should apply; whether any grant of the petition should be specifically tailored to the Intercontinental ECM or be more broadly applied to other ECMs as well; whether relief should extend to IPE traders with rights to trade only on the IPE electronic platform, or to IPE locals not registered with the FSA and, if so, what standards should apply to evaluate the qualifications of such persons.

In total, the Commission received three comment letters responding to the **Federal Register** notice, two of which

were submitted by the New York Mercantile Exchange ("NYMEX") in letters dated April 7, and May 27, 2004. The other comment was submitted by Intercontinental in a letter dated April 28, 2004. The Intercontinental comment letter primarily responded to issues critically raised in the NYMEX letter of April 7, 2004.

#### 1. NYMEX Comment Letters

The NYMEX comment letters include a generalized critical assessment of the petition. In so doing, the letters characterize the relief being sought as "broad and unrestricted," and argue against the grant of the petition. In arriving at this conclusion, NYMEX emphasizes several different aspects of the IPE institutional and regulatory environment.

In particular, NYMEX sets out its view of the regulatory landscape governing ECMs as one in which statutory exemption is conditioned on the commercial nature of the market. Following this line of reasoning, NYMEX asserts that the IPE electronic traders are best characterized as representing a retail rather than a commercial interest and, on that basis, concludes they should be denied eligibility to obtain trading privileges on ECMs.

In amplifying its objection to a grant of access for IPE electronic traders, NYMEX asserts that granting the petition for IPE electronic traders would open ECM access to a "potentially large group of unschooled and unsophisticated electronic traders who are not required to be registered here or in the U.K." NYMEX further concludes that granting such regulatory relief could impose risks to the integrity of trading on an ECM. Thus, NYMEX concludes that a grant of relief sought by Intercontinental would be contrary to statutory intent and the public interest.

Along a similar line of reasoning, NYMEX questions whether the IPE local traders (both Local Members and Individual Participants) could meet commercial standards justifying access to an ECM. NYMEX supports this conclusion by arguing that the lack of FSA registration for IPE local traders, combined with a lack of express qualifying and trading participation requirements, raises a question as to whether such traders could serve as effective "liquidity providers" on an ECM.

NYMEX also questions whether the petition is imbued with a full understanding of the meaning of "trading for one's own account" within the context of obtaining trading access to an ECM.

The NYMEX comments also respond to the Commission's inquiry whether any regulatory response to the petition should be tailored specifically to permit IPE members to trade solely on Intercontinental or should be more broadly designed to permit IPE members to trade on other ECMs as well. Although more generally opposing the grant of the petition, NYMEX, in response to this question, comments that it is unable to identify any factual circumstances that would be unique to Intercontinental's ECM. On this basis, NYMEX concludes there is no need to tailor any hypothetical relief to the specific factual circumstances of the Intercontinental ECM and, in this respect, questions the wisdom of "creating private definitions for public statutory categories." In summary, although NYMEX argues against granting the petition, NYMEX suggests that in any grant of relief the Commission "may wish to consider allowing such IPE members to trade on other ECMs."

#### 2. Intercontinental Letter

As noted, Intercontinental submitted a comment letter dated April 28, 2004. That letter generally responds to the issues raised in the NYMEX letter of April 7, 2004. At the outset, Intercontinental notes that the IPE, as an RIE regulated by FSA, is subject to a panoply of FSA requirements, which, according to Intercontinental, are designed to protect the functioning of the market and the interests of users.<sup>23</sup>

Intercontinental also comments that these FSA requirements on member access to an RIE should also be read in conjunction with the rules and requirements independently applied by

<sup>23</sup> Recognized Investment Exchanges and Recognized Clearing Houses, FSA Handbook, Release 033, July 2004. More specifically, Intercontinental represents that Part 2.7 of the RIE Sourcebook imposes obligations requiring an RIE to restrict membership to applicants (1) over whom it can with reasonable certainty enforce its rules contractually, (2) who have sufficient technical competence to use its facilities, (3) who it is appropriate to admit to membership having regard to the size and sophistication of users of its facilities and the nature of the business effected by means of or cleared through its facilities, and (4) if appropriate who have adequate financial resources in relation to their exposure to the UK recognized body or its central counterparty. See also FSA Handbook Glossary at M8, 01/10/04, which defines a member as "a person who is entitled, under an arrangement or agreement between him and that body, to use that body's facilities." Thus, all holders of IPE trading privileges are deemed "members," and are regulated as such under FSA regulations, irrespective of whether individuals within a particular class of traders hold any equity or voting rights in IPE.

<sup>22</sup> 69 FR 13286 (March 22, 2004).

IPE.<sup>24</sup> As a supplement to these rules and requirements, Intercontinental comments that IPE also applies a membership due diligence screening process in which the IPE inquiry seeks information on an applicant's personal history including, but not limited to, the applicant's experience and knowledge of derivatives trading, whether an individual applicant has been registered by another regulatory body, has ever been disciplined by another regulatory body, or been insolvent. Additionally, Intercontinental comments that, as part of the due diligence screening, IPE conducts an identification inquiry under anti-money laundering standards and reviews or confirms all information obtained with appropriate agencies.

With respect to IPE contracts traded on the electric platform, Intercontinental comments that IPE makes available two different training programs for new members before they can access the system. As a consequence of these requirements, Intercontinental maintains that the characterization by NYMEX that IPE electronic traders are "unschooled and unsophisticated," or of a retail nature, is not accurate. On this basis, Intercontinental concludes that the IPE members should be viewed as eligible to access the over-the-counter contracts traded on Intercontinental's ECM.

Intercontinental's comment letter also notes that it is not seeking relief solely for its own ECM, but rather does not oppose broad ECM access for the IPE membership. Intercontinental also acknowledges that relief is being sought solely for "principal-to-principal" trading.

While not responding to any aspect of NYMEX's comment letter, Intercontinental did add several clarifications with respect to its relief request. For instance, Intercontinental remarks that its systems are adequate to enforce the requirement that IPE members eligible for relief must be located in the U.K., as it inquires into a participant's physical location by collecting information on a participant's principal business address. Intercontinental also comments that it conducts an anti-money laundering inquiry for privately-owned companies in which the participant must present the company's registered address, as well as collecting the address and telephone number for each user as part of its process for new market users.

### III. Discussion

Under the CEA, ECMs are commercial markets executing principal-to-principal transactions. In view of the unregulated nature of these markets, Congress intended that access should be confined to professional traders—either ECEs as defined in section 1a(11) or other traders that have an interest in the underlying commodity as part of their business operations, perform a market-making role, or otherwise provide a similar trading function that improves market liquidity.

As noted above the Commission has previously acted to expand the ECE definition to include floor brokers and floor traders registered with the Commission and acting in a proprietary capacity, since these persons operate as knowledgeable, experienced professional traders who historically have provided a trading function that improves market liquidity.<sup>25</sup> The Commission stated in the **Federal Register** notice accompanying that action that in order to qualify as an ECE under the Order, the "CFTC-registered floor broker or floor trader must be a member of a DCM or otherwise have trading privileges on a DCM \* \* \* [and act] as a floor broker or floor trader, either on a DCM's open outcry market or [perform] an equivalent function on the DCM's electronic market." In the **Federal Register** notice, the Commission also acknowledged, as professional traders providing market-making type activities, that the floor broker or floor trader "need not have any connection to or experience in the underlying physical commodity." Finally, the Commission stated that the "floor broker or floor trader must either be an ECP or have its trades on the ECM guaranteed by a clearing member that is both a member of a CFTC-registered derivatives clearing organization and an ECP."

Underlying the Commission's prior action was the notion that registration was a proxy for the aforementioned knowledge, experience, and professionalism, and for the provision of a market-making or similar trading function that improves market liquidity.

As outlined above in Section II.A, Intercontinental maintains that its petition seeks relief of a similar nature, and further represents that granting its request would constitute an appropriate extension of the Commission's prior

action. Although NYMEX supported the Commission's prior action, NYMEX now opposes the Intercontinental petition for IPE traders. In contrast to Intercontinental's declaration, the comment letters submitted by NYMEX argue that the Intercontinental petition fails to satisfy standards established under the Commission's prior action to include CFTC-registered floor brokers and floor traders in the definition of an ECE.

The Commission believes that granting relief for IPE brokers would comply with the Commission's prior action to expand the ECE category to include CFTC-registered floor brokers and floor traders. IPE brokers, by virtue of having received FSA authorization as a prerequisite to engaging in the conduct of commodity brokerage on IPE, conform to that part of the standards enunciated in the Commission's prior action. The Commission also has entered into an information-sharing arrangement with the FSA.

With respect to IPE floor and electronic local traders, NYMEX correctly concludes that these traders are neither authorized nor approved by FSA, the U.K. regulator with jurisdiction over commodity futures exchanges and other instrumentalities operating in the U.K. financial services industry. Nonetheless, the Commission believes that it is appropriate to include these traders under the ECE category since, as identified above, IPE floor and electronic local traders do have to meet a schedule of criteria in order to establish eligibility as an IPE Local Member or Individual Participant. In order to demonstrate fitness, both IPE Local Members and Individual Participants must, among other things, successfully pass the Registered Trader examination that is administered by IPE.<sup>26</sup>

As either an applicant or an IPE-approved trader, Local Members and Individual Participants must meet a schedule of fees that is essentially the same for both classes of membership. Each applicant is required to pay an application fee of 500 pounds. If accepted to membership, each applicant would then be required to pay an annual subscription fee of 350 pounds per seat or membership. Additionally, each applicant would be subject to an annual minimum activity charge of 1000 pounds, if the applicant failed to trade at least 4000 lots per year.

Other applicable criteria differ for each of these two trader classes, most

<sup>24</sup> These are the same rules and requirements outlined above in Section II.

<sup>25</sup> 68 FR 2319 (January 16, 2003). The Commission also incorporated floor brokers and floor traders in the definition of an ECE as it relates to trading on a Derivatives Transaction Execution Facility. See Commission Regulation 37.1(b), and the discussion thereunder at 66 FR 42256.

<sup>26</sup> See IPE Rule G.10(c). The Registered Floor Trader exam tests knowledge of trading behavior and of the rules and regulations of IPE.

notably with respect to evidencing an adequate level of experience and knowledge. Local Members are required to either purchase or lease a seat on IPE and to serve both a trainee and probationary period. While in trainee status, an applicant may only enter a trading pit as an observer.<sup>27</sup> In order to achieve probationary status, an applicant must pass the Registered Trader exam. During the probationary period, an applicant may execute transactions on the exchange, but only under the supervision of another IPE member.<sup>28</sup>

After completion of the probationary period, the applicant's performance is subjected to peer review by other IPE members and the IPE Trading Committee.<sup>29</sup> Final acceptance or denial of membership is conditioned on confirmation of the IPE Trading Committee. Thus, the trainee and probationary periods required of Local Members appear to serve as a training period or apprenticeship preparatory to a new member receiving full floor trading privileges.

For Individual Participants, who only have trading privileges for the IPE electronic system, IPE has implemented other requirements that differ from those applicable to Local Members. Under IPE requirements, as in the case of Local Members, Individual Participants must also show fitness to be a member. However, as outlined above in Section II.C, in addition to successfully passing the Registered Trader Exam, applicants for Individual Participant membership must demonstrate substantial experience trading on a U.K. futures exchange, or otherwise satisfy the standards defining an Intermediate Customer under FSA Conduct of Business Rule 4.1.9R.

According to Intercontinental, electronic trader eligibility is limited to existing IPE-registered traders, to traders at other U.K. exchanges, to other individuals with substantial trading experience on U.K. futures exchanges, or to traders who have successfully passed the Registered Trader exam. Thus, according to Intercontinental, FSA-developed standards under COB Rule 4.1.9R, which define an intermediate customer, are used by IPE as a screening device to differentiate professional from retail experience among applicants.

As the above suggests, criteria set out under COB Rule 4.1.9R are intended for

use in determining whether a client would have experience meeting or qualifying at the intermediate customer level. Thus COB Rule 4.1.9R instructs that, in determining a client's experience and knowledge, a firm should inquire about:

1. The client's knowledge, understanding, and awareness of risks in the applicable investments and markets,
2. The length of time the client has been active in these markets, the frequency of dealings, and the extent to which client relied on advice,
3. The size and nature of the transactions undertaken for the client, and
4. The client's financial standing, which may include an assessment of net worth and portfolio.

As a practice that is functionally parallel to that required of financial firms under COB Rule 4.1.9R, Intercontinental has represented that IPE will confine eligibility for admission as an electronic trader to applicants with:

1. Sufficient knowledge and understanding of market and risks,
2. Who were active on such markets for a reasonable length of time,
3. Who have traded in appropriate size and quantity, and
4. Who have appropriate financial standing.

In this respect, IPE confirms that it will apply the criteria found in Rule 4.1.9R applicable to assessing experience and knowledge of an expert private customer as part of an independent determination made by IPE management. Moreover, IPE represents that the prior status an applicant may have attained as a customer of a financial services firm would not be determinative of eligibility, but that IPE would undertake an independent assessment of the applicant's experience and knowledge under the standards of COB Rule 4.1.9R.<sup>30</sup>

As a general matter, IPE also maintains that as an RIE it is organized as a wholesale market and is not open to retail membership. In this regard, IPE points out that FSA rules and standards

found in the Recognized Investment Exchange and Clearing House sourcebook ("REC") impose requirements on types of applicants eligible for membership. Among other things, REC Rule 2.7.3 states that FSA may conduct assessments of whether access to a UK recognized body's facilities is based on criteria designed to protect the orderly functioning of the market and the interests of investors. Further, Rule 2.7.3 states that FSA, in conducting any such assessments, may consider: (a) Whether the RIE limits access as a member to persons over whom it can with reasonable certainty enforce its rules, (b) who have sufficient technical competence to use the market's facilities, (c) whom it is appropriate to admit to membership having regard for the size and sophistication of users of its facilities and the nature of business thereon, and (d) where appropriate, the adequacy of financial resources in relation to a member's exposure to the UK recognized body or central counterparty.<sup>31</sup>

As noted, IPE local traders need not be authorized or approved by FSA as a pre-condition in obtaining trading privileges on IPE. The U.K. approach therefore differs somewhat from that applied under U.S. regulation, where Commission requirements mandate registration with a government body for both floor brokers and floor traders. However, even though qualifying determinations for local traders are reserved to IPE, those procedures are subject to FSA supervision. Thus, notwithstanding the formalistic differences in the treatment of local traders in the U.S. and U.K. regulatory systems, the Commission believes that the U.K. regulatory structure facilitates and enforces a level of regulation for the IPE local traders that meets applicable standards of professionalism established under the Commission's prior action expanding the ECE category to include

<sup>31</sup> Administratively, REC Rule 2.7.3 also seeks to ensure that an RIE's membership criteria are objective in their scope and are applied in an objective, non-discriminatory manner. Specifically, for access to electronic markets, REC Rule 2.7.4 provides that the FSA may review an RIE's rules and practices concerning procedures, controls, and security for inputting instructions into the system; the facilities provided and restrictions imposed on clients inputting instructions into the system; practices used to detect, identify, and prevent instructions to the system that breach any relevant restrictions; the quality and completeness of the audit trail; and procedures governing the determination to suspend system trading or member access.

<sup>27</sup> See IPE Rule 1.3.2.

<sup>28</sup> See IPE Rule 1.6.7(f).

<sup>29</sup> Under IPE Rule 1.6.7, the probationary period runs for a period of 90 days unless terminated earlier at the discretion of the IPE Trading Committee.

<sup>30</sup> IPE is posting the Individual Participant application form on its Web site. The application form includes an eligibility requirement in reference to the Intermediate Customer standards under FSA COB 4.1.9R. There are no specific FSA regulations governing an RIE's record-keeping obligations regarding membership applications or documents relating thereto. However, IPE maintains that Money Laundering Regulations 1993 require IPE retention of new client records, including IPE members, for a five-year period following the termination of the business relationship. In the case of an IPE member or holder of trading privileges, the five-year period would run from the date of rejection or resignation from membership.

CFTC-registered floor brokers and floor traders.<sup>32</sup>

#### IV. Conclusion

After consideration of the Intercontinental petition, and the additional material submitted by Intercontinental to accompany the petition, and the comment letters submitted in response to the **Federal Register** notice, the Commission has determined, consistent with the Intercontinental petition, that it is appropriate to issue an order, pursuant to Section 1a(11)(c) of the Act, that includes certain IPE floor and electronic brokers and traders, subject to certain conditions, within the definition of an ECE for eligibility to trade on an ECM.<sup>33</sup> As in the prior action to expand the ECE definition to include CFTC-registered floor brokers and floor traders, either in open outcry or electronic markets, the Commission believes that expanding the definition to include IPE floor and electronic brokers and traders is consistent with the purposes of the CFMA.<sup>34</sup> Moreover, and again as in the prior action, the Commission believes that inclusion of IPE floor and electronic brokers and traders in the definition of an ECE could potentially increase competition and efficiency, and reduce liquidity risk, on ECMs.

As noted above, underlying the Commission's prior action was the notion that registration serves as a proxy for the aforementioned knowledge, experience and professionalism, and for the provision of a market-making or similar trading function that improves market liquidity. Commission action taken here makes a similar finding for IPE floor and electronic brokers and traders with respect to their knowledge, experience and professionalism, and their ability to provide market-making or similar trading functions that improve market liquidity.

<sup>32</sup> The Commission has found the U.K. regulatory program generally comparable to the U.S. framework pursuant to a grant of relief under CFTC regulation 30.10. The review for this determination focused generally upon firms acting in the capacity of futures commission merchants for U.S. customers trading on U.K. exchanges, rather than on proprietary trading by brokers and traders. See 68 FR 58583 (October 10, 2003).

<sup>33</sup> As noted, Intercontinental seeks to include in the definition of an ECE four separate types of holders of trading privileges on IPE: the broker class is composed of Floor Members and General Participants and the local trader class is composed of Local Members and Individual Participants.

<sup>34</sup> The Commission's prior action to include CFTC-registered floor brokers and floor traders in the ECE definition specifically acknowledged that the prior action would reach a "floor broker or floor trader, either on a DCM's open outcry market or [when] performing an equivalent function on the DCM's electronic market." See 68 FR 2323 (January 16, 2003).

The Commission also notes that IPE registration of electronic local traders is based on eligibility pursuant to the Intermediate Customer standards under FSA COB 4.1.9R. The Commission considers the inclusion of this process in IPE registration as a reasonable proxy for an electronic local trader's knowledge, experience, professionalism, and ability to provide a market-making or similar trading function that improves market liquidity. Moreover, the Commission believes that the IPE has the experience and ability to apply the standards in an efficient and prudent manner. The Commission points out that these determinations are based on materials provided by, and/or representations made by, IPE and FSA and, as such, are particular to IPE. If another market or governmental regulator petitioned the Commission for a similar expansion of the ECE definition, an analogous showing to the Commission would be necessary.

The Commission also notes that it has previously expanded the ECE definition for purposes of trading on a DTEF.<sup>35</sup> That action incorporated within the ECE definition registered floor brokers and floor traders, whose trading obligations are guaranteed by a registered FCM, when trading for their own accounts on a DTEF.

In order to qualify as an ECE under the Commission's order, an IPE floor or electronic broker or trader must be a member of IPE or otherwise have trading privileges on IPE and be located in the U.K. Pursuant to those requirements, the qualifying IPE floor or electronic broker or trader also must be authorized by FSA or registered with IPE. The IPE floor or electronic broker or trader must have as a part of its business the business of acting as a commodity broker or local trader, either on IPE's open outcry or electronic market, but need not have any connection to or experience in the underlying physical commodity. The Commission believes that the trading expertise of IPE floor or electronic brokers or traders would be applicable to trading in any commodity product traded on an ECM. Among other things, the ability of an IPE floor or electronic broker or trader to interpret market momentum, and facilitate the adjustment of market prices to new information, is more a function of trading expertise than of experience in the underlying physical commodity.

A qualifying IPE floor or electronic broker or trader must be either an ECP or have its trades on the ECM guaranteed by a clearing member that is

both a member of an FSA-recognized derivatives clearing organization and an ECP. The Commission believes that requiring either the IPE floor or electronic broker or trader, or the guarantor thereof, to be an ECP provides sufficient financial backing for the IPE floor or electronic broker or trader and mitigates any credit and collection risk that might otherwise arise. The Commission notes that the guarantor of an IPE floor or electronic broker or trader would be placing its own money at risk, and expects that such guarantor would carefully consider the risk involved in the provision of the guarantee for that particular broker or trader.

#### V. Cost Benefit Analysis

Section 15 of the Act, as amended by section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new order under the Act. By its terms, section 15 does not require the Commission to quantify the costs and benefits of its action or to determine whether the benefits of the action outweigh the costs. Rather, section 15 simply requires the Commission to "consider the costs and benefits" of its order.

Section 15(a) further specifies that the costs and benefits of the proposed order shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular order is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The subject order is intended to reduce regulatory barriers to permit certain IPE floor or electronic brokers or traders, when acting in a proprietary capacity, to enter into transactions in exempt commodities on ECMs pursuant to section 2(h)(3) of the Act if such entities are either ECPs or have obtained a financial guarantee for such transactions from a clearing member that is both a member of a FSA-registered derivatives clearing organization and an ECP. The Commission has considered the costs and benefits of the order in light of the

<sup>35</sup> Commission regulation 37.1(b).

specific provisions of section 15(a) of the Act.

#### *A. Protection of Market Participants and the Public*

The order would deem certain professional IPE floor or electronic brokers or traders meeting the required conditions who are ECPs, or who have guarantees from clearing members that are members of FSA-registered derivatives clearing organizations and are ECPs, to be ECEs under section 1a(11)(c) and thus permit them to enter into proprietary transactions in exempt commodities on ECMs. Under the Act, ECEs are sophisticated investors who have the financial wherewithal or trading expertise to participate in these markets. Accordingly, there should be no effect on the Commission's ability to protect market participants and the public.

#### *B. Efficiency and Competition*

The order is expected to benefit efficiency and competition by, among other things, providing essential trading expertise to the market that enhances price discovery through both the speed and efficiency of market adjustment to new fundamentals and by generally increasing the pool of potential counterparties for participants trading on exempt commercial markets.

#### *C. Financial Integrity of Futures Markets and Price Discovery*

The order should have no effect, from the standpoint of imposing costs or creating benefits, on the financial integrity of the futures and options markets. The order should enhance the price discovery function of such markets.

#### *D. Sound Risk Management Practices*

The order should have no effect, from the standpoint of imposing costs, on the risk management practices of the futures and options industry. Where an individual or entity is qualified as an ECP, the individual or entity has been deemed under the Act to be sufficiently responsible to execute trades in certain excluded or exempt commodity transactions, and no further mitigation of credit risk is necessary. Moreover, where an individual or entity does not qualify as an ECP, the order requires that a clearing member of an FSA-recognized derivatives clearing organization that is itself an ECP guarantee the trades in order to mitigate the credit and collection risk.

#### *E. Other Public Interest Considerations*

The order is consistent with one of the purposes of the Act as articulated in

section 3 in that it would promote responsible innovation and fair competition among boards of trade, other markets, and market participants.

#### **VI. Order**

Upon due consideration, and pursuant to its authority under section 1a(11)(C) of the Act, the Commission hereby determines that certain professional International Petroleum Exchange ("IPE") floor or electronic brokers or local traders, who are authorized by the Financial Services Authority ("FSA") or registered with the IPE, when acting in a proprietary capacity, are appropriate persons as defined in section 1a(11)(C) and, thus, are deemed to be eligible commercial entities and may enter into contracts, agreements or transactions in an exempt commodity on an exempt commercial market under the following conditions:

1. The contracts, agreements, or transactions must be executed on an exempt commercial market that meets the requirements of section 2(h)(3)-(5) of the Act.

2. The IPE floor or electronic broker, denominated as either a Floor Member or General Participant pursuant to IPE membership rules, must be a member of IPE or otherwise have trading privileges on IPE, be located in the U.K., and be subject to the rules of IPE.

3. The IPE local trader, denominated as a Local Member or Individual Participant pursuant to IPE membership rules, must be a member of IPE or otherwise have trading privileges on IPE, be located in the U.K., and be subject to the rules of IPE.

4. The IPE Floor Member or General Participant must be authorized and regulated by the FSA.

5. The IPE Local Member or Individual Participant must be registered with the IPE.

6. The IPE Floor Member, General Participant, Local Member, or Individual Participant must have as a part of its business the business of acting as a professional commodity broker or trader on either the IPE open outcry or electronic markets.

7. The IPE Individual Participant must meet and satisfy the current qualifying standards of an Intermediate Customer pursuant to FSA Conduct of Business ("COB") Rule 4.1.9R. IPE must notify the Commission of any changes to the standards included in FSA COB Rule 4.1.9R.

8. The IPE Floor Member, General Participant, Local Member, or Individual Participant must be either an eligible contract participant, as that term is defined in section 1a(12) of the Act, or have its trades on the exempt

commercial market guaranteed by a clearing member that is a member of an FSA-recognized derivatives clearing organization and is an eligible contract participant.

Issued by the Commission this 8th day of November, 2004, in Washington, DC.

**Jean A. Webb,**

*Secretary of the Commission.*

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## **DEPARTMENT OF DEFENSE**

### **GENERAL SERVICES ADMINISTRATION**

### **NATIONAL AERONAUTICS AND SPACE ADMINISTRATION**

[OMB Control No. 9000-0078]

#### **Federal Acquisition Regulation; Submission for OMB Review; Make-or-Buy Program**

**AGENCIES:** Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

**ACTION:** Notice of request for comments regarding an extension to an existing OMB clearance (9000-0078).

**SUMMARY:** Under the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35), the Federal Acquisition Regulation (FAR) Secretariat has submitted to the Office of Management and Budget (OMB) a request to review and approve an extension of a currently approved information collection requirement concerning make-or-buy programs. A request for public comments was published at 69 FR 44645, July 27, 2004. No comments were received.

Public comments are particularly invited on: Whether this collection of information is necessary for the proper performance of functions of the FAR, and whether it will have practical utility; whether our estimate of the public burden of this collection of information is accurate, and based on valid assumptions and methodology; ways to enhance the quality, utility, and clarity of the information to be collected; and ways in which we can minimize the burden of the collection of information on those who are to respond, through the use of appropriate technological collection techniques or other forms of information technology.

**DATES:** Submit comments on or before December 15, 2004.

**ADDRESSES:** Submit comments regarding this burden estimate or any other aspect