

**COMMODITY FUTURES TRADING COMMISSION****Notice of Intent, 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 Social Border Financial Basis Contract, Offered for Trading on the IntercontinentalExchange, Inc., Performs a Significant Price Discovery Function**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of action and request for comment.

**SUMMARY:** The Commodity Futures Trading Commission ("CFTC" or "Commission") is undertaking a review to determine whether the Social Border Financial Basis ("SCL") contract, offered for trading on the IntercontinentalExchange, Inc. ("ICE"), an exempt commercial market ("ECM") under Sections 2(h)(3)–(5) of the Commodity Exchange Act ("CEA" or the "Act"), performs a significant price discovery function. Authority for this action is found in section 2(h)(7) of the CEA and Commission rule 36.3(c) promulgated thereunder. In connection with this evaluation, the Commission invites comment from interested parties.

**DATES:** Comments must be received on or before November 4, 2009.

**ADDRESSES:** Comments may be submitted by any of the following methods:

- Follow the instructions for submitting comments. Federal eRulemaking Portal: <http://www.regulations.gov>.
- E-mail: [secretary@cftc.gov](mailto:secretary@cftc.gov). Include Social Border Financial Basis (SCL) Contract in the subject line of the message.
- Fax: (202) 418–5521.
- Mail: Send to David A. Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- Courier: Same as mail above.

All comments received will be posted without change to <http://www.CFTC.gov/>.

**FOR FURTHER INFORMATION CONTACT:**

Gregory K. Price, Industry Economist, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone: (202) 418–5515. E-mail: [gprice@cftc.gov](mailto:gprice@cftc.gov); or Susan Nathan, Senior Special Counsel, Division of Market Oversight, same address.

Telephone: (202) 418–5133. E-mail: [snathan@cftc.gov](mailto:snathan@cftc.gov).

**SUPPLEMENTARY INFORMATION:****I. Introduction**

On March 16, 2009, the CFTC promulgated final rules implementing provisions of the CFTC Reauthorization Act of 2008 ("Reauthorization Act")<sup>1</sup> which subjects ECMs with significant price discovery contracts ("SPDCs") to self-regulatory and reporting requirements, as well as certain Commission oversight authorities, with respect to those contracts. Among other things, these rules and rule amendments revise the information-submission requirements applicable to ECMs, establish procedures and standards by which the Commission will determine whether an ECM contract performs a significant price discovery function, and provide guidance with respect to compliance with nine statutory core principles applicable to ECMs with SPDCs. These rules became effective on April 22, 2009.

In determining whether an ECM's contract is or is not a SPDC, the Commission will evaluate the contract's material liquidity, price linkage to other contracts, potential for arbitrage with other contracts traded on designated contract markets or derivatives transaction execution facilities, use of the ECM contract's prices to execute or settle other transactions, and other factors.

In order to facilitate the Commission's identification of possible SPDCs, Commission rule 36.3(c)(2) requires that an ECM operating in reliance on section 2(h)(3) promptly notify the Commission and provide supporting information or data concerning any contract: (i) That averaged five trades per day or more over the most recent calendar quarter; and (ii) (A) for which the ECM sells price information regarding the contract to market participants or industry publications; or (B) whose daily closing or settlement prices on 95 percent or more of the days in the most recent quarter were within 2.5 percent of the contemporaneously determined closing, settlement, or other daily price of another agreement.

**II. Determination of a SPDC****A. The SPDC Determination Process**

Commission rule 36.3(c)(3) establishes the procedures by which the Commission makes and announces its determination on whether a specific ECM contract serves a significant price

<sup>1</sup> 74 FR 12178 (Mar. 23, 2009); these rules became effective on April 22, 2009.

discovery function. Under those procedures, the Commission will publish a notice in the **Federal Register** that it intends to undertake a determination as to whether the specified agreement, contract, or transaction performs a significant price discovery function and to receive written data, views, and arguments relevant to its determination from the ECM and other interested persons.<sup>2</sup> After prompt consideration of all relevant information,<sup>3</sup> the Commission will, within a reasonable period of time after the close of the comment period, issue an order explaining its determination. Following the issuance of an order by the Commission that the ECM executes or trades an agreement, contract, or transaction that performs a significant price discovery function, the ECM must demonstrate, with respect to that agreement, contract, or transaction, compliance with the core principles under section 2(h)(7)(C) of the CEA<sup>4</sup> and the applicable provisions of Part 36. If the Commission's order represents the first time it has determined that one of the ECM's contracts performs a significant price discovery function, the ECM must submit a written demonstration of its compliance with the core principles within 90 calendar days of the date of the Commission's order. For each subsequent determination by the Commission that the ECM has an additional SPDC, the ECM must submit a written demonstration of its compliance with the core principles within 30 calendar days of the Commission's order.

**B. Social Border Financial Basis Contract**

The SCL contract is a monthly contract that is cash settled based on the difference between the price of natural gas at the Southern California Border hub for the month of delivery in the first publication of the month, as published in Intelligence Press Inc's ("IPI's") *Natural Gas Bidweek Survey*, and the final settlement price for New York Mercantile Exchange's ("NYMEX's")

<sup>2</sup> The Commission may commence this process on its own initiative or on the basis of information provided to it by an ECM pursuant to the notification provisions of Commission rule 36.3(c)(2).

<sup>3</sup> Where appropriate, the Commission may choose to interview market participants regarding their impressions of a particular contract. Further, while they may not provide direct evidentiary support with respect to a particular contract, the Commission may rely for background and context on resources such as its October 2007 *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* ("ECM Study"). [http://www.cftc.gov/stellent/groups/public/newsroom/documents/file/pr5403-07\\_ecmreport.pdf](http://www.cftc.gov/stellent/groups/public/newsroom/documents/file/pr5403-07_ecmreport.pdf).

<sup>4</sup> 7 U.S.C. 2(h)(7)(C).

Henry Hub physically-delivered natural gas futures contract for the same specified calendar month. The size of the SCL contract is 2,500 million British thermal units (“mmBtu”), and the unit of trading is any multiple of 2,500 mmBtu. The SCL contract is listed for up to 120 calendar months commencing with the next calendar month.

Based upon a required quarterly notification filed on July 27, 2009 (mandatory under Rule 36.3(c)(2)), the ICE reported that, with respect to its SCL contract, the total number of trades was 8,102 in the second quarter of 2009, resulting in a daily average of 126.6 trades. During the same period, the SCL contract had a total trading volume of 612,452 contracts and an average daily trading volume of 9,569 contracts. Moreover, the open interest as of June 30, 2009, was 417,121 contracts.

It appears that the SCL contract may satisfy the material liquidity, price linkage, and material price reference factors for SPDC determination. With respect to material liquidity, trading in the SCL contract averaged more than 9,000 contracts on a daily basis, with more than 100 separate transactions each day. In addition, the open interest in the subject contract was substantial. In regard to price linkage, the final settlement of the SCL contract is based, in part, on the final settlement price of the NYMEX’s physically-delivered natural gas contract, where the NYMEX is registered with the Commission as a designated contract market (“DCM”). In terms of material price reference, the ICE maintains exclusive rights over IPI’s bidweek price indices. As a result, no other exchange can offer such a basis contract based on IPI’s Socal bidweek index. While other third-party price providers produce natural gas price indices for a variety of trading centers, those indices may not be the same in value or quality as IPI’s price indices; each company’s bidweek indices are based on transactions that are consummated during the last five days of the month prior to delivery and are voluntarily submitted by traders. In addition, the ICE sells its price data to market participants in a number of different packages which vary in terms of the hubs covered, time periods, and whether the data are daily only or historical. For example, the ICE offers “West Gas End of Day” and “OTC Gas End of Day” with access to all price data or just 12, 24, 36, or 48 months of historical data.

### III. Request for Comment

In evaluating whether an ECM’s agreement, contract, or transaction performs a significant price discovery

function, section 2(h)(7) of the CEA directs the Commission to consider, as appropriate, four specific criteria: Price linkage, arbitrage, material price reference, and material liquidity. As it explained in Appendix A to the Part 36 rules,<sup>5</sup> the Commission, in making SPDC determinations, will apply and weigh each factor, as appropriate, to the specific contract and circumstances under consideration.

As part of its evaluation, the Commission will consider the written data, views, and arguments from any ECM that lists the potential SPDC and from any other interested parties. Accordingly, the Commission requests comment on whether the ICE’s SCL contract performs a significant price discovery function. Commenters’ attention is directed particularly to Appendix A of the Commission’s Part 36 rules for a detailed discussion of the factors relevant to a SPDC determination. The Commission notes that comments which analyze the contract in terms of these factors will be especially helpful to the determination process. In order to determine the relevance of comments received, the Commission requests that commenters explain in what capacity are they knowledgeable about one or several of the subject contracts.

### IV. Related Matters

#### A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (“PRA”)<sup>6</sup> imposes certain requirements on federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. Certain provisions of final Commission rule 36.3 impose new regulatory and reporting requirements on ECMs, resulting in information collection requirements within the meaning of the PRA; OMB previously has approved and assigned OMB control number 3038–0060 to this collection of information.

#### B. Cost-Benefit Analysis

Section 15(a) of the CEA<sup>7</sup> requires the Commission to consider the costs and benefits of its actions before issuing an order under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of such an order or to determine whether the benefits of such an order outweigh its costs; rather, it requires that the Commission “consider” the costs and benefits of its action. Section 15(a) further specifies that the costs and

benefits 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 bulk of the costs imposed by the requirements of Commission Rule 36.3 relate to significant and increased information-submission and reporting requirements adopted in response to the Reauthorization Act’s directive that the Commission take an active role in determining whether contracts listed by ECMs qualify as SPDCs. The enhanced requirements for ECMs will permit the Commission to acquire the information it needs to discharge its newly-mandated responsibilities and to ensure that ECMs with SPDCs are identified as entities with the elevated status of registered entity under the CEA and are in compliance with the statutory terms of the core principles of section 2(h)(7)(C) of the Act. The primary benefit to the public is to enable the Commission to discharge its statutory obligation to monitor for the presence of SPDCs and extend its oversight to the trading of SPDCs.

Issued in Washington, DC, on October 14, 2009 by the Commission.

David A. Stawick,

Secretary of the Commission.

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## COMMODITY FUTURES TRADING COMMISSION

### Notice of Intent, 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 (1) Phys, BS, LD1 (US/MM), AB–NIT Contract, et al., Offered for Trading on the Natural Gas Exchange, Inc., Perform Significant Price Discovery Functions

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of action and request for comment.

**SUMMARY:** The Commodity Futures Trading Commission (“CFTC” or “Commission”) is undertaking a review to determine whether the (1) Phys,<sup>1</sup> BS,<sup>2</sup>

<sup>1</sup> The acronym “Phys” indicates physical delivery of natural gas.

<sup>2</sup> The acronym “BS” indicates that the contract is a cash-settled basis swap.

<sup>5</sup> 17 CFR Part 36, Appendix A.

<sup>6</sup> 44 U.S.C. 3507(d).

<sup>7</sup> 7 U.S.C. 19(a).