core principle compliance by the IntercontinentalExchange, Inc., commence with the issuance of this Order.[40]

Issued in Washington, DC, on April 28, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

[FR Doc. 2010–10335 Filed 5–4–10; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

Order Finding That the ICE Waha Financial Basis Contract Traded on the IntercontinentalExchange, Inc., Performs a Significant Price Discovery Function

AGENCY: Commodity Futures Trading Commission.

ACTION: Final order.

SUMMARY: On October 9, 2009, the Commodity Futures Trading Commission ("CFTC" or "Commission") published for comment in the **Federal Register**[1] a notice of its intent to undertake a determination whether the Waha Financial Basis ("WAH") contract, traded 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 pursuant to section 2(h)(7) of the CEA. The Commission undertook this review based upon an initial evaluation of information and data provided by ICE as well as other available information. The Commission has reviewed the entire record in this matter, including all comments received, and has determined to issue an order finding that the WAH contract 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.

DATES: *Effective Date:* April 28, 2010.

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;* or Susan Nathan, Senior Special Counsel, Division of Market Oversight, same address. Telephone: (202) 418–5133. E-mail: *snathan@cftc.gov*.

SUPPLEMENTARY INFORMATION:

I. Introduction

The CFTC Reauthorization Act of 2008 ("Reauthorization Act")[2] significantly broadened the CFTC's regulatory authority with respect to ECMs by creating, in section 2(h)(7) of the CEA, a new regulatory category—ECMs on which significant price discovery contracts ("SPDCs") are traded—and treating ECMs in that category as registered entities under the CEA.[3] The legislation authorizes the CFTC to designate an agreement, contract or transaction as a SPDC if the Commission determines, under criteria established in section 2(h)(7), that it performs a significant price discovery function. When the Commission makes such a determination, the ECM on which the SPDC is traded must assume, with respect to that contract, all the responsibilities and obligations of a registered entity under the Act and Commission regulations, and must comply with nine core principles established by new section 2(h)(7)(C).

On March 16, 2009, the CFTC promulgated final rules implementing the provisions of the Reauthorization Act.[4] As relevant here, rule 36.3 imposes increased information reporting requirements on ECMs to assist the Commission in making prompt assessments whether particular ECM contracts may be SPDCs. In addition to filing quarterly reports of its contracts, an ECM must notify the Commission promptly concerning any contract traded in reliance on the exemption in section 2(h)(3) of the CEA that averaged five trades per day or more over the most recent calendar quarter, and for which the exchange sells its price information regarding the contract to market participants or industry publications, or 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 prices of another contract.

Commission rule 36.3(c)(3) established the procedures by which the Commission makes and announces its determination whether a particular ECM contract serves a significant price discovery function. Under those procedures, the Commission will publish notice in the **Federal Register** that it intends to undertake an evaluation whether the specified agreement, contract or transaction performs a significant price discovery function and to receive written views, data and arguments relevant to its determination from the ECM and other interested persons. Upon the close of the comment period, the Commission will consider, among other things, all relevant information regarding the subject contract and issue an order announcing and explaining its determination whether or not the contract is a SPDC. The issuance of an affirmative order signals the effectiveness of the Commission's regulatory authorities over an ECM with respect to a SPDC; at that time such an ECM becomes subject to all provisions of the CEA applicable to registered entities.[5] The issuance of such an order also triggers the obligations, requirements and timetables prescribed in Commission rule 36.3(c)(4).[6]

II. Notice of Intent to Undertake SPDC Determination

On October 9, 2009, the Commission published in the **Federal Register** notice of its intent to undertake a determination whether the WAH contract performs a significant price discovery function, and requested comment from interested parties.[7] Comments were received from the Industrial Energy Consumers of America ("IECA"), Working Group of Commercial Energy Firms ("WGCEF"), ICE, Platts, Economists Incorporated ("EI"), Federal Energy Regulatory Commission ("FERC"), and Financial Institutions

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[40] Because ICE already lists for trading a contract (i.e., the Henry Financial LD1 Fixed Price contract) that was previously declared by the Commission to be a SPDC, ICE must submit a written demonstration of compliance with the Core Principles within 30 calendar days of the date of this Order. 17 CFR 36.3(c)(4).

[1] 74 FR 52202 (October 9, 2009).

[2] Incorporated as Title XIII of the Food, Conservation and Energy Act of 2008, Public Law 110–246, 122 Stat. 1624 (June 18, 2008).

[3] 7 U.S.C. 1a(29).

[4] 74 FR 12178 (Mar. 23, 2009); these rules became effective on April 22, 2009.

[5] Public Law 110–246 at 13203; *Joint Explanatory Statement of the Committee of Conference,* H.R. Rep. No. 110–627, 110 Cong., 2d Sess. 978, 986 (Conference Committee Report). *See also* 73 FR 75888, 75894 (Dec. 12, 2008).

[6] For an initial SPDC, ECMs have a grace period of 90 calendar days from the issuance of a SPDC determination order to submit a written demonstration of compliance with the applicable core principles. For subsequent SPDCs, ECMs have a grace period of 30 calendar days to demonstrate core principle compliance.

[7] The Commission's Part 36 rules establish, among other things, procedures by which the Commission makes and announces its determination whether a specific ECM contract serves a significant price discovery function. Under those procedures, the Commission publishes a notice in the **Federal Register** that it intends to undertake a determination whether a 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.

Energy Group ("FIEG").[8] The comment letters from FERC[9] and Platts did not directly address the issue of whether or not the WAH contract is a SPDC; IECA concluded that the WAH contract is a SPDC, but did not provide a basis for its conclusion.[10] The other parties' comments raised substantive issues with respect to the applicability of section 2(h)(7) to the WAH contract, generally asserting that the WAH contract is not a SPDC as it does not meet the material price reference, price linkage, and material liquidity criteria for SPDC determination. Those comments are more extensively discussed below, as applicable.

III. Section 2(h)(7) of the CEA

The Commission is directed by section 2(h)(7) of the CEA to consider the following criteria in determining a contract's significant price discovery function:

- *Price Linkage*—the extent to which the agreement, contract or transaction uses or otherwise relies on a daily or final settlement price, or other major price parameter, of a contract or contracts listed for trading on or subject to the rules of a designated contract market ("DCM") or derivatives transaction execution facility ("DTEF"), or a SPDC traded on an electronic trading facility, to value a position, transfer or convert a position, cash or financially settle a position, or close out a position.
- *Arbitrage*—the extent to which the price for the agreement, contract or transaction is sufficiently related to the price of a contract or contracts listed for trading on or subject to the rules of a DCM or DTEF, or a SPDC traded on or subject to the rules of an electronic trading facility, so as to permit market participants to effectively arbitrage between the markets by simultaneously maintaining positions or executing trades in the contracts on a frequent and recurring basis.
- *Material price reference*—the extent to which, on a frequent and recurring basis, bids, offers or transactions in a commodity are directly based on, or are determined by referencing or consulting, the prices generated by agreements, contracts or transactions being traded or executed on the electronic trading facility.
- *Material liquidity*—the extent to which the volume of agreements, contracts or transactions in a commodity being traded on the electronic trading facility is sufficient to have a material effect on other agreements, contracts or transactions listed for trading on or subject to the rules of a DCM, DTEF or electronic trading facility operating in reliance on the exemption in section 2(h)(3).

Not all criteria must be present to support a determination that a particular contract performs a significant price discovery function, and one or more criteria may be inapplicable to a particular contract.[11] Moreover, the statutory language neither prioritizes the criteria nor specifies the degree to which a SPDC must conform to the various criteria. In Guidance issued in connection with the Part 36 rules governing ECMs with SPDCs, the Commission observed that these criteria do not lend themselves to a mechanical checklist or formulaic analysis. Accordingly, the Commission has indicated that in making its determinations it will consider the circumstances under which the presence of a particular criterion, or combination of criteria, would be sufficient to support a SPDC determination.[12] For example, for contracts that are linked to other contracts or that may be arbitraged with other contracts, the Commission will consider whether the price of the potential SPDC moves in such harmony with the other contract that the two markets essentially become interchangeable. This co-movement of prices would be an indication that activity in the contract had reached a level sufficient for the contract to perform a significant price discovery function. In evaluating a contract's price discovery role as a price reference, the Commission will consider the extent to which, on a frequent and recurring basis, bids, offers or transactions are directly based on, or are determined by referencing, the prices established for the contract.

IV. Findings and Conclusions

a. The Waha Financial Basis (WAH) Contract and the SPDC Indicia

The WAH contract is cash settled based on the difference between the bidweek price index of natural gas at the Waha hub in western Texas for the month of delivery, as published in Platts' *Inside FERC's Gas Market Report,* and the final settlement price of the New York Mercantile Exchange's ("NYMEX's") physically-delivered Henry Hub natural gas futures contract for the same calendar month. The Platts bidweek price, which is published monthly, is based on a survey of cash market traders who voluntarily report to Platts data on fixed-price transactions for physical delivery of natural gas at the Waha hub conducted during the last five business days of the month; such bidweek transactions specify the delivery of natural gas on a uniform basis throughout the following calendar month at the agreed upon rate. Platts' current policy is to use physical deals into interstate and intrastate pipelines at the outlet of the Waha header system and in the Waha vicinity in the Permian Basin in West Texas. Pipelines include El Paso Natural Gas, Transwestern Pipeline, Natural Gas Pipeline Co. of America, Northern Natural Gas, Delhi Pipeline, Oasis Pipeline, EPGT Texas and Lone Star Pipeline. The Platt's

[8] IECA describes itself as an "association of leading manufacturing companies" whose membership "represents a diverse set of industries including: Plastics, cement, paper, food processing, brick, chemicals, fertilizer, insulation, steel, glass, industrial gases, pharmaceutical, aluminum and brewing." WGCEF describes itself as "a diverse group of commercial firms in the domestic energy industry whose primary business activity is the physical delivery of one or more energy commodities to customers, including industrial, commercial and residential consumers" and whose membership consists of "energy producers, marketers and utilities." ICE is an ECM, as noted above. McGraw-Hill, through its division Platts, compiles and calculates monthly natural gas price indices from natural gas trade data submitted to Platts by energy marketers. Platts includes those price indices in its monthly *Inside FERC's Gas Market Report* ("Inside FERC"). EI is an economic consulting firm with offices located in Washington, DC, and San Francisco, CA. NGSA is an industry association comprised of natural gas producers and marketers. FERC is an independent Federal regulatory agency that, among other things, regulates the interstate transmission of natural gas, oil and electricity. FIEG describes itself as an association of investment and commercial banks who are active participants in various sectors of the natural gas markets, "including acting as marketers, lenders, underwriters of debt and equity securities, and proprietary investors." The comment letters are available on the Commission's Web site: *http://www.cftc.gov/lawandregulation/federalregister/federalregistercomments/2009/09-025.html*.

[9] FERC stated that the WAH contract is cash settled and does not contemplate actual physical delivery of natural gas. Accordingly, FERC expressed the opinion that a determination by the Commission that a contract performs a significant price discovery function "would not appear to conflict with FERC's exclusive jurisdiction under the Natural Gas Act (NGA) over certain sales of natural gas in interstate commerce for resale or with its other regulatory responsibilities under the NGA" and further that, "the FERC staff will continue to monitor for any such conflict * * * [and] advise the CFTC" should any such potential conflict arise. CL 07.

[10] IECA stated that the subject ICE contract should "be required to come into compliance with core principles mandated by Section 2(h)(7) of the Act and with other statutory provisions applicable to registered entities. [This contract] should be subject to the Commission's position limit authority, emergency authority and large trader reporting requirements, among others." CL 01.

[11] In its October 9, 2009, **Federal Register** release, the Commission identified material liquidity, material price reference and price linkage as the possible criteria for SPDC determination of the WAH contract. Arbitrage was not identified as a possible criterion and will not be discussed further in this document or the associated Order.

[12] 17 CFR part 36, Appendix A.

bidweek index is published on the first business day of the calendar month in which the natural gas is to be delivered. The size of the WAH contract is 2,500 million British thermal units ("mmBtu"), and the unit of trading is any multiple of 2,500 mmBtu. The WAH contract is listed for up to 72 calendar months commencing with the next calendar month.

The Henry Hub,[13] which is located in Erath, Louisiana, is the primary cash market trading and distribution center for natural gas in the United States. It also is the delivery point and pricing basis for the NYMEX's actively traded, physically-delivered natural gas futures contract, which is the most important pricing reference for natural gas in the United States. The Henry Hub, which is operated by Sabine Pipe Line, LLC, serves as a juncture for 13 different pipelines. These pipelines bring in natural gas from fields in the Gulf Coast region and ship it to major consumption centers along the East Coast and Midwest. The throughput shipping capacity of the Henry Hub is 1.8 trillion mmBtu per day.

In addition to the Henry Hub, there are a number of other locations where natural gas is traded. In 2008, there were 33 natural gas market centers in North America.[14] Some of the major trading centers include Alberta, Northwest Rockies, Southern California border and the Houston Ship Channel. For locations that are directly connected to the Henry Hub by one or more pipelines and where there typically is adequate shipping capacity, the price at the other locations usually directly tracks the price at the Henry Hub, adjusted for transportation costs. However, at other locations that are not directly connected to the Henry Hub or where shipping capacity is limited, the prices at those locations often diverge from the Henry Hub price. Furthermore, one local price may be significantly different than the price at another location even though the two markets' respective distances from the Henry Hub are the same. The reason for such pricing disparities is that a given location may experience supply and demand factors that are specific to that region, such as differences in pipeline shipping capacity, unusually high or low demand for heating or cooling or supply disruptions caused by severe weather. As a consequence, local natural gas prices can differ from the Henry Hub price by more than the cost of shipping and such price differences can vary in an unpredictable manner.

The Waha hub lies south of the prolific gas deposits in the San Juan and Permian Basins of West Texas, near the New Mexico border. The hub is accessible by several interstate and intrastate pipelines that serve customer bases in both the Western and Midwestern United States. As noted above, the cash market transactions included in the Platts index are those fixed-price gas deliveries into the following pipelines: El Paso Natural Gas, Transwestern Pipeline, Natural Gas Pipeline Company of America, Northern Natural Gas, Delhi Pipeline, Oasis Pipeline, EPGT Texas and Lone Star Pipeline. While the Waha pricing center does not appear to be far removed from the Henry Hub, the gas from Waha tends to flow to the Western and Midwest whereas the gas from the Henry Hub tends to flow East of the Mississippi.

The Waha (EPGT) and Waha (CDP/Atmos) Texas Hubs, two market centers near the Waha Hub, had an estimated throughput capacity in 2008 of 250 million cubic feet per day and 300 million cubic feet per day, respectively. Moreover, the number of pipeline interconnections at each market center was 10 in 2008. Lastly, the pipeline interconnection capacity of the Waha (EPGT) and Waha (CDP/Atmos) Texas Hubs in 2008 were 1.8 billion million cubic feet per day and 2.3 billion cubic feet per day, respectively.[15] The Waha hub is removed from the Henry Hub and is not directly connected to the Henry Hub by an existing pipeline.

The local price at the Waha hub typically differs from the price at the Henry Hub. Thus, the price of the Henry Hub physically-delivered futures contract is an imperfect proxy for the WAH contract's price. Moreover, the Waha hub is landlocked and so is less susceptible to exogenous factors such as extreme weather, which can cause the Waha gas price to differ from the Henry Hub price by an amount that is more or less than the cost of shipping, making the NYMEX Henry Hub futures contract even less precise as a hedging tool than desired by market participants. Basis contracts [16] allow traders to more accurately discover prices at alternative locations and hedge price risk that is associated with natural gas at such locations. In this regard, a position at a local price for an alternative location can be established by adding the appropriate basis swap position to a position taken in the NYMEX physically-delivered Henry Hub contract (or in the NYMEX or ICE Henry Hub look-alike contract, which cash settle based on the NYMEX physically-delivered natural gas contract's final settlement price).

In its October 9, 2009, **Federal Register** notice, the Commission identified material price reference, price linkage and material liquidity as the potential SPDC criteria applicable to the WAH contract. Each of these criteria is discussed below.[17]

1. Material Price Reference Criterion

The Commission's October 9, 2009, **Federal Register** notice identified material price reference as a potential basis for a SPDC determination with respect to this contract. The Commission considered the fact that 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, ICE offers the "OTC Gas End of Day" [18] package with access to all price data or just current prices plus a selected number of months (*i.e.,* 12, 24, 36 or 48 months) of historical data. These two packages include price data for the WAH contract.

The Commission also noted that its October 2007 *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* ("ECM Study")[19] found that in general, market participants view the ICE as a price discovery market for certain natural gas contracts. The study did not specify which markets performed this function; nevertheless, the Commission determined that the WAH contract, while not mentioned by name in the ECM Study, might warrant further study.

The Commission will rely on one of two sources of evidence—direct or indirect—to determine that the price of a contract was being used as a material price reference and therefore, serving a

[13] The term "hub" refers to a juncture where two or more natural gas pipelines are connected. Hubs also serve as pricing points for natural gas at the particular locations.

[14] *See http://www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2009/ngmarketcenter/ngmarketcenter.pdf.*

[15] *See http://www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2009/ngmarketcenter/ngmarketcenter.pdf.*

[16] Basis contracts denote the difference in the price of natural gas at a specified location minus the price of natural gas at the Henry Hub. The differential can be either a positive or negative value.

[17] As noted above, the Commission did not find an indication of arbitrage in connection with this contract; accordingly, that criterion was not discussed in reference to the WAH contract.

[18] The OTC Gas End of Day dataset includes daily settlement prices for natural gas contracts listed for all points in North America.

[19] *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf.*

significant price discovery function.[20] With respect to direct evidence, the Commission will consider the extent to which, on a frequent and recurring basis, cash market bids, offers or transactions are directly based on or quoted at a differential to, the prices generated on the ECM in question. Direct evidence may be established when cash market participants are quoting bid or offer prices or entering into transactions at prices that are set either explicitly or implicitly at a differential to prices established for the contract in question. Cash market prices are set explicitly at a differential to the section 2(h)(3) contract when, for instance, they are quoted in dollars and cents above or below the reference contract's price. Cash market prices are set implicitly at a differential to a section 2(h)(3) contract when, for instance, they are arrived at after adding to, or subtracting from the section 2(h)(3) contract, but then quoted or reported at a flat price. With respect to indirect evidence, the Commission will consider the extent to which the price of the contract in question is being routinely disseminated in widely distributed industry publications—or offered by the ECM itself for some form of remuneration—and consulted on a frequent and recurring basis by industry participants in pricing cash market transactions.

The Waha hub is a major trading center for natural gas in the United States. Traders, including producers, keep abreast of the prices of the WAH contract when conducting cash deals. These traders look to a competitively determined price as an indication of expected values of natural gas at Waha when entering into cash market transactions for natural gas, especially those trades providing for physical delivery in the future. Traders use the ICE WAH contract, as well as other ICE basis swap contracts, to hedge cash market positions and transactions—activities which enhance the WAH contract's price discovery utility. The substantial volume of trading and open interest in the WAH contract appears to attest to its use for this purpose. While the WAH contract's settlement prices may not be the only factor influencing spot and forward transactions, natural gas traders consider the ICE price to be a critical factor in conducting OTC transactions.[21] As a result, the WAH contract satisfies the direct price reference test.

In terms of indirect price reference, ICE sells the WAH contract's prices as part of a broad package. The Commission notes that the Waha hub is a major natural gas trading point, and the WAH contract's prices are well regarded in the industry as indicative of the value of natural gas at the Waha hub. Accordingly, the Commission believes that it is reasonable to conclude that market participants are purchasing the data packages that include the WAH contract's prices in substantial part because the WAH contract prices have particular value to them. Moreover, such prices are consulted on a frequent and recurring basis by industry participants in pricing cash market transactions. In light of the above, the WAH contract meets the indirect price reference test.

NYMEX lists a futures contract that is comparable to the ICE WAH contract on its ClearPort platform called the Waha Basis Swap (Platts IFERC) futures contract. However, unlike the ICE contract, none of the trades in the NYMEX contract are executed in NYMEX's centralized marketplace; instead, all of the transactions originate as bilateral swaps that are submitted to NYMEX for clearing. The daily settlement prices of the NYMEX version of the WAH contract are influenced, in part, by the daily settlement prices of the ICE WAH contract. This is because NYMEX determines the daily settlement prices for its natural gas basis swap contracts through a survey of cash market voice brokers. Voice brokers, in turn, refer to the ICE WAH price, among other information, as an important indicator as to where the market is trading. Therefore, the ICE WAH price influences the settlement price for the NYMEX's Waha contract. This is supported by an analysis of the daily settlement prices for the NYMEX Waha Basis Swap and ICE WAH contracts. In this regard, 99 percent of the daily settlement prices for the NYMEX Waha Basis Swap contract are within one standard deviation of the WAH contract's price settlement prices.

Lastly, the fact that the WAH contract does not meet the price linkage criterion (discussed below) bolsters the argument for material price reference. As noted above, the Henry Hub is the pricing reference for natural gas in the United States. However, regional market conditions may cause the price of natural gas in another area of the country to diverge by more than the cost of transportation, thus making the Henry Hub price an imperfect proxy for the local gas price. The more variable the local natural gas price is, the more traders need to accurately hedge their price risk. Basis swap contracts provide a means of more accurately pricing natural gas at a location other than the Henry Hub. An analysis of Waha natural gas prices showed that 96 percent of the observations were more than 2.5 percent different that the contemporaneous Henry Hub prices. The average Waha basis value between January 2008 and September 2009 was −$0.98 per mmBtu with a variance of $0.38 per mmBtu.

i. **Federal Register** Comments

ICE stated in its comment letter that the WAH contract does not meet the material price reference criterion for SPDC determination. ICE argued that the Commission appeared to base the case that the WAH contract is potentially a SPDC on what it characterizes as a disputable assertion. In issuing its notice of intent to determine whether the WAH contract is a SPDC, the CFTC cited a general conclusion in its ECM study "that certain market participants referred to ICE as a price discovery market for certain natural gas contracts." [22] ICE stated that CFTC's reason is "hard to quantify as the ECM report does not mention" this contract as a potential SPDC. "It is unknown which market participants made this statement in 2007 or the contracts that were referenced." [23] In response to the above comment, the Commission notes that it cited the ECM study's general finding that some ICE natural gas contracts appear to be regarded as price discovery markets merely as an indicia that an investigation of certain ICE contracts may be warranted, and was not intended to serve as the sole basis for determining whether or not a particular contract meets the material price reference criterion.

WGCEF [24], EI [25] and FIEG [26] all stated that the WAH contract does not satisfy the material price reference criterion. The commenters argued that other contracts (physical or financial) are not indexed based on the ICE WAH contract price, but rather are indexed based on the underlying cash price series against which the ICE WAH contract is settled. Thus, they contend that the underlying cash price series is the authentic reference price and not the ICE contract itself. The Commission believes that this interpretation of price reference is too limiting in that it only considers the

[20] 17 CFR part 36, Appendix A.

[21] In addition to referencing ICE prices, natural gas market firms participating in the Waha market may rely on other cash market quotes as well as industry publications and price indices that are published by third-party price reporting firms in entering into natural gas transactions.

[22] CL 04.

[23] CL 04.

[24] CL 02.

[25] CL 05.

[26] CL 08.

final index value on which the contract is cash settled after trading ceases. Instead, the Commission believes that a cash-settled derivatives contract could meet the material price reference criteria if market participants "consult on a frequent and recurring basis" the derivatives contract when pricing forward, fixed-price commitments or other cash-settled derivatives that seek to "lock in" a fixed price for some future point in time to hedge against adverse price movements.

As noted above, the Waha hub is a major trading center for natural gas in North America. Traders, including producers, keep abreast of the prices of the WAH contract when conducting cash deals. These traders look to a competitively determined price as an indication of expected values of natural gas at the Waha hub when entering into cash market transactions for natural gas, especially those trades that provide for physical delivery in the future. Traders use the ICE WAH contract to hedge cash market positions and transactions, which enhances the WAH contract's price discovery utility. While the WAH contract's settlement prices may not be the only factor influencing spot and forward transactions, natural gas traders consider the ICE price to be a crucial factor in conducting OTC transactions.

Both EI and WGCEF stated that publication of price data in a package format is a weak justification for material price reference. These commenters argue that market participants generally do not purchase ICE data sets for one contract's prices, so the fact that ICE sells the WAH prices as part of a broad package is not conclusive evidence that market participants are buying the ICE data sets because they find the WAH prices have substantial value to them. The Commission notes that Waha is a major natural gas trading point, and the WAH contract's prices are well regarded in the industry as indicative of the value of natural gas at the Waha hub. Accordingly, the Commission believes that it is reasonable to conclude that market participants are purchasing the data packages that include the WAH contract's prices in substantial part because the WAH contract prices have particular value to them.

ii. Conclusion Regarding Material Price Reference

Based on the above, the Commission finds that the WAH contract meets the material price reference criterion because cash market transactions are being priced on a frequent and recurring basis at a differential to the WAH contract's price (direct evidence). Moreover, the ECM sells the WAH contract's price data to market participants and it is reasonable to conclude that market participants are purchasing the data packages that include the WAH contract's prices in substantial part because the WAH contract prices have particular value to them. Furthermore, such prices are consulted on a frequent and recurring basis by industry participants in pricing cash market transactions (indirect evidence).

2. Price Linkage Criterion

In its October 9, 2009, **Federal Register** notice, the Commission identified price linkage as a potential basis for a SPDC determination with respect to the WAH contract. In this regard, the final settlement of the WAH contract is based, in part, on the final settlement price of the NYMEX's physically-delivered natural gas futures contract, where the NYMEX is registered with the Commission as a DCM.

The Commission's Guidance on Significant Price Discovery Contracts [27] notes that a "price-linked contract is a contract that relies on a contract traded on another trading facility to settle, value or otherwise offset the price-linked contract." Furthermore, the Guidance notes that, "[f]or a linked contract, the mere fact that a contract is linked to another contract will not be sufficient to support a determination that a contract performs a significant price discovery function. To assess whether such a determination is warranted, the Commission will examine the relationship between transaction prices of the linked contract and the prices of the referenced contract. The Commission believes that where material liquidity exists, prices for the linked contract would be observed to be substantially the same as or move substantially in conjunction with the prices of the referenced contract." Furthermore, the Guidance proposes a threshold price relationship such that prices of the ECM linked contract will fall within a 2.5 percent price range for 95 percent of contemporaneously determined closing, settlement or other daily prices over the most recent quarter. Finally, the Commission also stated in the Guidance that it would consider a linked contract that has a trading volume equivalent to 5 percent of the volume of trading in the contract to which it is linked to have sufficient volume potentially to be deemed a SPDC ("minimum threshold").

To assess whether the WAH contract meets the price linkage criterion, Commission staff obtained price data from ICE and performed the statistical tests cited above. Staff found that while the natural gas price at the Waha hub is determined, in part, by the final settlement price of the NYMEX physically-delivered natural gas futures contract (a DCM contract), the Waha hub price is not within 2.5 percent of the settlement price of the corresponding NYMEX Henry Hub natural gas futures contract on 95 percent the days. Specifically, during the third quarter of 2009, 4.2 percent of the WAH natural gas prices derived from the ICE basis values were within 2.5 percent of the daily settlement price of the NYMEX Henry Hub futures contract. In addition, staff finds that the WAH contract fails to meet the volume threshold requirement. In particular, the total trading volume in the NYMEX Natural Gas contract during the third quarter of 2009 was 14,022,963 contracts, with 5 percent of that number being 701,148 contracts. The number of trades on the ICE centralized market in the WAH contract during the same period was 120,050 contracts (equivalent to 30,012 NYMEX contracts, given the size difference).[28] Thus, centralized-market trades in the WAH contract amounted to less than the minimum threshold.

Due to the specific criteria that a given ECM contract must meet to fulfill the price linkage criterion, the requirements, for all intents and purposes, exclude ECM contracts that are not near facsimiles of DCM contracts. That is, even though an ECM contract may specifically use a DCM contract's settlement price to value a position, which is the case of the WAH contract, a substantive difference between the two price series would rule out the presence of price linkage. In this regard, an ECM contract that is priced and traded as if it is a functional equivalent of a DCM contract likely will have a price series that mirrors that of the corresponding DCM contract. In contrast, for contracts that are not look-alikes of DCM contracts, it is reasonable to expect that the two price series would be divergent. The Waha hub and the Henry Hub are located at opposite sides of the Gulf Coast natural gas market. While the Henry Hub and the Waha hub are both primarily supply centers, each center has its own unique physical characteristics that govern the flow of the gas, as well as a geographically

[27] Appendix A to the Part 36 rules.

[28] The WAH contract is one-quarter the size of the NYMEX Henry Hub physically-delivered futures contract.

unique customer base with a different demand schedule. These differences contribute to the divergence between the two price series and, as discussed below, increase the likelihood that the "basis" contract is used for material price reference.

i. **Federal Register** Comments

EI [29] stated that the WAH and NYMEX natural gas contracts are not economically equivalent and that the WAH contract's volume is too low to affect the NYMEX natural gas futures contract. WGCEF [30] stated that the WAH contract's price is determined, in part, by the final settlement price of the NYMEX Henry Hub futures contract. However, WGCEF goes on to state that the WAH contract "(a) is not substantially the same as the NYMEX [natural gas futures contract] * * * nor (b) does it move substantially in conjunction" with the NYMEX natural gas futures contract. ICE [31] pronounced that the WAH contract's trading volume is too low to affect the price discovery process for the NYMEX natural gas futures contract. In addition, ICE stated that the WAH contract simply reflects a price differential between Waha hub and the Henry Hub; "there is no price linkage as contemplated by Congress or the CFTC in its rulemaking." FIEG [32] acknowledged that the WAH contract is a locational spread that is based in part on the NYMEX natural gas futures price, but also questioned the significance of this fact relative to the price linkage criterion since the key component of the spread is the price at Waha hub and not the NYMEX physically-delivered natural gas futures price.

ii. Conclusion Regarding the Price Linkage Criterion

Based on the above, the Commission finds that the WAH contract does not meet the price linkage criterion because it fails the price relationship and volume tests provided for in the Commission's Guidance.

3. Material Liquidity Criterion

To assess whether the WAH contract meets the material liquidity criterion, the Commission first examined volume and open interest data provided to it by ICE as a general measurement of the WAH contract's size and potential importance, and second performed a statistical analysis to measure the effect that changes to WAH prices potentially may have on prices for the NYMEX Henry Hub Natural Gas (a DCM contract), the ICE Chicago Financial Basis contract (an ECM contract), the ICE TexOK Financial Basis contract (an ECM contract) and the ICE Permian Financial Basis contract (an ECM contract).[33]

The Commission's Guidance (Appendix A to Part 36) notes that "[t]raditionally, objective measures of trading such as volume or open interest have been used as measures of liquidity." In this regard, the Commission in its October 9, 2009, **Federal Register** notice referred to second quarter 2009 trading statistics that ICE had submitted for its WAH contract. Based upon on a required quarterly filing made by ICE on July 27, 2009, the total number of WAH trades executed on ICE's electronic trading platform was 1,165 in the second quarter of 2009, resulting in a daily average of 18 trades. During the same period, the WAH contract had a total trading volume on ICE's electronic trading platform of 100,490 contracts and an average daily trading volume of 1,570 contracts. Moreover, the open interest as of June 30, 2009, was 96,371 contracts, which includes trades executed on ICE's electronic trading platform, as well as trades executed off of ICE's electronic trading platform and then brought to ICE for clearing.[34]

Subsequent to the October 9, 2009, **Federal Register** notice, ICE submitted another quarterly notification filed on November 13, 2009,[35] with updated trading statistics. Specifically, with respect to its WAH contract, 1,252 separate trades occurred on its electronic platform in the third quarter of 2009, resulting in a daily average of 19 trades. During the same period, the WAH contract had a total trading volume on its electronic platform of 120,050 contracts (which was an average of 1,819 contracts per day).[36] As of September 30, 2009, open interest in the WAH contract was 114,238 contracts.[37] Reported open interest included positions resulting from trades that were executed on ICE's electronic platform, as well as trades that were executed off of ICE's electronic platform and brought to ICE for clearing.

In the Guidance, the Commission stated that material liquidity can be identified by the impact liquidity exhibits through observed prices. Thus, to make a determination whether the WAH contract has such material impact, the Commission reviewed the relevant trading statistics (noted above). In this regard, the average number of trades per day in the second and third quarters of 2009 were well above the minimum reporting level (5 trades per day). Moreover, trading activity in the WAH contract, as characterized by total quarterly volume, indicates that the WAH contract experiences trading activity that is greater than in thinly-traded contracts.[38] Thus, it is reasonable to infer that the WAH contract could have a material effect on other ECM contracts or on DCM contracts.

To measure the effect that the WAH contract potentially could have on a DCM contract, or on another ECM contract, Commission staff performed a statistical analysis [39] using daily settlement prices (between January 2, 2008, and September 30, 2009) for the ICE WAH contract, as well as for the NYMEX Henry Hub natural gas contract

[29] CL 06.

[30] CL 02.

[31] CL 04.

[32] CL 08.

[33] As noted above, the material liquidity criterion speaks to the effect that transactions in the potential SPDC may have on trading in "agreements, contracts and transactions listed for trading on or subject to the rules of a designated contract market, a derivatives transaction execution facility, or an electronic trading facility operating in reliance on the exemption in section 2(h)(3) of the Act."

[34] ICE does not differentiate between open interest created by a transaction executed on its trading platform versus that created by a transaction executed off its trading platform.

[35] *See* Commission Rule 36.3(c)(2), 17 CFR 36.3(c)(2).

[36] By way of comparison, the number of contracts traded in the WAH contract is similar to that exhibited on a liquid futures market and is roughly equivalent to the volume of trading for the NYMEX Palladium futures contract during this period.

[37] By way of comparison, open interest in the WAH contract is roughly equivalent to that in the ICE US Coffee "C" futures contract and the COMEX copper futures contract.

[38] Staff has advised the Commission that in its experience, a thinly-traded contract is, generally, one that has a quarterly trading volume of 100,000 contracts or less. In this regard, in the third quarter of 2009, physical commodity futures contracts with trading volume of 100,000 contracts or fewer constituted less than one percent of total trading volume of all physical commodity futures contracts.

[39] Specifically, Commission staff econometrically estimated a vector autoregression (VAR) model using daily settlement prices. A vector autoregression model is an econometric model used to capture the evolution and the interdependencies between multiple time series, generalizing the univariate autoregression models. The estimated model displays strong diagnostic evidence of statistical adequacy. In particular, the model's impulse response function was shocked with a one-time rise in WAH contract's price. The simulation results suggest that, on average over the sample period, a one percent rise in the WAH contract's price elicited a 0.8 percent increase in the NYMEX Henry Hub and Chicago prices, as well as 0.9 percent increase in the TexOk contract and a 1 percent increase in the Permian Basin contract. These multipliers of response emerge with noticeable statistical strength or significance. Based on such long run sample patterns, if the WAH contract's price rises by 10 percent, then the prices of NYMEX Henry Hub natural gas futures contract and the ICE Chicago Financial Basis contract would each rise by 8 percent. In addition, the price of ICE's TexOk Financial Basis contract would rise by 9 percent, and the price of the ICE's Permain Financial Basis would rise by 10 percent.

(a DCM contract) the ICE Chicago Financial Basis contract (an ECM contract), ICE TexOk Financial Basis contract (an ECM contract) and ICE Permian Financial Basis contract (an ECM contract).[40] The simulation results suggest that, on average over the sample period, a one percent rise in the WAH contract's price elicited a 0.8 percent increase in ICE Chicago and the NYMEX Henry Hub, a 0.9 percent increase in ICE TexOK and an equivalent increase in ICE Permian prices.

i. **Federal Register** Comments

As noted above, comments were received from seven individuals and organizations, with five comments being directly applicable to the SPDC determination of the ICE WAH contract. WGCEF, EI, FIEG and ICE generally agreed that the WAH contract does not meet the material liquidity criterion.

WGCEF [41] stated that the WAH contract does not materially affect other contracts that are listed for trading on DCMs or ECMs, as well as other over-the-counter contracts. Instead, the WAH contract is influenced by the underlying Waha cash price index and the final settlement price of the NYMEX Henry Hub natural gas futures contract, not vice versa. FIEG [42] stated that the WAH contract cannot have a material effect on NYMEX contract because the WAH contract trades on a differential and represents "one leg (and not the relevant leg) of the locational spread." The Commission's statistical analysis shows that changes in the ICE WAH contract's price significantly influences the prices of other contracts that are traded on DCMs and ECMs.

ICE opined that the Commission "seems to have adopted a five trade-per-day test to determine whether a contract is materially liquid. It is worth noting that ICE originally suggested that the CFTC use a five trades-per-day threshold as the basis for an ECM to report trade data to the CFTC." In this regard, the Commission adopted a five trades-per-day threshold as a reporting requirement to enable it to "independently be aware of ECM contracts that may develop into SPDCs" rather than solely relying upon an ECM on its own to identify any such potential SPDCs to the Commission. Thus, any contract that meets this threshold may be subject to scrutiny as a potential SPDC. As noted above, the Commission is basing a finding of material liquidity for the ICE WAH contract, in part, on the fact that there have been nearly 20 trades per day on average in the WAH contract during the second and third quarters of 2009, which is almost quadruple the five trades-per-day that is cited in the ICE comment. In addition, the Commission notes that the number of contracts per transaction in the WAH contract is high (approximately 96 contracts per transaction) and thus, as noted, trading volume (measured in contract units) is substantial. The WAH contract also has significant open interest.

ICE implied that the statistics provided by ICE were misinterpreted and misapplied by the Commission. In particular, ICE stated that the volume figures used in the Commission's analysis (cited above) "include trades made in *all listed months of each contract*" as well as in strips of contract months, and a "more appropriate method of determining liquidity is to examine the activity in a single traded month or strip of a given contract." ICE stated that only about 25 to 40 percent of the trades occurred in the single most liquid, usually prompt, month of the contract.

It is the Commission's opinion that liquidity, as it pertains to the WAH contract, is typically a function of trading activity in particular lead months and, given sufficient liquidity in such months, the WAH contract itself would be considered liquid. ICE's analysis of its own trade data confirms this to be the case for the WAH contract, and thus, the Commission believes that it applied the statistical data cited above in an appropriate manner for gauging material liquidity.

In addition, EI and ICE stated that the trades-per-day statistics that it provided to the Commission in its quarterly filing and which are cited above includes 2(h)(1) transactions, which were not completed on the electronic trading platform and should not be considered in the SPDC determination process. Commission staff asked ICE to review the data it sent in its quarterly filings. In response, ICE confirmed that the volume data it provided and which the Commission cited in its October 9, 2009, **Federal Register** notice, as well as the additional volume information it cites above, includes only transaction data executed on ICE's electronic trading platform. The Commission acknowledges that the open interest information it cites above includes transactions made off the ICE platform.[43] However, once open interest is created, there is no way for ICE to differentiate between "on-exchange" versus "off-exchange" created positions, and all such positions are fungible with one another and may be offset in any way agreeable to the position holder regardless of how the position was initially created.

ii. Conclusion Regarding Material Liquidity

Based on the above, the Commission concludes that the WAH contract meets the material liquidity criterion in that there is sufficient trading activity in the WAH contract to have a material effect on "other agreements, contracts or transactions listed for trading on or subject to the rules of a designated contract market * * * or an electronic trading facility operating in reliance on the exemption in section 2(h)(3) of the Act" (that is, an ECM).

4. Overall Conclusion

After considering the entire record in this matter, including the comments received, the Commission has determined that the WAH contract performs a significant price discovery function under two of the four criteria established in section 2(h)(7) of the CEA. Although the Commission has determined that the WAH contract does not meet the price linkage criterion at this time, the Commission has concluded that the WAH contract does meet both the material liquidity and material price reference criteria. Accordingly, the Commission is issuing the attached Order declaring that the WAH contract is a SPDC.

Issuance of this Order signals the immediate effectiveness of the Commission's authorities with respect to ICE as a registered entity in connection with its WAH contract,[44] and triggers the obligations, requirements—both procedural and substantive—and timetables prescribed in Commission rule 36.3(c)(4) for ECMs.

V. Related Matters

a. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA") [45] 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.

[40] Natural gas prices at the Chicago, Permian, and TexOk hubs were obtained by adding the daily settlement prices of ICE's Chicago Financial Basis, Permian Basin Financial Basis and TexOk Financial Basis contracts, respectively, to the contemporaneous daily settlement prices of the NYMEX Henry Hub physically-delivered natural gas futures contract.

[41] CL 02.

[42] CL 08.

[43] Supplemental data supplied by the ICE confirmed that block trades in the third quarter of 2009 were in addition to the trades that were conducted on the electronic platform; block trades comprised 44.3 percent of all transactions in the WAH contract.

[44] See 73 FR 75888, 75893 (Dec. 12, 2008).

[45] 44 U.S.C. 3507(d).

Certain provisions of 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 [46] 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 an order or to determine whether the benefits of the order outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions. 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 Commission may in its discretion give greater weight to any one of the five enumerated areas and could 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 accomplish any of the purposes of the Act. The Commission has considered the costs and benefits in light of the specific provisions of section 15(a) of the Act and has concluded that the Order, required by Congress to strengthen Federal oversight of exempt commercial markets and to prevent market manipulation, is necessary and appropriate to accomplish the purposes of section 2(h)(7) of the Act.

When a futures contract begins to serve a significant price discovery function, that contract, and the ECM on which it is traded, warrants increased oversight to deter and prevent price manipulation or other disruptions to market integrity, both on the ECM itself and in any related futures contracts trading on DCMs. An Order finding that a particular contract is a SPDC triggers this increased oversight and imposes obligations on the ECM calculated to accomplish this goal. The increased oversight engendered by the issue of a SPDC Order increases transparency and helps to ensure fair competition among ECMs and DCMs trading similar products and competing for the same business. Moreover, the ECM on which the SPDC is traded must assume, with respect to that contract, all the responsibilities and obligations of a registered entity under the CEA and Commission regulations. Additionally, the ECM must comply with nine core principles established by section 2(h)(7) of the Act—including the obligation to establish position limits and/or accountability standards for the SPDC. Section 4(i) of the CEA authorizes the Commission to require reports for SPDCs listed on ECMs. These increased responsibilities, along with the CFTC's increased regulatory authority, subject the ECM's risk management practices to the Commission's supervision and oversight and generally enhance the financial integrity of the markets.

c. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") [47] requires that agencies consider the impact of their rules on small businesses. The requirements of CEA section 2(h)(7) and the Part 36 rules affect ECMs. The Commission previously has determined that ECMs are not small entities for purposes of the RFA.[48] Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that this Order, taken in connection with section 2(h)(7) of the Act and the Part 36 rules, will not have a significant impact on a substantial number of small entities.

VI. Order

a. Order Relating to the ICE Waha Financial Basis Contract

After considering the complete record in this matter, including the comment letters received in response to its request for comments, the Commission has determined to issue the following Order:

The Commission, pursuant to its authority under section 2(h)(7) of the Act, hereby determines that the Waha Financial Basis contract, traded on the IntercontinentalExchange, Inc., satisfies the statutory material liquidity and material price reference criteria for significant price discovery contracts. Consistent with this determination, and effective immediately, the IntercontinentalExchange, Inc., must comply with, with respect to the Waha Financial Basis contract, the nine core principles established by new section 2(h)(7)(C). Additionally, the IntercontinentalExchange, Inc., shall be and is considered a registered entity [49] with respect to the Waha Financial Basis contract and is subject to all the provisions of the Commodity Exchange Act applicable to registered entities. Further, the obligations, requirements and timetables prescribed in Commission rule 36.3(c)(4) governing core principle compliance by the IntercontinentalExchange, Inc., commence with the issuance of this Order.[50]

Issued in Washington, DC, on April 28, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

[FR Doc. 2010–10324 Filed 5–4–10; 8:45 am]

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CORPORATION FOR NATIONAL AND COMMUNITY SERVICE

Sunshine Act Notice

The Board of Directors of the Corporation for National and Community Service gives notice of the following meeting:

DATE AND TIME: Wednesday, May 12, 2010, 10:30 a.m.–12 p.m.

PLACE: Corporation for National and Community Service, 1201 New York Avenue, NW., Suite 8312, Washington, DC 20525 (Please go to 10th floor reception area for escort).

CALL-IN INFORMATION: This meeting is available to the public through the following toll-free call-in number: 888–790–3168 conference call access code number 4567906. Any interested member of the public may call this number and listen to the meeting. Callers can expect to incur charges for calls they initiate over wireless lines, and the Corporation will not refund any incurred charges. Callers will incur no charge for calls they initiate over land-line connections to the toll-free telephone number. Replays are generally available one hour after a call ends. The toll-free phone number for the replay is 800–294–4341. The end replay date: June 12, 10:59 PM (CT).

STATUS: Open.

MATTERS TO BE CONSIDERED:

10:30–11:15 a.m.

I. Chair's Opening Comments

[46] 7 U.S.C. 19(a).

[47] 5 U.S.C. 601 *et seq.*

[48] 66 FR 42256, 42268 (Aug. 10, 2001).

[49] 7 U.S.C. 1a(29).

[50] Because ICE already lists for trading a contract (i.e., the Henry Financial LD1 Fixed Price contract) that was previously declared by the Commission to be a SPDC, ICE must submit a written demonstration of compliance with the Core Principles within 30 calendar days of the date of this Order. 17 CFR 36.3(c)(4).