matters relevant to the work of the ITAC); and ensuring that the ITAC is balanced in terms of points of view, demographics, geography, and entity or organization size.

This notice is issued pursuant to the Federal Advisory Committee Act (5 U.S.C., app. 2), 19 U.S.C. 2155, and 41 CFR part 102–3 relating to advisory committees.

Dated: April 28, 2010.

Nicole Y. Lamb-Hale,

Assistant Secretary for Manufacturing and Services.

[FR Doc. 2010–10495 Filed 5–4–10; 8:45 am]

BILLING CODE P

COMMODITY FUTURES TRADING COMMISSION

Order Finding That the San Juan Financial Basis Contract Traded on the IntercontinentalExchange, Inc., Does Not Perform 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 San Juan Financial Basis ("SNJ") 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 SNJ contract does not perform 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 price 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 a determination 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 SNJ contract performs a significant price discovery function and requested comment from interested parties.[7] Comments were received from Industrial Energy Consumers of America ("IECA"), Working Group of Commercial Energy Firms ("WGCEF"), Platts, ICE, Economists Incorporated ("EI"), Natural Gas Supply Association ("NGSA"),

---

[1] 74 FR 52188 (October 9, 2009).

[2] Incorporated as Title XIII of the Food, Conservation and Energy Act of 2008, Public Law No. 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.

Federal Energy Regulatory Commission ("FERC") and Financial Institutions Energy Group ("FIEG").[8] The comment letters from FERC [9] and Platts did not directly address the issue of whether or not the SNJ contract is a SPDC; IECA expressed the opinion that the SNJ contract did perform a significant price discovery function; and thus, should be subject to the requirements of the core principles enumerated in Section 2(h)(7) of the Act, but did not elaborate on its reasons for saying so or directly address any of the criteria. The remaining comment letters raised substantive issues with respect to the applicability of section 2(h)(7) to the SNJ contract and generally expressed the opinion that the SNJ contract is not a SPDC because it does not meet the material price reference, price linkage and material liquidity criteria for SPDC determination. These 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 designated 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.[10] 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.[11] 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

The San Juan Financial Basis (SNJ) Contract and the SPDC Indicia

The SNJ contract is cash settled based on the difference between the bidweek price index for a particular calendar month at the San Juan Basin on El Paso Natural Gas Company's pipeline, 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 their fixed-price transactions conducted during the last five business days of the month for physical delivery of natural gas at the San Juan Basin; such bidweek transactions specify the delivery of natural gas on a uniform basis throughout the following calendar month at the agreed upon rate. The Platts 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 SNJ contract is 2,500 million British thermal units ("mmBtu"), and the unit of trading is any multiple of 2,500 mmBtu. The SNJ

[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." 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"). ICE is an exempt commercial market, as noted above. 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/2009/09-013.html.*

[9] FERC stated that the SNJ contract is cash settled and does not contemplate the 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, "FERC staff will continue to monitor for any such conflict * * * [and] advise the CFTC" should any such potential conflict arise. CL 07.

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

[11] 17 CFR part 36, Appendix A.

contract is listed for up to 72 consecutive calendar months.

The Henry Hub,[12] 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.[13] 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 supply of natural gas in the San Juan Basin (encompassing the four-corner region of northwestern New Mexico, northeastern Arizona, and portions of Colorado and Utah) primarily comes from New Mexico natural gas production plants in the cities of Blanco, Chaco, Rio Vista, Milagro and Valverde. The El Paso Natural Gas Company's pipeline system, which is the largest natural gas pipeline system in the Western region of the United States, transports natural gas from the San Juan Basin production area to California, Arizona, and the Arizona/Nevada state border.[14]

The Blanco hub, a market center that includes the San Juan Basin, had an estimated throughput capacity of 1.2 billion cubic feet per day in 2008. Moreover, the number of pipeline interconnections at the San Juan Basin hub was 10 in 2008. Lastly, the pipeline interconnection capacity of the San Juan Basis hub in 2008 was 4.2 billion cubic feet per day, which constituted a 22 percent increase over the pipeline interconnection capacity in 2003.[15] The San Juan Basin is far removed from the Henry Hub and is not directly connected to the Henry Hub.

Natural gas prices at the San Juan Basin typically differ from those at the Henry Hub. Thus, the price of the Henry Hub physically-delivered futures contract is an imperfect proxy for the SNJ price. Moreover, exogenous factors, such as adverse weather, can cause the SNJ 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 SNJ 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 "West Gas End of Day" and "OTC Gas End of Day"[18] packages 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 SNJ 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 SNJ 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 is being used as a material price reference and therefore, serving a 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

[12] 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.

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

[14] *See http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/western.html.*

[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 SNJ 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.*

[20] 17 CFR part 36, Appendix A.

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.

Following the issuance of the **Federal Register** release, the Commission further evaluated ICE's data offerings and their use by industry participants. Although the San Juan Basin is a major trading center for natural gas in the United States and, as noted, ICE sells price information for the SNJ contract, the Commission has found upon further evaluation that the cash market transactions are not being directly based or quoted as a differential to the SNJ contract nor is that contract routinely consulted by industry participants in pricing cash market transactions. Thus, the contract does not meet the Commission's Guidance for the material price reference criterion. Moreover, there are other trading points in the same general vicinity, such as the Waha hub, that are referenced more frequently. Thus, it is not necessary for market participants to independently refer to the SNJ contract for pricing natural gas at this location. In these circumstances, the SNJ contract does not satisfy the direct price reference test for existence of material price reference. Furthermore, the Commission notes that publication of the SNJ contract's prices is not indirect evidence of material price reference. The SNJ contract's prices are published with those of numerous other contracts, which are of more interest to market participants. Due to the lack of importance of the San Juan Basin, the Commission has concluded that traders likely do not specifically purchase the ICE data packages for the SNJ contract's prices and do not consult such prices on a frequent and recurring basis in pricing cash market transactions.

i. **Federal Register** Comments

As noted above, WGCEF, ICE, EI, NGSA and FIEG addressed the question of whether the SNJ contract met the material price reference criterion for a SPDC.[21] The commenters argued that because the SNJ contract is cash-settled, it cannot truly serve as an independent "reference price" for transactions in natural gas at this location. Rather, the commenters argue, the underlying cash price series against which the ICE SNJ contract is settled (in this case, the Inside FERC's Gas Market Report price for natural gas at this location) is the authentic reference price and not the ICE contract itself. The Commission believes that this interpretation of price reference is too limiting and believes that a cash-settled derivatives contract could meet the price reference criterion 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 San Juan Basin is a significant trading center for natural gas in North America. However, traders do not consider the San Juan Basin to be as important as other natural gas trading points, such as the Waha hub and Henry Hub.

ICE[22] also argued that the Commission appeared to base the case that the SNJ contract is potentially a SPDC on a disputable assertion. In issuing its notice of intent to determine whether the SNJ 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." ICE states 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." 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. The ECM Study was not intended to serve as the sole basis for determining whether or not a particular contract meets the material price reference criterion.

Both EI[23] and WGCEF[24] 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, such as those for the SNJ contract. Instead, traders are interested in the settlement prices, so the fact that ICE sells the SNJ prices as part of a broad package is not conclusive evidence that market participants are buying the ICE data sets because they find the SNJ prices have substantial value to them. As mentioned above, the Commission notes that publication of the SNJ contract's prices is not indirect evidence of routine dissemination. The SNJ contract's prices are published with those of numerous other contracts, which are of more interest to market participants. Due to the lack of importance of the San Juan Basin, the Commission has concluded that traders likely do not specifically purchase the ICE data packages for the SNJ contract's prices and do not consult such prices on a frequent and recurring basis in pricing cash market transactions.

ii. Conclusion Regarding Material Price Reference

Based on the above, the Commission finds that the SNJ contract does not meet the material price reference criterion because cash market transactions are not priced either explicitly or implicitly on a frequent and recurring basis at a differential to the SNJ contract's price (direct evidence). Moreover, while the ECM sells the SNJ contract's price data to market participants, market participants likely do not specifically purchase the ICE data packages for the SNJ contract's prices and do not consult such prices on a frequent and recurring basis 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 SNJ contract. In this regard, the final settlement of the SNJ contract is based, in part, on the final settlement price of NYMEX's physically-delivered natural gas futures contract, where NYMEX is registered with the Commission as a DCM.

The Commission's Guidance on Significant Price Discovery Contracts[25] 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

[21] As noted above, IECA expressed the opinion that the SNJ contract met the criteria for SPDC determination but did not provide its reasoning.

[22] CL 04.

[23] CL 05.

[24] CL 02.

[25] Appendix A to the Part 36 rules.

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 to be deemed a SPDC ("minimum threshold").

To assess whether the SNJ 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 SNJ contract price is determined, in part, by the final settlement price of the NYMEX physically-delivered natural gas futures contract (a DCM contract), the imputed SNJ location price (derived by adding the NYMEX Henry Hub Natural Gas price to the ICE SNJ basis price) is not within 2.5 percent of the settlement price of the corresponding NYMEX Henry Hub natural gas futures contract on 95 percent or more of the days. Specifically, during the third quarter of 2009, only 2.2 percent of the SNJ 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 found that the SNJ 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. Trades on the ICE centralized market in the SNJ contract during the same period was 35,836 contracts (equivalent to 8,959 NYMEX contracts, given the size difference).[26] Thus, centralized-market trades in the SNJ contract amounted to less than the minimum volume threshold.[27]

i. **Federal Register** Comments

As noted above, WGCEF, ICE, EI, NGSA and FIEG addressed the question of whether the SNJ contract met the price linkage criterion for a SPDC.[28] Each of the commenters expressed the opinion that the SNJ contract did not appear to meet the above-discussed Commission guidance regarding the price relationship and/or the minimum volume threshold relative to the DCM contract to which the SNJ is linked. Based on its analysis discussed above, the Commission agrees with this assessment.

ii. Conclusion Regarding the Price Linkage Criterion

Based on the above, the Commission finds that the SNJ 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

As noted above, in its October 9, 2009, **Federal Register** notice, the Commission identified material price reference, price linkage and material liquidity as potential criteria for SPDC determination of the SNJ contract. To assess whether a contract meets the material liquidity criterion, the Commission first examines trading activity as a general measurement of the contract's size and potential importance. If the Commission finds that the contract in question meets a threshold of trading activity that would render it of potential importance, the Commission will then perform a statistical analysis to measure the effect that the prices of the subject contract potentially may have on prices for other contracts listed on an ECM or a DCM.

The total number of transactions executed on ICE's electronic platform in the SNJ contract was 391 in the second quarter of 2009, resulting in a daily average of 6.1 trades. During the same period, the SNJ contract had a total trading volume of 30,722 contracts and an average daily trading volume of 480 contracts. Moreover, open interest as of June 30, 2009, was 49,105 contracts, which included 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. In this regard, ICE does not differentiate between open interest created by a transaction executed on its trading platform and that created by a transaction executed off its trading platform.[29]

In a subsequent filing dated November 13, 2009, ICE reported that total trading volume in the third quarter of 2009 was 35,836 contracts (or 543 contracts on a daily basis). In terms of number of transactions, 402 trades occurred in the third quarter of 2009 (6.1 trades per day). As of September 30, 2009, open interest in the SNJ contract was 59,123 contracts, which included 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.

As indicated above, the average number of trades per day in the second and third quarters of 2009 was only slightly above the minimum reporting level (5 trades per day). Moreover, trading activity in the SNJ contract, as characterized by total quarterly volume, indicates that the SNJ contract experiences trading activity similar to that of other thinly-traded contracts.[30] Thus, the SNJ contract does not meet a threshold of trading activity that would render it of potential importance and no additional statistical analysis is warranted.[31]

i. **Federal Register** Comments

As noted above, WGCEF, ICE, EI, NGSA and FIEG addressed the question of whether the SNJ contract met the

[26] The size of the NYMEX Henry Hub physically-delivered natural gas futures contract is 10,000 mmBtu. The SNJ contract has a trading unit of 2,500 mmBtu, which is one-quarter the size of the NYMEX Henry Hub contract.

[27] Supplemental data subsequently submitted by the ICE indicated that block trades are included in the on-exchange trades; block trades comprise 61.4 percent of all transactions in the SNJ contract.

[28] As noted above, IECA expressed the opinion that the SNJ contract met the criteria for SPDC determination but did not provide its reasoning.

[29] 74 FR 52188 (October 9, 2009).

[30] 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.

[31] In establishing guidance to illustrate how it will evaluate the various criteria, or combinations of criteria, when determining whether a contract is a SPDC, the Commission made clear that "material liquidity itself would not be sufficient to make a determination that a contract is a [SPDC], * * * but combined with other factors it can serve as a guidepost indicating which contracts are functioning as [SPDCs]." For the reasons discussed above, the Commission has found that the SNJ contract does not meet either the price linkage or material price reference criterion. In light of this finding and the Commission's Guidance cited above, there is no need to evaluate further the material liquidity criteria since it cannot be used alone as a basis for a SPDC determination.

material liquidity criterion for a SPDC.[32] These commenters stated that the SNJ contract does not meet the material liquidity criterion for SPDC determination for a number of reasons.

WGCEF,[33] ICE[34] and EI[35] noted that the Commission's Guidance had posited concepts of liquidity that generally assumed a fairly constant stream of prices throughout the trading day, and noted that the relatively low number of trades per day in the SNJ contract did not meet this standard of liquidity. The Commission observes that a continuous stream of prices would indeed be an indication of liquidity for certain markets but the Guidance also notes that "quantifying the levels of immediacy and price concession that would define material liquidity may differ from one market or commodity to another."

WGCEF, FIEG[36] and NGSA[37] noted that the SNJ contract represents a differential, which does not affect other contracts, including the NYMEX Henry Hub contract and physical gas contracts. FIEG and WGCEF also noted that the SNJ contract's trading volume represents only a fraction of natural gas trading.

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." Furthermore, FIEG cautioned the Commission in using a reporting threshold as a measure of liquidity. 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"[38] 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 but this does not mean that the contract will be found to be a SPDC merely because it met the reporting threshold.

ICE and EI proposed 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 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."[39] A similar argument was made by EI, which observed that the five-trades-per-day number "is highly misleading * * * because the contracts can be offered for as long as 120 months, [thus] the average per day for an individual contract may be less than 1 per day."

It is the Commission's opinion that liquidity, as it pertains to the SNJ contract, is typically a function of trading activity in particular lead months and, given sufficient liquidity in such months, the ICE SNJ contract itself would be considered liquid. In any event, in light of the fact that the Commission has found that the SNJ contract does not meet the material price reference or price linkage criteria, according to the Commission's Guidance, it would be unnecessary to evaluate whether the SNJ contract meets the material liquidity criterion since it cannot be used alone for SPDC determination.

ii. Conclusion Regarding Material Liquidity

The Commission has found that the SNJ contract does not meet the material liquidity criterion.

4. Overall Conclusion

After considering the entire record in this matter, including the comments received, the Commission has determined that the SNJ contract does not perform a significant price discovery function under the criteria established in section 2(h)(7) of the CEA. Specifically, the SNJ contract does not meet the material price reference, price linkage or material liquidity criteria. Accordingly, the Commission will issue the attached Order declaring that the SNJ contract is not a SPDC.

Issuance of this Order indicates that the Commission does not at this time regard ICE as a registered entity in connection with its SNJ contract.[40] Accordingly, with respect to its SNJ contract, ICE is not required to comply with the obligations, requirements and timetables prescribed in Commission rule 36.3(c)(4) for ECMs with SPDCs. However, ICE must continue to comply with the applicable reporting requirements.

V. Related Matters

a. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[41] 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 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[42] 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

---

[32] As noted above, IECA expressed the opinion that the SNJ contract met the criteria for SPDC determination but did not provide its reasoning.

[33] CL 02.

[34] CL 04.

[35] CL 05.

[36] CL 08.

[37] CL 06.

[38] 73 FR 75892 (December 12, 2008).

[39] In addition, both EI and ICE stated that the trades-per-day statistics that it provided to the Commission in its quarterly filing and which were cited in the Commission's October 9, 2009, **Federal Register** notice includes 2(h)(1) transactions, which were not completed on the electronic trading platform and should not be considered in the SPDC determination process. The Commission staff asked ICE to review the data it sent in its quarterly filings; ICE confirmed that the volume data it provided and which the Commission cited includes only transaction data executed on ICE's electronic trading platform. As noted above, supplemental data supplied by ICE confirmed that block trades are in addition to the trades that were conducted on the electronic platform; block trades comprise about 61.4 percent of all transactions in the SNJ contract. The Commission acknowledges that the open interest information it provided in its October 9, 2009, **Federal Register** notice includes transactions made off the ICE platform. 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.

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

[41] 44 U.S.C. 3507(d).

[42] 7 U.S.C. 19(a).

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 fining 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. Amendments to section 4(i) of the CEA authorize 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.

The Commission has concluded that ICE's SNJ contract, which is the subject of the attached Order, is not a SPDC; accordingly, the Commission's Order imposes no additional costs and no additional statutorily or regulatory mandated responsibilities on the ECM.

c. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") [43] 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 exempt commercial markets. The Commission previously has determined that exempt commercial markets are not small entities for purposes of the RFA.[44] 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.

[43] 5 U.S.C. 601 *et seq.*

[44] 66 FR 42256, 42268 (Aug. 10, 2001).

VI. Order

Order Regarding the San Juan 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 San Juan Financial Basis contract, traded on the IntercontinentalExchange, Inc., does not at this time satisfy the material price reference, price linkage and material liquidity criteria for significant price discovery contracts. Consistent with this determination, the IntercontinentalExchange, Inc., is not considered a registered entity [45] with respect to the San Juan Financial Basis contract and is not subject to 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., are not applicable to the San Juan Basin Financial Basis contract with the issuance of this Order.

This Order is based on the representations made to the Commission by the IntercontinentalExchange, Inc., dated July 27, 2009, and November 13, 2009, and other supporting material. Any material change or omissions in the facts and circumstances pursuant to which this order is granted might require the Commission to reconsider its current determination that the San Juan Financial Basis contract is not a significant price discovery contract. Additionally, to the extent that it continues to rely upon the exemption in Section 2(h)(3) of the Act, the IntercontinentalExchange, Inc., must continue to comply with all of the applicable requirements of Section 2(h)(3) and Commission Regulation 36.3.

[45] 7 U.S.C. 1a(29).

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

David A. Stawick,

Secretary of the Commission.

[FR Doc. 2010–10343 Filed 5–4–10; 8:45 am]

BILLING CODE P

COMMODITY FUTURES TRADING COMMISSION

Order Finding that the TETCO–M3 Financial Basis Contract Traded on the IntercontinentalExchange, Inc., Does Not Perform 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 TETCO–M3 Financial Basis ("TMT") 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 TMT contract does not perform 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:

[1] 74 FR 52186 (October 9, 2009).