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 NGPL TxOk 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 NGPL TxOk 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.

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

David A. Stawick,

Secretary of the Commission.

[FR Doc. 2010–10308 Filed 5–3–10; 8:45 am]

BILLING CODE P

COMMODITY FUTURES TRADING COMMISSION

Order Finding That the AECO 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 AECO Financial Basis ("AEC") 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 AEC 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 AEC contract performs a significant price discovery function and requested comment from

[1] 74 FR 52196 (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.

interested parties.[7] Comments were received from the Industrial Energy Consumers of America ("IECA"), Working Group of Commercial Energy Firms ("WGCEF"), ICE, Economists Incorporated ("EI"), Natural Gas Supply Association ("NGSA"), Federal Energy Regulatory Commission ("FERC"), Financial Institutions Energy Group ("FIEG") and an anonymous individual.[8] The comment letter from FERC [9] did not directly address the issue of whether or not the AEC contract is a SPDC; IECA [10] and the anonymous commenter [11] concluded that the AEC contract is a SPDC, but did not provide a basis for their conclusions.[12] The other parties' comments raised substantive issues with respect to the applicability of section 2(h)(7) to the AEC contract, generally asserting that the AEC contract is not a SPDC as it does not meet the material liquidity, material price reference and price linkage 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, 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.[13] 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.[14] 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 whether 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.

IV. Findings and Conclusions

a. The AECO Financial Basis (AEC) Contract and the SPDC Indicia

The AEC contract is cash settled based on the difference between the AECO–C & Nova Inventory Transfer (Alberta) price index for natural gas in the month of production, as reported in the first publication of the month of Canadian Enerdata, Ltd.'s *Canadian Gas Price Reporter* ("CGPR") and the final settlement price for the New York Mercantile Exchange's ("NYMEX's") Henry Hub physically-delivered natural gas futures contract for the same specified calendar month. The transactions used to calculate the

[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.

[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. 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/2009/09-016.html.*

[9] FERC stated that the AEC 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 "FERC staff will continue to monitor for any such conflict . . . [and] advise the CFTC" should any such potential conflict arise. CL 06.

[10] CL 01.

[11] CL 08.

[12] 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.

[13] 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 AEC contract. Arbitrage was not identified as a possible criterion and will not be discussed further in this document or the associated Order.

[14] 17 CFR part 36, appendix A.

monthly Alberta price index are those that are conducted on the Natural Gas Exchange ("NGX") in a given month and specify the delivery of natural gas at the Alberta hub in the following month. The Alberta price index is computed as the volume-weighted average of the applicable natural gas transactions. The size of the AEC contract is 2,500 million British thermal units ("mmBtu"), and the unit of trading is any multiple of 2,500 mmBtu. The AEC contract is listed for up to 120 calendar months commencing with the next calendar month.

The Henry Hub,[15] 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.[16] 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 Alberta hub is far removed from the Henry Hub and is not directly connected to the Henry Hub by an existing pipeline. Located in the Canadian province of Alberta, the Alberta natural gas market is a major connection point for long-distance transmission systems that ship natural gas to points throughout Canada and the United States. The Alberta province is Canada's dominant natural gas producing region; six of the nine Canadian market centers are located in the Alberta province. The throughput capacity at the AECO–C hub is ten billion cubic feet per day. Moreover, the number of pipeline interconnections at that hub was four in 2008. Lastly, the AECO–C hub's capacity is 20.4 billion cubic feet per day.[17]

The local price at the Alberta 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 Alberta price. Moreover, exogenous factors, such as adverse weather, can cause the Alberta 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[18] 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 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 AEC contract. Each of these criteria is discussed below.[19]

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 maintains exclusive rights over using CGPR's Alberta price index for cash settlement purposes. As a result, no other exchange can offer such a basis contract based on CGPR's Alberta price index. While other third-party price providers produce natural gas price indices for this and other trading centers, market participants indicate that the CGPR price index is highly regarded for this particular location and should market participants wish to establish a hedged position based on this index, they would need to do so by taking a position in the ICE AEC contract since ICE has the right to the CGPR index for cash settlement purposes. In addition, 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"[20] 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 AEC contract.

The Alberta hub is a major trading center for natural gas in North America. Traders, including producers, keep abreast of the prices of the AEC contract when conducting cash deals. These traders look to a competitively determined price as an indication of expected values of natural gas at the Alberta hub when entering into cash market transactions for natural gas, especially those trades providing for physical delivery in the future. Traders use the ICE AEC contract, as well as other ICE basis swap contracts, to hedge cash market positions and transactions—activities which enhance the AEC contract's price discovery utility. The substantial volume of trading and open interest in the AEC contract appears to attest to its use for this purpose. While the AEC contract's settlement prices may not be the only

[15] 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.

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

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

[18] 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.

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

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

factor influencing spot and forward transactions, natural gas traders consider the ICE price to be a critical factor in conducting OTC transactions.[21]

Lastly, the fact that the AEC 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 Alberta natural gas prices showed that 98 percent of the observations were more than 2.5 percent different than the contemporaneous Henry Hub prices. Specifically, the average Alberta basis value between January 2008 and September 2009 was −$0.87 per mmBtu with a variance of $0.21 per mmBtu.

i. Federal Register Comments

ICE stated in its comment letter that the AEC contract does not meet the material price reference criterion for SPDC determination. ICE argued that the Commission appeared to base the case that the AEC contract is potentially a SPDC on two disputable assertions. First, in issuing its notice of intent to determine whether the AEC 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, and was not intended to serve as the sole basis for determining whether or not a particular contract meets the material price reference criterion.

Second, ICE argued that the Commission should not base a determination that the AEC contract is a SPDC merely because this contract has the exclusive right to base its settlement on the CGPR Alberta price index. While the Commission acknowledges that there are other firms that produce price indices for the Alberta hub, market participants indicate that the CGPR index is very highly regarded and should they wish to establish a hedged position based on this index, they would need to do so by taking a position in the ICE AEC swap since ICE has the exclusive right to use the CGPR index.[22]

WGCEF, NGSA, EI and FIEG all stated that the AEC contract does not satisfy the material price reference criterion. The commenters argued that other contracts (physical or financial) are not indexed basis the ICE AEC contract price, but rather are indexed based on the underlying cash price series against which the ICE AEC 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 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 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 Alberta hub is a major trading center for natural gas in North America. Traders, including producers, keep abreast of the prices of the AEC contract when conducting cash deals. These traders look to a competitively determined price as an indication of expected values of natural gas at the Alberta hub when entering into cash market transaction for natural gas, especially those trades that provide for physical delivery in the future. Traders use the ICE AEC contract to hedge cash market positions and transactions, which enhances the AEC contract's price discovery utility. While the AEC 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, such as those for the AEC contract. Instead, traders are interested in the settlement prices, so the fact that ICE sells the AEC prices as part of a broad package is not conclusive evidence that market participants are buying the ICE data sets because they find the AEC prices have substantial value to them. The Commission notes that the Alberta hub is a major natural gas trading point, and the AEC contract's prices are well regarded in the industry as indicative of the value of natural gas at the Alberta hub. Accordingly, the Commission believes that it is reasonable to conclude that market participants are purchasing the data packages that include the AEC contract's prices in substantial part because the AEC contract prices have particular value to them.

ii. Conclusion Regarding Material Price Reference

Based on the above, the Commission finds that the AEC contract meets the material price reference criterion because it is referenced on a frequent and recurring basis by cash market participants when pricing transactions (direct evidence). Moreover, the ECM sells the AEC contract's price data to market participants (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 AEC contract. In this regard, the final settlement of the AEC 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[23] notes that a "price-linked contract is a

[21] In addition to referencing ICE prices, natural gas market firms participating in the Alberta 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 when entering into natural gas transactions.

[22] Futures and swaps based on other Alberta indices have not met with the same market acceptance as the ICE AEC contract. For example, NYMEX previously listed a basis swap contract that was comparable to the AEC contract. However, ICE's exclusive agreement with Enerdata forced NYMEX to delist its contract because NYMEX could not find a suitable alternative price index. Up until the point of being delisted, there was no centralized-market trading in the NYMEX version of the AEC contract, so it never served as a source of price discovery for cash market traders with natural gas at the Alberta hub.

[23] Appendix A to the Part 36 rules.

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 which 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 AEC 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 Alberta price is determined, in part, by the final settlement price of the NYMEX physically-delivered natural gas futures contract (a DCM contract), the Alberta 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 or more of the days. Specifically, during the third quarter of 2009, only 2.4 percent of the Alberta 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 AEC contract fails to meet the volume threshold requirement. In particular, the total trading volume in the NYMEX physically delivered 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 AEC contract during the same period was 736,412 contracts (equivalent to 184,103 NYMEX contracts, given the size difference).[24] Thus, centralized-market trades in the AEC 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 even though the ECM contract may specifically use the settlement price to value a position, which is the case of the AEC contract. 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 Alberta hub and the Henry Hub are located in two different areas of North America. Moreover, both hubs are supply centers, where the Alberta hub handles a throughput volume that is ten times that of the Henry Hub. These differences contribute to the divergence between the two price series and, as discussed above, increase the likelihood that the "basis" contract is used for material price reference.

i. Federal Register Comments

NGSA stated that the AEC contract does not meet the price linkage criterion because basis contracts, including the AEC contract, are not equivalent to the NYMEX physically-delivered Henry Hub contract. EI also noted that the AEC and NYMEX natural gas contracts are not economically equivalent and that the AEC contract's volume is too low to affect the NYMEX natural gas futures contract. WGCEF stated that the Alberta price is determined, in part, by the final settlement price of the NYMEX Henry Hub futures contract. However, WCEF goes on to state that the AEC 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 opined that the AEC contract's trading volume is too low to affect the price discovery process for the NYMEX natural gas futures contract. In addition, ICE states that the AEC contract simply reflects a price differential between Alberta and the Henry Hub; "there is no price linkage as contemplated by Congress or the CFTC in its rulemaking." FIEG acknowledged that the AEC 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 the Alberta location 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 AEC 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 AEC 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 AEC market's size and potential importance, and second performed a statistical analysis to measure the effect that changes to AEC prices potentially may have on prices for the NYMEX Henry Hub Natural Gas (a DCM contract), the ICE Socal Border Financial Basis ("SCL") contract (an ECM contract) and the ICE HSC[25] Financial Basis contract (an ECM contract).[26]

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 AEC contract. Based upon on a required quarterly filing made by ICE on July 27, 2009, the total number of AEC trades executed on ICE's electronic trading platform was 7,263 in the second quarter of 2009, resulting in a daily average of 113.5 trades. During the same period, the AEC contract had a total trading volume on ICE's electronic trading platform of 806,438 contracts and an average daily trading volume of 12,601 contracts. Moreover, the open interest as of June 30, 2009, was 443,402 contracts, which includes trades executed on ICE's electronic trading platform, as well as trades executed off

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

[25] The acronym stands for Houston Ship Channel.

[26] 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.

of ICE's electronic trading platform and then brought to ICE for clearing.[27]

Subsequent to the October 9, 2009, **Federal Register** notice, ICE submitted another quarterly notification filed on November 13, 2009,[28] with updated trading statistics. Specifically, with respect to its AEC contract, 6,320 separate trades occurred on its electronic platform in the third quarter of 2009, resulting in a daily average of 95.8 trades. During the same period, the AEC contract had a total trading volume on its electronic platform of 736,412 contracts (which was an average of 11,158 contracts per day).[29] As of September 30, 2009, open interest in the AEC contract was 483,561 [30] contracts. 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 Appendix A to Part 36, the material liquidity criterion for SPDC determination specifies that an ECM contract should have a material effect on another contract. To measure the effect that the AEC contract has on a DCM contract, or on another ECM contract, Commission staff performed a statistical analysis [31] of ICE and NYMEX price data using daily settlement prices (between January 2, 2008, and September 30, 2009) for the NYMEX Henry Hub natural gas contract (a DCM contract) and the ICE Socal Border Financial Basis and HSC Financial Basis contracts (ECM contracts).[32] The simulation results suggest that, on average over the sample period, a one percent rise in the AEC contract's price elicited a 0.8 percent to 0.9 percent increase in each of the NYMEX Henry Hub, ICE SCL and ICE HSC contracts' prices.

i. Federal Register Comments

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

WGCEF [33] and NGSA [34] both stated that the AEC 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 AEC contract is influenced by the underlying Alberta cash price index and the final settlement price of the NYMEX Henry Hub natural gas futures contract, not vice versa. FIEG [35] stated that the AEC contract cannot have a material effect on NYMEX contract because the AEC 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 AEC contract's price significantly influences the prices of other contracts that are traded on DCMs and ECMs.

ICE [36] 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" [37] 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; the threshold is not intended to define liquidity in a broader sense. As noted above, the Division is basing a finding of material liquidity for the ICE AEC contract in part on the fact that there have been around 100 trades per day on average in the AEC contract during the second and third quarters of 2009, which is far more than the five trades-per-day that is cited in the ICE comment.

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 months of each contract*" as well as in strips of contract months, and the "more appropriate method of determining liquidity is to examine the activity in a *single* traded month or strip of a given contract." Furthermore, ICE noted that for the AEC contract (and other basis swap contracts), "about 25–40% of the trades * * * occurred in the single most liquid, usually prompt, month of * * * [the] contract." EI,[38] and FIEG also noted that contract months should be considered separately rather than on an aggregated basis. When done so, none of the contract months meet the material liquidity criterion.

It is the Commission's opinion that liquidity, as it pertains to the AEC contract, is typically a function of trading activity in particular lead months and, given sufficient liquidity in such months, the AEC contract itself would be considered liquid. ICE's analysis of its own trade data confirms this to be the case for the AEC 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. The 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

[27] 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. 74 FR 52196 (October 9, 2009).

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

[29] By way of comparison, the number of contracts traded in the AEC contract is similar to that exhibited on a liquid futures market and is roughly equivalent to the volume of trading for the ICE US Coffee "C" and Cocoa contracts during this period.

[30] By way of comparison, open interest in the AEC contract is similar to that exhibited on a liquid futures market and is roughly equivalent to that in the Commodity Exchange's Gold contract and the Chicago Board of Trade's soybean contract.

[31] Specifically, Commission staff econometrically estimated a vector autoregression model using daily natural gas price levels. A vector autoregression model is an econometric model used to capture the dependencies and interrelationships among multiple time series, generalizing the univariate autoregression model. 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 Alberta price. The simulation results suggest that, on average over the sample period, a one percent rise in the Alberta natural gas price elicited a 0.9 percent increase in the NYMEX Henry Hub price and the Southern California border gas price, as well as a 0.8 percent increase in HSC gas prices. These multipliers of response emerge with noticeable statistical strength or significance. Based on such long run sample patterns, if the Alberta price rises by 10 percent, then the price of NYMEX Henry Hub natural gas futures contract and the Sothern California gas price each would rise by about 9 percent; a 10 percent rise in the Alberta gas price would lead to a rise in the HSC contract's price by about 9 percent.

[32] Natural gas prices at the Alberta, HSC, and Socal trading centers were obtained by adding the daily settlement prices of ICE's AECO Financial Basis, HSC Financial Basis and Socal Border Financial Basis contracts, respectively, to the contemporaneous daily settlement prices of the NYMEX Henry Hub physically-delivered natural gas futures contract.

[33] CL 02.

[34] CL 05.

[35] CL 07.

[36] CL 03.

[37] 73 FR 75892 (December 12, 2008).

[38] CL 04.

executed on ICE's electronic trading platform.[39] The Commission acknowledges that the open interest information it cites above 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.

ii. Conclusion Regarding Material Liquidity

Based on the above, the Commission concludes that the AEC contract meets the material liquidity criterion in that there is sufficient trading activity in the AEC 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 AEC 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 AEC contract does not meet the price linkage criterion at this time, the Commission has determined that the AEC contract does meet both the material liquidity and material price reference criteria. Accordingly, the Commission will issue the attached Order declaring that the AEC 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 AEC contract,[40] and triggers the obligations, requirements—both procedural and substantive—and timetables prescribed in Commission rule 36.3(c)(4) for ECMs.

IV. 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 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") [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 ECMs. The Commission previously has determined that ECMs 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.

V. Order

a. Order Relating to the ICE AECO 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:

The Commission, pursuant to its authority under section 2(h)(7) of the Act, hereby determines that the AECO Financial Basis contract, traded on the IntercontinentalExchange, Inc., must comply with, with respect to the AECO Financial Basis contract, the nine core principles established by new section

[39] 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 32.4 percent of all transactions in the AEC contract.

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

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

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

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

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

2(h)(7)(C). Additionally, 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., shall be and is considered a registered entity [45] with respect to the AECO 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.[46]

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

David A. Stawick,

Secretary of the Commission.

[FR Doc. 2010–10299 Filed 5–3–10; 8:45 am]

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

[46] 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).

COMMODITY FUTURES TRADING COMMISSION

Order Finding That the NWP Rockies 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 22, 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 NWP [2] Rockies Financial Basis ("NWR") 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 NWR 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;* Christa Lachenmayr, Economist, Division of Market Oversight, same address. Telephone: (202) 418–5252. E-mail: *clachenmayr@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") [3] 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.[4] 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.[5] 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.[6] The issuance of such an order also triggers the obligations, requirements and timetables prescribed in Commission rule 36.3(c)(4).[7]

II. Notice of Intent To Undertake SPDC Determination

On October 22, 2009, the Commission published in the **Federal Register** notice of its intent to undertake a

[1] 74 FR 54550 (October 22, 2009).

[2] The acronym "NWP" indicates the Northwest Pipeline.

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

[4] 7 U.S.C. 1a(29).

[5] 74 FR 12178 (Mar. 23, 2009); these rules became effective on April 22, 2009.

[6] Pub. L. 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).

[7] 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.