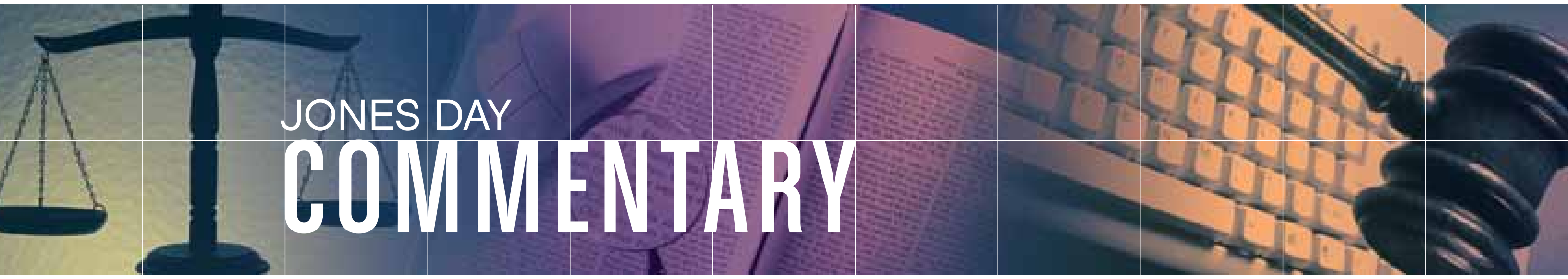
AUGUST 2009



CFTC SEEKS COMMENT ON WHETHER CARBON FINANCIAL INSTRUMENT IS A SIGNIFICANT PRICE DISCOVERY CONTRACT

As markets evolved over the past decade, lawmakers and regulators began to raise questions as to whether trading activity on unregulated electronic trading facilities could affect trading activity on regulated designated contract markets. To address this concern, the CFTC Reauthorization Act of 2008 expanded the authority of the Commodity Futures Trading Commission (the "CFTC") to regulate contracts traded on electronic trading facilities if those contracts perform a "significant price discovery function." On April 22, 2009, final rules for "significant price discovery contracts" became effective, and on August 20, 2009, the CFTC published a Notice of Intent to determine whether the Carbon Financial Instrument on the Chicago Climate Exchange should be regulated as a significant price discovery contract. The CFTC is seeking comment from any interested party on or before September 4, 2009.

The Chicago Climate Exchange is a voluntary greenhouse gas reduction program where members commit to reduce their greenhouse gas emissions. If a member of the Chicago Climate Exchange cannot meet its reduction requirements through new investments and/or technological improvements, it can purchase Carbon Financial Instrument contracts from other program participants who have unused allowances or eligible offsets.

Currently, Carbon Financial Instrument contracts are largely exempt from regulation by the CFTC. As a result of amendments under the Commodity Futures Modernization Act of 2000, the Commodity Exchange Act provides exemptions from most CFTC regulation for certain swaps and other derivative products for commodities traded on electronic trading facilities that limit participation to principal-to-principal transactions between eligible commercial entities. The CFTC refers to these electronic trading facilities as "exempt commercial markets." The Chicago Climate Exchange is one such exempt commercial market.

FACTORS FOR THE CFTC TO CONSIDER

Under the statute, there are four factors the CFTC should consider in determining whether a contract on an electronic trading facility performs a significant price discovery function:

- **Material Liquidity:** The extent to which trading volume of the unregulated contract is sufficient to have a material effect on regulated contracts or transactions.
- **Price Linkage:** The extent to which the unregulated contract relies upon or uses the daily or final settlement price of a regulated contract or transaction to value, transfer, convert, settle, or close out a position.
- **Arbitrage:** The extent to which the price for the unregulated contract is sufficiently related to the price of one or more regulated contracts so as to permit market participants to effectively arbitrage between the markets by simultaneously maintaining positions or executing trades in the regulated and unregulated contracts on a frequent and recurring basis.
- **Material Price Reference:** The extent to which bids, offers, or transactions of a commodity are based on or determined by reference to prices generated by contracts or transactions on the electronic trading facility.

No single factor is itself determinative, and the CFTC expressly eschewed the use of any "mechanical checklist or formulaic analysis." The regulated contracts discussed above can be contracts listed on a regulated designated contract market or derivatives transaction execution facility or another significant price discovery contract on or subject to the rules of an electronic trading facility.

In its Notice of Intent, the CFTC stated its initial impression that trading volume on the Chicago Climate Exchange may satisfy the material liquidity factor because daily trading on the Carbon Financial Instrument contract exceeds an average of 10 trades per day and 1,000 contracts per day. Likewise, the CFTC stated that the material price reference factor may be satisfied because the spot market for Carbon Financial Instruments is the Chicago Climate Exchange, and traders look there for price information and discovery for the Carbon Financial Instrument.

The CFTC also appears likely to examine, among other factors, the relationship between the Carbon Financial Instrument on the Chicago Climate Exchange and Carbon Financial Instrument futures on the Chicago Climate Futures Exchange that specify the delivery of Carbon Financial Instruments. The Chicago Climate Futures Exchange is a CFTC-regulated designated contract market and a wholly owned subsidiary of the Chicago Climate Exchange, Inc.

EFFECT OF SIGNIFICANT PRICE DISCOVERY CONTRACT DESIGNATION

If the CFTC issues an order determining that a contract on an electronic trading facility constitutes a significant price discovery contract, the electronic trading facility must comply with nine statutory core principles:

- **Contracts Not Readily Susceptible to Manipulation:** The electronic trading facility shall list only significant price discovery contracts that are not readily susceptible to market manipulation.
- **Monitoring of Trading:** The electronic trading facility shall monitor trading in a significant price discovery contract to prevent market manipulation, price distortion, and settlement disruption (which may involve market surveillance procedures such as collection of information on market participants' trading activity and positions).
- **Ability to Obtain Information:** The electronic trading facility shall establish and enforce rules to accomplish the goals of the core principles, including collecting information and documents on both a routine and nonroutine basis (such as the examination of books and records kept by participants) and recording and maintaining an effective audit trail for trade-related information.
- **Position Limitations or Accountability:** The electronic trading facility shall establish, where appropriate, position limitations or position accountability for speculators in significant price discovery contracts (taking into account any positions in any other cleared contracts that are deemed fungible with the applicable significant price discovery contract).

- **Emergency Authority:** The electronic trading facility shall adopt rules providing for the exercise of emergency authority where appropriate (including the authority to liquidate open positions in significant price discovery contracts and to suspend or curtail trading in significant price discovery contracts).
- **Daily Publication of Trading Information:** The electronic trading facility shall make public daily information on price, trading volume, and other trading data to the extent appropriate for significant price discovery contracts.
- **Compliance with Rules:** The electronic trading facility shall monitor and enforce compliance with the rules of the electronic trading facility.
- **Conflicts of Interest:** The electronic trading facility shall establish and enforce rules to minimize conflicts of interest in its decision-making process with a process for resolving such conflicts.
- **Antitrust Considerations:** Unless otherwise appropriate to achieve the purposes of the Commodity Exchange Act, the electronic trading facility shall, with respect to significant price discovery contracts, avoid adopting any rules or taking any actions that result in any unreasonable restraints of trade or any material anticompetitive burden on trading on the electronic trading facility.

These core principles are derived from a subset of core principles applicable to regulated designated contract markets, and the CFTC states that Congress intended that they be construed in a like manner.

WHAT HAPPENS NEXT

As noted above, comments must be received on or before September 4, 2009. The CFTC has requested that commenters focus their comments on the four factors outlined above, which are detailed at some length in an appendix to the final rules. Likewise, the CFTC has requested that commenters explain in what capacity they are knowledgeable about the Carbon Financial Instrument contract.

The CFTC will issue an order explaining its determination within a reasonable period of time after the close of the comment period. If the CFTC makes a determination that the Carbon Financial Instrument is a significant price discovery contract, the Chicago Climate Exchange will need to submit a written demonstration of its compliance with the core principles within 90 calendar days after the date of the CFTC's order.

LAWYER CONTACT

For further information, please contact your principal Firm representative or the lawyer listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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The author wishes to thank James P. Veverka and Angela Jin of the New York Office for their assistance in the preparation of this Commentary.