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COMMODITY FUTURES TRADING COMMISSION

IN THE MATTER OF:

ENERGY & ENVIRONMENTAL MARKETS

ADVISORY COMMITTEE MEETING

140 Broadway
New York, New York

September 16, 2009
8:00 a.m.

B E F O R E:

COMMISSIONER BART CHILTON

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2 Then for the last hour we'll go
3 ahead and move on to discussion of green cap
4 and trade, green cap markets and we have
5 several presenters there, and then we'll
6 open it up for discussion.

7 You know, the first meeting that we
8 had was fairly lively, actually, and I
9 thought informative. That said, I'd like to
10 dig a little bit deeper today into some of
11 these issues and have a more in-depth
12 discussion on all the ones that I just
13 mentioned, position limits, hedge
14 exemptions, the OTC legislation and on
15 carbon.

16 So with that, let me give you just a
17 quick couple of housekeeping items.
18 Chairman Gensler and former Acting Chairman
19 Dunn are used to this list of things. First
20 is, let's all, including myself, turn our
21 Blackberries off because it will interfere,
22 if it hasn't already, with the audio. We
23 have people that are not only on video in
24 our various regional offices, but we also
25 have some folks who are calling in on

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2 speaker, they're piped through the system,
3 so they should hear us. This is also
4 streaming live on our webcast, so we're
5 hooked up electronically.

6 The other housekeeping item is for
7 the court reporter and for me for ease of
8 operation, I'd like to -- when people want
9 to talk, I'd like them to say their name and
10 their location so it's, this is Bart Chilton
11 in New York, so that we know where to go and
12 we can keep a good record of how this goes.
13 I know that's a little bit goofy
14 particularly once you've said it two or
15 three times and you have people sitting next
16 to you, but, believe me, it will help
17 particularly in this situation where we're
18 having this virtual meeting.

19 With that, I think I'm actually
20 going to move to our colleagues. I don't
21 really have an opening statement other than
22 there's been a lot going on lately and I
23 commend the Chairman specifically but my
24 colleagues for the work that they've done on
25 looking at these issues, the issues in the

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2 chairing today's meeting and thank you
3 particularly to all the members of the
4 Energy Environmental Markets Advisory
5 Committee, I look forward to a productive
6 meeting where you give us valued advice and
7 contributions to our agenda.

8 Now, energy markets are at the
9 forefront of our regulatory mission and our
10 agenda, the top seven energy contracts, I
11 believe, if I got the numbers right last
12 night, have a notional value of over \$700
13 billion in the futures market and that's not
14 speaking to the over-the-counter derivatives
15 markets, of course.

16 So, it's essential that this agency
17 continues to police the energy markets for
18 fraud, manipulation and other abuses, of
19 course, promote market integrity and market
20 transparency in these markets for the
21 benefit of all the American public that
22 whether they're particularly gassing up
23 their cars or thinking about energy as it
24 relates to the cost of so many other
25 products in their daily lives.

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2 Earlier this summer, as Commissioner
3 Chilton said, we had three valuable hearings
4 into whether the Commission should set
5 position limits on energy markets. As you
6 know, Congress mandated in our statute that
7 we set position limits to protect the
8 American public. We do so in the
9 agricultural markets, of course, and
10 actually working with the exchanges we did
11 so in the energy metals markets through
12 actually June. It's not that long ago that
13 we didn't do that.

14 In that regard, I even understand
15 that the major exchange today will be
16 releasing a white paper on position limits.
17 I thank them for their contribution to this
18 dialogue, I look forward to reviewing their
19 paper later today, and over the course of
20 this important discussion, I believe that we
21 -- I believe that we should continue to
22 seriously consider the benefits to market
23 integrity and promoting markets in this
24 topic area and I look forward to hearing
25 from the members of the EEMAC in that

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2 regard.

3 As Commissioner Chilton said, we
4 also testified recently, I had the honor to
5 do so on behalf of the Commission on the
6 trade part of cap and trade. There are
7 other agencies that are far better suited to
8 look at cap but we already oversee markets
9 trading -- programs that came out of the
10 acid rain program, sulfur dioxide, nitrous
11 oxide and so forth and even a carbon
12 initiative out of the regional greenhouse
13 gas initiative.

14 But the four larger markets that
15 might be a result of congressional action we
16 look forward to the members of the EEMAC
17 providing insight into how we can best do
18 that, moving forward if we're asked by
19 Congress to do so.

20 So, again, I just want to thank you
21 all, I look forward to learning from the
22 presenters and I guess I turn it back to
23 Commissioner Chilton.

24 COMM. CHILTON: Commissioner Dunn is
25 fine.

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2 COMMISSIONER DUNN: Thank you very
3 much, Mr. Chairman, for leading today's
4 meeting and I commend you for your work in
5 this vitally important area and look forward
6 to hearing from the participants you've
7 gathered today to speak about energy
8 markets, carbon markets, regulatory reform
9 and legislation for these areas.

10 I just returned last week from
11 Switzerland attending an international
12 meeting of futures regulators and the
13 futures of energy futures was a topic of
14 conversation and I was so proud,
15 Mr. Chairman, of the efforts that you, Laura
16 Dearer, and citing the MOU and sharing
17 information, that was certainly a topic of
18 what regulators ought to be doing in this
19 area.

20 Our goal as Commissioners is to
21 ensure that the energy markets we regulate
22 function properly and are free of
23 manipulation and other abuses. Three days
24 of hearings regarding the possibility of
25 imposing position limits in energy markets

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2 that was held prior to the hearing. Most
3 importantly, can the CFTC effectively
4 regulate energy markets without having a
5 broad view into all the venues in which
6 these contracts are traded, are regulated
7 markets, over-the-counter markets and
8 oversea markets.

9 I am hopeful that this Advisory
10 Committee and the experts you've called to
11 speak today will be able to shed some light
12 on the best way forward in this area. I'm
13 also interested in hearing more about the
14 emergence of carbon markets and how best to
15 regulate this growing industry.

16 Lastly, I would like to hear from
17 the Advisory Committee, their thoughts on
18 what resources the CFTC will need to
19 effectively regulate energy markets and
20 carbon markets. I look forward to hearing
21 the experiences of our panelists and, once
22 again, Mr. Chairman, I thank you for calling
23 today's meeting.

24 COMM. CHILTON: Thank you,
25 Commissioner Dunn. Commissioner Sommers.

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2 COMMISSIONER SOMMERS: Thank you,
3 Commissioner Chilton and thanks for holding
4 this EEMAC meeting today and thanks to all
5 the members that are participating from New
6 York and Kansas City and here in D.C.

7 This is a very challenging time for
8 the CFTC, we're in the process, as you know,
9 of considering a number of very important
10 initiatives and I believe that the EEMAC
11 Committee is a critical source of input to
12 the Commission. There's such a wide range
13 of expertise and number of representatives
14 with a great deal of knowledge and
15 experience with our energy markets and it's
16 very important to us.

17 We're scheduled to discuss position
18 limits and the OTC regulatory proposal and
19 the legislative proposals regarding the
20 carbon markets, and I think that all of
21 these issues present very complicated
22 questions for the Commission.

23 I agree with Chairperson Gensler on
24 many of the initiatives and agree that it's
25 prudent for this agency to require greater

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2 transparency in our energy markets, and
3 before we make these policy changes we must
4 fully understand the consequences of
5 additional regulation in these markets.

6 Many of you and the organizations
7 that you represent have participated in the
8 meetings that we had over the last few weeks
9 and I think that today is just another step
10 in the process to inform this debate. So
11 thank you again for being here and I look
12 forward to the discussion.

13 COMM. CHILTON: Thank you very much.
14 Before we go ahead and start asking for
15 comments on the position limits and hedge
16 exemptions, we're going to have Steve
17 Sherrod give us a brief overview on energy
18 markets.

19 Do you have a Powerpoint, Steve?

20 MR. SHERROD: Thanks, Bart. No, I
21 don't have a Powerpoint. I should say
22 Commissioner Chilton.

23 COMM. CHILTON: No, that's fine, I'm
24 Bart to everybody.

25 MR. SHERROD: Good morning, I'm

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2 it's sufficient sometimes to result in the
3 traders resolving the situation before
4 there's a disruption.

5 We do have an escalation process
6 that we use, this includes sending warning
7 letters, we can refer activities that we
8 think are suspicious to our enforcement
9 division to take action, and the ultimate
10 action which rarely is taken is to request
11 the Commission take an emergency action.

12 So I think we focus in surveillance
13 on preventing disruptions so that, as
14 Commissioner Dunn said, the futures can play
15 their important role in the markets, in
16 price discovery and risk transference. We
17 focus on having fair trading, however, in
18 the last decade or so there have been a
19 number of occasions when traders have
20 engaged in disruptive activity by doing
21 things like banging the close.

22 Banging the close refers to the
23 practice of a trader acquiring a substantial
24 position during the day and then offsetting
25 that position before the end of the day

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2 In the new Disaggregated COT Report
3 we break the commercial trader positions
4 down into two pieces, the first piece breaks
5 out in the reportable positions for a
6 category and it's a mouthful, it's called
7 Producer Merchant Processor User, we didn't
8 use marketing to come up with that, that
9 category basically covers the entities that
10 are predominantly engaged in handling the
11 physical activity.

12 We categorize traders, so we look to
13 their predominant activity. A trader that
14 might be physically handling the particular
15 commodity might also be engaged in other
16 activities, so we have to make a judgment
17 call to try to categorize, we do that based
18 upon the information we gather from our
19 large trader reporting system process, we
20 have what's called a Form 40, we gather
21 additional information from the traders, our
22 surveillance economists talk with the
23 traders, try to discern the balance of their
24 business, and it's basically fiscal handlers
25 predominantly that will categorize that

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2 reportables.

3 For managed money those are
4 positions that are held by a money manager
5 that will be someone like a registered
6 commodity pool operator, a CPO, a registered
7 commodity trading adviser, someone that
8 might not be registered with the Commission
9 that our staff is aware manages money for
10 others. Examples would be something like a
11 hedge fund, someone that has an exclusion
12 from registration as a CTA or CPO.

13 So, again, we categorize the
14 traders, not the transactions, and we use
15 data and judgment to try to break out and
16 provide a better view into the positions of
17 our large traders in this new disaggregated
18 report.

19 We have welcomed comment on this new
20 disaggregation on the website, on the first
21 page of our website there's a link to the
22 commitment of traders and at the bottom of
23 that page you can submit comments to market
24 reports at cftc.gov, and I remind everyone
25 in considering your comments that there is a

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2 through over-the-counter swap agreements
3 with financial firms.

4 The data for these OTC swap
5 agreements comes from our special call, we
6 issue that to a variety of swap dealers and
7 index funds, we continue to review without
8 surveillance economists who we issued the
9 special call to and as we become aware of
10 large participants we will add firms to our
11 list of special call participants.

12 The index investment data represents
13 our best effort to provide a one-day
14 snapshot of the positions of the swap
15 dealers in the index funds and these figures
16 do not reflect any trading activity or
17 changes in positions that are taking place
18 during the quarter because, as I mentioned,
19 we will add firms to the list from time to
20 time.

21 We do provide data on numerous
22 energy markets in the in dex investment
23 data, including heating oil, natural gas,
24 the gasoline RBOB contract, the WFTI crude
25 oil markets. This investment data is more

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2 With that I want to move to this
3 whole discussion of position limits and
4 hedge exemptions, but maybe as a kickoff,
5 you know, Chairman Gensler mentioned a news
6 report and a white paper on position limits
7 and, you know, that has to do with this
8 exact subject, so I'm wondering, Deanna Dow
9 from CME, if you're there in D.C., if you'd
10 mind giving us an overview and informing
11 everybody who hasn't read the papers yet
12 this morning.

13 MS. DOW: Thank you, Commissioner
14 Chilton. I'm Deanna Dow, I'm here in the
15 Washington office. I wasn't expecting to be
16 asked to give an overview of our proposal
17 but I'm happy to kind of kick off the
18 discussion.

19 We are, in fact, this morning
20 releasing a white paper that is intended to
21 inform and shape the debate about position
22 limits. We have taken the lead, I guess you
23 would say or are interested in trying to
24 provide something of a framework that the
25 Commission, as well as the Congress, can use

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2 happen, you'll see the shift from the
3 regulated markets into the OTC space.

4 Again, the paper with all the
5 specifics and details will be coming out.
6 Just generally speaking, it would recommend
7 that there be a spot month limit, that there
8 also be single month limits as well as
9 limits across all markets and there are also
10 recommendations in there in terms of
11 aggregation across all markets. Thank you.

12 COMM. CHILTON: Thank you, Deanna.
13 This is Barton in New York again and I want
14 to apologize for sort of hitting you and
15 having you do it off the cuff but you did a
16 great job explaining it.

17 For my part, I'm really pleased that
18 people are sort of taking the charge of the
19 Chairman and thinking about these things and
20 I commend you putting your proposal forward.
21 You know, for my part, we're going to ensure
22 that whatever we do, I can't for the
23 Commissioners, but for myself I want to
24 ensure that whatever we do doesn't advantage
25 or disadvantage any individual exchange or

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2 any individual market participant but, you
3 know, I think to the extent that I have any
4 influence in this, we're going to reach the
5 right balance, we're going to do something
6 that is thoughtful, if we do something, and
7 we really appreciate the fact that people
8 are coming forward and giving ideas.

9 I did want to clarify one thing, if
10 any of my colleagues want to chime in on
11 this they're welcome to. When you talked --
12 Deanna, when you talked about studies at the
13 CFTC that proved something and just to be
14 clear, the studies that we've done recently
15 have not proved that speculators haven't had
16 an impact, they've proved that they weren't
17 driving prices, and as we talked about at
18 our hearings, the possibility that there is
19 some movement is something that we have to
20 be concerned about under the law. So that
21 doesn't prejudge what we may or may not do
22 to any extent, but the fact that we've had
23 these studies doesn't definitively say
24 they're doing anything other than they
25 weren't driving prices last year, driving

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2 markets, and it's the finite markets like
3 energy that concern us.

4 We need to remember our examples in
5 history, one example was Amaranth, Amaranth
6 did part of its trading in over-the-counter,
7 part of it in ICE, part of it on the NYMEX.
8 One of the forensic analyses done by the
9 Senate, they discovered that at one point
10 their position in natural gas was 80 percent
11 above the total U.S. natural gas production.

12 MR. CHILTON: Well, if anybody owns
13 80 percent of any market that's, in my
14 opinion, too large of a market and it will
15 have a significant price impact.

16 MR. COTA: If they had not done part
17 of their trading on the New York Mercantile
18 Exchange at the time they would never have
19 been found out, so these positions both need
20 to be disclosed and there needs to be
21 limits, that's a real example of something
22 that has occurred.

23 The notion of index funds and
24 passive investors going into markets and
25 overwhelming these finite markets is a real

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2 lot of the over-the-counter trade and we
3 want speculators in the markets but we're
4 concerned about that impact.

5 Like the comments made by the
6 Chicago Mercantile Exchange in Washington
7 just now, we're concerned that you need to
8 connect all of the dots. I applaud the CFTC
9 for its work, the FSA, I caught the press
10 release yesterday about sharing the data, I
11 think that needs to be done across a lot
12 more markets and you need to disclose what's
13 occurring in these markets.

14 I think that if a savvy trader knows
15 what's occurring in these markets both in
16 size and position, they will on their own
17 have a self-regulating effect, and that's
18 another reason why we believe as an industry
19 that more of these things should be -- come
20 off from over-the-counter, perhaps
21 over-the-counter to some extent but they
22 should be traded -- the back end needs to
23 be traded on exchanges and needs to be
24 cleared on exchanges, but exchanges will
25 have that function of regulating those

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2 the ground to get the gas to consumers.

3 We always establish credit with each
4 other and use those estimates as collateral,
5 so we establish our credit based on that.
6 If forced to go on an exchange and take that
7 CAPEX money and put it as collateral, that's
8 money that's not being used to put steel in
9 the ground, the result is a decrease in
10 supply while the economy is recovering,
11 that's a portended disaster for the
12 consumers with high prices just
13 skyrocketing.

14 So we haven't done a full study of
15 this but we believe that as much as 25 to 30
16 percent going back looking over if we had to
17 collateralize our trades for the last year,
18 roughly 25 to 30 percent in some cases would
19 have to be put aside and not invested in the
20 ground or by CAPEX, that's a large amount of
21 natural gas that will not come out of the
22 ground, forces prices up.

23 So we ask that in looking at this
24 issue as you move forward to consider a way
25 of allowing the -- if mandatory clearing --

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2 MR. FOX: So in a little over a year
3 on this Committee I really haven't heard too
4 many people opposed to the concept of
5 limits, most people seem to be in favor of
6 imposing limits, so I suggest we more or
7 less accept that and move on to the next
8 phase which is who is going to set these
9 limits and the process by which these limits
10 are achieved.

11 In the past the exchanges have set
12 the limits and in one exchange it was not to
13 have any limits and the other exchange I
14 suspect had granted exemptions to those
15 limits to some of the biggest speculators in
16 the market.

17 The interesting thing about
18 Amaranth, the case that's currently out in
19 the public is this concept of banging the
20 close, when I read that \$3,000 lots of
21 natural gas were sold in the last 30 minutes
22 that really only leaves one of two
23 situations, either they were exceeding the
24 position limits which on the last day would
25 be a thousand, so nobody could only really

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2 very short order in terms of the resources
3 and the impact of the Commission taking the
4 responsibility of setting position limits.

5 I think it will be a very difficult
6 task, I mean, this is quite a resource
7 intense activity that our compliance
8 department has to address day in and day
9 out, I mean, this is a routine daily
10 monitoring and calculating job that, you
11 know, it really is important to be there, to
12 know the market, to actually have the
13 contact with the participants to know their
14 trading patterns.

15 I think in terms of setting the
16 position limits, the formula needs to be
17 certainly something that the Commission has
18 blessed or signed off on and that is applied
19 across the board for all exchanges. I
20 understand the concerns about individual
21 exchanges setting limits in and of
22 themselves without it being a broad
23 application.

24 So, to me, the exchanges are in the
25 best position in terms of actually

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2 being low regulation entities, I do not
3 think that the current crisis of confidence
4 in markets is going to support large-scale
5 capital or trading volume flight to low or
6 no regulation entities.

7 So I think that we have an
8 opportunity today for the United States to
9 assume its global lead in ensuring that
10 markets are well regulated. As I said back
11 on July 29th when I testified before the
12 CFTC, taking these strong transparency
13 efforts have a lot more in common with Adam
14 Smith in preserving market integrity than
15 they do with Karl Marks, there is nothing
16 radical about encouraging competition and
17 market transparency by establishing strong,
18 clear and effective rules. Thank you.

19 COMM. CHILTON: Thank you, Tyson.
20 Before we go to -- Mike, did you have
21 something?

22 COMMISSIONER DUNN: Yes. Mr. Cicio,
23 I think, would like to have an intervention
24 as well here.

25 COMM. CHILTON: You know what,

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2 though, if it's okay, when you started to
3 speak a little bit ago, Commissioner Dunn,
4 Bob Pickel on the phone tried to chime in
5 and I stopped him, so let's have -- Bob, if
6 you're still there, why don't you go ahead.

7 MR. PICKEL: (Inaudible) I had this
8 one question then a couple of points -- in
9 Steve Sherrod's description of all -- I know
10 that the Commission is analyzing that, I
11 guess they're in the process of perhaps
12 considering an updated report, I was just
13 wondering about any incites you're gleaning
14 from that data as it stands.

15 Secondly, a few questions just
16 regarding the kind of practicalities as we
17 look into the OTC space for collecting this
18 information and potentially looking to
19 impose position limits on aggregated
20 exchange, OTC and overseas basis.

21 I think that's really a question --
22 the kind of things we looked at in recent
23 years was the ICE offerings that we
24 eventually introduced -- some additional
25 reporting kind of brought those into the

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2 position limits we're seeing.

3 Then secondly, these are again, we
4 say it all the time, but it's helpful to
5 emphasize, these are bilateral contracts
6 where even if somebody has the worst of
7 intentions, they need to engage in bilateral
8 negotiations probably with many different
9 entities in order to build up positions that
10 would somehow, at least, have some effect on
11 the exchange prices.

12 So there's kind of a practicality of
13 what exactly is the situation that is going
14 into the transaction, and then assuming you
15 can even get over that hurdle, what would be
16 the requirements regarding unwinding
17 positions if you're looking at aggregated
18 exchanges, OTC and overseas situation. On
19 exchange -- contracts or cancel some of the
20 contracts for whatever the settlement price
21 is on the OTC side he would need effectively
22 to negotiate out of any number of different
23 transactions with any number of different
24 counterparties.

25 Like there are a lot of

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2 practicalities here that we need to think
3 about as we look to expand if, in fact,
4 that's the direction we're going.

5 COMM. CHILTON: Thank you so much,
6 Bob, and I know you had to make a special
7 effort to be with us on the blower here, so
8 thanks very much.

9 We'll go to Paul in D.C. but I
10 wanted to just make a point. You know,
11 we've been putting position limits on ags
12 for a very long time and its worked out real
13 well and I don't think we see people sort of
14 running like Fred Flintstone overseas in the
15 ag markets. I'm convinced we can do it.

16 I have some other concerns that
17 Commissioner Dunn does about staffing and
18 how it's done, et cetera, but, you know, I'm
19 certainly not going to support anything
20 that's crazy or overzealous and going to
21 move things overseas, but there's an
22 appropriate balance, I think, that we can
23 reach, and I can tell you one thing
24 everybody, my colleagues are really smart
25 folks and whatever we do I think we'll get

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2 right.

3 So, Mr. Cicio, Paul Cicio in D.C.,
4 do you want to comment?

5 MR. CICIO: Yes, thank you,
6 Mr. Commissioner. I'll be brief. I would
7 like to simply identify with the remarks of
8 Mr. Slocum and I think he has captured it
9 very, very well.

10 I would add that the stakes are so
11 high, we've tried the old system, it doesn't
12 work, we need aggregate position limits, we
13 need position limits, just in that time
14 period of January to August of last year
15 with the run up of just natural gas it cost
16 consumers across the country \$40 billion
17 just in one commodity, think about all the
18 commodities, there's too much at risk.

19 Finally, there simply is a lack of
20 confidence to allow the exchanges to set
21 these position limits. It can be done as
22 Bart you just said, it's been done well in
23 the agriculture area and to think that it
24 cannot be done and done well in these other
25 commodities is a scare tactic.

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2 Consumers lack confidence in the
3 exchanges to set this, we do need their
4 expertise, we do need their help, we can do
5 this together, if we do it together there's
6 a win win for everyone including the
7 exchanges and we look forward to working
8 with them to achieve these fine results.

9 MS. DOW: Can I make one comment,
10 Mr. Chairman, in response to Mr. Cicio and
11 Mr. Slocum. I think in this particular case
12 it's not an issue of a race to the bottom,
13 it's an issue of the fact that there are
14 risk shifting and hedging needs out there
15 that sometimes require positions that may be
16 above the limits on exchange or that you can
17 carry in a market that's overseas that's a
18 foreign market and it's not subject to
19 position limits.

20 So the activity will continue, it's
21 not going to stop, just because you clamp
22 down on one market it does not stop, these
23 needs are still there, the hedging needs, so
24 the positions need to be placed somewhere,
25 so it's not a question of going to the

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2 in the gas, power and oil markets the
3 utilities, the producers, the generators,
4 transport companies.

5 I think in Steve's comments earlier
6 he mentioned a long name for a category
7 called the Producer Merchant Processor, et
8 cetera, that group of companies we represent
9 the larger part of, and what's unique, I
10 think, though, that I bring to the table
11 here is that the representatives from those
12 companies they are in the CCRO, are, in
13 fact, the risk management functions in each
14 of those companies, there are large
15 companies and small companies, and I think
16 there's a lot of analogous ideas, a lot of
17 analogous experience by risk managers in
18 these companies to what the CFTC is thinking
19 about doing to the markets overall, the
20 difference being that my representatives are
21 looking at their own company, trying to
22 manage those risks similar to the fashion
23 that you guys are thinking about in some way
24 for markets.

25 The two points I want to bring up in

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2 flies very well.

3 If, however, we implement the
4 proposal carefully and in particular for my
5 constituents that are in those opaque or
6 less transparent markets, if we can think
7 about potential impact of the limits that
8 we're discussing, I think there would be a
9 lot of benefits overall to the group in the
10 sense that the unintended consequences might
11 be reduced or mitigated greatly.

12 So we'll certainly make ourselves
13 available and I think it's important that
14 this group of companies, the
15 Producer/Merchants/Processing Group it's
16 such a large part of OTC markets and has
17 such an important role in hedging in the
18 fiscal world, it will be real important that
19 we get their voice in on this whole issue.

20 COMM. CHILTON: Thank you, Bob.
21 We'll use you as a resource and let me just
22 say that, you know, the record of this
23 Advisory Committee meeting can include any
24 materials that you think that we should be
25 looking at now and that goes for all the

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2 EEMAC participants and for the general
3 public as well.

4 Jack Cogen here in New York. Jack.

5 MR. COGEN: Thank you, Commissioner
6 Chilton. I want to expand on a couple of
7 threads of the remarks that Bob Pickel and
8 Kevin Fox touched on.

9 When we hear about position limits
10 and most of the conversation is about the
11 more liquid commodities and the liquid
12 portions of the commodities and the trading,
13 and I'm coming from the environmental
14 commodity side, so it's a little different.

15 First of all, I'm not speaking on
16 these remarks as the Chairman of the
17 International Business Trading Association
18 but as an outsource. We find that there's
19 certain things, as Kevin said, if the entire
20 market is a hundred contracts, who cares,
21 but we find in the new market that's often
22 going to be the case, and so when you look
23 at the limits you also have to look at what
24 is the impact of violating the limits, it's
25 very different to be controlling the nearby

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2 On the other hand, if we would not
3 have done reductions which take out 45
4 million tons of carbon from the atmosphere,
5 so you need to look at the limits but the
6 impact especially on new markets.

7 COMM. CHILTON: Thank you, Jack. I
8 want to make sure that -- we've got one more
9 speaker, Don, but we'll go after that back
10 to D.C. or Kansas City for maybe one or two
11 more, then I want to shift just a little bit
12 and talk about something we've actually
13 started talking about, but, Don, you want to
14 go ahead and make some comments first, then
15 we'll go back to D.C. if anybody wants.

16 MR. CASTURO: Thank you,
17 Commissioner. I just wanted to expound on
18 that topic a little bit more and move beyond
19 position limits to the idea of hedge
20 exemptions and as it relates to position
21 limits.

22 I want to commend the CME for
23 putting out their white paper on position
24 limits, I look forward to reviewing it,
25 particularly because they recognize that the

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2 MR. PANTANO: This is Paul Pantano
3 on the phone from the FIA, is it okay if I
4 make a quick comment?

5 COMM. CHILTON: Yes, thanks, I'm
6 glad you're with us, Paul, go right ahead.

7 MR. PANTANO: Thank you. I want to
8 bring to everybody's attention the testimony
9 that the -- the written testimony that the
10 FIA provided to the Commission on August 5th
11 on position limits.

12 The FIA has been a strong supporter
13 of increased transparency in the markets
14 but, you know, as we're talking about
15 position limits on U.S. futures exchanges,
16 the FIA is very concerned about the
17 migration of price discovery to foreign
18 markets and if you take a look at this
19 position paper that the FIA submitted to the
20 Commission it describes the examples of how
21 that can occur and while it's true that the
22 Commission is going to be very careful about
23 doing this, we just want to caution everyone
24 to think very carefully because companies
25 have exposure, they need to hedge that risk

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2 fully regulated, it's a DCM that provides
3 what I believe the perfect model for that
4 transparency which is to have these
5 transactions settle as futures positions
6 which are fully regulated and transparent.

7 There are other entities out there
8 that are clearing their transactions as
9 financially settled instruments and that's
10 where maybe some of the nontransparencies
11 happen. I know there have been many moves
12 recently to improve that but maybe that's
13 where the space needs to get looked at for
14 further thought on that.

15 I will have you notice a
16 over-the-counter -- probably 60 to 65
17 percent of our positions that we are
18 facilitating on a daily bases are cleared
19 right now between the two major entities
20 which is ICE and NYMEX and growing by the
21 day, natural gas is 35 to 40 percent.

22 So as we talk about the dark space,
23 if you will, the light is coming and has
24 been and actually clearing for us since 2004
25 has been one of the best things for our

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2 We also run agricultural markets in
3 the U.S. and as Commissioner Chilton has
4 pointed out, we find that that has worked
5 very, very well and, in fact, I have never
6 heard of a single complaint that's bubbled
7 up to my level of anyone that hasn't been
8 able to get an exemption that needs an
9 exemption and so I commend the staff at the
10 CFTC for working through those issues.

11 As Don Casturo mentioned that in
12 order to give a hedge exemption we would
13 necessarily need to see the entire global
14 position of a firm, that would include
15 positions on my competitors and in order to
16 grant the exemption there are no rules as to
17 what we might say that an entity should or
18 shouldn't do, particularly vis-a-vis with
19 their positions that are on the competitors,
20 so it's right that that policy of giving
21 hedge exemptions at the exchange level is
22 ripe for potential for anti-competitive
23 behavior.

24 I think, frankly, my company came up
25 with the idea of clearing OTC swaps, we put

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2 York.

3 MR. McCOY: Thank you again. Bill
4 McCoy of Morgan Stanley in New York. I want
5 to thank the Commission as well for focusing
6 on these vital issues and I want to echo
7 some of the comments we've been hearing
8 regarding not just discussion of position
9 limits but the importance of the hedge
10 exemptions and continuing to preserve the
11 hedge exemptions obviously for swap dealers
12 and having a thoughtful approach to it.

13 I mean, what I would stress is the
14 need that any structure where we start
15 looking at potentially aggregating futures
16 and OTC positions that it be in the context
17 of a very dynamic and flexible framework for
18 limits and hedge funds whether it's at the
19 Commission itself or through the exchanges
20 and, obviously, anything that remains static
21 is not going to be able to address the
22 changing market forces that will apply for
23 the commodities, and as Jack Cogen
24 mentioned, all the commodities are different
25 and therefore how these things are being

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2 set.

3 As we heard at the hearing from
4 representatives from -- such as Goldman
5 Sachs and J.P. Morgan about this concept of
6 the success of the special call, we too have
7 seen that the special call has served
8 extremely useful for ourselves internally as
9 well as we believe for the Commission in
10 helping the Commission get a better view
11 into the OTC markets and so this concept of
12 if there were a way of applying positions on
13 an aggregate basis, this concept of looking
14 to swap dealers for the information and then
15 looking through to various market
16 participants, again I would say this is a
17 flexible and dynamic framework for applying
18 the hedge funds should consider many factors
19 such as considerations may be on the issue
20 of -- investment money issues may have to be
21 given as to making distinctions between
22 discretionary and passive investors and how
23 -- whether position limits or hedge funds
24 more likely to be -- hedge exemptions,
25 rather, are more likely to be administered

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2 I did want to confirm that because I thought
3 I heard that and that was helpful.

4 Maybe my second point is not a
5 question, it's just an observation that Bill
6 just -- I think it was Bill from Morgan
7 Stanley in New York just mentioned
8 something. I think you're correct, we've
9 found as a Commission the special call of
10 swap dealers and index investors which is
11 done for I think close to 45 participants
12 very helpful, it was very rough at first, it
13 was labor intensive a year ago, its gotten
14 smoothed out, we hope, through that process
15 to actually give monthly, quarterly index
16 investment data, but I'm not -- I just want
17 to offer a counterview to Ben from J.P.
18 Morgan and Don I think spoke for Goldman
19 Sachs, and I don't know where we'll end up
20 but it's just a counterview, that the swap
21 houses, very important aggregators of risk
22 as you're using the words, whether position
23 limits should be -- whether they should be
24 exempt, basically.

25 We have position limits for others

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2 COMM. GENSLER: I think you were
3 also Deputy Secretary of Energy?

4 MS. MOLER: I've had a checkered
5 career, yes, sir.

6 COMM. CHILTON: She's done a great
7 job.

8 MS. MOLER: But the model works and
9 it saves the government resources and you
10 have the benefit of the expertise of the
11 industry and other stakeholder groups.

12 COMM. CHILTON: Thank you, Betsy,
13 and we're really pleased that you've joined
14 the EEMAC. We are going to break at a
15 quarter to, so I've only got like eleven
16 minutes, but John Riley the Chairman has
17 brought over from the House Agriculture
18 Committee, he's our director of legislative
19 affairs at the CFTC and I've known John for
20 a long time, he does a great job and he's
21 going to give us an update on where things
22 stand on the Hill on OTC legislation and,
23 again, we're going to take a break in about
24 eleven minutes. Go ahead, John.

25 MR. RILEY: Thank you very much,

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2 Commissioner Chilton, it's a pleasure to be
3 here with the Advisory Committee today and
4 going into the discussion.

5 I was asked to kick it off a little
6 bit in terms of where Congress is on OTC
7 derivatives legislation, to do that I guess
8 I'll just briefly note some recent events to
9 keep fresh in your mind, I don't think that
10 there's anything that news to members of the
11 Advisory Committee or the Commissioners, but
12 just having these things together.

13 Chairman Frank was interviewed this
14 week and he kind of made note of a change in
15 the congressional schedule that Congress
16 looks like it's going to be in this session
17 through December and that he was sort of
18 addressing the question of whether or not
19 there was time this year to deal with OTC
20 derivatives legislation and he said,
21 December is the new October, Congress has
22 time to get the bill done this year.

23 His committee along with, of course,
24 the House Ag Committee and the Senate
25 Banking Committee and the Senate

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2 Agricultural Committee are going to be the
3 focus of a lot of attention.

4 Important news within the last
5 couple of weeks was that Senator Dodd is
6 going to remain as chairman of the Banking
7 Committee, Senator Harkin has taken over as
8 chairman of Health, Education and Pensions
9 Committee, and Senator Blanche Lincoln from
10 Arkansas has taken over as chairman of the
11 Senate Agriculture Committee, they all have
12 committed themselves as far as their agendas
13 to move forward on OTC derivatives
14 legislation, and all of those committees, of
15 course, have been pretty active this year.

16 The House Agriculture Committee had
17 a couple of hearings, both Senate Ag and
18 Banking Committees had hearings on OTC
19 derivatives in June, it was in July that
20 Secretary Geitner testified before a joint
21 meeting of the House Agriculture and
22 Financial Services Committee which is one of
23 Chairman Frank's opportunities to point out
24 that there's not going to be a big turf
25 fight this year, that the Ag Committee and

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2 the Financial Services Committee are going
3 to get along and continue to join us, and
4 the Financial Services Committee had a
5 hearing in July as well with Chairman
6 Gensler and SEC Chair Shapiro.

7 Also I'll just note that there has
8 already been some action this year, as a
9 reminder, on OTC derivatives legislation, it
10 was February 12th that the House Ag
11 Committee approved its Bill HR977, it
12 primarily consisted of provisionals that
13 were included in last year's -- the bill
14 passed by the House last year focusing on
15 speculation and energy and agriculture
16 markets, but new provisionals were added
17 that were intended to bring more
18 transparency and oversight to the OTC
19 derivatives markets and that bill was
20 reported as well to the Financial Services
21 Committee.

22 Going into some other events that
23 occurred recently that you know of, it was
24 July 30th Chairman Pearson and Chairman
25 Frank released what they call their

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2 frequency areas where members I think are
3 looking for guidance. So that's all I had,
4 Commissioner Chilton. I turn it back over
5 to you.

6 COMM. CHILTON: Thank you, John,
7 that was very good. I did say I want to
8 take a break and that will be in a couple of
9 minutes from now, but I've gotten approval
10 from our technology people to go for another
11 five minutes. So who wants to speak up on
12 OTC stuff?

13 MR. SHELK: John Shelk from the
14 Electrical Power Supply Association. Skip
15 started to talk about this but I think
16 anybody that does the electricity sector
17 knows that different segments are often to
18 disagree much more frequently than we agree.

19 On the question of the OTC
20 derivatives and requiring them to be cleared
21 on exchange, this is an issue that has
22 brought all of the segments of the industry
23 together, I'm only here to represent the
24 Electric Power Supply Association which is
25 the competitor, also I think it's important

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2 impact the collateral and that's the number
3 one issue.

4 We're facing capital challenges
5 regardless of our type of company or --
6 public power, it touches on the issue we're
7 going to talk about, climate change, or
8 we're expected to invest billion of dollars
9 in retiring plants and other environmental
10 requirements, cyber security, so if you look
11 at that, this is an industry that is a very
12 highly capital intensive industry and
13 becoming more so.

14 So we'd like to work with you and
15 make sure that you all understand how --
16 electricity is -- things that are dealt with
17 by not just this Commission but any other
18 commission, electricity is literally
19 physically interactive. Betsy can speak to
20 that, having regulated that, so we want to
21 be sure that you understand that, and
22 there's a link, of course, to the climate
23 issue that we'll talk about after the break,
24 not only because of the investments that
25 were to address climate change but, of

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2 space, but Jeff could comment to or anyone
3 else.

4 MR. SHELK: The concern has been
5 more -- I've heard more on the fuel side
6 than the input side, where if we had to
7 actually clear these on the exchanges, we're
8 talking about as our members have explained
9 it to me and this has risen to the CEO-CFO
10 level and to the risk level that Bob
11 mentioned, that you would have to post cash
12 collateral on these fuel contracts, that's
13 what I've heard about more often.
14 Obviously, I'll be able to speak more to the
15 output side a little bit more.

16 I've been told right now that
17 because we have physical assets, we're not
18 financial players, we're consuming these
19 products, that we post liens on the power
20 plants and other non-cash collateral
21 principally that the mandatory clearing
22 would shift to --

23 COMM. GENSLER: I can't speak to
24 what Congress would do or even what my
25 fellow Commissioners. I could send a letter

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2 are not dealers provide lending, if you
3 will, imbedded into the FCM piece.

4 COMM. CHILTON: We're going to take
5 a break here. Sorry to cut that
6 conversation a little bit short. You know,
7 there is an OTC piece in the climate change
8 bill, so if you want to continue a part of
9 this discussion when we get to the climate
10 change part of that, you're welcome to do
11 so.

12 We'll start sharply in ten minutes
13 from now. Thank you.

14 (Whereupon, a short recess was
15 taken.)

16 COMM. CHILTON: I'm going to call us
17 back to order. I know people are still
18 taking their seats and that's okay. I was
19 neglectful, Tony Mansfield wanted to get in,
20 he's on the line, the phone line, and I
21 wasn't able to get to him, so I'm going to
22 exert my Chairman's prerogative here and let
23 Tony go ahead and say a word before we move
24 on to our carbon discussion. Tony, why
25 don't you go ahead.

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2 MR. MANSFIELD: Thank you for your
3 time and thank you Commission for convening
4 this meeting, but I'm here as a
5 representative for Shell Trading U.S.
6 Company. I just wanted to briefly follow up
7 on some of the points that were made with
8 regard to the position limits and
9 specifically just to encourage the
10 Commission as it considers this issue of the
11 position limits to also recognize and
12 appreciate even within the group of
13 commodities that we have been referring to
14 as the energy commodities, I think there are
15 some meaningful distinctions.

16 We've heard from a number of people
17 who have talked about the natural gas
18 markets, but I think that there is an
19 important and potentially meaningful
20 distinction between the natural gas market
21 which is a more bounded market in the United
22 States versus the crude oil markets which
23 are a more global market and one of the most
24 robust markets, and I think as the
25 Commission considers the issue of position

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2 cost associated with me paying a monthly
3 premium but that there is a long-term
4 benefit in case if something happens, and I
5 think that the long-term benefit from
6 mandatory clearing is reduced systemic risk
7 and there are clear benefits to end
8 consumers, the households whose
9 contributions help pay my salary to that
10 kind of insurance policy, and so that's all
11 I want to say on that. Thank you.

12 COMM. CHILTON: Thank you, Tyson,
13 and you sort of raised some questions, but
14 actually I would like to go ahead and move
15 on to carbon unless any of my colleagues
16 have something, but you raise interesting
17 points and I know Skip and Laura Campbell
18 may have something to say.

19 Laura, are you on the line, by the
20 way? Doesn't appear so. Let's move right
21 to carbon. Roy Cheruvellil who is in the New
22 York office is one of the folks who works on
23 green cap markets, cap and trade and has
24 done a fantastic job, he's done a great job
25 helping me out over the two years I've been

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2 at the Commission.

3 We don't have as deep a bench as I
4 hope we will in the future but we've got a
5 strong bench and Roy is really good on that
6 along with Rafael and Irina. So Roy is
7 going to give us a quick presentation on
8 carbon, about five minutes or so, we'll get
9 a couple of other people to speak and then
10 we'll open it up after that. Roy, go right
11 ahead.

12 MR. CHERUVELIL: Thank you. Good
13 morning, Commissioners, Committee members,
14 Commission staff and guests. It's my
15 pleasure to sit with you today and lead off
16 our discussion on environmental markets.

17 Our meeting this past May was a
18 fantastic start and we here at the
19 Commission are looking forward to learning
20 from the experience and expertise of the
21 Committee members once again here today.
22 It's been only four months since we last met
23 but the dynamic nature of environmental
24 markets, particularly those for carbon
25 dioxide give us a lot to talk about here

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2 declined including 2008, overall the growth
3 in emissions has been consistently positive.

4 In 2008 peak energy prices and a 2.2
5 percent reduction in total energy
6 consumption coupled with lower economic
7 growth, particularly in the latter part of
8 the year, led to a 2.8 percent decrease in
9 energy related carbon emissions. The EIA
10 has estimated that energy related carbon
11 emissions will fall again for this year but
12 will resume its rise with the projected
13 economic recovery in 2010.

14 This has taken place while
15 atmospheric concentrations of carbon dioxide
16 approach 400 parts per million by volume,
17 the highest they have been in quite
18 sometime, some say thousands if not millions
19 of years.

20 Moving ahead to the next slide. In
21 response to the growth in carbon emissions,
22 robust carbon trading markets have developed
23 around the world with the goal of carbon
24 abatement. The following chart contains
25 information on the aggregated global carbon

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2 market since 2002 in terms of volume and
3 also by dollar value.

4 It shows very clearly that carbon
5 markets have experienced significant rapid
6 growth in this period of time. The market
7 reached a total transactional value of
8 approximately \$126 billion in 2008,
9 essentially doubling in value from 2007. A
10 majority of this can be attributed to
11 transactions of allowances and derivatives
12 relating to the EU emission trading scheme,
13 or EUETS, the largest multi-national cap and
14 trade style, mandatory carbon abatement
15 program in the world, effectuated in 2005.
16 Voluntary carbon markets around the world
17 have also experienced rapid growth.

18 Industry sources have estimated that
19 the global carbon market in 2009 will be at
20 least as large despite weak economic
21 conditions and lower overall emissions.
22 Such explosive growth in global carbon
23 trading markets in tandem with a strong
24 prospect of a mandatory cap and trade
25 program in the U.S. which would drastically

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2 augment the size of the global marketplace
3 has kept us very closely attuned to these
4 market developments here at the CFTC.

5 Can we move on to the next slide,
6 please. The following chart provides a
7 breakdown of CFTC regulated emissions
8 futures contracts by open interest, current
9 and from one year ago. These contracts are
10 listed and traded on the Chicago Commodity
11 Futures Exchange and the New York Mercantile
12 Exchange, CFTC, DCMS.

13 Over the course of just a year total
14 open interest in emissions futures under the
15 CFTC's purview has grown approximately 53
16 percent from 66,000 at open interest to over
17 100,000. While the overall share of open
18 interest and carbon dioxide related futures
19 has remained relatively stable at 35 to 36
20 percent year on year, open interest in these
21 contracts has grown 48 percent, most of this
22 is represented by futures contracts
23 associated with the regional greenhouse gas
24 initiative allowances and with the carbon
25 financial instrument traded on the Chicago

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2 Climate Exchange, both of whom are
3 represented here today.

4 As many of you know, the Commission
5 recently put out a proposed determination
6 for public comment to classify the carbon
7 financial instrument contract traded as a
8 significant price discovery contract, such a
9 determination would give the CFTC full
10 oversight authority over the contract.

11 I'd also like to mention that we
12 have witnessed growth in the sulfur dioxide
13 and nitrogen dioxide allowance contracts
14 affiliated with the acid rain, budget
15 trading and clearing air market programs,
16 and have also seen the development of new
17 projects.

18 Experience with the regulation of
19 these markets has helped us gain a great
20 understanding and should place us in a good
21 position if and when a mandatory program is
22 active for carbon dioxide.

23 Moving on to the next slide, please.
24 The next slide charts the price of the EUA,
25 as I mentioned the most heavily traded

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2 considered traditional compliance entities,
3 oil and gas companies, utilities and large
4 industrials.

5 As with most of our markets, these
6 markets also contain the presence of
7 brokers, financial institutions,
8 intermediaries and hedge funds. Thus far
9 I'm happy to report that we have not had any
10 major surveillance issues or enforcement
11 actions with regards to CFTC regulated
12 emissions markets.

13 This does transition us to a couple
14 of important questions which I'd like to
15 toss out to our Committee members, if they
16 feel like addressing them.

17 There has been much public debate
18 about the role of financial institutions and
19 banks in a potentially mandatory -- in a
20 potential mandatory national cap and trade
21 market for carbon.

22 Some argue that the role of
23 financial institutions must be significantly
24 limited to prevent speculative bubbles,
25 while others say that financial institutions

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2 The Senate debate on an energy climate bill
3 will certainly wait for health care to be
4 resolved and for appropriations bills to be
5 enacted.

6 We also have to wait for the
7 financial services reform bill and to me
8 that suggests that the window is not 2009 as
9 many had hoped but possibly 2010, and if you
10 listen to what Senator Reed said yesterday,
11 2009 is really not on the table, but we also
12 have to understand that 2010 is an election
13 year and to me that means that the first
14 quarter is really the quarter we have to
15 think about, maybe it could spill over into
16 the second quarter, but you really have a
17 fairly narrow window here to see a climate
18 cap and trade bill passed.

19 I think there are some things that
20 could help us toward passage of a bill,
21 continued positive signals from China and
22 other developing countries, particularly
23 Copenhagen I think would help a Senate vote
24 and most importantly a legislative success
25 in health care would help a Senate vote.

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2 I think there are two things beyond
3 that that actually have to happen if we want
4 to see an energy and climate bill emerge
5 from the Congress. First, I think we can't
6 expect every Democratic Senator to vote for
7 an energy climate bill, so we will need a
8 pretty solid number of Republican votes.
9 Right now even Republican Senators with
10 years of leadership on climate change have
11 been reluctant to return to that leadership
12 role, and that's really because the mood in
13 Congress is deeply partisan.

14 I think to get a bill that would
15 have to change, we would have to see a
16 number of Republican Senators work
17 constructively with the Democrats and the
18 administration to develop and pass a bill.
19 Maybe even more important, I think the
20 administration would have to advance a
21 fairly detailed vision for what must be in a
22 bill and generally become much more involved
23 in the legislative process than it has been
24 to date, a little bit more like the first
25 Bush administration did in enacting the

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2 testified yesterday before the Energy
3 Committee in the Senate on cost containment
4 issues on a cap and trade bill, but one of
5 the things that really struck me was the
6 amount of discussion about market
7 manipulation and market oversight and it
8 came from some Senators who just don't like
9 markets and it came from some Senators who
10 probably would never vote for a bill of this
11 kind no matter what it says, but who are
12 using this as a reason not to vote for it,
13 and I think it's worth pointing that out,
14 that this whole issue is very key to what
15 actually might happen or not happen.

16 COMM. CHILTON: Professor Stevens,
17 are you on line with us? If not, I want to
18 go to really our regulated entities, RGGI
19 and CCX. John Shrag is here in New York
20 with Reggie Johnson.

21 MR. SHRAG: Thank you, Commissioner,
22 thanks for including the Regional Greenhouse
23 Gas Initiative and, as you know, I'm a
24 representative of Regional Greenhouse Gas
25 Initiative, Inc. which is a not for profit

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2 auctions that RGGI is known for and the
3 secondary market.

4 We've developed a very strong
5 relationship with your staff, Roy, Rafael
6 and Irina in understanding the secondary
7 market, the independent market monitor firm
8 has worked with them and created sets of
9 methodologies for doing market monitoring of
10 carbon markets and I think that the RGGI
11 states and RGGI, Inc. understand RGGI as a
12 playground, if you will, for that kind of
13 development for bidders, for analysts, for
14 journalists and for regulators, and that's
15 been very productive and we look forward to
16 continuing that.

17 I think if you talk about the
18 monitoring of the auctions, they are as
19 important as the originating device to the
20 extent that allowances are allocated and
21 originate through auctions, as important for
22 an overall sense of integrity as the
23 secondary markets are and the derivatives
24 markets.

25 The way that the RGGI program, which

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2 transparency, no counterparty risk in
3 providing the hedging medium for those
4 people who are involved in that market.

5 We also run a voluntary cap and
6 trade called the Chicago Climate Exchange
7 and in that market we have a significant
8 number of players, about 600 million tons of
9 baseline which would make it about 30
10 percent of the Europe size as far as
11 underlying emissions.

12 We have two objectives in our group,
13 number one is to establish a market when
14 there is no mandate from a federal, state or
15 regional level and that is what we have done
16 in the United States and we have partnered
17 with the China National Petroleum
18 Corporation, Petro China, to establish such
19 a market and that is called the PNJ Climate
20 Exchange.

21 In the voluntary market which is
22 relevant to the debates, I'd like to briefly
23 describe what we do there. Even though we
24 were exempt under the CFTC, we opted for
25 oversight and chose to be regulated by FINRA

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2 Are you NatSource, where are you now?

3 MR. COGEN: I'll speak on behalf of
4 IETA. I am NatSource, an aggregator and
5 portfolio manager of carbon, we are managing
6 approximately a million dollars worth of --
7 (inaudible.) The remarks I'm going to make
8 actually represent my role as chairman of
9 the International Emissions Trading
10 Association. IETA represents or has
11 members, 170 corporations, approximately 50
12 percent being large industrial emitters, the
13 other 50 percent being financial
14 institutions, legal firms and the various
15 support and firms that are necessary for an
16 international carbon market.

17 IETA supports clear and stringent
18 market oversight policies to ensure that
19 carbon markets achieve the greatest possible
20 emissions reductions at the lowest possible
21 cost. We support measures to achieve
22 transparency, require robust disclosure
23 information to the regulator, create open
24 markets and provide fair competition in
25 order to enable covered industries, their

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2 capital, OTC transactions are now covered
3 industries or offset producers to use their
4 physical assets as collateral instead of
5 posting cash as required by an exchange.

6 This is key and these firms will
7 often choose to go to OTC transactions since
8 they can free up capital to be used for
9 other more productive purposes, instead of
10 locking it up as collateral for years at a
11 time potentially in these type of
12 transactions for as long as ten years, the
13 result is a lower cost of financing in the
14 OTC market.

15 OTC markets without the long-terms
16 planning, unlike exchanges, OTC markets
17 allow for elongated contracts and therefore
18 enable the industry to manage its needs for
19 any duration necessary. OTC markets allow
20 for customization to business needs, a key
21 advantage of OTC transactions is the ability
22 to tailor the transaction to the exact
23 amount of the carbon or other energy
24 commodity needed, the ability to precisely
25 match the OTC transaction with the carbon

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2 exposure has very real accounting
3 implications and can negatively affect the
4 stability of profits of the corporation.

5 Finally, on this point, OTC markets
6 are absolutely necessary to develop offset
7 projects. OTC markets provide the
8 flexibility to develop contract structures
9 that are tailored to the finance needs of
10 offset projects. A typical offset structure
11 in the carbon market extends five to ten
12 years into the future and often allow best
13 efforts to deliver the volume as opposed to
14 the absolute need or an exchange for firm
15 delivery of the commodity.

16 Given the challenges in developing
17 offset projects and regulatory approvals as
18 well as the unpredictability of weather,
19 offsets would be impossible to trade on the
20 exchanges prior to the creation and
21 issuance.

22 IETA believes market oversight
23 policy should encourage a wide range of
24 market participation, including financial
25 institutions. The private sector would need

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2 COMMISSIONER SOMMERS: I don't have
3 anything.

4 COMM. CHILTON: Others want to chime
5 in here? Sean Cota here has something. I
6 want to double-check to make sure that
7 Professor Stevens didn't join us. Rob, are
8 you there? Okay, we'll move on. Sean Cota
9 has a comment.

10 MR. COTA: I think that we need to
11 be careful as we go into these carbon
12 markets that we realize that there are going
13 to be a lot more connected to energy price
14 than were NOX or SOX, and the oversight is
15 differentials between NOX and SOX and how
16 it's been traded in the past is different
17 from what carbon trading will be because
18 there were different levels of oversight.

19 So with most large NOX and SOX
20 emitters, you've got the EPA as an additional
21 regulator because there are individual
22 permits for large power plants and large
23 consumers, in addition, you've got state
24 regulatory commissions that are overseeing
25 both power plant productions and our

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2 the transparency in the energy markets,
3 it's my opinion that the disruptions we
4 potentially have seen in the energy markets
5 will be even more compounded because the
6 carbon market is going to be so much bigger.

7 So that's my concern for the
8 Commission going forward and that the past
9 successes which in my opinion have been
10 successes and NOX and SOX will not
11 necessarily readily translate to carbon
12 without a significant amount of market
13 oversight.

14 COMM. CHILTON: Thank you, Sean.
15 Benjamin Feldman in D.C., did you want to
16 make a comment?

17 MR. FELDMAN: Thank you. First,
18 Bart, I would like to commend you on your
19 speech yesterday in New York on the subject
20 of cap and trade legislation and some of the
21 things that you laid out with which we
22 wholeheartedly agree.

23 Also, just to sort of refer back to
24 what Jack Cogen was mentioning and Roy's
25 basic question which is, what's the role of

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2 pretty quickly after that. Tyson, did you
3 want to make some remarks?

4 MR. SLOCUM: Yes. Thank you very
5 much, Bart. First I just want to applaud
6 the CFTC for putting the question out there
7 whether or not the Chicago -- the carbon
8 product on the Chicago Climate Exchange,
9 whether it meets the test of influencing the
10 price. You know, Public Citizen definitely
11 supports bringing the Chicago Climate
12 Exchange under enhanced regulation, that
13 would increase reporting requirements and
14 position limits and I think importantly that
15 would provide the CFTC with access to the
16 cash market and I think that moves us closer
17 to where the Senate has been, where you've
18 got Senator Barbara Boxer supporting a
19 legislative action by Feinstein and Snow
20 that would give the CFTC jurisdiction over
21 both the cash and the futures market,
22 whereas the House bill that passed in June
23 kind of splits up jurisdiction between cash
24 and futures with FERC taking cash and CFTC
25 taking futures.

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2 So I believe that having one agency
3 oversee both markets would be better and I
4 appreciate Roy's presentation that showed 90
5 percent correlation between carbon dioxide
6 prices in Europe and futures prices with a
7 key fossil fuels, I think that really
8 underscores how important it is for the CFTC
9 to have jurisdiction over these markets
10 because they're all going to be interrelated
11 and it's really important that we have
12 strong regulatory jurisdiction over what are
13 going to be emerging carbon markets in the
14 United States. So that's all I wanted to
15 say. Thank you.

16 COMM. CHILTON: Thank you, Tyson.
17 Betsy.

18 MS. MOLER: Thank you.
19 Mr. Chairman, we noted your remarks last
20 week with great interest where you said you
21 did not support mandatory exchange trading
22 and we at Exxon and I believe the vast
23 majority of our sector agree with that. We
24 do need over-the-counter markets, we have
25 lots of very, very peculiar little products

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2 and the trading associated with regional
3 powers markets is huge, three-quarters of
4 the United States consumers are served by
5 regional power markets, so this is not a
6 trivial thing.

7 We have endorsed having the CFTC
8 have oversight over OTC markets and products
9 and absolutely understand the importance of
10 that, things like position limits and
11 disclosure and transparency and everything,
12 but if we're to have a successful cap and
13 trade market, we have to have the ability to
14 do the trading, develop the deep liquid
15 markets.

16 Here I think we can all put on our
17 consumer hats because if they're not
18 flexible enough and big enough, this whole
19 cap and trade thing is not going to work and
20 that's what's really important. It's also
21 true if you treat them as transmission
22 organizations then we would be happy to work
23 with you and your staff to understand these
24 creatures if that would be at all helpful.

25 COMM. CHILTON: Thank you, Betsy. I

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2 want to wrap up here unless there are other
3 people who feel a burning desire to make a
4 comment now and you're welcome to. Jack
5 Cogen here.

6 MR. COGEN: A very brief remark.
7 One of the things as we separate energy from
8 the beginning discussion and environmental
9 pieces, I think what we all seem to agree on
10 is don't separate -- (inaudible) -- we'll
11 take everything else, and that's one of the
12 things that we want to get through to the
13 Congress as well is that carbon is not
14 exceptional, it works, it's another
15 commodity and all the same rules should
16 apply.

17 COMM. CHILTON: Thank you, Jack. Is
18 there somebody else in D.C.?

19 MS. DOW: I just wanted to mention,
20 Mr. Chairman, you talked about the fact that
21 there is another venture out there, the
22 grain exchange venture, I just wanted to
23 acknowledge it's a partnership launched,
24 we're one of the founding partners, CME
25 Group, it involves environmental brokerage

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2 But the other thing that I was told
3 from people during the break is that doing
4 this virtually has been very helpful and so
5 my intention would be at the next EEMAC
6 meeting we do the same thing. So finally in
7 that regard, I want to thank the CFTC staff.
8 First of all, really, the technical people,
9 Lamar Dunn in D.C. and John Rogers and
10 Robert Young here who we had the great
11 slides that we had earlier this year, we got
12 them here in New York, I'm sorry, we don't
13 have them all in D.C., but we're looking at
14 the Grand Canyon and the Tetons and it makes
15 for a nice environment, we thank Robert.

16 Also Laurie Chowns (phonetic) in
17 Kansas City, thank her. I thank our
18 presenters, Roy Cheruvelil and Steve Sherrod
19 and John Riley, and then finally our staff
20 Tammy Semega, Mandy and their staff, and
21 finally the folks -- the office directors,
22 Venel Hickson and Henry Hansen here and then
23 Holy Arines and Elizabeth Ritter and Laura
24 Gardy on my staff and all the Commissioners
25 and their staffs for working with us as we

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2 have been going forward.

3 Unless there's anything else from my
4 colleagues, anything?

5 COMM. GENSLER: I just want to make
6 a big thank you from the three Commissioners
7 here. It's great to get your advice, the
8 fidelity and the clarity with you addressing
9 these issues.

10 COMM. CHILTON: Thank you so much to
11 all of our presenters and all the EEMAC
12 members and as always our e-mails are open
13 and feel free to holler at us, tell us what
14 we're doing right and what we're doing wrong
15 more importantly.

16 Thank you. The meeting is
17 adjourned, have had a good day.

18 (Time noted: 11:05 a.m.)

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