Energy and Commerce QFRs

1. What are the CFTC's views on the potential for CFTC regulation of Financial Transmission Rights traded on Independent System Operators? Could these contracts for electricity transmission potentially fall under CFTC jurisdiction?

The CFTC does not have regulatory authority over cash or forward commodity transactions and the sale and marketing of such commodities. The Commission's regulatory jurisdiction is determined by whether a given transaction is a contract of sale of a commodity for future delivery (commonly known as a futures contract), which primarily serves to manage price risk in a commodity.

Determining whether any given transaction constitutes a contract of sale of a commodity for future delivery is governed by a body of case law and administrative actions on the subject matter applied to the particular facts and circumstances surrounding such transactions. If the relevant facts and circumstances demonstrate that given agreements constitute "... transactions involving contracts of sale of a commodity for future delivery, traded or executed on a [designated contract market] ... or any other board of trade, exchange or market ..." then, pursuant to Section 2(a)(1)(A) of the Commodity Exchange Act (CEA), the transactions would be subject to the CFTC's exclusive jurisdiction on a contract by contract basis.

In the absence of the facts and circumstances under which Financial Transmission Rights (FTRs) are currently being traded, it is difficult to answer the question with more specificity. Nevertheless, it is clear that the CFTC does not have regulatory authority over cash or forward commodity transactions that are commonly associated with the physical sale and marketing of such commodities, including physical energy transactions that fall into this category.

2. Why has the CFTC intervened in two separate lawsuits to which it is not a party, to challenge the Federal Energy Regulatory Commission's (FERC) authority to assert its anti-manipulation authority with respect to Amaranth? Is CFTC escalating its disagreement with FERC from merely providing a position to a judge where it was already a party, as it did in the matter of CFTC v. Amaranth et al. in the Southern District of New York?

The CEA provides in Section 2(a)(1)(A) that the CFTC shall have exclusive jurisdiction with respect to futures trading on a designated contract market such as the New York Mercantile Exchange (NYMEX). An unbroken line of federal court decisions dating from the mid-1970s holds that this grant of exclusive jurisdiction to the CFTC bars other federal regulatory agencies from exercising jurisdiction over this activity.

In July 2007, the CFTC brought an enforcement action against Amaranth in the U.S. District Court for the Southern District of New York alleging that Amaranth had attempted to manipulate the settlement price of the NYMEX natural gas futures contract in 2006 through a pattern of unlawful trading on the NYMEX. Also in July 2007, the FERC filed an administrative enforcement action similarly alleging that Amaranth had manipulated the settlement price of the NYMEX natural gas futures contract in 2006 through unlawful trading activity on the NYMEX. The FERC alleges that Amaranth's futures trading had downstream effects on physical natural gas prices and thereby violated the Natural Gas Act (NGA), as amended by the Energy Policy Act of 2005. The FERC has asserted that the alleged manipulative trading activity on NYMEX does not fall within the scope of the CFTC's exclusive jurisdiction under the CEA and, further, that the Energy Policy Act of 2005 implicitly limits the CFTC's exclusive jurisdiction with respect to futures trading that is alleged to have affected physical natural gas prices.

The CFTC disagrees with the FERC's interpretation of the CEA, and does not believe that the Energy Policy Act of 2005 lessened the scope of its exclusive jurisdiction under the CEA. Because the FERC has charged the Amaranth respondents with engaging in an unlawful pattern of futures trading on a designated contract market, the CFTC believes that the FERC action conflicts with the exclusive jurisdiction provision in the CEA. Equally important, the CFTC believes that the FERC action conflicts with the fundamental policy objective underlying Congress's grant of exclusive jurisdiction to the CFTC: avoiding inconsistent standards governing trading on U.S. futures exchanges. This is of critical importance to the continued expansion of the futures markets, which have witnessed dramatic growth since 2000.

The respondents in the FERC administrative action have challenged the agency's authority to prosecute the case in three different forums. First, in July 2007, respondent Brian Hunter filed an action in the U.S. District Court for the District of Columbia seeking declaratory and injunctive relief to block the FERC action. The district court denied Hunter's motion for a temporary restraining order on July 24, 2007 and denied his motion for a preliminary injunction on December 10, 2007. In neither of these rulings did the court reach the exclusive jurisdiction issue. The CFTC has not sought to participate in the Hunter case.

Second, on August 16, 2007, Amaranth filed a motion challenging the FERC's authority to prosecute its case by seeking injunctive relief in the case filed by the CFTC against Amaranth in New York. The presiding judge ordered briefing on Amaranth's motion, making clear on the record that he expected the CFTC to address the exclusive jurisdiction question in its brief. In response to the court's directive, the CFTC on September 28, 2007 filed a brief opposing Amaranth's request for a preliminary injunction and setting out the CFTC's position regarding the scope of its exclusive jurisdiction over futures trading on designated contract markets. On November 1, 2007, the court denied Amaranth's request for a preliminary injunction without reaching the exclusive jurisdiction issue.

Finally, various respondents in the FERC case requested reconsideration of the agency's decision to file charges in the case, asserting that the CEA vests in the CFTC exclusive jurisdiction over futures trading on the NYMEX. On November 30, 2007, the FERC issued an adjudicatory Order that denied those reconsideration requests and for the first time spelled out its theory for asserting jurisdiction over futures trading on a designated contract market.

Various respondents petitioned for review of the FERC's November 30, 2007 Order in the U.S. Court of Appeals for the District of Columbia Circuit. Because the FERC has now issued a formal Order taking a position on the scope of the CFTC's exclusive jurisdiction under the CEA that directly conflicts with the CFTC's views on that issue, the CFTC concluded that full participation in the appeal as an intervenor was both necessary and warranted. As the agency charged with administering the CEA for the past 34 years, it is incumbent on the CFTC to provide the D.C. Circuit with its views regarding the important questions presented in this appeal.

In opposing Amaranth's motion in the New York case, the CFTC's brief argued that "FERC should be permitted to determine in the first instance the scope of its new anti-manipulation authority under [the Energy Policy Act of 2005] in light of the pre-existing statutory grant of exclusive jurisdiction over futures trading to the CFTC in the CEA . . . If FERC's determination is adverse to the respondents in that action . . . they will have an opportunity to petition for review of that decision by the U.S. Court of Appeals for the District of Columbia." That is what has now occurred.

Accordingly, the CFTC's request to intervene in the D.C. Circuit case – which is the first instance in which we have sought to intervene in any matter involving Amaranth – does not represent an escalation of our legal disagreement with the FERC. Rather, it is a response to FERC's position on the scope of the CFTC's exclusive jurisdiction, as spelled out in the November 30, 2007 Order. Further, as Chairman Kelliher testified before the Subcommittee on December 12, 2007, the "respectful disagreement" between the CFTC and the FERC over this legal issue is "best resolved by the courts." *[Source: December 12, 2007 House Energy and Commerce Subcommittee on Oversight and Investigations Hearing, "Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?"]* The CFTC agrees with Chairman Kelliher that this question should appropriately be decided by the courts, and we believe that the courts should hear fully from both of the interested agencies.

3. Would the CFTC support or oppose legislation that would eliminate no action letters and require electronic exchanges to register with the CFTC as designated contract markets if they are trading on a Foreign Board of Trade through terminals in the U.S. for commodities that are designated for delivery in the U.S. (such as West Texas Intermediate Crude for Cushing, OK delivery)?

In 2006, the CFTC carefully examined this issue in its review of our foreign board of trade (FBOT) policy. At that time, the CFTC concluded that it would be problematic to have a requirement that FBOTs register with the CFTC as designated contract markets if their members used U.S. terminals to trade commodities that are subject to U.S. delivery.

The CFTC found that the best way to handle the issue was to continue its no-action approach, a response that reflects the internationally accepted "deference to home regulator" approach used by regulators in many developed market jurisdictions to govern access to foreign electronic exchanges by persons located in their jurisdictions. This approach generally is based upon a review of, and ongoing reliance upon, the foreign market's "home" regulatory regime, and is designed to maintain a threshold level of regulatory protections while avoiding the imposition of duplicative regulation.[1]

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[1] See, e.g., United Kingdom Financial Services Authority, Financial Services Handbook, Recognised Overseas Investment Exchanges (ROIE), Section 6; Australian Securities and Investments Commission, Policy Statement 177.8 describing alternative licensing for overseas markets; Ontario Securities Commission Staff Notice 21-702, Regulatory Approach for Foreign-Based Stock Exchanges; and Autorite des marches financiers (Quebec), Policy Statement Respecting the Authorization of Foreign-Based Exchanges. The German Bundesanstalt für

The CFTC has followed the no-action approach since 1996 and it has never experienced any market integrity or customer protection problems. The CFTC held an FBOT hearing in June 2006, including a related open public comment opportunity, during which market users, foreign exchanges and even competitive domestic exchanges overwhelmingly confirmed the success of the CFTC's approach in terms of market and customer protection and access to additional products. Subsequently, the CFTC issued a Statement of Policy re-affirming the use of the FBOT no-action process, but also enhancing it through support of information-sharing conditions where no-action relief is sought for FBOT contracts that could adversely affect the pricing of contracts traded either on a designated contract market or on any cash market for commodities subject to the CEA.

Requiring designation rather than issuing no-action letters may trigger responsive regulation by foreign jurisdictions that could lead to the imposition of greater regulatory costs on U.S. futures exchanges, such as full registration in those foreign jurisdictions. Since U.S. exchanges generally operate in multiple foreign jurisdictions, they could become subject to a wide variety of different, and possibly conflicting, regulatory requirements in every jurisdiction in which their trading systems are made available.

Even if foreign jurisdictions were more measured and only required full registration by U.S. futures exchanges when they listed commodities that were deliverable in those jurisdictions, it would still expose U.S. futures exchanges to greater regulation abroad. Notably, several U.S. exchanges that permit foreign access currently list futures contracts on commodities that are produced or delivered in foreign jurisdictions, including the CME, NYMEX and ICE Futures U.S.

Finally, the no-action procedure provides the CFTC with flexibility in dealing with particular foreign exchanges and different practices. Requiring designation would result in standardized requirements and conditions on FBOTs and would be less tailored to a particular foreign exchange that is already subject to regulation in its home jurisdiction.

Finanzdienstleistungsaufsicht (BAFIN) authorizes the placement of foreign terminals in Germany under Sections 37i et seq. of the German Securities Trading Act.