UNIVERSITY OF MARYLAND
SCHOOL OF LAW

June 6, 2008

Mr. Donald S. Clark
Federal Trade Commission
Office of the Secretary
Room H-135 (Annex G)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Market Manipulation Rulemaking, P082900

Dear Mr. Clark,

In response to the request for comments within Federal Trade Commission's Advance Notice of Proposed Rulemaking ("ANOPR") concerning, "Prohibitions On Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007," I attach the testimony I delivered to the United States Senate Committee on June 3, 2008 at its hearing entitled, "Energy Market Manipulation and Federal Enforcement Regimes."

One of the important aspects of that hearing was to provide guidance to the Federal Trade Commission in carrying out its responsibilities tasked to it under Energy Independence and Security Act of 2007. My testimony specifically addressed many of the questions posed in the ANOPR as well as the general information about the markets.

Thank you.

Michael Greenberger
Law School Professor
University of Maryland
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Testimony of

Michael Greenberger

Law School Professor

University of Maryland School of Law

500 West Baltimore Street

Baltimore, MD 21201

Before the United States Senate Committee on Commerce, Science, and Transportation

Regarding

Energy Market Manipulation and Federal Enforcement Regimes

Tuesday, June 3, 2008

10:00 a.m.

253 Russell Senate Office Building

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Introduction

My name is Michael Greenberger.

I want to thank the committee for inviting me to testify on the important issue that is the subject of today's hearings.

After 25 years in private legal practice, I served as the Director of the Division of Trading and Markets ("T&M") at the Commodity Futures Trading Commission ("CFTC") from September 1997 to September 1999. In that capacity, I supervised approximately 135 CFTC personnel in CFTC offices in DC, New York, Chicago, and Minneapolis, including lawyers and accountants who were engaged in overseeing the Nation's futures exchanges. During my tenure at the CFTC, I worked extensively on, *inter alia*, regulatory issues concerning exchange traded energy derivatives, the legal status of over-the-counter ("OTC") energy derivatives, and the CFTC authorization of trading of foreign exchange derivative products on computer terminals in the United States.

While at the CFTC, I also served on the Steering Committee of the President's Working Group on Financial Markets ("PWG"). In that capacity, I drafted, or oversaw the drafting of, portions of the April 1999 PWG Report entitled "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management," which recommended to Congress regulatory actions to be taken in the wake of the near collapse of the Long Term Capital Management (LTCM) hedge fund, including Appendix C to that report which outlined the CFTC's role in responding to that near collapse. As a member of the International Organization of Securities Commissions' ("IOSCO") Hedge Fund Task Force, I also participated in the drafting of the November 1999 report of IOSCO's Technical Committee relating to the LTCM episode: "Hedge Funds and Other Highly Leveraged Institutions."

After a two year stint between 1999 and 2001 as the Principal Deputy Associate Attorney General in the U.S. Department of Justice, I began service as a Professor at the University of Maryland School of Law. At the law school, I have, *inter alia*, focused my attention on futures and OTC derivatives trading, including academic writing and speaking on these subjects. I currently teach a course that I designed several years ago entitled "Futures, Options, and Derivatives," in which the United States energy futures trading markets are featured as a case study of the way in which unregulated or poorly regulated futures and derivatives trading cause dysfunctions within those markets and within the U.S. economy as a whole. One result of this dysfunction, as I describe to my students, is the needlessly high prices which energy consumers now pay because of the high probability of excessive speculation, illegal manipulation, and fraud within those markets.

The question whether there has been manipulation of U.S. energy futures markets in general, and U.S. delivered crude oil contracts specifically, has been the subject of many hearings. I have previously testified at three of those hearings, the most recent held on December 12, 2007 hearing before the Subcommittee on Oversight and Investigations of the U.S. House Committee on Energy and Commerce. To put the issue of today's hearing in context, I summarize the points I made at that hearing immediately below.

Summary of Prior Testimony

One of the fundamental purposes of futures contracts is to provide price discovery in the "cash" or "spot" markets. Those selling or buying commodities in the "spot" markets rely on futures prices to judge amounts to charge or pay for the delivery of a commodity.[1] Since their creation in the agricultural context decades ago, it has been widely understood that, unless properly regulated, futures markets are easily subject to distorting the economic fundamentals of price discovery (*i.e.*, cause the paying of unnecessarily higher or lower prices) through excessive speculation, fraud, or manipulation.

The Commodity Exchange Act ("CEA") has long been judged to prevent those abuses. Accordingly, ***prior*** to the hasty and last minute passage of the Commodity Futures Modernization Act of 2000 ("CFMA"), "all futures activity [was] confined by law (and eventually to criminal activity) to [CFTC regulated] exchanges alone."[2] At the behest of Enron, the CFMA authorized the "stunning" change to the CEA to allow the option of trading energy commodities on deregulated "exempt commercial markets," *i.e.*, exchanges exempt from CFTC, *or any other* federal or state, oversight, thereby rejecting the contrary 1999 advice of the President's Working Group on Financial Markets. *Id.* This is called the "Enron Loophole."

Two prominent and detailed bipartisan studies by the Permanent Subcommittee on Investigations' ("SPI") staff represent what is now conventional wisdom: hedge funds, large banks and energy companies, and wealthy individuals have used "exempt commercial energy futures markets" to drive up needlessly the price of energy commodities over what economic fundamentals dictate, adding, for example, what the SPI estimated to be @ $20-$30 per barrel to the price of a barrel of crude oil. At the time, the price of crude oil had reached a then record high of $77. The conclusion that speculation has added a large premium to energy products has been corroborated by many experts, including most recently and most prominently, George Soros.[3]

[1] *See* Written Testimony of Professor Michael Greenberger, *Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?: Hearing Before the H. Subcomm. on Oversight and Investigations*, 3-5 (2007) *available at* http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1011&context=cong_test (last visited June 1, 2008).

[2] PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, COMMODITIES REGULATION 28 (Cumm. Supp. 2008).

[3] *See, e.g.,* Edmund Conway, *George Soros: rocketing oil price is a bubble*, DAILY TELEGRAPH (May 27, 2008) *available at* http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml (last visited June 1, 2008) (quoting Mr. George Soros as stating "Speculators are largely responsible for driving crude prices to their peaks in recent weeks and the record oil price now looks like a bubble"); Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs*, U.S. Senate 2 (May 20, 2008) *available at* http://hsgac.senate.gov/public/_files/052008Masters.pdf (last visited June 1, 2008) (quoting Michael W. Masters as stating "Are Institutional Investors contributing to food and energy price inflation? And my unequivocal answer is YES"); Alejandro Lazo, Energy *Stocks Haven't Caught Up With Oil Prices*, WASH. POST (Mar. 23, 2008) *available at* http://www.washingtonpost.com/wpdyn/content/article/2008/03/21/AR2008032103825.html (last visited June 1, 2008) (quoting Mr. Fadel Gheit as stating "The largest speculators are the largest financial companies"); Michelle

The SPI staff and others have identified the Intercontinental Exchange ("ICE") of Atlanta, Georgia as an unregulated facility upon which considerable exempt energy futures trading is done. For purposes of facilitating exempt natural gas futures, ICE is deemed a U.S. "exempt commercial market" under the Enron Loophole. For purposes of its facilitating U.S. WTI crude oil futures, the CFTC, by informal staff action, deems ICE to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter alia*, @ 30% of trades in U.S. WTI futures. That staff informal action may be terminated instantly by the CFTC under existing law.[4]

Virtually all parties now agree the Enron Loophole must be repealed. The simplest way to repeal would be to add two words to the Act's definition of "exempt commodity" so it reads: an exempt commodity does "not include an agriculture *or energy* commodity;" and two words to 7 U.S.C. § 7 (e) to make clear that "agricultural *and energy* commodities" must trade on regulated markets. An "energy commodity" definition which includes crude oil, natural gas, heating oil, gasoline, heating oil, metals, etc. must then be added.[5] In the absence of quick CFTC action permitted by law, the statute should also be amended to forbid an exchange from being deemed an unregulated foreign entity if its trading affiliate *or* trading infrastructure is in the U.S.; *or* if it trades a U.S. delivered contract within the U.S. that significantly affects price discovery.

A Critique of the Farm Bill's "End the Enron Loophole" Provision

On May 22, 2008, the Food Conservation and Energy Act of 2008[6] (the "Farm Bill") was enacted into law by a Congressional override of President Bush's veto. Title XIII of the Farm Bill is the CFTC reauthorization act, which, in turn, includes a provision that was intended to "close" the Enron Loophole.[7] Rather than returning to the status quo ante prior to the passage of

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Foss, United States Natural Gas Prices to 2015, Oxford Institute for Energy Studies 34 (2007) *available at* http://www.oxfordenergy.org/pdfs/NG18.pdf (last visited June 1, 2008) (asserting "The role of speculation in oil markets has been widely debated but could add upwards of $20 to the price per barrel"); *Economist Blames Subsidies for Oil Price Hike*, ADVANTAGE BUS. MEDIA (2008), *available at* http://www.chem.info/ShowPR.aspx?PUBCODE=075&ACCT=0000100&ISSUE=0609&ORIGRELTYPE=DM&RELTYPE=PR&PRODCODE=00000&PRODLETT=M&CommonCount=0 (last visited June 1, 2008) (quoting Dr. Michelle Foss as stating "We have an overpriced commodity, and this is going to be around for a while"); Kenneth N. Gilpin, *OPEC Agrees to Increase Output in July to Ease Oil Prices*, N.Y. TIMES (June 3, 2004) *available at* http://www.nytimes.com/2004/06/03/business/03CNDOIL.html?ei=5007&en=5dbd50c5b369795b&ex=1401681600&partner=USERLAND&pagewanted=all&position (last visited June 1, 2008) (quoting Mr. Kyle Cooper as stating "There is not a crude shortage, which is why OPEC was so reluctant to raise production."); *Speculators 'not to blame' for oil prices*, UPSTREAM, (April 4, 2008) available at http://www.upstreamonline.com/live/article151805.ece (last visited June 1, 2008) (quoting Mr. Sean Cota as stating "It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude prices"); Mike Norman, *The Danger of Speculation*, FOXNEWS.COM (Aug. 19, 2005) *available at* http://www.foxnews.com/story/0,2933,166038,00.html (last visited June1, 2008) (Mr. Norman stating "Oil prices are high because of speculation, pure and simple. That's not an assertion, that's a fact. Yet rather than attack the speculation and rid ourselves of the problem, we flail away at the symptoms.").

[4] *See* Greenberger, *supra* note 1, at 11-12 (giving a complete discussion of the no-action letter process including termination).

[5] *See* Greenberger, *supra* note 1, at 17 (providing a complete explanation of this solution).

[6] Food Conservation and Energy Act of 2008, Pub. L. No. 110-234, § 13201; 122 Stat. 923 (2008).

[7] *Id*.

the Enron Loophole by simply bringing *all* energy futures contracts within the full U.S. regulatory format with exceptions to regulation granted on a case-by-case basis under section 4 (c) of the CEA, the Farm Bill amendment requires the CFTC and the public to prove on a case-by-case basis through lengthy administrative proceedings that an *individual* energy contract should be regulated if the CFTC can prove that that contract "serve[s] a significant price discovery function" in order to detect and prevent "manipulation."[8] This contract-by-contract process will take months, if not years, to complete and it will then only apply to a single contract. It will doubtless be followed by lengthy and costly judicial challenges during which the CFTC and the energy consuming public will be required to show that its difficult burden has been met. It has also been widely reported that the CFTC intends to use the new legislation to show that only a single unregulated natural gas futures contract, *and not any crude oil futures contracts*, should be removed from the Enron Loophole and be fully regulated. Thus, by CFTC pronouncement, crude oil, gasoline and heating oil futures contracts will not be covered by the new legislation.

It bears repeating that the regulatory approach within the Farm Bill amendment, especially as narrowly construed by the CFTC, differs completely from the regulatory concept underlying the Commodity Exchange Act prior to the passage of the Enron Loophole. Before that highly deregulatory measure was enacted, *all* energy futures contracts were automatically covered by the Act's protections (i.e., recognizing that the very nature of publishing the prices of futures contracts provides price discovery) unless the proponent of the contract carried the burden of demonstrating to the CFTC that lesser or no regulation is required under § 4 (c) of the Act, *i.e.*, that there will be no fraud or manipulation pursuant to less than the full regulatory posture. In other words, while the burden had been on the traders to show that a contract should be deregulated, the Farm Bill puts the burden on the public to prove on an expensive case-by-case basis that an energy futures contract should be regulated.

Moreover, the Farm Bill's attempt to end the Enron Loophole will doubtless lead to further regulatory arbitrage. If the CFTC should be able to prove that an individual energy futures contract has a "significant price discovery function," and thus should be subject to regulation, traders will almost certainly simply move their trading to equivalent contracts that remain exempt from regulation. This was the exact strategy employed by Amaranth when NYMEX imposed speculation limits on it in the natural gas futures market. Amaranth simply moved those trades that exceeded NYMEX limits to the unregulated ICE exchange, where no speculation limits were in place.[9]

Again, the easiest course to end the Enron Loophole was not chosen as part of the Farm Bill. The most effective closure would have simply returned the Commodity Exchange Act to the status quo ante prior to passage of the Enron Loophole. To accomplish this, would have required

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[8] *Id*.
[9] Greenberger, *supra* note 1, at 7.

a two word change in two sections of the Act, requiring that "energy" commodities be treated as "agricultural" commodities, thereby requiring that all energy futures trading (as is now true of all agricultural futures trading) be done on regulated exchanges unless the regulated exchange demonstrates the need for a legitimate regulatory exemption to CFTC under § 4 (c) of the Act.[10]

The Farm Bill Did Not Close the "Foreign" Board of Trade Exemption

As mentioned above, the Intercontinental Exchange ("ICE") of Atlanta, Georgia for purposes of facilitating U.S. delivered WTI crude oil futures, is deemed by the CFTC, through an informal staff no-action letter, to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter alia*, @ 30% of trades in U.S. WTI futures. Moreover, as will be shown below[11], the Dubai Mercantile Exchange, in affiliation with NYMEX, a U.S. exchange, has also been granted permission to trade the U.S. delivered WTI contract on U.S. terminals, but is, by virtue of a CFTC no-action letter, regulated by the Dubai Financial Service Authority ("DFSA"). The CFTC has made it clear that the Farm Bill amendment could not be applied to cover any U.S. delivered crude oil futures contracts on the ICE or DME. Instead, those U.S. trades can only be regulated by the U.K. and Dubai, respectively.

It has been a fundamental tenet, recognized by exchanges all over the world, that if the trading of futures contracts takes place within the United States, that trading, unless otherwise exempted or excluded by the Act itself or by the CFTC through an exemption granted pursuant to the Futures Trading Practices Act of 1992, (otherwise referred to as section 4 (c)), is subject to the regulatory jurisdiction of the CFTC.[12] Recognition of the sweeping reach of U.S. jurisdiction is evidenced by the fact that most major foreign futures exchanges have asked the CFTC for an exemption from the full regulatory requirements of the Commodity Exchange Act ("CEA") to which they might otherwise be subject in order to allow those foreign entities to conduct trading in the U.S. on U.S. based trading terminals of foreign delivered futures contracts.[13] That exemption, premised on section 4(c), has been issued to many foreign exchanges through staff no-action letters, which permit trading on a foreign exchanges' U.S-based terminals without these exchanges being subject to U.S. statutory or regulatory requirements.[14]

These staff no-action letters have been referred to as Foreign Board of Trade exemptions (FBOTs) – a term which as of today is not found in the CEA. The FBOT exemption was entirely the creation of CFTC staff and it has never been formally approved by the Commission itself.

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[10] For the precise description of this two word legislative fix, see Greenberger, *supra* note 1, at 13-14, 17.
[11] *See infra* notes 62-66 and accompanying text.
[12] Johnson & Hazen, Derivatives Reg., section 4.05[6] at p. 984 (2004 ed.) ("[E]ven without substantial activity in the United States, jurisdiction will exist [even] when conduct abroad has a substantial effect on U.S. markets or U.S. investors." (footnotes and citations omitted).
[13] *See* U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *available at* http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief (last visited May 29, 2008).
[14] *Id*. (showing that the commission has issued eighteen no-action letters to foreign boards of trade).

The FBOT staff no-action letters include many conditions controlling the scope of the exemption.[15] For example, the foreign exchange must be regulated in its "home" country by a regulatory entity that ensures that there will be no fraud, manipulation, or excessive speculation on those exchanges and otherwise offers an equivalent regulatory format to that of the CFTC.[16] These staff no-action letters also require that the foreign exchange submit trading data directly to the CFTC on the latter's request for enforcement or investigative purposes and that the home regulator similarly make its own trading data available to the CFTC upon request.[17] The FBOT staff no-action letter contemplates, for example, if fraud, manipulation or excessive speculation affecting U.S. commodity markets were detected by the CFTC, the no-action letter would be terminated immediately and enforcement proceedings would be commenced by the CFTC against the foreign exchange for its adverse impacts on U.S. markets and U.S. consumers.[18]

The staff FBOT no-action letter process never contemplated that an exchange owned by or affiliated with a U.S. entity would escape the CFTC's regulation imposed on traditional U.S. exchanges.[19] Nor did it contemplate that foreign exchanges would trade U.S. delivered contracts in direct competition with fully regulated U.S. exchanges.[20] Finally, because the step of authorizing foreign exchanges to trade on U.S. soil was so fraught with unforeseen potential problems, the staff FBOT no-action letters by their terms can be terminated for any reason or for no reason.[21]

In response to this staff FBOT no-action process, virtually every major foreign exchange in the world has placed its terminals within the U.S. pursuant to a no-action letter.[22] The latter factor is evidence that those many foreign exchanges recognize that they cannot obtain desirable liquidity or compete effectively worldwide without a U.S. terminal presence. It is therefore a further fundamental tenet of futures trading that foreign exchanges must have a U.S. presence. However, none of these FBOT exchanges, save the Intercontinental Exchange ("ICE") and the Dubai Mercantile Exchange ("DME") mentioned below, is owned by or affiliated with a U.S. entity; nor do they trade U.S. delivered futures contracts.

The former International Petroleum Exchange ("IPE"), a British exchange then trading foreign-delivered petroleum contracts with trading matching located in London, received a

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[15] *See* 17 C.F.R. 140.99 (2008); CFTC Regulation 140.99 (2008); *e.g.*, U.S. Commodity Futures Trading Commission, Access to Foreign Markets from the U.S., *available at* http://www.cftc.gov/international/foreignmarketsandproducts/foreignmkts.html (last visited May 29, 2008).
[16] Greenberger, *supra* note 1, at 11-12; *e.g.*, LIFFE Administration & Management, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 38, 64-66 (July 23, 1999).
[17] Greenberger, *supra* note 1, at 12; *e.g.* LIFFE, *supra* note16, at 68-71.
[18] Greenberger, *supra* note 1, at 12; *e.g.* LIFFE, *supra* note 16, at 64.
[19] Greenberger, *supra* note 1, at 12.
[20] *Id*.
[21] Greenberger, *supra* note 1, at 12; *e.g.*, LIFFE, *supra* note 16, at 73.
[22] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *available at* http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief (last visited May 29, 2008).

CFTC staff FBOT no-action letter permitting the presence of U.S. IPE terminals to trade foreign contracts.[23] In 2001, IPE was bought by the ICE, an Atlanta-based, U.S. owned exchange, whose prominent founders were, *inter alia*, Goldman Sachs, Morgan Stanley, and British Petroleum.[24]

Sometime after 2001, it is my understanding that the trade matching computerized systems for all ICE trades were brought to the United States. ICE has a U.K. subsidiary, ICE Futures Europe, but that subsidiary does not ultimately control the trading on ICE; nor, as I understand it, are the ICE trade matching engines within the U.K.[25] In January 2006, ICE announced that it would trade the West Texas Intermediate ("WTI") crude oil contract, a contract which had theretofore been traded exclusively on the New York Mercantile Exchange ("NYMEX"), an exchange fully regulated by the CFTC.[26] It is also my understanding that this was the first time that a "foreign" exchange operating under an FBOT traded on its U.S. terminals a U.S. delivered futures contract. Despite the fact that ICE is now a U.S. owned exchange with U.S. trading engines trading U.S. delivered crude oil contracts, the CFTC continues to treat ICE as a U.K. entity for purposes of its energy contracts. Therefore, the Financial Services Authority ("FSA") of the United Kingdom has exclusive regulatory control over these contracts.[27]

For purposes of U.S. delivered natural gas futures contracts, ICE has also been exempted from CFTC regulation by the so-called Enron Loophole passed as part of the Commodity Futures Modernization Act of 2000.[28] As part of the CFTC Reauthorization Act within the recently passed Farm Bill, provision was made for the CFTC to demonstrate on a case-by-case basis that an energy contract deregulated by the Enron Loophole has a "significant price discovery" affect, thereby bringing that contract under CFTC jurisdiction.[29] Were it not for the staff FBOT no-action letter given to the IPE to trade foreign crude oil contracts outside of CFTC regulation, the West Texas Intermediate ("WTI") futures contract traded on ICE would doubtless be deemed a contract that significantly affects price discovery under the new Farm Bill amendment. Accordingly, it would be subject to U.S. regulation.

While the plain language of the Farm Bill amendment by its terms does not contemplate exemptions for U.S. delivered contracts affecting price discovery, even if traded by a foreign

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[23] IPE, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 152, 53 (Nov. 12, 1999).
[24] *See* IPE, CFTC No-Action Letter, 2002 CFTC Ltr. LEXIS 90, 3 fn.3 (July 26, 2002).
[25] *See* ICE Futures Europe, *available at* https://www.theice.com/about_futures.jhtml (last visited May 29, 2008).
[26] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT, at 5 (June 27, 2006).
[27] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *available at* http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief (last visited May 29, 2008); *see*, *e.g.* ICE, CFTC No-Action Letter, 2003 CFTC Ltr. LEXIS 3 (2003).
[28] *See* 7 U.S.C. §2(h)(3) and (g) (2000).
[29] *See* Food Conservation and Energy Act of 2008, Pub. L. No. 110-234, § 13201; 122 Stat. 923 (2008). As noted above, the Farm Bill amendment has inherent weaknesses standing on its own. *See supra* notes 6-10 and accompanying text.

exchange, the CFTC and ICE have maintained that the ICE traded WTI contract will nevertheless continue to be outside the CFTC's jurisdiction even if the Farm Bill amendment were applied to it. Again, this conclusion relies, not on statutory language, but on the 1999 staff no-action letter issued to the old British based IPE.[30] That is, even if the CFTC found (as it almost certainly would) that the WTI contract significantly affects the price of crude oil, gasoline, and heating oil to U.S. consumers, the CFTC and ICE have taken the position that that contract as traded on ICE will continue to be outside the CFTC's jurisdiction.[31] In short, ICE will continue to be regulated by the U.K.'s Financial Services Authority for purposes of the WTI contract traded on its U.S. terminals instead of the CFTC.

The Senate Permanent Investigating Subcommittee has now issued two reports, one in June 2006[32] and one in June 2007[33], that make a very strong (if not irrefutable case) that trading on ICE has been used to manipulate or excessively speculate in U.S. delivered crude oil and natural gas contracts.[34] The June 2006 report cited economists who then concluded that when a barrel of crude was @ $77 in June 2006, $20 to $30 dollars of that cost was due to excessive speculation and/or manipulation on unregulated exchanges.[35] If that assessment is correct, @ one quarter of the price of crude oil, and crude oil derivatives, such as gasoline and heating oil are the direct results of market malpractices by traders. Of course, we also know through U.S. enforcement actions and criminal prosecutions that Enron, using the Enron Loophole, for its Enron Online (an exchange that was deregulated in the way ICE is deregulated today), drove the price of electricity up almost 300% a year for California consumers in the 2000-2001 era.[36]

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[30] *See* Written Testimony of Jeffrey Harris, *Chief Economist Before the Committee on Energy and Natural Resources United States Senate*, 5-7 (2008) *available at* http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opaharris040308.pdf (last visited May 29, 2008); Written Testimony of Jeffrey C. Sprecher, Chairman and CEO of Intercontinental Exchange, *Natural Gas Hearings* (2007) *available at* https://www.theice.com/showpr.jhtml?id=6685; Written Testimony of Sir Bob Reid, Chairman ICE Futures, *Before the Commodity Futures Trading Commission Public Hearing on Foreign Boards of Trade* (2006) *available at* https://www.theice.com/publicdocs/press/TESTIMONY_OF_SIR_BOB_REID_JUN_27.pdf (last visited May 29, 2008).

[31] *See supra* note 30 and accompanying text.

[32] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT (June 27, 2006) [hereinafter June 2006 Report].

[33] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET, (June 25, 2007) [hereinafter June 2007 Report].

[34] *See* June 2007 Report at 4, 6, 8, 51-53, 111, 119; June 2006 Report at 40-41, 49.

[35] June 2006 Report, *supra* note 32, at 2, 23. George Soros recently warned that "Speculation... is increasingly affecting the price…. The price has this parabolic shape which is characteristic of bubbles." Edmund Conway, *George Soros: rocketing oil price is a bubble*, DAILY TELEGRAPH (May 27, 2008) *available at* http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml (last visited May 29, 2008).

[36] Peter Navarro & Michael Shames, *Aftershocks—And Essential Lessons—From the California Electricity Debacle*, 16 ELECTRICITY J. 24, 24 (2003).

The CFTC has vigorously maintained that the U.K.'s FSA regulatory model is at the "forefront internationally"[37] and that it has shared meaningful market information about ICE WTI trades with the CFTC.[38] It is self evident, however, when a barrel of crude is approaching $140 and predicted by Goldman Sachs to soon pass $200[39] (with attendant high prices being paid by U.S. consumers for gasoline and heating oil) that U.S. regulators would need and want real time, fully audited data pertaining to the critically important WTI contract; rather than data passed by ICE from the U.S. to the FSA and then from the FSA to the CFTC in a haphazard, incomplete, and unaudited fashion. In fact, confidence in the legitimacy of the information being shared between the CFTC and FSA has led the CFTC to insist on May 29 that it will receive better data from the FSA and ICE in order to probe whether there has been improper "market manipulation" in the crude oil markets[40]

Recognizing that the CFTC and ICE are taking the position that the new "End the Enron Loophole" rider on the Farm Bill will not reach WTI trading on ICE, S. 2995 was introduced on May 8, 2008, to address the FBOT exemption under which ICE is operating outside of CFTC jurisdiction for the purposes of crude oil.[41]

The major tenet of that legislation is that any exchange operating under an FBOT exemption may only do so if the CFTC finds that the non-U.S. regulator has regulation that is equivalent to that of the U.S. in several respects.[42] Acting Chairman Lukken has already repeatedly stated that he has concluded that the U.K.'s FSA regulation is not only comparable,

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[37] Walter Lukken, Acting Chairman CFTC, Letters to the Editor: CFTC proud of its strong partnership with the FSA, FIN. TIMES (April 25, 2008) *available at:* http://search.ft.com/ftArticle?queryText=%22US+regulator+takes+FSA+to+task+over+poor+derivatives+oversight&y=12&aje=true&x=9&id=080422000166&ct=0 (last visited May 29, 2008).

[38] *Id*. *See also* Walter Lukken, CFTC Commissioner, Remarks to the Federation of European Securities Commissions: Smart Regulation for the Global Marketplace (June 26, 2007) *available at* *http://www.cftc.gov/newsroom/speechestestimony/opalukken-25.html;* Walter Lukken, CFTC Commissioner, Address at the ISDA Energy, Commodities and Developing Products Conference: The Derivatives World is Flat (June 14, 2006) *available at* http://www.cftc.gov/newsroom/speechestestimony/opalukken-20.html (last visited May 29, 2008). *But see infra* notes 71-74 and accompanying textual discussion (where on May 29, 2008, the CFTC ha suddenly reversed its stance in its regard).

[39] Neil King Jr. and Spencer Swartz, *U.S. News: Some See Oil at $150 This Year --- Range of Factors May Sustain Surge; $4.50-a-Gallon Gas*, WALL ST. J., May 7, 2008, at A3.

[40] U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html (last visited May 30, 2008) (stating that the CFTC has begun increased surveillance of crude oil market prices); James Quinn, *Oil prices to be probed by US regulator CFTC,* DAILY TELEGRAPH (May 30, 2008) *available at* http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/30/cnoil130.xml (last visited May 30, 2008) (stating that the CFTC "has launched an unprecedented investigation into possible market manipulation in the US crude oil market amid record prices" that has caused critical damage to the global economy).

[41] Oil Trading Transparency Act, S. 2995, 110th Cong. (2008); *e.g.*, Press Release, Levin and Feinstein Introduce Oil Trading Transparency Act (May 8, 2008) *available at* http://feinstein.senate.gov/public/index.cfm?FuseAction=NewsRoom.PressReleases&ContentRecord_id=de99b838-011a-438e-02af-23a90bb2fca9&Region_id=&Issue_id= (last visited May 29, 2008); Press Release, Levin and Feinstein Introduce Oil Trading Transparency Act (May 8, 2008) *available at* http://levin.senate.gov/newsroom/release.cfm?id=297513 (last visited May 29, 2008).

[42] Oil Trading Transparency Act, S. 2995, 110th Cong. § 2 (e)(1)(a) (2008).

but a model for U.S. regulators.[43] This statement is reflected in the no-action letters that have already been awarded to ICE and, more recently, to the Dubai Mercantile Exchange, where the CFTC has concluded that the Dubai Financial Service Authority's regulation of oil futures markets "is the equivalent of the" CFTC.[44]

Thus, if S. 2995 is enacted, it will preserve the status quo of FBOTs being allowed to trade U.S. delivered energy future contracts within the United States, but not be subject to U.S. regulation. For example, ICE—even though U.S. owned with U.S. trading engines, trading critically important U.S. delivered energy futures contracts (contracts that would almost certainly otherwise by regulated under the End the Enron Loophole amendment)—would continue to be regulated by the United Kingdom. Similarly, DME, in partnership with U.S. owned NYMEX will be allowed to trade the U.S. delivered WTI contract within the U.S., but be regulated by the Dubai Financial Service Authority.

Allowing ICE, DME and other FBOTs to be regulated by foreign regulators, like the U.K.'s Financial Services Authority and the Dubai Financial Service Authority, undermines the stability of the U.S. crude oil futures markets. CFTC Commissioner Bart Chilton has recently stated, "I am generally concerned about a lack of transparency and the need for greater oversight and enforcement of the derivatives industry by the FSA."[45] Similar concerns have been voiced already by experts who argue that the U.K.'s Financial Services Authority's public disclosure, regulatory oversight, and enforcement actions are much more lax than the CFTC's regulation of exchanges and transactions [46]

For example, during last summer's subprime mortgage crisis, Northern Rock PLC, one of the U.K.'s largest banks, had difficulty raising funds and borrowed billions of dollars from the U.K.'s central bank.[47] After news of the bailout was released to the public, thousands of

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[43] *See supra* notes 37-38 and accompanying text.
[44] *See* IPE, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 152, 53 (Nov. 12, 1999); Dubai Mercantile Exchange, CFTC No-Action Letter, 2007 CFTC Ltr. LEXIS 6 (May 24, 2007).
[45] Jeremy Grant, *Companies & Markets: US regulator takes FSA to task for poor derivatives oversight*, FIN. TIMES (April 22, 2008) *available at:* http://search.ft.com/ftArticle?queryText=%22US+regulator+takes+FSA+to+task+over+poor+derivatives+oversight&y=12&aje=true&x=9&id=080422000166&ct=0 (last visited May 29, 2008); *see, e.g.,* Testimony of Jane Carlin, Chairwoman, Over-the-Counter Derivative Products Committee, Securities Industry Association, *Hearing on Commodity Futures Trading Commission Reauthorization before the House Agriculture Committee* (May 20, 1999) *available at* http://www.sifma.org/legislative/testimony/archives/Carlin5-20-99.html (last visited May 30, 2008); June 2006 Report, *supra* note 32, at 49. "To continue the present situation, in which the CFTC does not police two of three major markets trading U.S. energy futures, is to turn a blind eye to an increasingly large segment of these markets, thereby impairing the ability to detect, prevent, and prosecute market manipulation and fraud." *Id*.
[46] *See* Allistair MacDonald, *Assessing U.K. Watchdog: FSA's Regulatory Model Gets Some Raves in U.S.; A Lapdog at Home?*, WALL STREET J., July 23, 2007, *available at* http://online.wsj.com/article/SB118515214144274556.html (last visited May 29, 2008); Steve Pearlstein, *Auditing Reform: Mission Accomplished!*, WASH. POST, Dec. 15, 2006, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/12/14/AR2006121401796.html (last visited May 29, 2008).
[47] *See* BBC NEWS*, Rock expects £30bn loan this year*, Nov. 7, 2007, *available at* http://news.bbc.co.uk/1/hi/business/7073556.stm (last visited May 29, 2008).

customers wary of losing their savings stood in long lines for several days outside of Northern Rock's branches to withdraw deposits.[48] With Northern Rock on the brink of collapse, FSA provided over $100 billion in loans to the bank and in February 2008, the British government finally was required to nationalize it.[49] In March 2008, FSA published an internal report stating that its regulation of Northern Rock "was not carried out to a standard that is acceptable," and highlighted its failure to provide adequate supervision, oversight, and resources.[50] In addition to FSA's self-criticism, earlier this month the European Union opened a formal investigation into FSA's restructuring of Northern Rock.[51]

This series of events exemplifies FSA's inability to provide regulatory oversight and enforcement that is equivalent to the CFTC.[52] Yet, that is the very conclusion the CFTC adopts today as it continues to look to the FSA as a "model" regulator. To the extent that S. 2995 leaves it in the hands of the FSA and the Dubai Financial Service Authority to govern the trading of WTI contracts on U.S. terminals without U.S. supervision on a finding of "comparability" or "equivalency," it affords the U.S. consumer virtually no meaningful protection from fraud, manipulation, or excessive speculation in these markets. For almost eight decades, the prevention of fraud, manipulation, and excessive speculation was the foremost Congressional promise to those who need to trade in these markets to protect their commercial well-being.

Indeed, the language of S. 2995 either expressly or implicitly concedes two critical points. First, there is no statute to date that provides any exemption for U.S. trading on Foreign Boards of Trade. The Commodity Exchange Act says nothing about Foreign Boards of Trade.[53] The proposed legislation then wholly endorses the concept of an FBOT exemption despite the fact that many have argued that any foreign exchange which wants to introduce trading of its contracts in the U.S. ought to be regulated by the CFTC just as U.S. Designated Contract Markets ("DCMs") are so regulated.[54]

Certainly, the question whether a foreign exchange may trade U.S. delivered commodities within the U.S. free of U.S. regulation should be the subject of extensive debate. S.

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[48] *See Crisis deepens for Northern Rock*, REUTERS Sep. 17, 2007, *available at* http://www.iht.com/articles/2007/09/17/asia/17northern.php (last visited May 29, 2008).
[49] *See* Stephen Castle, *EU to investigate Northern Rock nationalization in Britain*, INTERNATIONAL HERALD TRIBUNE, April 2, 2008, *available at* http://www.iht.com/articles/2008/04/02/business/rock.php (last visited May 29, 2008).
[50] *See* ASSOCIATED PRESS, *British regulator admits failings in oversight of Northern Rock, announces new procedures*, INTERNATIONAL HERALD TRIBUNE, March 26, 2008, *available at* http://www1.wsvn.com/news/articles/world/MI81198/ (last visited May 29, 2008).
[51] *See* Castle, *supra* note 49.
[52] It is also worth noting that "the FSA places an emphasis on deterrence, rather than the use of high-profile prosecutions and fines in the US." Grant, *supra* note 45.
[53] *See generally* Oil Trading Transparency Act, S. 2995, 110th Cong. § 2 (2008); Commodity Exchange Act, 7 U.S.C. § 1 (2008).
[54] *See*, *e.g.*, Ian Talley, *Congress Seeks to Curb Oil Speculation*, SMARTMONEY (May 28 , 2008) *available at* http://www.smartmoney.com/breaking-news/ON/index.cfm?story=ON-20080528-000641-1015 (last visited May 29, 2008).

2995, which has not had the benefit of a full hearing in either House of Congress, by its terms when read in light of long standing CFTC practices not only sanctions U.K. regulation of ICE's WTI trading; it opens the door to any foreign exchange operating under an FBOT exemption escaping U.S. regulation for any U.S. delivered commodity, e.g., the Henry Hub natural gas contract, based solely on the "comparability" finding by the CFTC-- a finding which the CFTC has been quite generous in granting. Under that rationale, there is nothing to prevent the Dubai futures exchanges from trading Henry Hub natural gas futures contracts within the U.S. free of U.S. oversight on a finding by the CFTC of comparability of Dubai regulators, which the CFTC has already done in the Dubai Mercantile Exchange no-action letter. If that were to happen, the only salient feature of the End the Enron Loophole amendment (regulating Henry Hub natural gas contracts which are now traded on ICE outside of an FBOT exemption) would be undercut by foreign exchanges escaping that reform by trading in the U.S. under their foreign flag and being regulated by their "comparable" foreign regulator.

I understand that certain investment banks and their representatives have advanced the argument that if Congress does not accede to S. 2995, they have threatened to move their trading "offshore" to escape U.S. regulation of foreign exchanges.[55] However, the entire history of these markets is that every foreign exchange badly needs to trade within the U.S. That is evidenced by the eighteen staff FBOT no-action letters issued to foreign exchanges to date.[56] The desire to be in the U.S. is so prevalent that ICE apparently brought its IPE trading engines and trading matching systems to the U.S.–not just its trading terminals.[57]

The argument is also advanced that the investment banks will figure out a clever technological way to "trade abroad" with U.S. based technology that will fall short of traditional terminals. In that way, these traders say they can stay within the U.S. but appear to be trading offshore. However, if there is any trading in the U.S. of any kind (whatever the technology) of a futures contract within the U.S., it is subject to U.S. jurisdiction.[58] Indeed, if U.S. citizens manipulate foreign exchanges, they are subject to criminal sanctions, and, in most instances, would be extradited back to the U.S. to face criminal or civil charges, if not civil fines, if their actions impacted domestic markets and those exchanges had any meaningful contacts with the U.S.[59]

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[55] *See* Carlin, *supra* note 45.
[56] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *available at* http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief (last visited May 29, 2008).
[57] *See* IPE, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 152 (Nov. 12, 1999). The letter explained the "request, on behalf of The International Petroleum Exchange of London Limited, ("IPE" or "Exchange") and its members, that the Division grant no-action relief to permit IPE to make its electronic trading and order matching system, known as Energy Trading System II ("ETS"), available to IPE members in the United States." *Id.*
[58] *See* Johnson & Hazen, *supra* note 12.
[59] *See* Press Release, Department of Justice, U.S. Charges 47 After Long-Term Undercover Investigation Involving Foreign Exchange Markets, and (Nov. 19, 2003), *available at* http://www.fbi.gov/dojpressrel/pressrel03/wooden111903.htm.

Indeed, if one were to be swept away by speculative and hypothetical fever proffered by the investment banks about the terrible things that would happen if S. 2995 does not pass, would one not worry that a U.S. exchange, such as NYMEX, might flee U.S. restrictions by affiliating with a "foreign" exchange freed from U.S. supervision under the proposed legislation? NYMEX has already established joint ventures with Dubai, which the CFTC finds to be a country with comparable regulation.

Foremost is the Dubai Mercantile Exchange, which is a joint venture between NYMEX, Tatweer (a member of Dubai Holding) and the Oman Investment Fund.[60] This entity is regulated by the Dubai Financial Services Authority[61] and was granted a CFTC no-action letter in 2007.[62] As of May 16, 2008, the DME with NYMEX as its partner received CFTC approval to begin trading WTI contracts.[63] In this way, NYMEX now effectively participates in the trading of critically important U.S. delivered contracts on U.S. terminals owned by the DME while escaping U.S. oversight on the DME's U.S. terminals. I worry that NYMEX's escape from U.S. control of these U.S. DME trades is wholly consistent with S. 2995.[64]

Finally, S. 2995 does not incorporate all of the conditions within the present FBOT no-action letter typically issued by CFTC staff.[65] Most importantly, the legislation does not provide (as to the staff FBOT no-action letters) that upon detecting fraud, manipulation, or excessive speculation by the FBOT, the CFTC can terminate the no-action letter and/or can charge traders on FBOT for those malpractices. S. 2995 leaves that issue untouched and, by implication, I fear that it will allow the CFTC to follow its well-worn path of least resistance: i.e., place enforcement responsibilities on the Dubai Financial Services Authority, for example, to remedy excessive gasoline prices paid by American consumers.

In sum, voters, I am sure, will not accept lightly a pronouncement of Congressional futility evidenced by a failure to insist on full U.S. regulation of U.S. trading in U.S. delivered commodities by U.S. owned entities merely because certain U.S. resident managers of, *inter alia*, U.S. investment banks and hedge funds have threatened to take their business (but not themselves) to foreign countries– especially when those threats defy every basic premise of futures trading, i.e., the need of each the world's futures exchanges wherever they are located to

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[60] Dubai Mercantile Exchange (DME), *available at* http://www.dubaimerc.com/ (last visited May 29, 2008).
[61] *Id*.
[62] Dubai Mercantile Exchange, CFTC No-Action §Letter, 2007 CFTC Ltr. LEXIS 6 (May 24, 2007).
[63]Babu Das Augustine, *Dubai 'could emerge as derivatives trading hub'*, GULFNEWS.COM (May16, 2008) *available at* http://www.gulfnews.com/business/General/10213595.html (last visited June 1, 2008).
[64] *See generally* Oil Trading Transparency Act, S. 2995, 110th Cong. § 2 (e)(1)(a) (2008).
[65] *See id*; 17 C.F.R. 140.99 (2008); CFTC Regulation 140.99 (2008). Some officials are also skeptical of the assertion that the CFTC and FSA have comparable regulatory structures because, "exchanges in London are not required to monitor daily trading to prevent manipulation, publish daily trading information, or impose and enforce position limits that prevent excessive speculation." Senator Dianne Feinstein & Senator Olympia J. Snowe, Letter to Walter Lukken, Acting Chair of the Commodity Futures Trading Commission (2008) *available at* http://feinstein.senate.gov/public/index.cfm?FuseAction=NewsRoom.PressReleases&ContentRecord_id=c9784c93-0be4-0e7d-e6b2-05bce9339894&IsPrint=true (last visited May 29, 2008).

have a vibrant U.S. based market. Once futures trading of any kind is initiated within, or has substantial impacts upon the U.S., the trader is fully subject to U.S. civil and criminal jurisdiction. If those traders wish to leave the U.S. permanently to conduct their business and otherwise enjoy their leisure time abroad, it seems self evident that the overwhelming majority of your constituents now unnecessarily paying $4.00 and up for a gallon of gasoline will gladly accept.

The CFTC's Newly Announced "Multiple Energy Market Initiatives"

For at least the last two years, two Acting Chairmen of the CFTC (Sharon Brown-Hruska and then Walter Lukken), and the CFTC Chief Economist, Jeffrey Harris, have repeatedly assured Congress, market participants, and anyone else who would listen, that the dramatic rise in crude oil, natural gas, gasoline, heating oil, and agricultural products is caused exclusively by supply/demand market fundamentals.[66] These regulators have based their conclusions on the CFTC's "exhaustive" research of all relevant market data.[67]

Indeed, as recently as May 20, 2008 before the full Senate Homeland Security and Government Affairs Committee, the CFTC's Mr. Harris, testified that "all the data modeling and analysis we have done to date indicates there is little economic evidence to demonstrate that prices are being systematically driven by speculators in these markets [agriculture and energy markets].' . . . [O]ur *comprehensive* analysis of the *actual* position data of these traders fails to

[66] Walt Lukken, CFTC, Acting Chairman, Prepared Remarks: Compliance and Enforcement in Energy Mkts.-- The CFTC Perspective (Jan. 18, 2008) *available at* http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken-34.pdf (last visited June 1, 2008) (quoting Mr. Walter Lukken "While speculators play a integral role in the futures markets, the report concludes that speculative buying, as a whole does not appear to drive up price."); Tina Seeley, *Energy Mkts. Not Manipulated, U.S. Regulator Says (Update1),* BLOOMBERG.COM (May 7, 2008), *available at* http://www.bloomberg.com/apps/news?pid=20601072&sid=aX0iaEd9bOMU&refer=energy (last visited June 1, 2008) (quoting Mr. Walter Lukken "We have not seen that speculators are a major factor in driving these prices."); Ian Talley and Stephen Power, *Regulator Faults Energy-Futures Proposal*, WALL ST. J. (May 9, 2008), (stating that Mr. Walter Lukken commented that his agency hadn't seen evidence indicating that speculators are "a major factor" in driving up oil prices); Oral Testimony of Walter L. Lukken, Commissioner, CFTC, *Before the Committee on Agriculture, U.S. House of Representatives*, (April 27, 2006) (quoting Mr. Walter Lukken "[B]ased on our surveillance efforts to date, we believe that crude oil and gasoline futures markets have been accurately reflecting the underlying fundamentals of these markets."); Sharon Brown-Hruska, CFTC, Chairman, *Address before the International Monetary Fund: Futures Mkts. in the Energy Sector* (Jun. 15, 2006) *available a*t http://www.cftc.gov/newsroom/speechestestimony/opabrownhruska-46.html (last visited Jun. 1, 2008) (stating "To date, the staff' findings have shown that these large speculators as a group tend to inject liquidity into the markets rather than having an undue impact on price movements.") (last visited June 1, 2008); Sharon Brown-Hruska, CFTC, Chairman, *Keynote Address at the Managed Funds Association Annual Forum* (Jun. 25, 2005) *available at* http://www.cftc.gov/opa/speeches05/opabrownhruska34.htm (last visited June 1, 2008) (stating the CFTC's study of the role of managed funds in our markets, "[C]ontradicts with force the anecdotal observations and conventional wisdom regarding hedge funds and speculators, in general.").

[67] *See, e.g., supra* note 66 and accompanying text.

support the contention" that there is excessive speculation or manipulation. Rather, he said prices are being driven "by powerful economic fundamental forces and the laws of supply demand."[68]

I have already cited the abundance of informed academic and trader opinions that reaches conclusions quite the opposite of those of Ms. Brown-Hruska and Messrs. Lukken and Harris.[69] Those who have blamed speculation as a material factor in the rise of energy prices have estimated, for example, that up to $90 of the present price of the barrel of crude oil has nothing to do with supply/demand, but, instead, is caused by unpoliced trader malpractices.[70]

In a rather dramatic about face, the CFTC suddenly announced on May 29, 2008 (or just nine days after Mr. Harris testimony) that that agency will now collect substantial amounts of new data to determine what is undergirding high energy prices.[71] That release was divided into three parts: (1) an attempt to collect additional data not previously within the CFTC's possession

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[68] Richard Hill, *Lieberman Says He Will Consider Legislation to Address Commodity Prices*, 40 BNA 21 (May 26, 2008) (emphasis added).

[69] *See, e.g.,* Edmund Conway, *George Soros: rocketing oil price is a bubble*, DAILY TELEGRAPH (May 27, 2008) *available at* http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml (last visited June 1, 2008) (quoting Mr. George Soros as stating "Speculators are largely responsible for driving crude prices to their peaks in recent weeks and the record oil price now looks like a bubble"); Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs*, U.S. Senate, 2 (May 20, 2008) *available at* http://hsgac.senate.gov/public/_files/052008Masters.pdf (last visited June 1, 2008) (quoting Mr. Michael W. Masters as stating "Are Institutional Investors contributing to food and energy price inflation? And my unequivocal answer is YES"); Alejandro Lazo, *Energy Stocks Haven't Caught Up With Oil Prices*, WASH. POST ONLINE (Mar. 23, 2008) *available at* http://www.washingtonpost.com/wpdyn/content/article/2008/03/21/AR2008032103825.html (last visited June 1, 2008) (quoting Mr. Fadel Gheit as stating "The largest speculators are the largest financial companies"); Michelle Foss, *United States Natural Gas Prices to 2015*, Oxford Institute for Energy Studies 34 (2007) *available at* http://www.oxfordenergy.org/pdfs/NG18.pdf (last visited June 1, 2008) (asserting "The role of speculation in oil markets has been widely debated but could add upwards of $20 to the price per barrel"); *Economist Blames Subsidies for Oil Price Hike*, ADVANTAGE BUS. MEDIA, (2008), *available at* http://www.chem.info/ShowPR.aspx?PUBCODE=075&ACCT=0000100&ISSUE=0609&ORIGRELTYPE=DM&RELTYPE=PR&PRODCODE=00000&PRODLETT=M&CommonCount=0 (last visited June 1, 2008) (quoting Dr. Michelle Foss as stating "We have an overpriced commodity, and this is going to be around for a while"); Kenneth N. Gilpin, *OPEC Agrees to Increase Output in July to Ease Oil Prices*, N.Y. TIMES (June 3, 2004) *available at* http://www.nytimes.com/2004/06/03/business/03CNDOIL.html?ei=5007&en=5dbd50c5b369795b&ex=1401681600&partner=USERLAND&pagewanted=all&position (last visited June 1, 2008) (quoting Mr. Kyle Cooper as stating "There is not a crude shortage, which is why OPEC was so reluctant to raise production."); *Speculators 'not to blame' for oil prices*, UPSTREAM, (April 4, 2008) *available at* http://www.upstreamonline.com/live/article151805.ece (last visited June 1, 2008) (quoting Mr. Sean Cota as stating "It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude prices"); Mike Norman, *The Danger of Speculation* FOXNEWS.COM, (Aug. 19, 2005) *available at* http://www.foxnews.com/story/0,2933,166038,00.html (last visited June1, 2008) (Mr. Norman stating "Oil prices are high because of speculation, pure and simple. That's not an assertion, that's a fact. Yet rather than attack the speculation and rid ourselves of the problem, we flail away at the symptoms.").

[70] *See* Alexander Kwiatkowski and Grant Smith, *Blame Wall Street for $135 Oil on Wrong-Way Betting (Update 3)*, BLOOMBERG.COM (May 22, 2008) *available at* http://www.bloomberg.com/apps/news?pid=20601087&refer=home&sid=a3MgWEz_Qch0 (last visited June 1, 2008).

[71] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html (last visited May 30, 2008).

about trading activities pertaining to ICE's WTI contracts; (2) the collection of new data pertaining to "index trading" by swaps dealers, e.g., certain investment banks and hedge funds; and (3) the public announcement of an ongoing nationwide crude oil investigation commenced by the CFTC in December 2007 looking into possible unlawful trading malpractices.

It suffices to say for now that the credibility of well over two years of assurances by Ms. Brown-Hruska and Messrs. Lukken and Harris that all was fine in these markets based on the CFTC's analysis of "comprehensive" data has been wholly undermined by the May 29 release. It is now clear that the data that was being analyzed by the CFTC as the basis of its assurances of regularity in these markets was, as many had repeatedly warned over the last two years, totally inadequate and unreliable.

There can be little doubt that this complete reversal by the CFTC was not motivated by a newly minted aggressive regulatory stance. Rather, it was almost certainly driven by political forces that no longer allowed Messrs. Lukken and Harris to continue their rosy assessment.

First, it is certainly more than a mere coincidence that the now revealed CFTC investigation into manipulation of the oil markets is said to have begun in December 2007. As shown below,[72] that was the very month that this Congress mandated that the Federal Trade Commission ("FTC")—rather than the CFTC—examine the crude oil futures markets, especially in light of the CFTC's foot dragging. Nothing has spurred the CFTC into action over these last four years more than legislation undercutting its regulatory turf. We need only look at the comparable scenario created by Congress in 2005 when it gave Federal Energy Regulatory Commission ("FERC") the authority to explore natural gas futures markets in light of the record high natural gas prices at that time.[73] That legislation also caused the CFTC to abandon its long-standing assertion that the rise in natural gas prices was caused by supply/demand only in order to protect its primacy in overseeing the natural gas futures markets. As noted above,[74] to date, neither the courts nor Congress has been kind to the CFTC in its attempt to undercut FERC's efforts to police natural gas futures markets. The same will doubtless be true when the CFTC attempts to elbow the FTC out of its crude oil investigations.

Second, the month of May 2008 has otherwise been unkind to the CFTC because of mounting harsh criticism for the agency's noblesse oblige attitude toward the economic distress of the American consumer faced with crippling gas prices. Those criticisms have been joined by further threats to cut back the CFTC's authority. For example, Senator Lieberman, Chairman of the Senate Homeland Security and Government Affairs committee, at the committee's May 20 hearing flatly rejected Mr. Harris' assurances that speculation is not at play in energy and agricultural price dysfunctions. Senator Lieberman called for the study of dramatic legislative

[72] Energy Independence and Security Act of 2007, Publ. L. No. 110-140 § 811, 121 Stat. 1492 (2007).
[73] Energy Policy Act of 2005, Pub.L.No. 109-58, 119 Stat. 594 (2005).
[74] *See infra* notes 116-25 and accompanying text.

measures that would bypass the CFTC and directly bar, by legislative directive, speculators from both energy and agricultural futures markets.[75]

Senator Lieberman's and other legislative conclusions about the adverse impact of speculation were doubtless driven by the testimony of Michael W. Masters, Managing Member of Masters Capital Management, LLC, at the May 20 hearing.[76] Mr. Masters showed that investment banks and hedge funds, for example, who were "hedging" their off exchange bets on energy prices on regulated exchanges were quite remarkably and inexplicably being treated by NYMEX, for example, and the CFTC as "commercial interests," rather than as the speculators they self evidently are.[77] By lumping these investment banks and hedge funds with traditional commercial oil dealers, even fully regulated U.S. exchanges were not applying traditional speculation limits to the transactions engaged in by these speculative interests.[78] Mr. Masters demonstrated beyond all doubt that a huge percentage of the trades in WTI futures, for example, were controlled by non-commercial interests.[79] It is now clear that the CFTC in its pre-May 29 assurances had never before examined the positions of these "swaps dealers", because in that release it required these banks and hedge funds to report their trades to the CFTC and the CFTC committed "to review whether classification of these types of traders can be improved for regulatory and reporting purposes."[80]

Indeed, Senator Bingaman, Chairman of the Senate Energy Committee and Natural Resources Committee in a May 27, 2008 letter to Acting Chairman Lukken, stated: "[I] remain concerned that the Commission's assertions to date –discounting the potential role of speculation in driving up oil prices—have been based on a *glaringly incomplete set of data*."[81] Senator Bingaman referenced not only the likelihood of the CFTC not having adequate data on foreign boards of trade who do business in the U.S. or the over-the-counter unregulated futures markets, but the CFTC's sanctioned practice of "classify[ing] so-called 'swaps dealers'—including large investment banks [--] as 'commercial' market participants, alongside physical hedgers such as oil companies and airlines, rather than as 'non-commercial participants," the latter of whom would be subject to speculation limits.[82] In other words, Senator Bingaman realized that when Messrs.

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[75] *See* Hill, *supra* note 68.

[76] Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs, U.S. Senate*, (May 20, 2008) *available at* http://hsgac.senate.gov/public/_files/052008Masters.pdf (last visited June 1, 2008).

[77] *Id.* at 7-8.

[78] *Id.* at 7.

[79] *Id*. at 8, 11.

[80] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html (last visited May 30, 2008).

[81] Letter from Senator Jeff Bingaman to Walter Lukken, Acting Chairman, CFTC (May 27, 2008) (emphasis added) *available at* http://energy.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=0fdd0eb4-4b1d-49f0-a3a2-f89fd0e4b1d3&Month=5&Year=2008&Party=0 (last visited June 1, 2008).

[82] *Id.*

Lukken and Harris had been assuring the Senate Energy and Natural Resources Committee that speculators played no role is the oil prices run up, they were not counting certain investment banks and hedge funds, for example, as speculators![83]

Finally, a bipartisan coalition of 22 Senators on May 23, 2008 sent a strongly worded letter to the CFTC asking that agency to show cause as to why the charade of treating the U.S.-owned ICE as a U.K. entity when that exchange is run out of Atlanta, Georgia and is trading the WTI U.S. delivered crude oil contract not be ended immediately as the underlying CFTC staff FBOT no-action letters allow by their express terms.[84] That Senate letter made clear that an unsatisfactory answer from the CFTC would very likely lead to further legislative diminishment of that agency's authority.

Each of the above referenced factors almost certainly explain the dramatic change represented by the CFTC's May 29 release. The question remains whether the release is merely for appearances sake; or whether it truly represents seriousness on the part of the agency to finally investigate these matters.

There is evidence within the May 29 release that may call into question the sincerity of CFTC's new stance. First, the November 1999 staff FBOT no-action letter that the CFTC views as governing ICE's U.S. delivered energy trades expressly gives the CFTC the absolute right to collect immediately and directly any data it needs from either the FSA (the purported U.K. regulator of the Atlanta-based ICE) or from ICE itself.[85] Ignoring the express language of the no-action letters, the CFTC has now for the second time felt obliged to negotiate with FSA and ICE the right to obtain the very data it could collect under the no-action letter.[86] This unneeded subservience, especially to ICE, reflects unwillingness by the CFTC to even use effectively the power expressly granted to it by its own no-action letters.

Indeed, while the CFTC publicly announced its new initiative at 1 PM on May 29,[87] at 1:05 PM that afternoon ICE felt obliged to issue a press release announcing that it had

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[83] *See* Gene Epstein, *Commodities: Who's Behind the Boom?*, BARRONS (March 31 2008) *available at* http://online.barrons.com/article/SB120674485506173053.html?mod=b_hps_9_0001_b_this_weeks_magazine_home_top&page=sp (last visited June 1, 2008) (demonstrating that a similar problem of miscategorizing investment banks and hedge funds as "commercial" farming interests exists in the agricultural futures markets).
[84] Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), *available at* http://cantwell.senate.gov/news/record.cfm?id=298325 (last visited June 1, 2008).
[85] *See supra* notes 15-18 and accompanying text.
[86] Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight, CFTC & FSA (2006) *available at http://www.fsa.gov.uk/pubs/mou/cftc.pd* ; Financial Services Authority, FSA signs regulatory cooperation agreement with the CFTC, (Nov. 20, 2006) *available at* http://www.fsa.gov.uk/pages/Library/Communication/PR/2006/118.shtml (last visited June 1, 2008).
[87] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, (May 29, 2008), *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html (last visited May 30, 2008).

"facilitated" the turning over of the data called for in the CFTC release.[88] It is self evident that ICE, in its capacity as the second largest trader of WTI and as an unregulated U.S. exchange, was almost certainly going to be an entity of interest to the CFTC in its market investigation. The seeming subservience of the CFTC to ICE in negotiating with the exchange over the information the agency deems necessary for its investigation is akin to asking a key witness to an investigation whether and to what extent it will agree to turn over material relevant to the investigation. That is simply not the way in which serious investigation is conducted, especially when dealing with suspicions that manipulative activity may be found in these markets.

Moreover, CFTC Commissioner Bart Chilton has acknowledged that the public announcement within the May 29 release raises the specter that "some people [will] head for the paper shredder [.]"[89]

It is also important to note that the CFTC release makes clear that it has not, in fact, finalized its agreement to obtain all of the relevant data it needs from the FSA and ICE. In this regard, there are only "near-term commitment[s]" to obtain from the FSA and ICE "more detailed identification of market end users" and "to provide improved data formatting so trading information can be seamlessly integrated into the CFTC's surveillance system[.]"[90] In other words, not only did the CFTC never know who the end users were trading WTI crude oil contracts on ICE (crucial information for determining which entities might be engaging in manipulative behavior) and not only did it not have any of the FSA data accessible for purposes of CFTC surveillance programs, *it does not have this information today*; it only has a "near term commitment" that the information will be provided. In this regard, the CFTC's assurance to Senator Lieberman only two weeks ago that there was no manipulation in these markets based a "comprehensive analysis of actual position data of these traders" seems to be nothing more than a flight of fancy since critical portions of that data are not even now within the possession of the CFTC after its much ballyhooed May 29 Memorandum of Understanding with the FSA and ICE.

My own view is that there can be no "final" commitment by FSA and ICE on these "near term commitment" points, because the United Kingdom's FSA is going to have to reconfigure (or more likely reinvent) the collection of its own data in order to be able to satisfy the CFTC's investigative needs in this regard. These "near term" failures in data collection only serve to highlight the total laxity of the FSA regulatory process as it applies to these markets; the extent to which CFTC analysis has been and will be uninformed; and the absurdity of the CFTC's

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[88]Press Release, Intercontinental Exchange, Ltd., ICE Facilitates Agreement to Provide Industry's Most Comprehensive Reporting for U.S. Energy Futures Contracts, (May, 29, 2008), *available at* http://ir.theice.com/releasedetail.cfm?ReleaseID=312956 (last visited June 1, 2008).

[89] Tina Seeley, *CFTC Targets Shipping, Storage in Oil Investigation (Update2)*, BLOOMBERG.COM (May 30, 2008) *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aGzRMmD_b9MA&refer=home (last visited June 1, 2008).

[90] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, *available at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html (last visited May 30, 2008).

continuous charade that a U.S. owned exchange (ICE) located in Atlanta and trading critically important U.S. delivered energy products (WTI) should be regulated by the United Kingdom, whose regulation of these markets is self evidently lacking by the latter's need to mask its inadequacies through "near term commitments."

Yet, another factor within the CFTC's May 29 release evidences the weakness of relying on foreign regulators to police U.S. commodity trading. Among the new information required by the May 29 CFTC release is the requirement that ICE notify the CFTC when those who trade on ICE "exceed position accountability levels, as established by U.S. designated contract markets, for WTI crude oil contracts."[91] In other words, because FSA does not have "accountability levels" and because ICE therefore does not establish them, the CFTC is requiring ICE to comply with accountability levels at its main competitor, NYMEX.

Needless to say, that is a highly circular way in which to bring an Atlanta-based exchange trading the U.S. delivered WTI contract, but regulated by the United Kingdom, under traditional and long established U.S. controls on excessive speculation and manipulation. Again, would it not be easier to simply require this Atlanta exchange to register in the United States? The "Rube Goldberg" quality of the CFTC's reliance on the FSA would be humorous were it not be for the fact that U.S. consumers are sinking under the weight of increasing gas prices that many respectable observers believe are caused in some substantial measure by outsized speculation and possible manipulation on ICE.

Another important weakness of the CFTC release is that, while it tries to accommodate concerns about the inadequacy of the United Kingdom's regulation of ICE, the release does not address the fast growing problem of *other* foreign exchanges trading in the U.S. who are quickly moving into the U.S. delivered WTI contract. For example, as mentioned above,[92] the Dubai Mercantile Exchange ("DME") received a May 2007 staff FBOT no-action letter enabling that Dubai exchange to bring its terminals into the U.S. without registering as a CFTC regulated designated contract market. DME is joined in this endeavor by NYMEX, but its U.S. trading activities are regulated by the Dubai government.

James Newsome, the President of NYMEX, the former Chairman of the CFTC (2001-2004), and a member of the DME board of directors recently opined that "he sees big opportunities for the DME and a huge potential for [DME] emerging as the derivatives trading hub of South Asia, Middle East and Africa region."[93] He notes at the recent first anniversary of the DME WTI contract, the DME volumes "are very similar to the volumes of the WTI . . . when [it was] launched" on NYMEX itself.[94]

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[91] *Id*.
[92] *See supra* note 46.
[93] Babu Das Augustine, Dubai 'could emerge as a derivatives trading hub', GULFNEWS.COM, May 16, 2008, *available at* http://www.gulfnews.com/business/General/10213595.html (last visited June 1, 2008).
[94] *Id.*

The Dubai/NYMEX venture is the playing out of NYMEX's long threatened strategy to level the playing field with ICE, i.e., if an Atlanta-owned exchange can be regulated as if it were in the UK, a New York exchange will follow suit under the banner of an FBOT no-action letter granted to a Dubai exchange. Of course, the CFTC May 29 release is careful to limit improved data collection only to ICE and does not address the parade of foreign exchanges to which the CFTC has offered a safe harbor from U.S. regulation.

It is self evidently absurd that the American public can rest secure that the CFTC found in the DME no-action letter, that Dubai's regulatory scheme is comparable to that of the U.S. [95] The fact that the CFTC, as recently as May 2007, could conclude that Dubai's regulation is in fact comparable to that in the U.S. simply demonstrates that there is not a foreign regulator in the world who would not satisfy the CFTC's comparability standard. In this regard, I am sure that the American consumers will take little comfort from an explanation that they are being protected from manipulation and excessive speculation driving up gas price—not by U.S. regulators—but by the Dubai government's oversight of the forthcoming trading of the U.S. delivered WTI contract on the DME's U.S. trading terminals. I do not envy any Member of Congress explaining that proposition to his or her constituents.

Finally, NYMEX President Newsome has further opined that "[t]he reports on the role of speculators on oil prices are grossly exaggerated. If you look at the data on who is actually trading, the level of commercial participants remains 70 to 72 percent." Of course, as Michael Masters recently explained,[96] Dr. Newsome's calculation treats investment banks and hedge funds laying off the risk of their off exchange swaps transactions on NYMEX as the same as a heating oil dealer using the WTI contract on NYMEX to hedge his business risk. If those banks and hedge funds were properly classified as speculators, about 70 percent of the trading on NYMEX would be speculative—not commercial. And, if you were to add all of the WTI trading on NYMEX and ICE speculation might very well approach 80-90 per cent of the WTI trades executed by U.S. owned exchanges. By any objective assessment, the crude oil market is now overwhelmingly dominated by speculation, most of which is not subject to the age old controls imposed upon speculators in these markets. One can easily see then how Goldman Sachs, a huge trader in these markets itself, could confidently predict that oil will soon reach $200 a barrel.[97]

The Need to Expedite the FTC Investigation into Crude Oil Futures Markets

Soaring energy prices have infiltrated all sectors of the economy and they have drastically reduced the quality of life for millions of Americans. In a May 23, 2008 letter to the CFTC, a bipartisan group of 22 Senators stated the depth of economic emergency caused by the oil shock: "The doubling of crude oil prices in one year is unprecedented in the century old

[95] Dubai Mercantile Exchange, CFTC No-Action Letter, 2007 CFTC Ltr. LEXIS 6 (May 24, 2007).

[96] *See* Masters, *supra* notes 76-79 and accompanying text.

[97] Neil King Jr. and Spencer Swartz, *U.S. News: Some See Oil at $150 This Year --- Range of Factors May Sustain Surge; $4.50-a-Gallon Gas*, WALL ST. J., May 7, 2008, at A3.

history [of these markets]. With oil central to our nation's economy and current standard of living, today's skyrocketing oil represents a massive new tax on American families and business . . ."[98] As Senator Bingaman, Chair of the Senate Energy and Natural Resources Committee, also reminded Acting CFTC Chairman Lukken last week, "American families, farmers and businesses are currently struggling under the weight of record-setting fuel prices."[99]

Faced with years of inertia by the CFTC in policing the crude oil futures markets (or for that matter even recognizing any problem worthy of an investigation), Congress included within the Energy Independence and Security Act of 2007 (EISA),[100] a provision expanding the power of the FTC to combat price manipulation with respect to crude oil markets.[101] The statute specifically provided that it was:

> unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Federal Trade Commission may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens.[102]

The 2007 FTC anti-manipulation legislation is virtually identical to 2005 legislation enacted by Congress requiring FERC to investigate and prohibit market manipulation in the natural gas markets.[103] By January 2006, FERC issued a final rule under the 2005 legislation implementing its anti-manipulation provisions.[104] Pursuant to that rulemaking, FERC resolved all major interpretive issues it viewed as arising under the 2005 legislation, including adopting the anti-manipulation definitions within Section 10 (b) of the Securities and Exchange Act of 1934.[105] In short, FERC has provided the FTC with the template for an investigative order under the virtually identical legislation governing the FTC's mandate.

In July 2007, FERC issued a show cause order under its anti-manipulation rule against the Amaranth Advisors hedge fund, alleging that Amaranth manipulated NYMEX natural gas

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[98] Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), *available at* http://cantwell.senate.gov/news/record.cfm?id=298325 (last visited June 1, 2008).
[99] Letter from Senator Jeff Bingaman to Walter Lukken, Acting Chairman, CFTC (May 27, 2008). Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), *available at* http://cantwell.senate.gov/news/record.cfm?id=298325 (last visited June 1, 2008).) (stating that Exxon Mobile executive has testified that the price of crude oil should be between $50 to $55 dollars per barrel based on supply and demand principles).
[100] Energy Independence and Security Act of 2007, Publ. L. No. 110-140, 121 Stat. 1492 (2007).
[101] *Id*. at § 811. Although the FTC has always had the power to provide consumer protection by preventing "unfair methods of competition" and "deceptive acts" that affected commerce, until the passage of the 2007 Act, it did not have the authority to target price manipulation directly. 15 U.S.C. § 45 (2008).
[102] Energy Independence and Security Act of 2007, Publ. L. No. 110-140 § 811, 121 Stat. 1492 (2007).
[103] Energy Policy Act of 2005, Pub. L.No. 109-58, 119 Stat. 594 (2005).
[104] 71 Fed. Reg. 4244 para. 6 (Jan. 26, 2006).
[105] *Id*. at para. 2.

futures contracts to affect the price of those contracts.[106] In so doing, FERC made it clear that the term within the legislation making it "unlawful for any person, directly or indirectly, to use or employ, *in connection with* the purchase" of natural gas included the authority to investigate and issue appropriate relief within the natural gas futures markets, because those markets are "in connection with" the purchase of the commodity in question. FERC has now completed over 64 investigations into these markets, reaching settlements in a substantial portion of those cases.

In sum, FERC has used its 2005 legislative authority after which the 2007 FTC crude oil anti-manipulation legislation was modeled to resolve all major issues about the scope of its mandate, including a definition for market manipulation and a clear understanding that, if that manipulation emanates within futures markets, FERC has the statutory authority to investigate and regulate therein. Therefore, the FTC has a readymade model order, resolving many critical issues about the scope of its authority under the 2007 legislation, which should have enabled it to move quickly to determine whether the unbearably high prices experienced in the crude oil markets by U.S. consumers are related exclusively to market fundamentals or, in crucial part, to trading malpractices.

<u>The National Emergency in the Petroleum Markets Authorizes to FTC to Move Faster</u>

Instead of taking swift and decisive action to address the growing threat of fast rising crude oil, gasoline, and heating oil prices, the FTC opted to employ a leisurely administrative route that, unless adjusted as suggested below, will mean that a rule governing investigation under the 2007 crude oil anti-manipulation legislation will not be in place until this coming fall at the earliest. Rather than issuing a proposed rule based on the model established by FERC in the natural gas markets, the FTC instituted an advanced notice of proposed rulemaking ("ANOPR") with the comment period to close on June 6, 2008.[107] The ANOPR is 39 pages long and it raises in a most highly academic fashion many of the issues long ago confronted and resolved in 2005-2006 by FERC in the natural gas context.

Moreover, picking up the signal that time is not of the essence, the American Petroleum Institute ("API"), represented by the Covington & Burling law firm, has already requested an extension of the June 6 ANOPR deadline, claiming that the issues are too difficult to resolve in anything less than a 90 period.[108] If this extension were granted, the comment period for the ANOPR would not even end until late summer. At that juncture and pace, the FTC would then analyze the ANOPR comments before it even issued a *proposed* rule with its own 30 day comment period. Under this schedule (if not extended by further requests for more time), months

[106] 120 F.E.R.C. P. 61085, 2007 F.E.R.C. LEXIS 163 (2007).
[107] 16 C.F.R. Part 317 (2008).
[108] Letter from the American Petroleum Institute to Donald Clark, Secretary, U.S. Federal Trade Commission (May 19, 2008) *available at* http://www.ftc.gov/os/comments/marketmanipulation/080519ampetrolinstreqeot.pdf (last visited May 31, 2008).

would pass before the promulgation of the final rule at which time the FTC would only then begin its investigation.

To be sure, in the absence of a full-blown emergency, agency rulemaking requires a notice and comment period on a proposed rule, with the discretion to precede the proposed rule with an ANOPR to flesh out novel issues in aid of developing the proposed rule. However, the Administrative Procedure Act ("APA") provides critically important exceptions to these procedures in well-defined exigent circumstances. For example, the APA specifically provides that the notice and comment requirements can be bypassed or short-circuited when, "the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[109] Therefore, when an agency faces emergencies or situations where delaying for notice and comment would seriously harm the public interest, the agency can promulgate a final rule without notice and comment, especially when the critical issues have already been resolved under an identical companion statute by another federal agency charged with the identical investigative mission in highly related markets and by comments received by the FTC pursuant to the FTC's existing ANOPR.[110]

The present crude oil and gas price shocks presents precisely the circumstances for which the APA exception was intended. Sky rocketing oil, gasoline, and heating oil prices have placed a stranglehold on the American economy and every American consumer. George Soros recently warned that, if left unattended, the oil price crisis (which he views as being grounded in excessive speculation) will drag the United States into the most serious full blown recession since the end of World War II.[111]

Surely, the present crisis would allow the FTC to bypass full-blown APA procedures. Indeed, after receiving comments on the ANOPR, the FTC could model an interim final rule based on those comments and the tailor made companion FERC template. The FTC's investigation could at least proceed under the interim rule while it takes notice and comment on that interlocutory order. If the FTC acts expeditiously, it may stave off economic chaos by bringing discipline to what many sophisticated economists and market observers believe are unnecessarily chaotic markets driven by a high level of speculative manipulation.

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[109] 5 U.S.C. § 553 (b)(B) (2008).

[110] *See id.*; Edison Electric Institute, et al., v. EPA, 821 F.2d 714, 720 (D.C. Cir. 1987) ("[T]here was a need for immediate action."); Chamber of Commerce v. SEC, 443 F.3d 890, 908 (D.C. Cir. 2006) (exception to notice and comment permitted "in emergency situations" or where "delay would result in serious public harm") (dicta) (citing cases).

[111] Edmund Conway, George Soros: rocketing oil price is a bubble, DAILY TELEGRAPH (May 27, 2008) *available at* http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml (last visited May 29, 2008).

Indeed, when FERC went through its rulemaking process on suspected manipulation leading to fast rising natural gas prices, it expedited its proceeding.[112] In that case, FERC "balanced the necessity for immediate implementation of this Final Rule against the principles of fundamental fairness" and determined that the persistent high energy prices could lead to opportunities for price manipulation.[113] FERC concluded that it "would be contrary to the public interest to delay regulations that implement Congressional intent to prohibit manipulation in energy markets[;]" implementing a Final Rule would protect energy markets from manipulation.[114] Again, because the FTC legislation is nearly identical to that enactment authorizing FERC, it is certain that Congress expected the FTC to follow the example set by FERC. Given the self-evident nature of the emergency before us, the harm that delay could cause the public, and the example of effective response given by FERC, the FTC should greatly expedite its rulemaking process in order to bring stability to the gas and oil markets.[115]

The FTC's Investigation of the Crude Oil Markets Cannot Be Blocked by the CFTC

In its ANOPR, FERC has posed the question of the degree to which the 2007 statutory mandate permits it to overlap the jurisdiction of the CFTC into the crude oil futures markets. Doubtless, the CFTC's sudden reversal of position in announcing its own investigation into these markets on May 29, 2008 was intended to aggravate that concern on the part of the FTC.[116]

An effort was made to thwart FERC in its investigation of the natural gas futures markets pursuant to the 2005 legislation by claiming it was infringing on the province of the CFTC. In *CFTC v. Amaranth Advisors*,[117] Amaranth tried to enjoin FERC from proceeding with its administrative action because it could face the possibility of having to defend itself in two different proceedings pertaining to the natural gas futures markets.[118] The court refused to enjoin the FERC investigation, by explaining, *inter alia*, that Congress expressly envisioned that there would be overlap between the enforcement actions of these two agencies.[119]

Important Members of Congress have also weighed in when the CFTC has attempted to preempt FERC's examination of the natural gas futures markets. For example, in a recent hearing before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, the Ranking Member Joe Barton (R-TX) (who was the Committee Chair when the 2005 statute was passed) stated, "I'm also disappointed to see that CFTC has challenged FERC's authority to investigate and pursue the energy market manipulators despite the

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[112] Prohibition of Energy Market Manipulation, 114 F.E.R.C. P61,047, 61 (F.E.R.C. 2006).
[113] *Id.*
[114] *Id.*
[115] If absolutely necessary the FTC could propose an interim rule for investigation after the ANOPR period has closed and then expedite the rulemaking process through the APA's § 553(d), until reaching a final rule.
[116] *See supra* notes 71-74 and accompanying text.
[117] 523 F.Supp.2d 328 (S.D.N.Y. 2007).
[118] *Id.* at 328-29.
[119] *Id.* at 332.

Congress's explicit grant of authority to FERC in the Energy Policy Act of 2005."[120] Acting Chairman Lukken replied that the CFTC had opposed FERC action because the Commodity Exchange Act had conferred exclusive jurisdiction over these contracts to the CFTC.[121] Rep. Barton retorted,

> Well, then there's no way you can have exclusive jurisdiction with this [2005] statutory authority on the books. And what I want to inform you of, as the acting chairman, is that this wasn't something serendipitous or inadvert[ent]. It was put in directly because of what since has transpired. And the -- Mr. Kelliher [, FERC Chairman,] and his compadres at the FERC are doing exactly, or at least attempting to do exactly what we hoped they would do, which is work with your agency but *use their own authorities* to ferret out the bad actors and try to make our markets more open and transparent and accessible in a nonbiased way to any willing participant.[122]

Rep. Barton elaborated further:

> So I'm -- I don't see how the -- your agency or the courts can rule, unless they assume that the members of Congress who passed this didn't know what we were talking about and didn't understand the English language. But I just, you know, I want to put on the record at this oversight hearing that this was -- this particular section was done at my express request because of concerns I had at the time about speculation in the oil and gas markets so that we could give the FERC some authority, which was ambiguous at that time.[123]

Rep. Barton's statements leave little room for doubt that both FERC (under the 2005 legislation) and the FTC (under the 2007 legislation modeled after the 2005 statute) have the authority to examine the role futures markets play in manipulating the natural gas markets (in the case of FERC) and the petroleum markets (in the case of the FTC).

Finally, the mere fact that the CFTC has begun its own "investigation" into the current price calamity is no reason for the FTC to delay its own inquiry.[124] As Rep. Barton said, "This is not an area that we have too many regulators and too many overseers."[125] The enormity of the economic chaos that looms in spiking crude oil prices imperils both the stability of the global economy, as well as the American people. Given the magnitude of these issues, both agencies should cooperate to work simultaneously in this area.

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[120] Rep. Joe Barton, Subcommittee on Oversight & Investigations, Statements during the Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation? (Dec. 12, 2007) (emphasis added).
[121] Walter Lukken, Acting Chairman CFTC, *Statements during the Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?* (Dec. 12, 2007).
[122] Barton, *supra* note 120.
[123] *Id*.
[124] *See supra* notes 117-119 and accompanying text.
[125] Barton, *supra* note 120.

The FTC Is Required to Adopt SEC's Definition of Manipulation

In its ANOPR, the FTC includes a considerable discussion pertaining to the standard it should adopt in determining whether conduct is manipulative. Once again, this issue has been settled under the 2005 legislation as explained in FERC's final investigative order. Congress passed the FERC legislation in 2005 in direct response to the scandal in the natural gas markets that decimated the Western electricity markets in 2000 and 2001. The 2005 provision was modeled on the securities laws, and FERC's final order under that statute notes that the anti-manipulation provisions in the Energy Policy Act of 2005 "closely track" section 10b of the Securities Exchange Act of 1934.[126] Moreover, both statutes "specifically dictate that the terms 'manipulative or deceptive device or contrivance' are to be used 'as those terms are used in section 10(b) of the Securities Exchange Act of 1934.'"[127] FERC therefore patterned its own rule after the SEC's 10b-5 and said it would interpret its own rules "consistent with analogous SEC precedent that is appropriate under the circumstances."[128]

Similarly, Congress modeled the FTC's new 2007 anti-manipulation provision on 10(b) of the Securities Exchange Act of the 1934 and Rule 10b-5 to once again make it clear (as was the case with FERC) that the FTC must use the extensive securities precedent to guide its manipulation investigations in the petroleum markets. For example, "manipulative or deceptive device or contrivance" has clearly been defined by the SEC and adopted by FERC, and have also been interpreted by the courts. The courts have established that this standard covers "knowing or intentional misconduct" and not price changes caused by negligence or natural market forces. Rather, the SEC's definition is designed to prevent fraudulent or manipulative conduct that affects market prices "that are intended to mislead… by artificially affecting market activity."[129] The Supreme Court has interpreted the phrases "manipulative or deceptive" in conjunction with "device or contrivance," to be applicable to intentional conduct.[130] The SEC has broadly interpreted the securities laws to attack "the full range of ingenious devices that might be used to manipulate securities prices."[131]

Accordingly, the FTC (as is true of FERC and the SEC) is not required to demonstrate reliance, loss causation, or damages, because "the Commission's duty to enforce the remedial

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[126] Prohibition of Energy Market Manipulation, 114 F.E.R.C. P61,047; 2006 FERC LEXIS 105 (Jan 19, 2006).
[127] *Id.*
[128] *Id.*
[129] Santa Fe Industries v. Green, 430 U.S. 462, 476 (1977); Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 374 (6th Cir. 1981) (holding that SEC is empowered to prevent manipulation of markets "by artificial means… unrelated to the natural forces of supply and demand.").
[130] Ernst & Ernst, 425 U.S. at 197, 199.
[131] Santa Fe Industries, 430 U.S. at 476.

and preventative terms of the statute in the public interest, and not merely to police those whose plain violations have already caused demonstrable loss or injury."[132]

The FTC Is Free to Investigate the Futures Trading Subsidiaries of Banks

The FTC is specifically has general authority "to prevent persons, partnerships, or corporations… from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."[133] However, while the FTC has broad authority to protect commerce, as it has noted in the ANOPR, it explicitly prohibited from regulating, inter alia, "banks."[134]

As has been noted above, investment banks are prime players in the crude oil futures markets. I anticipate that a question will be raised about whether the FTC can investigate those institutions.

The FTC's authorizing legislation does not provide a definition of a "bank;"[135] rather, it cross references another section of the statute, which is concerned with FTC enforcement.[136] This section provides a list of those institutions that qualify as "banks," and makes it clear that the term relates to depository institutions registered as in that capacity with federal banking regulators.[137]

However, even if non-depository institutions, such as Morgan Stanley or Goldman Sachs, are for some reason deemed to be "banks" for purposes of FTC regulation, the futures trading

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[132] *See*, *e.g.*, SEC v. Credit Bancorp, Ltd., 195 F.Supp2d 475, 490-91 (S.D.N.Y. 2002) *quoting* Berko v. SEC, 316 F.2d 137, 143 (2d Cir. 1963) *citing* SEC v. North American Research & Dev. Corp., 424 F.2d 63, 84 (2d Cir. 1970)(reliance not an element of a Rule 10-b(5) claim in the context of an SEC proceeding).
[133] 15 U.S.C. § 45(a)(2) (2008).
[134] *Id*.
[135] 15 U.S.C. § 44 (2008).
[136] *See* 15 U.S.C. § 57(a)(f)(2) (2008).
[137] *See id.* The statute specifically mentions the following institutions as being considered banks:

> (A) national banks and Federal branches and Federal agencies of foreign banks, by the division of consumer affairs established by the Office of the Comptroller of the Currency; (B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) [25A] of the Federal Reserve Act [12 USCS §§ 601 et seq. or §§ 611 et seq.], by the division of consumer affairs established by the Board of Governors of the Federal Reserve System; and (C) banks insured by the Federal Deposit Insurance Corporation (other banks referred to in subparagraph (A) or (B)) and insured State branches of foreign banks, by the division of consumer affairs established by the Board of Directors of the Federal Deposit Insurance Corporation. *Id*.

The statute also presents a cross reference for additional guidance on definitions to the Banks and Banking portion of the United States Code. *Id.*; 15 U.S.C. § 1813 (2008) (listing its own definitions of the word "bank"). It is also worth noting that these definitions are immediately follow by a section entitled "Definitions relating to depository institutions." 15 U.S.C. § 1813(c) (2008). This reinforces the idea that the types of institutions being excluded are institutions of which "a substantial portion of the business of which institution consists of receiving deposits or exercising fiduciary powers…." 69 Am. Jur. 2d Securities Regulation-Federal § 338. *See* Miller v. U.S. Bank of Washington, 865 P.2d 536, 541 (1994).

done by those institutions are executed through subsidiaries neither registered with the banking regulators nor with the SEC.[138]

Finally, to the extent that the FTC finds that a "bank" is involved in manipulative activity within the crude oil markets, courts have ruled that the FTC has investigatory power with regard to banks, even if enforcement activities with regard to those institutions are beyond the Commission's authority. In *FTC v. Rockefeller*,[139] the FTC brought suit to enforce subpoenas it had issued to various banks in order to conduct an energy-related investigation.[140] The banks sought to quash the subpoenas, arguing that the information sought ran afoul of the "bank" exemption within the FTC's governing statute.[141] The court first determined that the FTC's authority to "conduct an investigation of the energy industry is undisputed."[142] The court ultimately held that the FTC was lawfully permitted to demand information from the banks there in pursuit of its statutory obligation to investigate the energy industry.[143]

For all of these reasons, the FTC should be urged by this Committee to fulfill aggressively the 2007 Congressional mandate to stop any manipulative practices within the petroleum markets, including activity within the crude oil futures markets distorting crude oil prices. The path for such an investigation has already been well marked by FERC. The FTC should use all of the powers available to it to promulgate its rule and begin it investigation expeditiously. The stability of the American economy demands nothing less.

[138] *See* Morgan Stanley, Annual Report (Form 10-K), at 114, 148, 157, 202 (Nov. 30, 2007); The Goldman Sachs Group, Inc., Annual Report (Form 10-K), at 17-18, 80, 189-92 (Nov. 30, 2007).
[139] FTC v. Rockefeller, 441 F.Supp. 234 (S.D.N.Y. 1977).
[140] *Id*. at 236.
[141] *Id*. at 237. The banks contended that because they were exempt from the FTC jurisdiction, the subpoenas issued by the FTC were invalid. *Id*. at 240.
[142] *Id*. at 240.
[143] *Id*.