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January 3, 2011

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

VIA ELECTRONIC MAIL

RE: Prohibition of Market Manipulation, Notice of Proposed Rulemaking,
RIN 3038-AD27

Dear Secretary Stawick:

I. INTRODUCTION.

In accordance with the Commodity Futures Trading Commission's (the "CFTC" or the "Commission") Notice of Proposed Rulemaking, *Prohibition of Market Manipulation* (the "Proposed Rule"), issued pursuant to Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"),[1] and published in the *Federal Register* on November 3, 2010,[2] the Working Group of Commercial Energy Firms (the "Working Group") hereby submits comments on the Commission's proposed market manipulation rules pursuant to new Section 6(c) of the Commodity Exchange Act ("CEA").

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are energy producers, marketers, and utilities. The Working Group considers and responds to requests for public comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2 *Prohibition of Market Manipulation*, 75 Fed. Reg. 67,657 (Nov. 3, 2010).

II. EXECUTIVE SUMMARY.

The Working Group strongly supports the goals of the Act to enhance transparency and reduce systemic risk in the swap markets and offers these comments to help the Commission implement rules required by the Act in a timely and responsible manner. In implementing its Proposed Rule, the Working Group respectfully recommends that the Commission do the following.

1. Adopt Clear and Enforceable Rules. The Working Group supports the adoption of clear and enforceable rules and strongly suggests that the Commission implement rules that recognize and reflect the unique characteristics of (i) commodity markets, and (ii) the differences between the regulatory frameworks administered by the CFTC under Title VII of the Act and other regulatory agencies with similar market manipulation authority, such as the Federal Energy Regulatory Commission ("FERC"), the Securities and Exchange Commission ("SEC"), and the Federal Trade Commission ("FTC").

2. Identify Jurisdictional Boundaries. Should the Commission decide to implement rules under its market manipulation authority that conflict or overlap with the market manipulation authority of the FERC, the Public Utility Commission of Texas ("PUCT"), the SEC, or the FTC, market participants will face substantially more uncertainty with respect to their activities in energy markets and exorbitant costs in attempting to comply with all of the regulatory regimes, thereby reducing participation in key energy markets. To avoid such a result, the CFTC should implement its new market manipulation authority in a manner that respects the jurisdiction of these agencies.
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3. Require Specific Intent for Market Manipulation. The Commission should take caution in following judicial precedent interpreting the rules promulgated under the SEC's, the FERC's, and the FTC's market manipulation authority. While it is true that new Section 6(c)(1) provides the Commission with market manipulation authority that is similar to the language granting the SEC, the FERC, and the FTC their anti-manipulation authority, there are nevertheless key differences, as detailed in Part III.C, below, which limit the Commission's reliance on precedent interpreting the market manipulation authority of other agencies.

III. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.

The Working Group shares the fundamental goal the Commission seeks to achieve through this rulemaking—to ensure the integrity of the commodities markets—and generally supports the Commission's proposed rules implementing new CEA Section 6(c). Further, the Working Group appreciates the opportunity to participate in this proceeding and provides the following comments and concerns.

A. THE WORKING GROUP SUPPORTS CLEAR AND ENFORCEABLE RULES.[3]

Section 753 of the Act provides the Commission enforcement authority to investigate, and sanction if needed, actions attempting to manipulate or resulting in the manipulation of the commodities markets. Specifically, Section 753 adds new Subsection 6(c)(1), which provides in part:

> It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations . . . .

The Commission proposes that, because it believes this Section is patterned after Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), it should treat Section 6(c)(1) as Section 10(b) has been interpreted—as "a broad, catch-all provision reaching fraud in all its forms."[4] The Commission's rules, however, should recognize and reflect the unique characteristics of (i) commodity markets, and (ii) the differences between the regulatory frameworks administered by the CFTC under Title VII of the Act and other regulatory agencies with similar market manipulation authority, *i.e.,* the FERC, SEC, and FTC.

B. JURISDICTIONAL CONCERNS.

With certain exceptions as discussed in Part III.C below, the Commission's anti-manipulation authority granted under new CEA Section 6(c)(1) appears to be similar to the anti-manipulation authority granted to FERC in Sections 315 and 1283 of the Energy Policy Act of 2005 ("EPAct 2005"), the FTC in Sections 811 and 812 of the Energy Independence and Security Act of 2007 ("EISA"), and the SEC under Section 10(b) of the Exchange Act. Because the text of new CEA Section 6(c)(1) has some similarities with the text of Section 10(b) of the Exchange Act, the Commission believes it should adopt essentially the same rules as the SEC for purposes of implementing these new CEA provisions.

Section 753 of the Act provides the Commission authority and enforcement powers to prohibit manipulative behavior "*in connection with* any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity." The Working Group is concerned that, in interpreting this language, the Commission's anti-manipulation efforts may overlap with those of other federal agencies, such as the FERC, the PUCT,[5] the SEC, or the FTC, thus resulting in conflicting or duplicative

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[3] The Working Group further recommends that the Commission adopt new enforcement and compliance policy statements to ensure that the prohibitions on market manipulation are clearly defined so that market participants can understand and effectively comply with them. The Working Group will expand on this recommendation in response to other CFTC proposed rulemakings.

[4] Proposed Rule at 67,658.

[5] The PUCT has primary jurisdiction over activities conducted within the Electric Reliability Council of Texas ("ERCOT"). The transmission of electric energy occurring wholly within ERCOT is not subject to the

regulation. Consequently, the Working Group strongly recommends that, as required by Section 720 of the Act, the CFTC address in its "Memorandum of Understanding" ("MOU") with FERC potential jurisdictional issues that could arise from the similarities in the statutory market manipulation authority granted to the FERC and the SEC to ensure that regulations within the respective jurisdictions are properly coordinated to minimize duplication or conflicts between the agencies' regulations.

In the same vein, the Working Group respectfully recommends that the Commission enter into specific arrangements and agreements with the FERC to avoid overlapping investigations under circumstances that potentially invoke the jurisdiction of each before those circumstances actually arise. Indeed, the Antitrust Division of the Department of Justice ("DOJ") and the FTC have long had an agreement, which relates principally to clearance procedures for merger reviews but also includes antitrust investigations, allocating primary areas of responsibility, on an industry-wide basis, to each in order to avoid overlapping investigations relating to matters that potentially invoke the jurisdiction of each.[6]

The Working Group seeks to prevent a situation in which one agency asserts exclusive jurisdiction over an area the other has claimed within its jurisdiction. In past cases where clarity was lacking, courts were asked to decide which agency had jurisdiction, resulting in increased litigation costs, depletion of scarce resources, and uncertainty. For example, in response to EPAct 2005, the CFTC and FERC, working collaboratively and pursuant to a statutory mandate, crafted an MOU[7] attempting to coordinate the sharing of information in their oversight, investigative, and enforcement activities of mutual interest. Yet litigation relating to jurisdictional disputes between the two agencies still ensued.[8] In this case, the MOU did not go

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FERC's jurisdiction under Sections 203, 205, or 206 of the Federal Power Act. ERCOT has its own market monitor, which provides oversight of its markets, and provides an annual state of the market report. The PUCT enforces ERCOT's market rules.

[6] The DOJ and the FTC first entered into the memorandum agreement in 1948, which required the agencies to "clear" an investigation with the other before proceeding with it. *See* 4 Trade Reg. Rep. (CCH) ¶ 9,565.05 (1993); *see also* FTC, *Overview of the FTC/DOJ Clearance Agreement, available at* http://www.ftc.gov/opa/2002/04/clearanceoverview.shtm. In 1993, the procedure for clearing investigation and jurisdiction with the other agency was updated and clarified. *See* CCH Trade Reg. Rep. ¶ 50,125 (1993). In 2002, because the clearing process had become more difficult with the convergence of industries' boundaries, the agencies entered into a more formal agreement. *See* Press Release, DOJ, *DOJ and FTC Announce New Clearance Procedures for Antitrust Matters, Memorandum Of Agreement Allocates Industry Sectors Between Agencies* (Mar. 5, 2002), *available at* http://www.justice.gov/opa/pr/2002/March/02_at_119.htm; *see also* 3 THE DEPARTMENT OF JUSTICE MANUAL TIT. 7 at 353-57 (ANTITRUST) (2d ed. 2006) (describing history and procedures relating to coordination between the DOJ and FTC).

[7] *See* Memorandum of Understanding Between the Federal Energy Regulatory Commission (FERC) and the Commodity Futures Trading Commission (CFTC) Regarding Information Sharing and Treatment of Proprietary Trading and Other Information (Oct. 12, 2005); *see also* Press Release, CFTC, *CFTC Chairman Jeffrey and FERC Chairman Kelliher Sign MOU on Information Sharing, Confidentiality* (Oct. 15, 2005), *available at* http://cftc.gov/opa/press05/opa5127-05.htm.

[8] In signing the Memorandum of Understanding, then-CFTC Chairman Jeffery stated, "This MOU will result in a more effective and efficient working relationship with FERC." *See* Press Release, CFTC, *CFTC Chairman Jeffrey and FERC Chairman Kelliher Sign MOU on Information Sharing, Confidentiality* (Oct. 15, 2005), *available at* http://cftc.gov/opa/press05/opa5127-05.htm. Notwithstanding the good intentions of both agencies to clarify their

far enough in defining the jurisdictional boundaries of each agency. Thus, the Working Group respectfully recommends that, prior to the formation of the MOU, the Commission host a technical conference with the FERC and market participants to facilitate the formation of specific arrangements and agreements between the two agencies that clearly inform the regulated industries and the respective agencies where jurisdiction will lie under particular circumstances. Doing so will promote efficiency and certainty and reduce wasteful litigation costs. Additionally, such efforts will be particularly important in providing guidance and reducing costs to end-users who now will be subject to regulation by the CFTC and tasked with the responsibility of complying with these new rules.

C. SCIENTER REQUIREMENT.

The Commission states in the preamble of the Proposed Rule that in violating new CEA Section 6(c)(1) and the Commission's implementing rule, a person must act with "scienter." In other words, the Commission's market manipulation authority would reach only "intentional" acts and not inadvertent conduct or mistakes. While the Working Group supports a scienter requirement, we are concerned with the Commission's proposal to include "recklessness," the nature of which is inherently subjective.

Courts apply a variety of canons, or rules, to help them determine the meaning of a statute. In interpreting statutes, a judge tries to ascertain the intent of the legislature in enacting the law. One basic canon of statutory construction is as follows: "Where Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[9] Thus, in applying this canon to the scienter requirement in Section 6(c), we emphasize that Congress used "recklessness" where it meant for "recklessness" to be the operative legal principle (*i.e.,* Section 6(c)(1)(A)), and it chose not to include "recklessness" under Section 6(c)(1). Thus, the Working Group strongly suggests that the Commission refrain from adding a reckless scienter standard into Section 6(c)(1) and simply apply a rule that contemplates a single scienter standard—specific intent. This alternative would significantly reduce the element of subjectivity and uncertainty that currently exists under the Proposed Rule and reconfirm that market manipulation is an intentional act.

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respective jurisdictions pursuant to the statutory mandate, a subsequent enforcement action resulted in questions arising about their respective jurisdictions. In 2007, the two agencies disagreed over which had jurisdiction to penalize Amaranth Advisors and former head trader Brian Hunter for alleged manipulation of natural gas futures contracts on the NYMEX. The CFTC intervened on behalf of Hunter in his appeal to the U.S. Court of Appeals for the District of Columbia Circuit seeking to enjoin the FERC from proceeding with its enforcement action. Like Hunter, the CFTC argued that it had exclusive jurisdiction over futures trading, and the FERC consequently lacked any and all jurisdiction over the matter. *See Hunter v. FERC*, 527 F. Supp. 2d 9 (D.D.C. 2007); *Hunter v. FERC*, 569 F. Supp. 2d 12 (D.D.C. 2008); *Hunter v. FERC*, 348 Fed. Appx. 592, 2009 U.S. App. LEXIS 23417, at *5 (D.C. Cir. Oct. 13, 2009).

[9] *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)).

Because "reckless" is not in the statute, as amended by the Act, the Commission proposes to follow judicial precedent interpreting and applying Section 10(b) of the Exchange Act and SEC Rule 10b-5[10] to the securities markets in applying the scienter standard under Subsection 6(c)(1) and the Commission's implementing rule. The Working Group cautions that in doing so, the Commission's reliance will be misplaced. While it is true that new Section 6(c)(1) provides the Commission with market manipulation authority that is similar to the language granting the SEC, the FERC, and the FTC their anti-manipulation authority, one major difference remains—the Exchange Act, the Federal Power Act ("FPA") and the Natural Gas Act ("NGA"), as amended by EPAct 2005, and EISA do not expressly provide the SEC, the FERC, or the FTC authority over *attempted* manipulation.[11] To the extent that the agencies believe they have jurisdiction over attempt offenses, such is not pursuant to the express statutory language of the Exchange Act, FPA, NGA, or EISA. Thus, all judicial precedent applying a scienter requirement that embraces recklessness in the context of the securities and energy markets, which are not subject to an attempt offense, are inapposite to the scienter requirement that can be applied pursuant to Subsection 6(c)(1), which expressly includes an attempt offense.[12] Attempt is a specific-intent offense, and therefore, while it might be argued that a person recklessly manipulates, it cannot be said that a person recklessly attempts to manipulate.

The Working Group respectfully reminds the Commission of its words: "[J]udicial precedent interpreting and applying Exchange Act Section 10(b) and SEC Rule 10b-5 in the context of the securities markets should guide, *but not control*, application of the scienter standard under Subsection 6(c)(1) and the Commission's implementing rule."[13] Accordingly, the Working Group supports the Commission's adoption of a specific-intent scienter standard, but the Working Group respectfully recommends that the Commission refrain from applying a lesser scienter requirement, which embraces recklessness, to an offense that by definition requires specific intent.

Moreover, the Working Group requests that in following the judicial precedent interpreting Section 10(b), the Commission clarify that it seeks to follow such precedent only with respect to applying its market manipulation authority under new Section 6(c)(1), and not its

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[10] Rule 10b-5, 17 C.F.R. § 240.10b-5, was adopted by the SEC to implement Section 10(b) of the Exchange Act.

[11] Further, it is even more evident that in enacting new CEA Section 6(c)(1) and (3), Congress was drawing upon the existing statutory language under CEA Section 9(a)(2) and not Section 10(b) of the Exchange Act, as the text of new CEA Subsection 6(c)(3) is substantially similar to the text of CEA Subsection 9(a)(2).

[12] In the preamble of the Proposed Rule, the Commission cites *Drexel Burnham Lambert, Inc. v. CFTC,* 850 F.2d 742 (D.C. Cir. 1988), in support of its recklessness scienter standard. In *Drexel*, the United States Court of Appeals for the District of Columbia held that recklessness was sufficient to satisfy CEA Section 4b's scienter requirement, relying on judicial precedent applying a recklessness scienter requirement under Section 10(b) of the Exchange Act. Yet, while the CEA anti-fraud provision, Section 4b, includes an attempt offense, the Court was not actually ruling on an action for attempt. Further, the Court was relying on judicial precedent interpreting Section 10(b) of the Exchange Act, which, as previously stated, does not include an offense for attempt.

[13] Proposed Rule at 67,659 (emphasis added).

authority under existing CEA Section 9(a)(2), which requires a "knowing" scienter standard. That is, the Commission states in the preamble of the Proposed Rule that its authority under Section 9(a)(2) is *not* affected by new Section 6(c)(1),[14] and, therefore, to the extent the Commission adopts a reckless scienter standard under its new market manipulation authority, the Working Group requests that the Commission refrain from applying such standard to its existing authority under Section 9(a)(2).

With respect to the Proposed Rule as it stands, the Working Group strongly suggests that the Commission confirm that it will not adopt a scienter requirement that creates an implied presumption that sophisticated traders understand and are aware of the effects of their actions taken in the normal course of business on other commodity or securities markets. Rather, the CFTC should evaluate alleged manipulation on a case-by-case basis, taking into consideration the facts and circumstances of each case. In addition, the determination of whether or not a trader's allegedly deceptive or fraudulent acts demonstrate a reckless mindset should be limited to the impacts in the markets in which the trader was transacting.

D. FALSE REPORTING.

Section 753 of the Act adds Subsection 6(c)(1)(A), which expressly prohibits false reporting. This provision places the burden on market participants to ensure that any information that could "affect or tend to affect the price of any commodity in interstate commerce" is true, accurate, and sufficient. Market participants that knowingly report false information or act with a "reckless disregard" of the fact that reported information is false will be subject to market manipulation under this transaction. While this section requires that a person have knowledge or act with reckless disregard, the Working Group is nevertheless concerned that this rule will place a heavy burden on all market participants as they attempt to comply with the new reporting requirements proposed by the CFTC pursuant to the Act.

The Working Group supports the exception for "good-faith mistakes," which do not amount to manipulation by false reporting. Yet the Working Group respectfully recommends that the Commission clarify the scope of the safe harbor for "good-faith mistakes" in the reporting of information set forth in new CEA Section 6(c)(1)(C). For example, the Working Group suggests that the Commission create a safe harbor for companies that currently have, or establish, programs to prevent the intentional or reckless reporting of information. In creating such safe harbor, we do not intend to suggest that the Commission should not be permitted to sanction rogue traders who deviate from prescribed standards of conduct. Rather, the Working Group respectfully suggests that the Commission recognize companies who diligently seek to comply with the Commission's regulations through comprehensive compliance programs and consider such as a mitigating factor in any enforcement determination. The Working Group believes that promoting a culture of compliance, supported by effective compliance programs, will encourage the flow of truthful information and avoid discouraging good faith reports that may subsequently prove to be inaccurate.

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[14] *Id*. (explaining that "nothing in section 6(c)(1) affects the applicability of section 9(a)(2) . . . .").

Finally, the Working Group supports the Proposed Rule to the extent that, in the case of a false reporting violation, it does not permit the Commission to impose a civil penalty of an amount equal to the greater of $1 million or treble damages pursuant to Section 6(c)(10)(C)(ii). The Working Group encourages the Commission to confirm that such penalty authority applies only to violations of market manipulation under Section 6(c)(1).

E. Disclosure Obligations of Nonpublic Information.

The Working Group is confident that the implementing rules do not create a new regime of affirmative disclosure obligations for market participants. Subsection 6(c)(1) provides in part: "no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction . . . ." The Working Group comments here in support of such language to the extent it does not impose an independent obligation to make disclosure "absent a relationship of trust and confidence."[15] The Working Group recommends that the Commission provide certainty to market participants and clarify that this provision means that, in the ordinary course of business, transacting parties are not under a duty to disclose proprietary information, such as their personal assessment of the relevant market.

IV. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the energy swap markets in the United States. The Working Group fully appreciates that as the CFTC sets out to implement proper regulation and oversight, it must strike the appropriate balance so that it neither discourages competition nor deters productive activity in the energy swap markets. The Working Group respectfully submits that the Commission consider its comments set forth herein regarding the Proposed Rule. If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ Mark W. Menezes_
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15 *See* Order No. 670, *Prohibition of Energy Market Manipulation,* 114 FERC STATS. & REGS.¶ 31,202, 71 Fed. Reg. 4244 (2006).