



January 3, 2011

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David A. Stawick, Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: Prohibition of Market Manipulation, 17 CFR Part 180, Proposed Rule, 75 Fed. Reg. 67657 (Nov. 3, 2010), RIN Number 3038-AD27

Dear Mr. Stawick:

The Edison Electric Institute (“EEI”) respectfully submits these comments in response to the Commodity Futures Trading Commission’s (“Commission’s” or “CFTC’s”) Notice of Proposed Rulemaking (“NOPR”)¹ implementing anti-manipulation authority in section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).² In addition, EEI supports the comments being filed in response to the NOPR by the Coalition of Physical Energy Companies, which has addressed some additional points and provided some additional details, including regulatory text.

In the NOPR, the Commission has proposed to add two new sections to its regulations at 17 CFR Part 180. Section 180.1 would prohibit intentional or reckless (1) use of or attempt to use manipulative devices, schemes, or artifices to defraud, (2) untrue or misleading statements or attempts to make statements of material fact, (3) practices or attempts to engage in practices that would operate as a fraud or deceit, or (4) false, misleading, or inaccurate reports concerning crop or market information or conditions that affect or tend to affect commodity prices in interstate commerce, with a good faith exception and non-disclosure provision. Section 180.2 would prohibit manipulation or attempts to manipulate the price of any swap, commodity, or future delivery subject to the rules of any registered entity.³

¹ 75 Fed. Reg. 67657 (Nov. 3, 2010).

² Pub. L. No. 111-203 (2010).

³ NOPR at 67662.

EEI has a Direct Interest in This Proceeding

EEI appreciates the opportunity to submit these comments in response to the NOPR. EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI also has more than 65 international electric companies as affiliate members, and more than 170 industry suppliers and related organizations as associate members.

EEI's members are not financial entities. Rather, the typical EEI member is a medium-sized electric utility with relatively low leverage and a conservative capital structure.⁴ EEI members are largely end users as contemplated by the Dodd-Frank Act,⁵ engage in swaps to hedge commercial risk, and have an established track record of using these tools in a manner that *reduces* systemic risk. EEI is supportive of Commission regulations that protect the markets and allow its members to hedge their risks in a cost effective manner.

The CFTC Should Implement its Anti-Manipulation and Anti-Fraud Authority in Coordination with FERC to Avoid Conflicting and Duplicative Regulation

Section 753 of the Dodd-Frank Act amended section 6(c) of the Commodity Exchange Act ("CEA")⁶ "to expand the authority of the Commission to prohibit fraudulent and manipulative behavior." New CEA section 6(c)(1) is similar to the anti-manipulation authority granted to FERC in sections 315 and 1283 of the Energy Policy Act of 2005.⁷

EEI encourages the CFTC to implement its new authority under Section 6(c)(1) in a cooperative manner with FERC so as to minimize the potential to subject market participants that are under the jurisdiction of both FERC and the CFTC to conflicting or duplicative regulation. Section 720 of the Dodd-Frank Act requires the CFTC and FERC to negotiate a memorandum of understanding ("MOU") establishing procedures for resolving conflicts in overlapping jurisdiction and avoiding duplicative regulation. EEI encourages the Commission to address this issue in the MOU.

⁴ EEI members are subject to substantial state regulatory requirements in addition to oversight by the Federal Energy Regulatory Commission ("FERC"). EEI's diverse membership includes utilities operating in all regions, including in regions with Regional Transmission Organizations and Independent System Operators that have active market monitoring units.

⁵ CEA §§ 2(h)(1)(A) and 2(h)(1)(8).

⁶ 7 U.S.C. 1 *et seq.* (2006).

⁷ Pub. L. No. 109-58, 119 Stat. 594-1143, adding section 4A to the Natural Gas Act, 15 U.S.C. 717 *et seq.* and section 222 to Part II of the Federal Power Act, 16 U.S.C. 824 *et seq.*

The CFTC Should Implement its Anti-Fraud and Anti-Manipulation Authority Judiciously in Dialogue with the Regulated Community

Under the Dodd Frank Act, regulation of the swaps markets is new and is the subject of close to 40 rulemakings initiated by the Commission to date. Many key terms and concepts have not yet been defined or otherwise finalized. In such a context, it may be difficult for market participants to know in advance what conduct the Commission ultimately may consider manipulative or fraudulent behavior. The prospect of prosecution for behavior that is not clearly understood to be manipulative or fraudulent in an evolving regulatory environment is quite disconcerting.

Although the CFTC had anti-manipulation authority prior to the Dodd-Frank Act, the act has expanded that authority and applied it in new contexts, creating substantial regulatory uncertainty. Therefore, EEI encourages the CFTC to be judicious in implementing its section 753 authority. We encourage the Commission to provide guidance to market participants, who may not have been previously regulated by the CFTC – and to give the participants the ability to comply – before the Commission enforces its new authority, in particular in areas that were not previously regulated by the Commission and for which there may not be CFTC precedent.

The NOPR largely restates the broad statutory language of section 753 as regulatory text without qualification or illustration. By doing so, the NOPR raises concerns about: (1) what types of conduct might run afoul of the new text, even if the conduct was not undertaken with specific intent to manipulate or defraud, particularly where such conduct does not in fact have significant market and price effects; (2) how well the proposed new regulations patterned after Securities Exchange Act (“Exchange Act”) section 10b⁸ will fit in the commodity and swaps markets that are the focus of the Commission’s regulatory oversight; and (3) confusion the new regulations will create in light of the Commission’s historic interpretation of CEA sections 6 and 9.

EEI understands that in using the broad statutory language, the Commission may be seeking to retain flexibility to address creative new schemes that could constitute criminal conduct. However, additional guidance is necessary to ensure that participants in the swaps markets can meaningfully comply with the Commission’s implementation of its new Dodd-Frank Act authority and to avoid undue regulatory uncertainty.

For this reason, EEI strongly recommends that at the earliest time possible, but at least before the Commission issues a final rule, the Commission or its staff hold a workshop with the industry and other members of the public where the participants can discuss,

⁸ 15 U.S.C. 78j(b).

among other things: the scope of the proposed regulations; examples of prohibited behavior; examples of acceptable behavior; the applicability of agency price manipulation and other comparable precedent; the process the agency's enforcement staff might use to pursue claims of market manipulation; and the value of self-reports and cooperation during an investigation and other factors the staff might use to determine an appropriate remedy. As a result of this dialogue, we also recommend that the Commission provide examples of permitted and prohibited conduct. In this way, the Commission will have greater assurance that compliance with the new regulations will not impede legitimate market operations and that enforcement of the regulations will be efficient and productive.

Proposed Section 180.1 Should Incorporate a Clearer Intent Standard

EEI appreciates the Commission's inclusion of a scienter⁹ requirement as a basic element of the behavior prohibited by proposed section 180.1. The Commission proposes to follow its precedent regarding intent required for price manipulation – and the Supreme Court's interpretation of Exchange Act section 10(b) and the Securities and Exchange Commission's Rule 10b-5 – in defining the scienter required for a violation of section 6(c)(1) as intentional behavior or reckless conduct, not just negligence or even gross negligence. The Commission also proposes to follow Supreme Court precedent on section 10(b) in interpreting “in connection with” under section 6(c)(1), interpreting it to mean misstatements or other misconduct made “in a manner reasonably calculated to influence market participants.”¹⁰

However, under current CFTC precedent, the Commission and the courts require proof that a defendant specifically intended to influence prices.¹¹ If the Commission intends to lower the intent standard to one of “recklessness,” EEI requests that the CFTC apply a standard of “extreme recklessness,” as a number of federal courts have done,¹² requiring an extreme departure from the standards of ordinary care to the extent that the danger to buyers or sellers was either known to the defendant or so obvious that the defendant must have been aware of it.¹³

In addition, the Commission should be careful in looking to securities law precedent in interpreting proposed section 180.1 and the underlying provisions of the Dodd-Frank Act.

⁹ The Commission states that “scienter” refers to a mental state embracing the intent to deceive, manipulate, or defraud. NOPR at 67659.

¹⁰ NOPR at 67759.

¹¹ *In re Indiana Farm Bureau Cooperative*, Comm. Fut. L. Rep. (CCH) § 21,796 at 27,283.

¹² See, e.g., *Phillips v. LCI Int'l*, 190 F.3d 609, 621 (4th Cir. 1999); *Ross v. BankSouth*, 885 F.2d 723, 730 n. 10 (11th Cir. 1989).

¹³ *SEC v. Lyttle*, 538 F.3d 601, 603, quoting *Makor Issues and Rights v. Tellabs*, 513 F.3d 702, 701 (7th Cir. 2008).

The securities and derivatives markets are fundamentally different. The securities markets are composed primarily of retail investors and are generally for the purpose of raising capital. In contrast, the futures and derivatives markets are dominated by sophisticated parties and were largely developed for the purpose of managing risks. In addition, the nature of the trading and counterparties are quite different in the derivatives markets than in the securities markets, and there are more fiduciary relationships in securities markets than in derivatives markets.

As a result, anti-fraud laws in the securities markets may not always transfer well to the derivatives markets. Anti-fraud laws in the securities market context were typically developed to protect retail investors and to ensure there is full disclosure in those capital-raising markets. There is no counterpart backdrop of full disclosure in the derivatives markets, so concepts of failure to disclose generally will not apply.

The CFTC Should Provide Additional Clarity about Proposed Subsection 180.1(b)

The Dodd-Frank Act supplements the CFTC's existing authority to prohibit fraudulent statements and conduct in connection with jurisdictional activities. For example, the act retains and expands the prohibition on making false statements to the CFTC. The act also retains and expands the prohibition on false or misleading reports of crop or market information through the mail or interstate commerce, to include knowing and reckless statements with a good-faith exception for mistaken transmission of false, misleading, or mistaken information to a reporting service. The act further retains the prohibition on false or misleading statements or omissions made in connection with specified transactions or activities.

At the same time, as particularly relevant here, in new CEA subsection 6(c)(1), the act specifies that "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, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect."¹⁴

The NOPR reflects but does not sufficiently address this nondisclosure provision. Proposed subsection 180.1(b) repeats the subsection 6(c)(1) statutory text. But with the exception of a short discussion of "puffery," which would not trigger the otherwise applicable prohibitions, the preamble gives no further explanation of section 180.1(b) or its implications for market participants.

¹⁴ Dodd-Frank Act § 753(a), 124 Stat. at 1754.

EEI requests that the Commission provide additional clarity with respect to this subsection. Under the CFTC's pre-Dodd-Frank Act anti-fraud authority, most violations have involved instances of fraudulent or deceptive statements (*e.g.*, a broker making fraudulent statements to clients or a commodity pool operator making deceptive statements in advertisements) and classic acts of fraud (*e.g.*, an introducing broker promising to invest money for a customer and then stealing the customer's money). Though the proposed rule is likely to apply to a broader range of activities, under section 180.1(b) the same basic inquiry should still apply – namely whether the statements were made with the intent to deceive, manipulate, or defraud.

Under the CFTC's pre-Dodd-Frank authority, the Commission has prohibited fraud mainly in connection with transactions involving retail investors or organized markets. As a result, the Commission's fraud authority has been used mostly to protect unsophisticated investors, in part by requiring certain disclosures aimed at protecting such investors.¹⁵

However, the circumstances surrounding swap transactions are quite different. Unlike futures or options transactions that are traded on organized markets, swap transactions are generally negotiated bilaterally between two sophisticated parties. Yet the proposed rule does not recognize this difference. It should do so, founded on the Dodd-Frank Act provision not generally requiring disclosure of nonpublic information, while providing guidance as to types of statements the Commission would consider materially misleading.

Proposed Section 180.2 Should Be Deleted or, at a Minimum, Renoticed and Modified to Reflect the NOPR Preamble's Intent Requirement

EEI recommends that the Commission consider deleting section 180.2 because the section is so broadly worded as to provide no helpful guidance to the regulated community as to what it prohibits beyond section 180.1. Deleting the section would avoid uncertainty and confusion without undermining the Commission's general authority under Dodd-Frank Act section 753.

If the Commission chooses not to delete section 180.2, EEI recommends that the Commission carve this section out of the current rulemaking initiative and issue a separate and more detailed NOPR for public comment. This would allow the industry and others to make meaningful comments on the proposal and would allow the Commission to provide guidance to the industry and to have an adequate record on which to reach a reasoned decision.

¹⁵ 17 C.F.R. §§ 32.5, 33.7.

In addition, as part of this rulemaking, EEI requests that the Commission affirm in regulatory text that the scienter requirement for section 180.2 is specific intent, under the Commission's four-prong test. The NOPR preamble indicates that the Commission proposes to interpret "the prohibition on price manipulation and attempted price manipulation to encompass every effort to influence the price of a swap, commodity, or commodity futures contract that is intended to interfere with the legitimate forces of supply and demand in the marketplace."¹⁶ The Commission goes on to reaffirm a "broad" reading of the term "manipulation" with respect to section 6(c)(3) and the traditional four-part test for establishing manipulation under the CEA, which includes a requirement that the accused "specifically intended" to create an artificial price. This standard has been interpreted by the courts to require specific intent to manipulate. But the regulatory text of section 180.2 does not reflect this preamble discussion. The Commission should modify the regulatory text to affirm that the Commission intends to apply a specific intent standard in implementing the section.

EEI appreciates the opportunity to submit these comments. Please contact me, Henri Bartholomot at (202) 508-5622, or Lopa Parikh at (202) 508-5098 if you have any questions about them.

Respectfully submitted,



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¹⁶ NOPR at 67660.