



May 20, 2009

VIA ELECTRONIC MAIL:

<https://secure.commentworks.com/ftc-marketmanipulationNPRM/>

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

Re: Market Manipulation Rulemaking, PO82900

Dear Mr. Clark:

The Futures Industry Association, Managed Funds Association, CME Group, Inc., Intercontinental Exchange, Inc., and National Futures Association (collectively, the "Futures Group") file this comment letter on the Part 317 rules proposed by the Federal Trade Commission ("Commission") and entitled "Prohibition of Energy Market Manipulation Rule." 74 Fed. Reg. 18304, 18327 (April 22, 2009). In two prior comment letters, the Futures Group endorsed the adoption by the Commission of new anti-manipulation protections for non-futures, wholesale markets in crude oil and gasoline. We also focused our comments on the possible application of the Commission's new rules to commodities, conduct and trading already subject to manipulation and fraud proscriptions under the Commodity Exchange Act. The Futures Group greatly appreciates the willingness of the Commission and its staff to consider carefully our prior comments and, in some instances, to modify its proposal in response to our comments.

From the Futures Group's perspective, however, the Commission's proposal continues to fail to recognize the statutory exclusive jurisdiction of the Commodity Futures Trading Commission ("CFTC") over futures trading in crude oil, gasoline and petroleum distillates. As a result, as written the Commission's proposal is not in accordance with the exclusive jurisdiction provision of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 2(a)(1) (A), and would impose

conflicting fraud standards on futures market professionals and participants contrary to the expressed intent of Congress when it enacted the CEA's exclusive jurisdiction provision in 1974. The Futures Group requests that the Commission correct these legal deficiencies before issuing its final rules.

CFTC Exclusive Jurisdiction

The Commission's discussion of the CFTC's exclusive jurisdiction in the Federal Register notice confirms the need for a safe harbor for futures market participants operating within the CFTC's exclusive jurisdiction. While explaining that the comment letters filed by the CFTC, the Futures Group and others had highlighted the scope, history and purpose of the CEA's exclusive jurisdiction provision, the Commission wrote that it "recognizes the CFTC's jurisdiction 'with respect to accounts, agreements ... and transactions involving contracts of sale of a commodity for future delivery.'" 74 Fed. Reg. at 18311. We respectfully note that the Commission has omitted a key word from the Commission's reference to 7 U.S.C. § 2(a)(1)(A). Congress did not grant the CFTC mere "jurisdiction;" Congress made sure in 7 U.S.C. § 2(a)(1)(A) the CFTC's jurisdiction over exchange trading in futures and related activities would be "exclusive." By omitting the key word in the CFTC's statutory authority, the Commission implicitly acknowledged the weakness of its legal position, if it still intends to have its proposed Part 317 rules apply to futures trading.¹

The Futures Group again asks the Commission to adopt a safe harbor from its proposed Part 317 rules for futures market activities. The safe harbor would only remove from the Commission's Part 317 rules those market participants that engage in conduct or activities solely in connection with futures trading. If a market participant only trades futures, the safe harbor would make the Commission's new rule inapplicable to that futures trading activity. In this regard, the safe harbor would apply even if the market participant's futures trading allegedly had an impact on cash or other non-futures market oil or gasoline prices. Consistent with the congressionally-acknowledged, price discovery function that futures markets perform, futures prices are supposed to be relied upon by those engaged in cash or forward market business activities. When Congress created the CFTC in 1974, Congress fully appreciated the reach of the futures markets' price discovery effects and still decided to grant exclusive regulatory jurisdiction to the CFTC.² The requested safe harbor would comport with that congressional decision.

The Futures Group's requested safe harbor would not apply where a market participant engaged in activities outside the futures markets for crude oil, gasoline or petroleum distillates, whether that conduct occurred in conjunction with futures trading or independent of such trading. When a market participant's alleged misconduct involves conduct or activities in cash or other

¹ If the Commission does not intend to apply its Part 317 rules to conduct that involves only futures trading, our requested safe harbor would effectuate that intention.

² See S. Rep. No. 93-1131, 93d Cong. 2d Sess. 6, 12 (1974) (while granting exclusive jurisdiction to "make clear that ... the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies," the Committee recognized "[t]rading in futures provides not only the market of today, but of months ahead, and affords guidance to buyers and sellers of agricultural commodities in planning ahead, and in financing and marketing commodities from one season to another.")

non-futures crude oil and gasoline markets, as well as futures trading, the Futures Group would expect the Commission and the CFTC to coordinate their respective investigatory and enforcement activities, as the Commission suggests. 74 Fed. Reg at 18311 (“the Commission intends to work cooperatively with the CFTC in furtherance of the Commission’s duty to prevent fraud in wholesale petroleum markets”).

The Commission’s April Federal Register notice declined “to adopt a blanket safe harbor for futures market activities[,]” “[a]t this time.” 74 Fed. Reg. at 18311. Respectfully, the Futures Group believes this is exactly the time to adopt the requested safe harbor for futures trading activities within the CFTC’s exclusive jurisdiction. In that way, the Commission would effectuate Congress’ intent that futures exchanges, futures professionals and futures market participants would know their trading and related activities would be subject exclusively to the comprehensive regulatory and enforcement regime found in the CEA and CFTC regulations. At the same time, the Commission would still be able to exercise its enforcement jurisdiction in areas outside the CEA’s exclusive jurisdiction provision for futures markets.

Fraud Standards

We understand that the Commission intends its new fraud rules in Part 317 to complement, not contradict, the CEA’s anti-fraud provisions and other prohibitions. As we discussed in our October 17, 2008, comment letter, however, if the Commission applies its Part 317 rules to futures trading activities, those rules would conflict with and contradict at least Section 4b of the CEA, 7 U.S.C. § 6b, as recently amended by Public Law No. 110-246, 122 Stat. 2194-95 (2008). (Our October 17, 2008, comment letter is attached and our discussion of this issue is found at pp. 14-17 of that letter.) Section 4b is the over-arching anti-fraud provision for futures market activities set forth in the CEA.

In summary and without restating every aspect of our prior comment, the anti-fraud prohibitions in Section 4b have been calibrated by Congress to apply special intent standards to intermediaries acting for their customers in futures markets and not to apply where one trader defrauds other traders because self-regulating exchange markets already handle that misconduct subject to Commission oversight. The Proposed Part 317 rules would conflict with these limitations. In addition, Congress in 2008 enacted special provisions to remove the possibility that futures market participants would generally have an affirmative obligation to disclose material non-public market information. 122 Stat. 2195. Section 4b does require affirmative disclosures only where necessary to make any statements already made “not misleading in any material respect.” It is not clear from the prohibitions in proposed Rule 317.3 whether its provisions would apply in the same manner or whether they would differ. Of course, the requested safe harbor would make that concern moot, as only Section 4b of the CEA would apply to those engaged in only futures trading activities.

In short, the CEA provides a comprehensive anti-fraud and anti-manipulation system for futures markets, including prohibiting false reports that affect or tend to affect commodity prices (7 U.S.C. § 13(a)(2)). Inevitably, the Commission’s Part 317 rules would conflict with those CEA provisions leading to the potential for uncertain, duplicative or conflicting federal regulatory standards for futures market participants, the very problem the CEA’s exclusive jurisdiction provision was enacted to prevent. These conflicts illustrate and underscore the need for the Commission to adopt the safe harbor we have requested.

Conclusion

The Futures Group opposes fraud and manipulation in any market. We appreciate the effort the Commission and its staff have devoted to achieving the goal of an effective prohibition on fraudulent conduct in wholesale markets for crude oil, gasoline and petroleum distillates. We also recognize that the Commission and the CFTC have limited resources available to police the markets within their jurisdiction. In our view, these resource limitations only make more compelling the arguments for respecting the congressional grant of exclusive CFTC jurisdiction over futures trading and for enhanced cooperation by the Commission and the CFTC where their jurisdiction overlaps.

The safe harbor we have requested would comply with the CEA, serve the public interest and lead to more effective law enforcement for energy markets. We thank the Commission for its consideration and look forward to working with the Commission as it moves forward to implement the antifraud provisions it decides to adopt.

Sincerely,

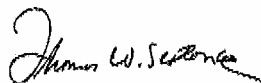


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Attachment

ATTACHMENT



October 17, 2008

VIA ELECTRONIC MAIL:

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

Re: Market Manipulation Rulemaking, PO82900

Dear Mr. Clark:

In 2007, Congress passed Section 811 of the Energy Independence and Security Act ("EISA") which authorized the Federal Trade Commission ("Commission") to issue regulations making it unlawful to use or employ any manipulative device or contrivance when buying or selling at wholesale crude oil, gasoline or petroleum distillates. On May 7, 2008, the Commission issued an Advanced Notice of Proposed Rulemaking on whether to exercise that Section 811 authority and, if so, what the regulations should provide. 73 Fed. Reg. 25614. In response, the Commission received 155 public comments. Following its review of those comments, the Commission decided to propose Part 317 of its rules to create a new prohibition for wholesale purchase and sale transactions in crude oil, gasoline and petroleum distillates. 73

Fed. Reg. 48317. Proposed Rule 317.3 would generally mirror the securities law prohibitions found in Rule 10b-5 of the Securities and Exchange Commission (“SEC”). The Commission has requested public comment on its proposal.

The undersigned Futures Industry Association, CME Group, Inc.,¹ Managed Funds Association, Intercontinental Exchange, Inc.,² and National Futures Association³ (“Group”) submit these comments on the Commission’s proposal. The Futures Group requests that the Commission:

1) Reverse its decision to override the Commodity Exchange Act’s (“CEA”) grant of “exclusive jurisdiction” to the Commodity Futures Trading Commission (“CFTC”) over all futures and options trading, including energy futures and options, (7 U.S.C. § 2(a)(1)(A)) and adopt an appropriate safe harbor exemption from the prohibitions in the Commission’s proposed Rule 317.3 as described in our comment letter of June 23, 2008 (Section I);

¹ CME Group now owns and operates four different U.S. futures exchanges: Chicago Mercantile Exchange Inc. (“CME”), the Board of Trade of the City of Chicago, Inc. (“CBOT”), New York Mercantile Exchange Inc. (“NYMEX”) and Commodity Exchange, Inc. (“COMEX”). CME Group, the Futures Industry Association and the Managed Funds Association were described in our comment letter of June 23, 2008.

² Intercontinental Exchange, Inc. owns three futures exchanges: ICE Futures U.S. (formerly the New York Board of Trade), ICE Futures Europe, and ICE Futures Canada (formerly the Winnipeg Commodity Exchange). ICE also operates an over the counter energy trading platform, which is an exempt commercial market, as defined by the Commodity Exchange Act.

³ National Futures Association (“NFA”) is a registered futures association under Section 17 of the CEA and a limited-purpose national securities association under Section 15A(k) of the Securities Exchange Act of 1934. As the industry-wide self-regulatory organization for the U.S. futures industry, NFA is first and foremost a regulatory body devoted to customer protection. NFA regulates the activities of over 3,700 Member firms that include futures commission merchants, introducing brokers, commodity pool operators and commodity trading advisors. NFA also regulates the activities of approximately 55,000 registered account executives who work for those Members.

2) Explicitly restrict the scope of proposed Rule 317.3 to make it inapplicable to ethanol as well as sugar, corn and other commodities, which may be used in the process of making ethanol, that are the subject of futures and options trading (Section II); and

3) Impose specific intent and price effects requirements as elements of an offense under the final version of proposed Rule 317.3 in order to avoid having its provisions contradict and conflict with CEA legal requirements unless the Commission adopts our suggestions in Sections I and II.

I. The Commission's Final Rule Must Comport with the CEA's Exclusive Jurisdiction Provision.

In our June comment letter, the Futures Group described in detail the statutory text, history, and public policy principles that support the CEA's grant of exclusive jurisdiction to the CFTC. *See* Futures Group Letter of June 23, 2008. As we demonstrated, Congress designed the CFTC's exclusive jurisdiction to make absolutely certain that the provisions of the CEA, as well as the CFTC's regulations issued pursuant to that statute, would be the sole legal standards applicable to futures trading. As the Commission itself acknowledged in 2000, Congress provided the CFTC with exclusive jurisdiction "to create uniform rules for the operation of the futures market." FTC Denial of Petition to Quash Civil Investigative Demands-File No. 9923259 at 5 (Feb. 25, 2000). The Commission's proposed Rule 317.3 would upset that uniformity.

The reasons for the preclusive grant of CFTC exclusive jurisdiction are well documented. In 1974, when the CFTC was created, Congress feared conflicting or duplicative regulation would be applied to futures trading activities by other federal agencies or state regulatory bodies, a legal and compliance burden Congress believed would impair the operations of U.S. futures markets. Congress enacted CFTC exclusive jurisdiction to avoid the conflicts and inefficiencies

that plagued securities regulation and has amended the CEA many times over the years, and amended it again as recently as a few months ago, to ensure that the CFTC would be the sole regulator of the futures markets and related markets.⁴

As we also discussed in our June letter, every court to address the merits of this issue has found the CFTC's exclusive jurisdiction supersedes other agencies' efforts to regulate futures trading and the market operations that comprise the futures industry. We cited two major decisions by the U.S. Court of Appeals for the Seventh Circuit which the Commission thus far has ignored in this rulemaking. *Board of Trade of City of Chicago v. SEC*, 677 F.2d 1137 (7th Cir. 1982) and *Chicago Mercantile Exch. v. SEC*, 883 F.2d 537 (7th Cir. 1989). In one of those decisions, the Seventh Circuit dealt with the interplay of the first two sentences in 7 U.S.C. § 2(a)(1)(A) and established that the first sentence grants the CFTC exclusive regulatory jurisdiction over commodity futures and options, while the second sentence recognizes that other agencies may have jurisdiction "except as hereinabove provided," that is, except for those activities covered by -- "the [CFTC] exclusive jurisdiction clause." *Board of Trade of City of Chicago v. SEC*, 677 F.2d 1137, 1145 (7th Cir. 1982).⁵

⁴ As described in our June 23 letter, in the 2008 Farm Bill, Congress created a new type of statutory classification, called a "significant price discovery contract," that is analogous to a futures contract and made sure that CFTC regulation of the trading of such contracts would be subject to exclusive CFTC jurisdiction. Pub. L. No. 110-246, 122 Stat. 1651, 2201 (June 18, 2008). We have attached a full and up-to-date version of the CEA's exclusive jurisdiction provision to this letter.

⁵ Apparently relying on the second sentence in 7 U.S.C. § 2(a)(1)(A), and disregarding Seventh Circuit precedent that is directly to the contrary, the Commission claims "CFTC exclusive jurisdiction is not intended to remove jurisdiction conferred to other agencies under other laws." 73 Fed. Reg. at 48324, n.90. The Commission cites three cases in support of this position. The first, *FTC v. Roberts*, 276 F.3d 583 (D.C. Cir. 2001), actually supports CFTC exclusive jurisdiction over futures price manipulation. In *Roberts* the DC Circuit rejected a challenge to a Commission investigatory subpoena, holding that a marketer of educational courses in futures trading had not made a "compelling enough" argument that those sales activities were covered by CFTC exclusive jurisdiction over "transactions involving" futures contracts "to overcome this court's long-standing chariness about entertaining challenges to administrative subpoenas." 276 F.3d at 592. The Court contrasted activities that would be subject to CFTC exclusive jurisdiction, for example, "actions closely linked to the
(Footnote Continued...)

Despite this legal authority and unbroken chain of precedent, the Commission concluded that “CFTC authority over manipulation relating to commodities futures markets is not exclusive and, moreover, is separate from CFTC’s exclusive authority under CEA Section 2(a)(1)(A).” 73 Fed. Reg. at 48324. Respectfully, the Commission misreads the CEA. The Commission’s conclusion depends on the assumption that Congress limited the CFTC’s exclusive jurisdiction to the futures contract instruments themselves, but not the activity involved in trading those contracts, including attempted or actual price manipulation. That view is precluded by the CEA. Congress stated the purpose of the CEA as follows: “it is further the purpose of the [CEA] ... to deter and prevent price manipulation.” 7 U.S.C. § 5(b). To that end, the CEA’s comprehensive regulatory protections and prohibitions apply to everyone who trades futures contracts and the various professionals and markets through which futures are traded. Granting the CFTC

(Footnote Continued)

actual trading of commodities,” with marketing instructional videos that might or might not result in actual futures trading. The *Roberts* courts read the CFTC’s exclusive jurisdiction to apply to “business deals that involve the buying and selling of futures,” a conclusion the court found “comports with Congress’ goals of conferring on the CFTC sole regulatory authority over futures contract markets....” 276 F. 3d at 590. Most tellingly, the court analyzed carefully the meaning of the first sentence in 7 U.S.C. § 2(a)(1)(A) granting exclusive CFTC jurisdiction and did not rely on the second sentence in that provision, the so-called agency savings clause, because the Commission and other agencies “retain their jurisdiction” only for those matters “beyond” what Congress covered in the first sentence, the actual trading of futures. 276 F.3d at 591. Futures manipulation involves the actual trading of futures and therefore *Roberts* undermines the Commission’s position in footnote 90.

The Commission also relies upon and misconstrues two district court decisions; neither concerned futures transactions or other matters within CFTC exclusive jurisdiction. In *SEC vs. Hopper*, 2006 WL 778640 (S.D. Tex. March 24, 2006) the SEC alleged that the defendants issued false corporate disclosures of their companies’ trading activities relating to sham non-futures energy transactions. The court rejected an attempt by the defendants to raise a CFTC exclusive jurisdiction defense because neither the corporate disclosures nor the non-futures transactions were covered by CFTC exclusive jurisdiction. *US vs. Reliant Energy Services, Inc.*, 420 F. Supp.2d 1043 (N.D. Cal. 2006) did not even mention the CFTC’s “exclusive jurisdiction” over futures. Instead, it merely held that criminal prosecutions for non-futures commodity price manipulation may be brought under the CEA without disturbing the “exclusive regulatory authority” of the Federal Energy Regulatory Commission.

exclusive jurisdiction over instruments, but not trading, would defeat the very congressional purpose that the Commission itself identified in 2000. See *infra* at 3.

Moreover, the statutory terms that Congress enacted do not limit the CFTC's exclusive jurisdiction to just the futures contract instruments themselves. Congress expressly and broadly intended that CFTC exclusive jurisdiction would apply "with respect to accounts, agreements . . . and transactions involving" futures and options contracts "traded or executed" on a regulated market. 7 U.S.C. § 2(a)(1)(A). By focusing on the forms and means for trading (accounts, agreements and transactions), as well as the actual trading of futures contracts, Congress made clear that, without limitation, the CFTC's exclusive jurisdiction covered those whose futures trading practices might constitute price manipulation.⁶

The Commission's failure to apply the CEA's exclusive jurisdiction provision as written is surprising because only six years ago the Commission endorsed a different and more accurate view in its Supreme Court brief filed in the *Roberts* case. There, the Commission unambiguously stated: "7 U.S.C. § 2(a)(1)(A) gives the CFTC exclusive jurisdiction over the regulation of commodities and commodities trading markets." Brief For Respondent-FTC, *Ken Roberts Co. v. FTC*, No. 01-1772, 537 U.S. 820 (cert denied), 2002 WL 32135703 at * 5 (August 2, 2002). Citing the *Roberts* decision itself, the Commission explained that "the CEA

⁶ Congress enacted the CEA's exclusive jurisdiction provision in 1974 as part of the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389. One additional provision of the 1974 Act, Section 412, confirms our reading of the exclusive jurisdiction provision. In Section 412, Congress made clear that if other agencies, other than the new CFTC of course, had started proceedings under other laws against futures traders or brokers before the 1974 amendments took effect, those proceedings "shall not be abated by reason of any provision of this Act." 88 Stat. 1414. This provision was needed, in the words of the Tenth Circuit to avoid the creation of a "no man's land," where pre-1974 misconduct, like fraud or manipulation, which post-1974 fell within the CFTC's exclusive jurisdiction, could not be reached by other regulatory bodies. See *SEC v. American Commodity Exchange, Inc.*, 546 F.2d 1361, 1367-69 (10th Cir. 1976). If Congress had not intended CFTC exclusive jurisdiction to include fraudulent or manipulative misconduct with respect to futures trading, Section 412 would not have been necessary.

contemplates ‘a regime in which other agencies may share power with the CFTC over activities that **lie outside** the scope of 7 U.S.C. § 2(a)(1)(A), but within other jurisdictional authority of the CFTC.’” *Id.* Emphasis added.

Futures price manipulation prevention and prosecution do not “lie outside” the CEA’s exclusive jurisdiction provision; price manipulation prevention and prosecution lie at the heart of the CEA and the CFTC’s regulatory mission. See 7 U.S.C. § 5(b). Under the Commission’s view, however, the CFTC’s exclusive jurisdiction would shrink to nothing because each substantive regulatory provision of the CEA “is separate from” the CEA’s exclusive jurisdiction clause, including all the statute’s price manipulation prohibitions. Each of the substantive regulatory provisions and enforcement prohibitions in the CEA -- from registration, position reporting, recordkeeping, and speculative limits to anti-fraud and anti-manipulation prohibitions -- are contained in provisions “separate from” the CEA’s exclusive jurisdiction. As a result, the Commission’s new reading would empower the SEC to regulate futures on securities and securities indexes; the Treasury Department to regulate futures on exempt securities and foreign currency; the Energy Department, Federal Energy Regulatory Commission (“FERC”) as well as the Commission to regulate energy futures trading; the Environmental Protection Agency to regulate emissions credit futures trading; and the Agriculture Department to regulate agricultural futures trading. This is exactly the result -- balkanized, duplicative and conflicting regulation -- that Congress designed the CEA’s broadly-stated exclusive jurisdiction provision to avoid.⁷

⁷ See *e.g.* S. Rep. No. 95-850 at 23 (1978). (“The vesting of jurisdiction to regulate commodity futures trading in more than one agency would only lead to costly duplication and possible conflict of regulation or over-regulation.”) The feared costs of multiple agency jurisdiction over futures markets are not merely hypothetical. As described in our June 23, 2008 letter at 14, FERC has asserted jurisdiction over pure futures market trading activities in the Amaranth case, based on FERC’s restrictive and incorrect view of CFTC exclusive jurisdiction. In one instance, FERC’s asserted authority caused NYMEX to lose significant market liquidity in its natural gas
(Footnote Continued...)

Congress did not intend the CFTC's exclusive jurisdiction provision to be a nullity. No rules of statutory construction would favor disregarding the plain meaning of a statute's text in order to adopt a tortured interpretation that makes the statute meaningless. *See Williamson v. United States*, 512 U.S. 594 (1994) (Noting the "general presumption that Congress does not enact statutes that have almost no effect.") and *Trichilo v. Sec'y of Health & Human Servs.*, 823 F.2d 702, 706 (2d Cir.1987) ("[W]e will not interpret a statute so that some of its terms are rendered a nullity"). No court has ever read the CFTC's exclusive jurisdiction provision to be a nullity. Neither has any agency, including the Commission, ever read the provision in that manner. The Commission should reconsider and remedy its recent misreading of the CEA's exclusive jurisdiction provision. The appropriate remedy is the addition of a safe harbor to the Commission's final Rule which recognizes the exclusive jurisdiction of the CFTC as understood and articulated by the Commission in its *Roberts* brief,⁸ an interpretation shared by the Futures Group.

(Footnote Continued)

futures contract on the last day of trading in an expiring contract month, including in particular during the final 30-minute closing range that is used for purposes of establishing the final settlement price for that contract month. This is significant because this final settlement price is used as a price benchmark. See Futures & Derivatives Law Report, Brian Regan and De'ana Dow, "Cases Studies: Recent Legislative and Regulatory Developments in Response to Changes in Natural Gas Markets, 13, 22-23 (July/August 2008) (FERC insisted on NYMEX regulatory changes resulting in 40% loss of market volume in last day of trading). (The article is attached.)

⁸ The Commission advised the Court that CFTC exclusive jurisdiction was properly recognized in a string of cases concerning "regulation of the actual sale of options or futures contracts." *See Roberts Cert Brief *10* (citing *Chicago Mercantile Exch. v. SEC*, 883 F.2d 537 (7th Cir. 1989), cert. denied, 496 U.S. 936 (1990) (trading of futures contracts); *Board of Trade v. SEC*, 677 F.2d 1137 (7th Cir.), vacated as moot, 459 U.S. 1026 (1982) (trading in options on mortgage-backed certificates); *SEC v. American Commodity Exch., Inc.*, 546 F.2d 1361 (10th Cir. 1976) (regulation of fictitious commodity options enterprise); *International Trading, Ltd. v. Bell*, 556 S.W.2d 420 (Ark. 1977), cert. denied, 436 U.S. 956 (1978) (deceptive sale of commodity options contracts); *Clayton Brokerage Co. v. Mouer*, 531 S.W.2d 805 (Tex. 1975) (sale of commodity options contracts); *Minnesota v. Coin Wholesalers, Inc.*, 250 N.W.2d 583 (Minn. 1976) (sale of silver coins on margin).

As described in our June 23 letter, a safe harbor from the final Commission rule is most appropriate where the alleged misconduct -- whether actual or attempted price manipulation, fraud or false reporting -- occurs solely with respect to futures trading activities which we have shown is subject to the CEA's exclusive jurisdiction provision, as in the *Amaranth* case. The CFTC's exclusive jurisdiction must be recognized even where futures prices that have been the subject of an alleged manipulation were disseminated to and relied upon by others in physical wholesale markets. Otherwise the statutory text and congressional purpose of the CEA's exclusive jurisdiction would have little meaning because futures prices are routinely disseminated to and relied upon by businesses and non-futures market participants world-wide, as Congress well understands. 7 U.S.C. § 5(a). Different considerations, however, may apply when the alleged misconduct occurs in both the futures market and the physical wholesale market. In that circumstance, where the result of the alleged misconduct is a futures price manipulation, including an artificial futures price, we still believe the CFTC's exclusive jurisdiction should control. But we understand, and recommend, that the Commission and the CFTC may develop and implement guidelines to coordinate their enforcement activities where the misconduct did not involve only futures trading activities.

In many instances when two agencies have overlapping jurisdiction, it is appropriate, as the Commission insists (73 Fed. Reg. at 48324-25), for both agencies to share jurisdiction and to work cooperatively to achieve the public interest. That is why our June 23, 2008, letter called for the Commission and the CFTC to coordinate enforcement in non-futures areas outside the CEA's exclusive jurisdiction. But congressional grants of exclusive jurisdiction, by their express terms, and by their infrequency, are the exceptions to this general rule and embody special congressional purposes that all agencies must respect. Congress could have created the CFTC in

1974 and given it merely “jurisdiction” as opposed to “exclusive jurisdiction.” Congress chose the latter. The Commission must follow the words in the CEA as Congress wrote them, affording the word “exclusive” the full measure of statutory authority that the common and ordinary understanding of the term conveys. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) (“When terms used in a statute are undefined, we give them their ordinary meaning.”).

The safe harbor we have recommended to the Commission is compelled by the language and purposes of the grant of exclusive jurisdiction in the CEA. The Commission should adopt that safe harbor in its final rules.

II. The Commission Should Clarify Its Definition of Gasoline.

The Commission described its definition of "gasoline," in proposed Rule 317.2(b) to include “ethanol.” According to the Commission, "manipulative or deceptive conduct involving non-petroleum based commodities that directly or indirectly affect the price of gasoline (e.g., ethanol) ... may be the subject of Commission enforcement under the proposed Rule." 73 Fed. Reg. at 48325. Section 811 of EISA, however, does not mention or authorize the application of the Commission’s prohibition to “non-petroleum based commodities.” Nevertheless, the Commission contends “manipulation of ethanol may be covered under the proposed Rule where changes in ethanol or other commodity prices directly or indirectly affect wholesale gasoline prices.” 73 Fed. Reg. at 48325.

Section 811 does not authorize the Commission to prohibit any misconduct that directly or indirectly affects wholesale gasoline prices. Section 811 merely allows the Commission to prohibit, the “direct or indirect” use or employment of a manipulative device or contrivance in connection with a wholesale gasoline sale or purchase; that is, someone either directly uses a manipulative device or works in concert with someone else who uses the manipulative device

and thereby “indirectly” uses the device. The phrase “directly or indirectly” modifies “use or employ” in Section 811, nothing more or less. In fact, Section 811 does not refer at all to “price” and surely does not expressly prohibit conduct “indirectly affecting wholesale gasoline prices.”

The Commission is correct that Section 811 appears to have been modeled after Section 10(b) of the Securities Exchange Act. Not even the SEC has ever attempted to stretch the reach of Section 10(b) to cover misconduct in a commodity futures market that might affect the price of a security. For example, the SEC has never claimed that a silver price manipulation in the futures market has indirectly affected the price of a mining company’s stock and therefore was actionable under SEC Rule 10b-5. Nor has the SEC ever contended that a price manipulation of silver futures constituted a manipulative device in a mining company's stock, a price manipulation of copper futures constituted a manipulative device in an electronics company's stock or a price manipulation in crude oil or natural gas futures constituted a manipulative device in an energy company's stock.

The SEC has never asserted these claims because it knows Section 10(b) does not allow it (and the CEA’s exclusive jurisdiction provision would bar it, in any event). The Commission should similarly interpret Section 811 not to cover activities in collateral markets that might be shown to have a price effect on wholesale gasoline purchases or sales.

The Commission’s use of “ethanol” as an example of a non-petroleum based commodity illustrates well the legal and practical reasons that should compel the Commission to reconsider its position. Ethanol, an alternative fuel that is an additive in certain gasoline blends, is subject to futures trading and therefore is a statutory “commodity” under the CEA. 7 U.S.C. § 1a (4). Ethanol futures trading is subject to the CFTC’s exclusive jurisdiction and should not be subject to proposed Rule 317.3. Moreover, ethanol can be produced from a variety of agricultural feed-

stocks, some of which also are the subject of futures trading. The most common type of ethanol in the United States is produced from corn, a commodity that is the subject of futures trading on CBOT. In other parts of the world, ethanol is produced from sugar, a commodity that is the subject of futures trading on NYMEX and ICE Futures U.S. In addition, there is active research being conducted to derive ethanol from a wide variety of other agricultural sources.⁹

Under the Commission's proposed definition of "gasoline," futures and options trading in corn and sugar, and perhaps even other agricultural commodities, could become subject to the Commission's regulatory jurisdiction. Nothing in EISA suggests that Congress intended to grant the FTC authority over price manipulation in ethanol or agricultural commodities. Agricultural commodities are the historical core of the CEA and CFTC regulation. Futures trading in ethanol and related agricultural commodities squarely falls within the CFTC's exclusive regulatory jurisdiction. 7 U.S.C. § 2(a)(1)(A). For these reasons, the Futures Group requests that the Commission delete its reference to "ethanol" as a subset of "gasoline" within the ambit of the proposed Rule 317.3 and clarify that conduct that merely indirectly affects gasoline prices is outside the scope of proposed Rule 317.3.

III. The Commission's Proposed Rule Contradicts the CEA in Material Respects.

The Commission emphasized that its proposed rule "is not intended to impose contradictory requirements on regulated entities in the futures markets or otherwise." 73 Fed. Reg. at 48325. The Futures Group understands that the Commission does not intend to impose

⁹ See <http://www.ers.usda.gov/AmberWaves/April06/Features/Ethanol.htm> The Commission's expansive view of gasoline to include other commodities that may effect indirectly gasoline prices could also cause interest rate or foreign currency futures trading activities to become subject to the Commission's enforcement powers under proposed Rule 317.3 if the Commission alleged that interest rates or currency values indirectly affected crude oil prices.

conflicting requirements on futures market participants, but its proposal would contradict the CEA in multiple ways. Under the CEA, price manipulation constitutes acting with specific intent to create an artificial price. The Commission could have adopted the same formulation for its proposed price manipulation prohibition, but chose not to do so. Instead, the Commission decided to propose a rule following the SEC Rule 10b-5 template, resulting in a prohibition that contradicts the CEA by eschewing as elements of a violation both specific intent and artificial price effects. 73 Fed. Reg. 48328 and 48329. In fact, the Commission does not even use the word manipulation in its prohibition.

Under the Commission's proposed rule, any person would violate the anti-deception and anti-manipulation provisions of Section 811 of EISA by buying or selling wholesale crude oil, gasoline or petroleum distillates when such person recklessly (not with specific intent) --

- "a) uses or employs any device to defraud;
- b) makes any untrue statement of a material fact or omits to state a material fact necessary to make prior statements made in light of the circumstances under which they were made not misleading; or
- c) engages in any act, practice or course of business that operates or would operate as a fraud or deceit upon any person."

Proposed Rule 317.3

The rejection by the Commission of the specific intent standard as part of its proposed Rule contradicts CFTC jurisprudence and imposes a significant threat to the proper functioning of the U.S. futures markets in crude oil and gasoline. When the CFTC was asked years ago to consider abandoning the specific intent standard as the required *mens rea* for finding manipulation, the CFTC responded that it was "unable to discern any justification for a weakening of the manipulative intent standard which does not wreak havoc with the market place." *In the Matter of Indiana Farm Bureau* CFTC No. 75-14, 1982 WL 30249 * 5. If the

Commission's proposed Rule 317.3 is to be applied to futures (which would be both unauthorized and unwise) at least the Commission should defer to the CFTC's expert views on the scienter element for manipulation as applied to the specialized needs of the futures marketplace.

Similarly, the Commission contradicts legal standards developed under the CEA when it proposes to find a respondent to have committed price manipulation without requiring any proof of a price effect, what CEA jurisprudence calls "price artificiality." 73 Fed. Reg. at 48329. In order to prove a futures price manipulation, the CFTC must show that the defendants conduct created an artificial price or, in an attempt case, constituted an attempt to create an artificial price. In an action to enforce proposed Rule 317.3, the Commission claims it would not need to prove that a defendant's conduct had any effect on price "identifiable price effects before such conduct is culpable." 73 Fed. Reg. at 48329. To the extent proposed Rule 317.3 would prohibit conduct that did not create or attempt to create an artificial futures price, it would directly contradict the CEA.¹⁰ Thus, the Commission's proposed Rule 317.3 conflicts with both the specific intent and artificial price elements of futures market price manipulation under the CEA. These contradictions will be difficult for market participants to reconcile.

If applied to futures trading, the Commission's rule also would contradict the principal antifraud provision of the CEA, which Congress amended and re-enacted last spring in Section

¹⁰ The CEA also prohibits false reporting: it is unlawful for any person "knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce" 7 U.S.C. § 13(a)(2). To the extent that CEA false reporting prohibition requires a showing that the false report "affects or tends to affect the price of any commodity in interstate commerce" and the Commission's proposed Rule requires no showing of price effect, another potential conflict arises with the CEA and the Commission's proposal. We would urge the Commission to adopt the CEA's false reporting legal standard to avoid creating confusion and uncertainty in the market place.

13102 of the 2008 Farm Bill.¹¹ Section 4b embodies certain carefully-crafted limitations on its scope, limitations which the Commission's proposed Rule 317.3 plainly lacks. Therefore the Commission's proposed Rule also contradicts CEA § 4b.

Section 4b makes it unlawful for any person in connection with a futures contract:

¹¹ Under Public Law No. 110-246, 122 Stat. 2194-95 (2008), Section 4b of the CEA will now read:

“(a) Unlawful Actions. - It shall be unlawful -

(1) for any person, in or in connection with any order to make, or the making of, any contract of sale or any commodity in interstate commerce or for future delivery that is made, or to be made, on or subject to the rules of a designated contract market, for or on behalf of any other person; or

(2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, or other agreement, contract, or transaction subject to paragraphs (1) and (2) of section 5a(g), that is made, or to be made, for or on behalf of, or with, any other person, other than on or subject to the rules of a designated contract market -

(A) to cheat or defraud or attempt to cheat or defraud the other person;

(B) willfully to make or cause to be made to the other person any false report or statement or willfully to enter or cause to be entered for the other person any false record;

(C) willfully to deceive or attempt to deceive the other person by any means whatsoever in regard to any order or contract or the disposition or execution of any order or contract, or in regard to any act of agency performed, with respect to any order or contract for or, in the case of paragraph (2), with the other person; or

(D)(i) to bucket an order if the order is either represented by the person as an order to be executed, or is required to be executed, on or subject to the rules of a designated contract market; or

(ii) to fill an order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of the other person to become the buyer in respect to any selling order of the other person, or become the seller in respect to any buyer order of the other person, if the order is either represented by the person as an order to be executed, or is required to be executed, on or subject to the rules of a designated contract market unless the order is executed in accordance with the rules of the designated contract market.

(b) Clarification - Subsection (a)(2) of this section shall not obligate any person, in or in connection with a transaction in a contract of sale of a commodity for future delivery, or other agreement, contract or transaction subject to paragraphs (1) and (2) of section 5a(g), with another person, to disclose to the other person nonpublic information that may be material to the market price, rate or level of the commodity or 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.”

“(A) to cheat or defraud or attempt to cheat or defraud the other person;

(B) willfully to make or cause to be made to the other person any false report or statement or willfully to enter or cause to be entered for the other person any false record;

(C) willfully to deceive or attempt to deceive the other person by any means whatsoever in regard to any order or contract or the disposition or execution of any order or contract, or in regard to any act of agency performed, with respect to any order or contract for or, in the case of paragraph (2), with the other person”

122 Stat. 2194-95.

When compared to the three prohibitions in proposed Rule 317.3, the overlap is apparent. Both cover actions that defraud or deceive, as well as making false statements. In at least one respect, the actual prohibitions in Section 4b are even broader, as they expressly cover attempts to defraud or deceive.¹²

But Section 4b contains two limitations that are absent from proposed Rule 317.3. First, for trading in cash commodities and futures on regulated exchanges called “contract markets,”¹³ Section 4b’s prohibitions apply only to those acting as *intermediaries or agents*, or “for or on behalf of” the party being defrauded or deceived. See CEA § 4b(1). See *Commodity Trend Serv. Inc. vs. CFTC*, 233 F.3d 981, 991-992 (7th Cir 2000). Second, for all other futures trading,

¹² Section 4b as amended also echoes another aspect of the Commission’s proposal insofar as it makes clear that Congress does not intend any affirmative disclosure obligation to apply to futures trading (as in the abstain or disclose insider trading principle embraced in securities regulation). Section 4b states 122 Stat 2195:

“(b) Clarification - Subsection (a)(2) of this section shall not obligate any person, in or in connection with a transaction in a contract of sale of a commodity for future delivery, or other agreement, contract or transaction subject to paragraphs (1) and (2) of section 5a(g), with another person, to disclose to the other person nonpublic information that may be material to the market price, rate or level of the commodity or 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.”

¹³ The CME, CBOT, NYMEX, COMEX and ICE Futures US are each contract markets under the CEA.

