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Speech

CFTC and Energy Markets: "The Cop on the Beat – Protecting Consumers"

Comments of Bart Chilton, Commissioner
United States Commodity Futures Trading Commission

before the

American Public Gas Association
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Thank you for the invitation to be with you today in Memphis. I'd like to take some time to discuss CFTC and its oversight of America's energy markets.

First, I want to assure you that the Commission is very much present as "the cop on the beat," in these markets. I know that is important to you and it is important to energy consumers throughout our nation.

We're a small agency, but we're working harder, smarter, and more efficiently than ever before. It's critically important for you, your members, and American consumers that energy trading platforms in the United States remain free from the corrupting influences of fraud, abuse and manipulation, and we're working diligently to achieve that objective.

Also, please be assured that you were well-represented at the Commission's hearing on exempt commercial energy markets, held in Washington in September. Ms. Campbell did a superlative job of presenting your interests to the Commission and to the public. The information gathered during that hearing was critical in formulating the CFTC's position on Exempt Commercial Markets (ECMs), as described in our recent reauthorization testimony before Congress. So, let's talk about these markets and about what the CFTC has requested to address problems that we see in this area.

EXEMPT COMMERCIAL MARKETS

The Exempt Commercial Markets provision in the CEA – otherwise known as the Enron Loophole – has turned out to be the "Achilles Heel" of the CFMA. It was inserted, literally, at the eleventh hour at the behest of Enron's attorneys. There was never a hearing or any open, public discussions on this provision. The good thing it did was increase competition; for example, it helped foster the incredible growth of the InterContinental Exchange (ICE). But the provision has resulted in some significant unintended consequences that need to be addressed now.

It is very difficult for the CFTC to achieve our mandate when we have look-alike energy markets operating "in the dark," that are not subject to the same rules and regulations as other risk management markets. The good government approach to this is not to wait for another economic calamity to occur. We have seen what can happen with the hedge fund Amaranth. So for me the question isn't "if" but "how" and "when" something should be done to address the Enron Loophole, and I think the sooner the better.

In October, the Commission was asked to testify before the House Committee on Agriculture concerning its reauthorization, and one of the main points of that testimony concerned the need to address this section of the CEA. The Commission suggested that Congress enact legislative changes in four areas to address the problems we're facing in these "dark" markets: 1) large trader reporting; 2) position limits or levels; 3) self-regulatory oversight; and 4) emergency authority. In making these suggestions, the Commission was careful not to "throw the baby out with the bathwater"; we recognize that ECMs have been useful vehicles for innovative and creative ideas, and we don't want to stifle that. But at the same time, we had to come up with some measured suggestions to address these "look-alike" markets, which are essentially operating in competition with regulated markets like NYMEX, but without the regulatory burdens or benefits.

Up to this point, ECMs have been operating sort of like cars driving on a highway without speed limits. Most of the time, drivers operate in a safe and responsible manner, but occasionally, somebody drives too fast, and the result is disastrous. The CFTC is suggesting that it's time Congress put up some speed limit signs on the ECM highway: not only will the road be safer, but the CFTC patrol car will be out there as well, ready to turn on the siren and pick up those who run afoul of the rules of the road.

STABLE MARKETS AND THE CFTC

As mentioned, your markets work best when they are free of fraud, abuse and manipulation, and we are the Federal agency – the cops on the beat, if you will – that has that responsibility. If market users are skittish about using these markets because of concerns about the deck being stacked or anything else, we have a market failure and nobody benefits. And quite frankly, at our hearing in September, we received testimony from some that said they were not now using risk management markets due to significant volatility – in part, they said, due to concerns over manipulation.

That is why it is so vitally important that we are strong on the enforcement front. I can tell you that we meet each Friday and get a briefing on what is happening in the markets. We are not

some “Andy Griffith” operation. We are more like “Elliot Ness” or “James Bond,” or in the case of crooked operations we are shutting down; we are more like the “Terminator.”

We are the 21st century cops on the beat. Every day, since these are really 24-7 worldwide trading markets now, we are mining the internet, e-mails and instant messages in an effort to gather critical evidence in very high tech, complicated cases – both domestically and internationally. In fact, at any one time, we are investigating approximately 750 to 1000 individuals and entities. Some are under suspicion of fraud, some for manipulation, and some for a large variety of other potential violations under the Commodity Exchange Act. That’s more than two for every CFTC employee.

ENERGY MARKET MANIPULATIONS

The Commission has been particularly active in the area of manipulation. We’ve seen the tragedies and scandals in Enron, and cases in Amaranth and British Petroleum, and the CFTC has vigorously pursued actions in these areas. You all remember what we did in Enron? In that case, the Commission vigorously went after predatory and unlawful conduct that harmed American consumers—specifically, a pre-arranged buying spree in natural gas in the Henry Hub spot market, which had a direct and adverse effect on the NYMEX futures price—and ultimately settled with Enron for $35 million. Since that time, the agency has charged a total of 63 companies and individuals for violations of the CEA in the energy sector, and obtained over $300 million in civil monetary penalties in settlements.

More recently, the Commission entered into a joint settlement with the Department of Justice in a case against British Petroleum involving massive manipulation and attempted manipulation of the propane market. In that settlement, the Commission and DOJ obtained a whopping $303 million in combined civil monetary penalties, consumer fraud fund monies, and restitution, as well as undertakings by BP to compliance with stringent compliance, ethics, and monitoring programs. The Commission was extremely tough in this case, and worked toward a settlement that we hope will set the benchmark for how energy companies operate their trading and compliance programs.

In addition, we continue to assist other members of the President's Corporate Fraud Task Force in their respective prosecutions of misconduct in the energy arena. In other words, if you manipulate these markets, we’re watching, and we’re going to get you. To continue with my traffic cop metaphor, it’s like those commercials for drunk drivers: don’t even try it, because the road blocks are set up, the sobriety check points are in place, and we’ll make you walk the line. And if you stumble, we’ll make you pay the price.

JURISDICTION

Speaking of energy markets, I also want to discuss something that we do not agree on. But that is okay. We can’t agree on everything. As you know, the Amaranth case is currently being litigated. The Federal Energy Regulatory Commission (FERC) has also filed a suit, and APGA filed an amicus brief in support of their position regarding jurisdiction on this matter.

There are often jurisdictional issues between agencies. I’ve seen them between four different agencies. It is a common thing in government, but the public doesn’t generally hear about these

issues because they are resolved amicably – most of the time by MOUs – or memorandums of understanding. These MOUs are used for many things. Sometimes they are created due to a specific conflict or issue. Other times, the agencies have simply developed an MOU because they know they are going to have to work with each other on myriad issues. The CFTC and FERC already had an MOU in existence. Guess what? In that MOU it says that the CFTC has exclusive jurisdiction over risk management markets. But, MOUs are only as good as those who it is supposed to use them. The CFTC-FERC MOU didn't work so well.

What may have happened is that FERC, having a new Act – the Energy Policy Act of 2005 (EPAct) saw that they might have additional jurisdiction – jurisdiction that they saw as helping consumers. There is certainly nothing wrong with that, of course.

The problem arose when FERC decided to take their new Act for a little jurisdictional test drive in the Amaranth case. But they took their Act on the road too soon, I think, and it has resulted in a rendition of dueling government banjos. And that is very disappointing. It is the type of government that I have worked in for over 20 years and try to avoid. And, I can tell you that we at the CFTC are not "your father's regulator," and we are trying very hard – under our principles-based regulatory structure – to do better for consumers and our nation. So, more than anything, I'm disappointed in how this has all gone.

Santayana – the Spanish philosopher – said, "Those who cannot remember the past are doomed to repeat it." Well, we remember our history in this area and we will continue to assert our exclusive jurisdiction to ensure that the CEA is implemented as intended.

Here is a little more background: When the Commodity Exchange Act was written in 1974, Congress did so to ensure that there was someone with oversight who actually understood the futures and options markets. That's why the CFTC was created. And Congress wanted to ensure that one expert regulator's oversight preempted not only other federal regulators, but also state regulators. It wanted a sole agency in charge of all these risk management markets. Congress knew that if others claimed jurisdiction, the CFTC would soon be rendered toothless – and that would not be good for consumers –and so the CEA specifically states that we have this exclusive jurisdiction. And that exclusive jurisdiction has been upheld over the years in seminal and hotly contested matters, such as the Ginnie Mae case, the IPs case and the Dow Jones cases.

But even if you disregard all of that, as it appears FERC has, there is one overriding reason why we retain exclusive jurisdiction. Federal statutes cannot be read in a vacuum. They can not be read alone. You can't pick and choose one over the other. You have to read each all of them in concert. The reason for this is that when Congress enacts a statute, it knows what other statutes are out there, and promulgates law intending that all laws be interpreted *in pari materia,* meaning that they are to be construed together.

In other words, in 2005 when the EPAct was enacted, the CEA's exclusive jurisdiction was well established, had been for 30 years, and if Congress had meant to overturn it or change it in some way by the terms of the EPAct it would have explicitly done so. A plain reading of EPAct will show you, Congress did not do this in 2005; rather, it gave FERC certain manipulation authority, but it did not in any way overturn the exclusive jurisdiction of the CEA. Therefore, the CEA's exclusive jurisdiction remains in full force and effect, and we are bound to interpret are statutes accordingly.

So for me, as you can tell, this exclusive jurisdiction is really important. It is important to the work we do every day to ensure that we protect price discovery. Exclusive jurisdiction is important to allowing us to continue to guard against fraud, abuse and manipulation. And, exclusive jurisdiction is important to allowing us to ensure that the futures and options markets remain viable efficient and effective tools not only for hedgers and speculators, but also for consumers. I realize your regulator is FERC, but I have to say, I think the things I have said are also important to your industry and it is important to our country.

CONCLUSION

Well, we have covered just a little on the regulatory landscape today. There are many more issues out there and be assured we will be working hard to address them as best we can. Please feel free to let me know your thoughts and opinions on issues of mutual interest, now and in the future. It has been a pleasure to be with you. Thank you.