Senate Floor Statement of Senator Carl Levin
on the Introduction of the Close the Enron Loophole Act

Mr. President, today I am introducing the Close the Enron Loophole Act to help prevent price manipulation and dampen the excessive speculation that have unfairly increased the cost of energy in the United States.

This legislation is the product of more than four years of work examining U.S. energy commodity markets by the Senate Permanent Subcommittee on Investigations, which I chair. That work has shown that U.S. market prices for crude oil, natural gas, jet fuel, diesel fuel and other energy commodities are more unpredictable and variable than ever before, and too often are imposing huge cost increases on the backs of working American families and businesses. The legislation I am introducing today is essential to help ensure that our energy markets provide prices that reflect the fundamentals of supply and demand for energy instead of prices boosted by manipulation or excessive speculation. It is also essential to close an egregious loophole in the law that was championed by Enron and other large energy traders in the heyday of deregulation and that continues to haunt our energy markets and harm American consumers through inflated and distorted energy prices.

The “Enron loophole” is a provision that was inserted at the last-minute, without opportunity for debate, into commodity legislation that was attached to an omnibus appropriations bill and passed by Congress in late December 2000, in the waning hours of the 106th Congress. This loophole exempted from U.S. government regulation the electronic trading of energy commodities by large traders. The loophole has helped foster the explosive growth of trading on unregulated electronic energy exchanges. It has also rendered U.S. energy markets more vulnerable to price manipulation and excessive speculation with resulting price distortions. This legislation is necessary to close the Enron loophole and reduce our vulnerability to manipulation and excessive speculation by providing for regulation of the electronic trading of energy commodities by large traders.

A stable and affordable supply of energy is vital to the national and economic security of the United States. We need energy to heat and cool our homes and offices, to generate electricity for lighting, manufacturing, and vital services, and to power our transportation sector – automobiles, trucks, boats, and airplanes.

Over 80 percent of our energy comes from fossil fuels—oil, natural gas, and coal. About fifty percent is from oil and natural gas. The U.S. consumes around 20 million barrels of crude oil each day, over half of which is imported. About 90 percent of this oil is refined into products such as gasoline, home heating oil, jet fuel, and diesel fuel.

The crude oil market is the largest commodity market in the world, and hundreds of millions of barrels are traded daily in the various crude oil futures, over-the-counter, and spot markets. The world’s leading exchanges for crude oil futures contracts are the New York Mercantile Exchange

(NYMEX) and the Intercontinental Exchange, known as ICE Futures in London. Futures contracts for gasoline, heating oil, and diesel fuel are also traded on these exchanges. Presently, regulatory authority over the U.S. crude oil market is split between British and U.S. regulators.

Natural gas heats the majority of American homes, is used to harvest crops, powers 20% of our electrical plants, and plays a critical role in many industries, including manufacturers of fertilizers, paints, medicines, and chemicals. It is one of the cleanest fuels we have, and we produce most of it ourselves with only 15% being imported, primarily from Canada. In 2005 alone, U.S. consumers and businesses spent about $200 billion on natural gas.

Only part of the natural gas futures market is regulated. Natural gas produced in the United States is traded on NYMEX and on an unregulated ICE electronic trading platform located in Georgia. The price of natural gas in both the futures market and in the spot or physical market depends on the prices on both of these U.S. exchanges.

Trading abuses plague existing energy markets. The key federal regulator, the Commodity Futures Trading Commission (CFTC), reports that overall in recent years it has issued several hundred million dollars in fines for trading abuses in the energy markets. Several major enforcement actions are pending. Since 2001, the Senate Permanent Subcommittee on Investigations has been examining the vulnerability of U.S. energy markets to price manipulation and excessive speculation due to the lack of regulation of electronic energy exchanges under the so-called “Enron loophole.” Although the CFTC and Federal Energy Regulatory Commission have brought a number of enforcement cases against energy traders, the CFTC’s ability to prevent abuses before they occur is severely hampered by its lack of regulatory authority over key energy markets.

The Subcommittee first documented the weaknesses in the regulation of our energy markets in a 2003 staff report I initiated called, *“U.S. Strategic Petroleum Reserve: Recent Policy Has Increased Costs to Consumers But Not Overall U.S. Energy Security.”* The report found that crude oil prices were “affected by trading not only on regulated exchanges like the NYMEX, but also on unregulated ‘over-the-counter’ (OTC) markets which have become major trading centers for energy contracts and derivatives. The lack of information on prices and large positions in these OTC markets makes it difficult in many instances, if not impossible in practice, to determine whether traders have manipulated crude oil prices.”

In June 2006, the Subcommittee issued a staff report entitled, *“The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat.”* This bipartisan staff report analyzed the extent to which the increasing amount of financial speculation in energy markets had contributed to the steep rise in energy prices over the past few years. The report concluded that “[s]peculation has contributed to rising U.S. energy prices,” and endorsed the estimate of various analysts that the influx of speculative investments into crude oil futures accounted for approximately $20 of the then-prevailing crude oil price of approximately $70 per barrel.

The 2006 report recommended that the CFTC be provided with the same authority to regulate and monitor electronic energy exchanges, such as ICE, as it has with respect to the fully regulated futures markets, such as NYMEX, to ensure that excessive speculation in the energy markets did

not adversely effect the availability and affordability of vital energy commodities through unwarranted price increases.

In June 2007, the Subcommittee released another report, *"Excessive Speculation in the Natural Gas Market."* Our report found that a single hedge fund named Amaranth dominated the natural gas market during the spring and summer of 2006, and Amaranth's large-scale trading significantly distorted natural gas prices from their fundamental values based on supply and demand.

The report concluded that the current regulatory system was unable to prevent these distortions because much of Amaranth's trading took place on an unregulated electronic market. The report recommended that Congress close the "Enron loophole" that exempted such markets from regulation.

I am attaching a copy of the Executive Summary from our report to this statement. Mr. President, I ask unanimous consent that this document be included in the Congressional Record after my statement.

The Executive Summary describes how Amaranth used the major unregulated electronic market, ICE, to amass huge positions in natural gas contracts, outside regulatory scrutiny, and beyond any regulatory authority. During the spring and summer of 2006, Amaranth held by far the largest positions of any trader in the natural gas market. According to traders interviewed by the Subcommittee, during this period natural gas prices for the following winter were "clearly out of whack," at "ridiculous levels," and unrelated to supply and demand. At the Subcommittee's hearing in June of this year, natural gas purchasers, such as the American Public Gas Association and the Industrial Energy Consumers of America, explained how these price distortions increased the cost of hedging for natural gas consumers, which ultimately led to increased costs for American industries and households. The Municipal Gas Authority of Georgia calculated that Amaranth's excesses increased the cost of their winter gas purchases by $18 million.

Finally, when Amaranth's positions on the regulated futures market, NYMEX, became so large that NYMEX directed Amaranth to reduce the size of its positions on NYMEX, Amaranth simply switched those positions to ICE, an unregulated market that is beyond the reach of the CFTC. In other words, in response to NYMEX's order, Amaranth did not reduce its size; it merely moved it from a regulated market to an unregulated market.

This regulatory system makes no sense. It is as if a cop on the beat tells a liquor store owner that he must obey the law and stop selling liquor to minors, yet the store owner is allowed to move his store across the street and sell to whomever he wants because the cop has no jurisdiction on the other side of the street and none of the same laws apply. The Amaranth case history shows it is clearly time to put the cop on the beat in all of our energy exchanges.

The Subcommittee held two days of hearings relating to issues covered in its 2007 report. Both of the major energy exchanges, NYMEX and ICE, testified that they would support a change in the law that would eliminate the current exemption from regulation for electronic energy markets, in order to reduce the potential for manipulation and excessive speculation. Consumers and users of natural gas and other energy commodities—the American Public Gas Association,

the New England Fuel Institute, the Petroleum Marketers Association of America, and the Industrial Energy Consumers of America—also testified in favor of closing the Enron loophole. The legislation I am introducing today is intended to end the exemption from regulation that electronic energy trading facilities now have. The bill includes suggestions made by the exchanges, the CFTC, and natural gas users, and I will continue to seek their input as the legislative process moves forward.

Essentially, this bill would restore the CFTC's ability to police all U.S. energy exchanges to prevent price manipulation and excessive speculation from hiking energy prices. In particular, it would restore CFTC oversight of large-trader energy exchanges that were exempted from regulation in the 2000 Commodity Futures Modernization Act by means of the Enron loophole. The bill would require the CFTC to oversee these facilities in the same manner and according to the same standards that currently apply to futures exchanges like NYMEX. Because these energy exchanges currently restrict trading to large traders, however, the bill would not require them to comply with rules applicable to retail trading or trading by brokers on behalf of smaller traders. In all other respects, however, including the rules that create position limits and accountability levels to stop price manipulation and excessive speculation, the bill would apply the same rules to energy exchanges like ICE as currently apply to futures exchanges like NYMEX.

The bill also would require large trades in U.S. energy commodities conducted from within the United States on a foreign board of trade to be reported to the CFTC. This provision is intended to ensure that the CFTC has a more complete view of the positions of U.S. energy traders buying or selling energy commodities for delivery in the United States. This provision could be waived by the CFTC if the CFTC reaches agreement with the foreign board of trade to obtain the same information.

Mr. President, preventing price manipulation and excessive speculation in U.S. energy markets is not an easy undertaking. I welcome good-faith comments on how this bill can be improved. I want to make it clear, however, that in my opinion the Enron loophole has got to be closed. Recent cases have shown us that market abuses and failures did not stop with the fall of Enron. They are still with us. We cannot afford to let the current situation continue, allowing energy traders to use unregulated markets to avoid regulated markets. It's time to put the cop back on the beat in all U.S. energy markets. The stakes for our energy security and for competition in the market place are too high to do otherwise.

I ask unanimous consent to place a copy of the bill, a bill summary, and a section-by-section analysis in the Record following my remarks and the Executive Summary I mentioned earlier.

SUMMARY OF THE CLOSE THE ENRON LOOPHOLE ACT

Closes the "Enron Loophole." The bill would close the Enron loophole and require government oversight of the trading of energy commodities by large traders to prevent price manipulation and excessive speculation.

Since 2000, the "Enron loophole" in §2(h)(3) of the Commodity Exchange Act has exempted from oversight the electronic trading of energy commodities by large traders. As a hedge fund known as Amaranth Advisors demonstrated in the natural gas market in 2006, the Enron loophole makes it impossible to prevent traders from distorting energy prices through large trades on these unregulated exchanges. Under this bill, a trading facility that functions as an energy exchange would be subject to Commodity Futures Trading Commission (CFTC) oversight to prevent price manipulation and excessive speculation. The bill would:

Require oversight of Energy Trading Facilities (ETFs). ETFs would have to comply with the same standards that apply to futures exchanges, like NYMEX, to prevent price manipulation and excessive speculation. The only difference would be that regulatory provisions governing retail trading and brokers on a futures exchange would not apply because trading on an ETF is restricted to large traders trading amongst themselves. ETFs would function as self-regulatory organizations under CFTC oversight in the same manner as futures exchanges.

Require ETFs to establish trading limits on traders, such as position limits or accountability levels, to prevent price manipulation and excessive speculation, subject to CFTC approval, in the same manner as futures exchanges. Position limits set a ceiling on the number of contracts that a trader can hold at one time on a trading facility; accountability levels, when exceeded, trigger a review by regulators of a trader's holdings in order to prevent price manipulation and excessive speculation. The CFTC would ensure that position limits and accountability levels for similar contracts on different exchanges are on parity with each other and applied in a functionally equivalent manner. The CFTC would also ensure that a trader's positions on multiple exchanges and other markets, when combined, are not excessive.

Define "energy commodity" as a commodity used as a source of energy, including crude oil, gasoline, heating oil, diesel fuel, natural gas, and electricity, or results from the burning of fossil fuels, including carbon dioxide and sulfur dioxide.

Define "energy trading facility" as a trading facility that trades contracts in an energy commodity (other than in the cash or spot market) between large traders ("eligible commercial entities"), and provides either for the clearing of those contracts or a price discovery function in the futures or cash market for that energy commodity. Clearing services, which are already subject to CFTC oversight, generally guarantee the performance of a contract, and facilitate the trading of those contracts. A trading facility performs a price discovery function when the price of transactions are publicly disseminated and can affect the prices of subsequent transactions.

Require large-trader reporting for domestic trades on foreign exchanges. Large trades of U.S. energy commodities taking place from the United States on foreign exchanges would have to be reported to the CFTC. Traders would be relieved of this reporting requirement if the CFTC reached agreement with a foreign board of trade to obtain the same information.

CLOSE THE ENRON LOOPHOLE ACT
SECTION-BY-SECTION ANALYSIS

SECTION 1. SHORT TITLE.

The title of this bill is the "Close the Enron Loophole Act".

SEC. 2. ENERGY TRADING FACILITIES.

This section amends the Commodity Exchange Act (CEA) to regulate energy trading facilities that are currently exempt from Commodity Futures Trading Commission (CFTC) oversight under section 2(h)(3) of the CEA. After defining the terms "energy commodity" and "energy trading facility," this section delineates the criteria required for an energy trading facility to be registered with the CFTC. The specified criteria are based upon existing criteria in the CEA for futures markets (designated contract markets) and derivatives transaction execution facilities so that energy trading facilities will operate under a comparable degree of self-regulation and CFTC oversight as current facilities, taking into account certain differences between the types of markets.

Section 2(a). Definitions. This section defines the terms "energy commodity" and "energy trading facility."

The term **"energy commodity"** means a commodity (other than an excluded commodity, a metal, or an agricultural commodity) that is used as a source of energy or that results from the burning of fossil fuels to produce energy. Examples of energy commodities that are used as a source of energy include crude oil; gasoline, heating oil and other products refined from crude oil; natural gas; and electricity. Examples of energy commodities that result from the burning of fossil fuels to produce energy include carbon dioxide and sulfur dioxide.

The term **"energy trading facility"** means a trading facility (as defined in section 1a(33) of the CEA) that: (A) is not a designated contract market (DCM); and (B) facilitates the trading of energy commodities between eligible commercial entities (essentially large, sophisticated traders); and either (i) provides a clearing service for products traded on the facility or (ii) the CFTC determines that trading on the facility provides a price discovery function on a trading facility or in the cash market for an energy commodity.

The definition of "energy trading facility" represents a subset of trading facilities that would otherwise qualify as "exempt commercial markets" under current law. In essence, it requires the regulation of energy trading facilities that exhibit the key attributes of a futures exchange – the trading of standardized and cleared contracts for future delivery of a commodity having a finite supply.

The definition of "energy trading facility" excludes the trading of energy commodities that are "spot sales of a cash commodity or sales of a cash commodity for deferred shipment or delivery," since the bill is not intended to apply to the cash market for energy commodities. This exclusion, however, does not encompass contracts that are commonly referred to as "swaps," since swaps are not spot sales of a cash commodity or sales of a cash commodity for deferred shipment or delivery. Because swaps in the energy market are economically and functionally equivalent to futures contracts for energy commodities, this bill ensures that they will be regulated in a functionally equivalent manner.

The definition restricts the bill's application to energy trading facilities that allow only "exempt commercial entities" (ECEs) to participate, meaning large sophisticated traders who trade with each other on a principal-to-principal basis. This restriction is identical to the restriction in current law for trading facilities that qualify as exempt commercial markets under section 2(h)(3). A trading facility that permits brokered or intermediated transactions or participation by persons other than ECEs would not qualify as an energy trading facility subject to the type of regulation provided under this bill. Instead, as is the case under current law, a facility that allows the trading of futures contracts by persons other than ECEs must register with and be designated by the CFTC as a contract market subject to the regulations that apply to a DCM.

The definition also addresses the concern that, despite the advantages and widespread use of clearing services to facilitate trading, if the presence of a clearing function triggers regulatory oversight, then alternative trading platforms may develop that do not provide clearing services in order to avoid the reporting and monitoring requirements essential to an effective regulatory system. To address this concern, the bill provides that a trading facility that does not provide clearing services still may qualify as an energy trading facility subject to regulation if the CFTC determines the facility "performs a significant price discovery function in relation to an energy commodity listed for trading on a trading facility or in the cash market for the energy commodity." Factors for the CFTC to consider in determining whether a trading facility performs such a significant price discovery function include the extent to which the prices of contracts traded on the facility are linked to or derived from the prices of futures contracts traded on a DCM, the volume of trading on the facility, whether prices of completed transactions are immediately posted or disseminated, and the extent to which traders engage in arbitrage trading between the contracts traded on the facility and those traded on a regulated market.

Section 2(b). Oversight of Energy Trading Facilities. This section specifies that an energy trading facility, and any agreement, contract, or transaction traded on that facility, shall be subject to the regulatory requirements established in a new CEA section 2(j).

Section 2(b)(1) amends CEA section 2(h)(3) to exclude energy trading facilities from qualifying as an exempt commercial market in order to make it clear that those facilities must instead comply with the new CEA section 2(j).

Section 2(b)(2) adds a new section 2(h)(7) to the CEA. This new section provides that notwithstanding any other provision of the CEA, an energy trading facility and persons trading on an energy trading facility are subject to the new CEA section 2(j). This clarifying provision means, for example, that a trading facility that meets the criteria for an energy trading facility could not operate as a derivatives transaction execution facility (DTEF) under another provision of the CEA.

Section 2(c). Standards Applicable to Energy Trading Facilities. This section adds a new section 2(j) to the CEA, specifying the standards that an applicant must meet to register with the CFTC as an energy trading facility.

Commission Approval of Energy Trading Facilities. A new section 2(j)(1) makes it illegal for any person to enter into an agreement, contract, or transaction on an energy trading facility unless such facility has been registered with the Commission as an energy trading facility. Section 6 of this bill provides a timeline for facilities in operation on the date of enactment of this Act under CEA section 2(h)(3) to submit an application, obtain registration, and comply with these requirements.

Applications for Operation as Energy Trading Facility. New section 2(j)(2) provides that a facility must submit an application to the Commission for operation as an energy trading facility in order to register as an energy trading facility. The Commission is authorized to establish such application requirements as it deems appropriate. New section 2(j)(3) provides that the Commission shall make a determination on any such application within 120 days after receiving it.

Criteria for Approval of Applications. New section 2(j)(4) specifies the criteria that an applicant must meet for registration as an energy trading facility. Because an energy trading facility may trade instruments that possess the same characteristics as futures contracts traded on a designated contract market, several of the criteria, particularly those regarding prevention of price manipulation, excessive speculation, and price distortion, are identical to the criteria applicable to a designated contract market (DCM). Other DCM criteria are not used, such as those applicable to intermediated or brokered transactions, since those types of transactions are not permitted on an energy trading facility. In addition, because energy trading facilities conduct all trading on a principal-to-principal basis, a number of the criteria applicable to a derivatives transaction execution facility are included in the section. The criteria are as follows.

New section 2(j)(4)(A): PREVENTION OF PRICE MANIPULATION AND EXCESSIVE SPECULATION.—This section requires the facility to have the capacity to prevent price manipulation, excessive speculation, price distortion, and disruption through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions. The term "excessive speculation" as used in this bill has the same meaning as the term "excessive speculation" in section 4a(a) of the Act as "causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity." [Equivalent to DCM Criteria: Prevention of Market Manipulation, CEA §5(b)(2)].

New Section 2(j)(4)(B): MONITORING OF TRADING.— This section requires the facility to monitor trading to prevent price manipulation, excessive speculation, price distortion, and disruption of the delivery or cash-settlement process. [Equivalent to DCM Core Principles: Monitoring of Trading, CEA §5(d)(4); see also DTEF Core Principles: Monitoring of Trading, CEA §5a(d)(3)].

New Section 2(j)(4)(C): CONTRACTS NOT READILY SUSCEPTIBLE TO MANIPULATION.— This section requires the facility to list for trading only contracts that are not readily susceptible to manipulation. [Equivalent to DCM Core Principles: Contracts Not Readily Susceptible to Manipulation, CEA §5(d)(3)].

New Section 2(j)(4)(D): FINANCIAL INTEGRITY OF TRANSACTIONS.— This section requires the facility to establish and enforce rules and procedures for ensuring the financial integrity of transactions cleared and settled through the facilities of the energy trading facility. [Based on DCM Criteria: Financial Integrity of Transactions, CEA §5(b)(5); and DTEF Registration Criteria: Transactional Financial Integrity, CEA §5a(c)(4)].

New Section 2(j)(4)(E): ABILITY TO OBTAIN INFORMATION.— This section requires the facility to establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require. [Equivalent to DCM Criteria: Ability to Obtain Information, CEA §5(b)(8)].

New Section 2(j)(4)(F): POSITION LIMITS OR ACCOUNTABILITY LEVELS.— This section requires the facility to reduce the potential threat of price manipulation, excessive speculation, price distortion, or disruption of the delivery or cash-settlement process, by adopting position limits or position accountability levels for speculators, where necessary and appropriate. [Equivalent to DCM Core Principles: Position Limitation or Accountability, CEA §5(d)(5)].

New Section 2(j)(4)(G): EMERGENCY AUTHORITY.— This section requires the facility to adopt rules to provide for the exercise of emergency authority to liquidate or transfer open positions in any contract, suspend or curtail trading in any contract, and require market participants in any contract to meet special margin requirements. [Equivalent to DCM Core Principles: Emergency Authority, CEA §5(d)(6)].

New Section 2(j)(4)(H): DAILY PUBLICATION OF TRADING INFORMATION.— This section requires the facility to make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the facility. [Equivalent to DCM Core Principle: Daily Publication of Trading Information; CEA §5(d)(8); see also DTEF Core Principles: Daily Publication of Trading Information, CEA §5a(d)(5)].

New Section 2(j)(4)(I): DETERRENCE OF ABUSES.— This section requires the facility to establish and enforce trading and participation rules that will deter abuses and to maintain the capacity to detect, investigate, and enforce those rules. [Based on DTEF Registration Criteria: Deterrence of Abuses, CEA §5a(c)(2)].

New Section 2(j)(4)(J): TRADE INFORMATION.— This section requires the facility to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the facility to use the information for the purposes of assisting in the prevention of price manipulation, excessive speculation, price distortion, or disruption of the delivery or cash-settlement process, and providing evidence of any violations of the rules of the facility. [Based on DCM Core Principles: Trade Information, CEA §5(d)(10)].

New Section 2(j)(4)(K): TRADING PROCEDURES.— This section requires the facility to establish and enforce rules or terms and conditions defining, or specifications detailing, trading procedures to be used in entering and executing orders traded on the facility. [Based on DTEF Registration Criteria: Trading Procedures, CEA §5a(c)(3); see also DCM Criteria: Trade Execution Facility, CEA §5(b)(4)].

New Section 2(j)(4)(L): COMPLIANCE WITH RULES.— This section requires the facility to monitor and enforce the rules of the facility, including any terms and conditions of any contracts traded on or through the facility and any limitations on access to the facility. [Equivalent to DTEF Core Principles: Compliance with Rules, CEA §5a(d)(2); see also DCM Core Principles: Compliance with Rules, CEA §5(d)(2)].

New Section 2(j)(4)(M): DISCLOSURE OF GENERAL INFORMATION.— This section requires the facility to disclose publicly and to the Commission information concerning: (i) contract terms and conditions; (ii) trading conventions, mechanisms, and practices; (iii) financial integrity protections; and (iv) other information relevant to participation in trading on the facility. [Equivalent to DTEF Core Principles: Disclosure of General Information, CEA §5a(d)(4); see also DCM Core Principles: Availability of General Information, CEA §5(d)(7)].

New Section 2(j)(4)(N): FITNESS STANDARDS.— This section requires the facility to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, and any other persons with direct access to the facility, including any parties affiliated with any of the persons described in this paragraph. [Equivalent to DTEF Core Principles: Fitness Standards, CEA §5a(d)(6); see also DCM Core Principles: Governance Fitness Standards, CEA §5(d)(14)].

New Section 2(j)(4)(O): CONFLICTS OF INTEREST.— This section requires the facility to establish and enforce rules to minimize conflicts of interest in the decision making process of the facility and establish a process for resolving such conflicts of interest. [Equivalent to DTEF Core Principles: Conflicts of Interest, CEA §5a(d)(7); and DCM Core Principles: Conflicts of Interest, CEA §5(d)(15)].

New Section 2(j)(4)(P): RECORDKEEPING.— This section requires the facility to maintain business records for a period of 5 years. [Equivalent to DTEF Core Principles: Recordkeeping, CEA §5a(d)(8); and DCM Core Principles: Recordkeeping, CEA §5(d)(17)].

New Section 2(j)(4)(Q): ANTITRUST CONSIDERATIONS.— This section requires the facility to endeavor to avoid: (i) adopting rules or taking any actions that result in any unreasonable restraint of trade; or (ii) imposing any material anti-competitive burden on trading on the facility. [Equivalent to DTEF Core Principles Antitrust Considerations, CEA §5a(d)(9); and DCM Core Principles: Antitrust Considerations, CEA §5(d)(18)].

Compliance with Criteria. New section 2(j)(5) provides that an energy trading facility must continue to comply with all of the criteria in section 2(j)(4) to continue operation, and that violation of any of the criteria shall constitute a violation of the Commodity Exchange Act. The trading facility shall have reasonable discretion in establishing the manner in which it complies with these criteria.

Position Limits and Accountability Levels. New section 2(j)(6) directs the Commission to ensure that the position limits and accountability levels that are established for energy trading facilities are on a parity with the position limits and accountability levels established for similar contracts traded on a designated contract market and applied in a functionally equivalent manner. This provision is designed to ensure that there is no regulatory advantage to trading on an energy trading facility compared to a designated contract market, or vice versa.

Additionally, once a trader's position exceeds a position limit or an accountability level on a particular trading facility, this section directs the Commission to take such action as may be necessary and appropriate, in light of the trader's overall positions in that commodity, to reduce the potential threat of price manipulation, excessive speculation, price distortion, or disruption of the delivery or cash-settlement process. Such a comprehensive approach may have to be undertaken by the CFTC, since it may be beyond the authority of a particular trading facility to obtain information about or limit a trader's relevant positions when those positions are outside of the exchange itself. The Commission may direct a trader, or direct a trading facility to direct a trader, to limit, reduce or liquidate any position in any market, as the Commission determines necessary to reduce the potential threat of price manipulation, excessive speculation, price distortion or disruption of the delivery or cash-settlement process.

In order to make a determination on the appropriate action to take, the Commission is authorized to obtain from a trader information regarding all of the trader's exchange and off-exchange positions in that commodity. The Commission will be receiving on a regular basis, through its large trader reporting system, information regarding any trader's positions on a designated contract market or an energy trading facility that exceed the levels for reportable positions; the Commission may choose to request additional information on other positions in the commodity held by the trader if the Commission determines this additional information is necessary to make any determinations required by this section. The authority to obtain this position information parallels the Commission's existing authority under CEA sections 3(b), 4i, and 8a(5) to require traders to retain transaction records for commodities traded on CFTC-regulated facilities and provide them to the Commission upon request. The Commission recently described this authority in its proposed rulemaking "Maintenance of Books, Records and Reports by Traders," 72 Fed. Reg. 34413 (June 22, 2007). The information specified to be provided to the Commission under the new section 2(j)(5)(C) is identical to the information specified to be provided to the Commission in that proposed rulemaking.

The Commission's review of a trader's entire position does not relieve an individual exchange of the authority and responsibility to review a trader's position on that exchange once a position limit or accountability level on that exchange has been exceeded. Rather, it is anticipated that the Commission's comprehensive review of the trader's entire position in a commodity will be undertaken in addition to the review conducted by the individual exchange on which the trader has taken a position in excess of an accountability level or position limit. Based on this comprehensive review, the Commission will then determine whether any additional action, beyond that initially taken by the exchange, is necessary to limit, reduce or liquidate the trader's position to reduce the potential threat of price manipulation, excessive speculation, price distortion, or disruption of the delivery or cash-settlement process. In making or implementing any such determinations, the Commission should continue to work in consultation and cooperation with the affected exchanges.

New section 2(j)(6)(D) specifies criteria the Commission or an exchange may consider when determining whether to require a trader to limit, reduce, or liquidate a position in an energy commodity in excess of an accountability level. In making any such determination with respect to an energy commodity, the Commission, a designated contract market, or an energy trading facility should consider, as appropriate: (i) the person's open interest in a contract, agreement, or transaction involving an energy commodity relative to the total open interest in such contracts, agreements or transactions; (ii) the daily volume of trading such contracts, agreements or transactions; (iii) the person's overall position in related contracts, including options, and the overall open interest or liquidity in such related contracts and options; (iv) the potential for such positions to cause or allow price manipulation, excessive speculation, price distortion, or disruption of the delivery or cash-settlement process; (v) the person's record of compliance with rules, regulations, and orders of the Commission, a designated contract market, or an energy trading facility, as appropriate; (vi) any justification provided by the person for such positions; and (vii) other such factors determined to be appropriate by the Commission.

The criteria specified in this section are not intended to be the exclusive criteria that may be applied, but are set forth to provide additional guidance to the Commission, the exchanges, and persons trading on the exchanges in addition to the general language pertaining to "excessive speculation" in section 4 of the CEA.

Section 2(d). Information for Price Discovery Determination. This section provides the Commission with the authority to obtain from an electronic trading facility or a derivatives transaction execution facility any information the Commission determines is necessary for the Commission to evaluate whether such a facility performs a price discovery function in relation to a contract in an energy commodity under the definition of energy trading facility.

Section 2(e). Conforming Amendments. This section amends the CEA in a variety of sections to provide the Commission with a comparable degree of authority over the operation of an energy trading facility that it possesses with respect to a designated contract market or a derivatives transaction execution facility.

SEC. 3. REPORTING OF ENERGY TRADES.

Section 3 of the bill adds a new CEA section 2(k) to require persons that trade from within the United States on a foreign board of trade a contract for future delivery of an energy commodity that has a physical delivery point within the United States to keep records of such trades and to report large trades in such contracts to the Commission. The Commission is authorized to waive the reporting requirement if the Commission determines that a foreign board of trade is providing the Commission with equivalent information in a usable format pursuant to an agreement between the Commission and the foreign board of trade. The purpose of this provision is to ensure that U.S. commodity regulators have full access to trading information from U.S. traders conducting transactions from U.S. locations involving U.S. energy commodities such as crude oil and gasoline.

SEC. 4. ANTIFRAUD AUTHORITY.

Section 4 of the bill amends Section 4b of the CEA, the CFTC's main anti-fraud authority. Section 4b is revised to clarify the CFTC’s authority to bring fraud actions in off-exchange principal-to-principal futures transactions. In November 2000, the Seventh Circuit Court of Appeals ruled that the CFTC could only use Section 4b in intermediated transactions--those involving a broker. *Commodity Trend Service, Inc.* v. *CFTC,* 233 F.3d 981, 991-992 (7th Cir. 2000). As subsequently amended by the CFMA, the CEA now permits off-exchange futures and options transactions that are done on a principal-to-principal basis, such as energy transactions pursuant to CEA Sections 2(h)(1) and 2(h)(3).

Subsection 4b(a)(2) is amended by adding the words `or with' to address the principal-to-principal transactions. This new language clarifies that the CFTC has the authority to bring anti-fraud actions in off-exchange principal-to-principal futures transactions, including exempt commodity transactions in energy under Section 2(h) as well as all transactions conducted on derivatives transaction execution facilities. The new Section 4b clarifies that market participants in these transactions are not required to disclose information that may be material to the market price, rate or level of the commodity in such off-exchange transactions. It also codifies existing law that prohibits market participants from using half-truths in negotiations and solicitations by requiring a person to disclose all necessary information to make any statement they have made not misleading in any material respect. The prohibitions in subparagraphs (A) through (D) of the new Section 4b(a) would apply to all transactions covered by paragraphs (1) and (2). Derivatives clearing organizations (DCOs) are not subject to fraud actions under Section 4b in connection with their clearing activities.

The amendments to Section 4b(a) of the CEA regarding transactions currently prohibited under subparagraph (iv) (found in paragraph 2(D) of this bill) are not intended to affect in any way the CFTC's historical ability to prosecute cases of indirect bucketing of orders executed on designated contract markets. See, *e.g.,Reddy* v. *CFTC,* 191 F.3d 109 (2nd Cir. 1999); *In re DeFrancesco, et al.,* CFTC Docket No. 02-09 (CFTC May 22, 2003) (Order Making Findings and Imposing Remedial Sanctions as to Respondent Brian Thornton).

This language clarifying the Commission’s anti-fraud authority was included in bills in the previous Congress to reauthorize the Commodity Exchange Act, one of which was passed by the House of Representatives (H.R. 4473, passed by the House on Dec. 14, 2005) and the other of which was reported to the full Senate by the Senate Committee on Agriculture, Nutrition, and Forestry (S. 1566, S. Rpt. No. 109-119; 109th Cong., 1st Sess.).

SEC. 5. COMMISSION RULEMAKING.

Section 5 of the bill requires the CFTC, within 180 days after enactment of this Act, to issue a proposed rule setting forth the process for submitting an application for registration as an energy trading facility. The section requires the CFTC, within 270 days after the date of enactment, to finalize this rule.

SEC. 6. EFFECTIVE DATE.

Section 6(a) of the bill provides that it shall be immediately effective upon enactment, with several exceptions.

Existing trading facilities. The first exception applies to existing trading facilities. Section 6(b) provides that a trading facility operating under the exemption in CEA section 2(h)(3) on the date of enactment shall have 180 days after the Commission issues a final rule on registration applications to submit such an application. Section 5 of the bill authorizes the Commission to take 270 days to issue this rule. During this period (270 days plus 180 days), the prohibition on trading in the new section 2(j)(1) shall not apply. For any such facility in operation on the date of enactment of this Act that submits an application to the Commission for operation as an energy trading facility within the 180-day period, the suspension of the prohibition in section 2(j)(1) is extended until the Commission makes a determination on whether to approve that application.

Subsection (c) provides that if the Commission approves the registration as an energy trading facility of a facility operating under the exemption under CEA section 2(h)(3) on the date of enactment of this Act, the facility may submit a written request to the Commission for a 6-month extension to fully implement any requirement made applicable by this Act—other than an information reporting or recordkeeping requirement—and that the Commission shall grant any such request. The Commission, in its discretion, may grant an additional 6-month extension. The Commission may not grant any extension for any information reporting or recordkeeping requirement. This section is intended to ensure that facilities currently in operation that must register as an energy trading facility will have sufficient time to come into compliance with the new requirements of this Act, and that the operations of those facilities will not be disrupted during the transition period. Altogether, this section effectively provides existing trading facilities with over two years to come into compliance with the Act.

Requirements applicable to domestic use of a foreign board of trade. Section 6(d) of the bill states that the reporting requirements applicable to trades from domestic terminals on a foreign board of trade are effective 180 days after enactment.