The Honorable Collin Peterson  
Chairman  
House Committee on Agriculture  
1301 Longworth House Office Building  
Washington, DC 20515

Re: Answer of Professor Michael Greenberger to the June 24, 2008 PSI Staff Analysis of His June 2008 Senate Testimony

Dear Chairman Peterson:

You have asked that I respond in writing to the June 24, 2008 Joint Analysis of the Majority and Minority Staffs of the United States Senate Permanent Subcommittee on Investigations (“PSI”) of my June 3, 2008 testimony before the United States Senate Committee on Commerce, Science and Transportation.

At the outset, after having reviewed the PSI staff analysis, I feel even more confident about my testimony and the recommendations and conclusions reached therein for the reasons described in detail below. As you know, you have invited me to testify on both July 10 and 11, 2008 at your Committee’s hearings to discuss whether there is excessive speculation in the crude oil futures markets and, if so, what kind of legislation might remedy that problem. In the course of my testimony on those scheduled topics of discussion, I am fully prepared to answer any questions the Members of the Committee may wish to pose to me about this letter or the PSI analysis itself.

**The Issue about Which There Is Disagreement**

As I show below, since I first testified on this subject on December 12, 2007, my basic point has been that prior to the enactment of the Enron Loophole on December 20, 2000, all U.S. traded energy futures contracts based on U.S. delivered energy commodities, including standardized energy swaps agreements, were required to be executed on a U.S. regulated exchange. Those exchanges were directly overseen by the U.S. Commodity Futures Trading Commission (“CFTC”) under the Commodity Exchange Act (“CEA”) and by each exchange’s elaborate self regulatory surveillance systems. That CFTC and self regulatory oversight was designed by Congress to prevent excessive speculation and manipulation in these markets. I have therefore urged that closing the Enron Loophole should therefore mean returning all U.S. energy futures contracts to the status quo ante on December 19, 2000, the day before the Enron Loophole went into effect.
As I further show in detail below, the “Close the Enron Loophole” amendment within the recently enacted Farm Bill does not automatically return all U.S. energy futures trading to U.S. regulated exchanges. Rather, it allows the CFTC to place on a contract-by-contract basis any of the thousands of presently unregulated U.S. energy futures contracts (but not the rapidly growing multi-billion dollar standardized U.S. energy swaps market) back under the CEA’s regulatory regime if the CFTC “in its discretion” decides to demonstrate, pursuant to notice and comment procedures and judicial review provisions dictated by the Administrative Procedure Act and administrative law procedural cases, that the contract serves a “significant price discovery function.” Section 13201 of that statute provides detailed statutory criteria in sections 13201 (b) to establish through informal rulemaking required under that section and 13204 (b) the way in which “significant price discovery function” requirements should be made by the CFTC.

The Farm Bill Amendment affords the CFTC 9 months to develop criteria by notice and comment rulemaking to govern its “significant price discovery function” determination and then 6 months to apply those criteria to the energy contracts the CFTC decides “in its discretion” are subject to the legislation. That would mean that the Farm Bill’s regulatory infrastructure is not required to be in place until September 2009.

As I demonstrate below, the administrative requirements that must be complied with by the CFTC in promulgating and applying its rule, and the likely judicial review of those actions to follow by those many parties (both energy traders and consumers) adversely affected by any CFTC decision of this kind will likely further prolong that Act’s implementation.

Conversely, as I show below, by legislatively requiring that all energy contracts within a U.S. regulatory format, as was true before passage of the Enron Loophole, the administrative and litigation target would shrink. Energy consumers will have little about which to complain. And, those opposed to reregulation will not have administrative action to attack procedurally or substantively, but they will be forced to demonstrate that a federal statute enacted pursuant to the Commerce Clause, to ensure financial stability in these markets critically important to the well being of this Nation’s economy, has no rational basis -- a standard universally understood to be very difficult for someone challenging Congressional action to meet.

As I show below, out of the “thousands” 1 of contracts traded on the U.S. owned Intercontinental Exchange (“ICE”) now outside the scope of U.S. contract market regulation, the CFTC has now at least twice publicly stated that only ICE’s benchmark Henry Hub natural gas contract on that exchange will be subject to reregulation. The reregulation of that contract has no bearing on crude oil, gasoline, or heating oil prices.

Despite the plain language of the Farm Bill amendment, the CFTC has taken the position that the trading of ICE’s U.S. benchmark crude oil contract (which covers @ 30% of the trading in that U.S. futures market) will not be subject to reregulation under the Farm Bill amendment.

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1 Statement of ICE Chairman and CEO, Jeffrey Sprecher, Commodity Futures Trading Commission, Public Hearing On Exempt Commercial Markets 113 (Sept. 18, 2007) (unpublished manuscript, on file with Anderson Court Reporting).
The CFTC contends that ICE, for purposes of trading of that U.S. benchmark contract on U.S. terminals, is a “foreign” exchange because its wholly owned London subsidiary has been assigned by its U.S. parent intra-corporate oversight of those U.S. terminals. The CFTC has reached this decision despite the fact that: ICE is headquartered in Atlanta, Georgia; the electronic server matching the ICE WTI trading is located in Chicago; and the overwhelming majority of the ICE WTI trading is conducted on trading terminals located within the U.S.

In sum, the Farm Bill Amendment, which was brought to the Senate floor on December 13, 2007, certainly does not now meet the challenges presented today by the dire economic circumstances faced by the U.S. consumers of crude oil and its derivatives (e.g., gasoline and heating oil), i.e., it does not require administrative action for 15 months; it places the burden on the CFTC “in its discretion” to prove that a contract should be reregulated subject to time consuming administrative and judicial constraints; it will only apply to ICE’s natural gas futures contract according to public statements by the CFTC; and it does not apply to the billions of dollars being traded by U.S. swaps dealers executing standardized energy futures contracts.

In this regard, I agree with PSI staff’s assertion in its analysis (at 2) that I am now “proposing a return to the legal framework for commodity trading prior to the enactment of the” Enron Loophole, when all U.S. energy futures, including standardized energy swaps, were required to be executed on a CFTC regulated contract market. I make this recommendation in the wake of the financial crisis in which this country finds itself because of rapidly skyrocketing oil, gasoline, and heating oil prices.

Legislative Support for Returning to Complete Regulation of the U.S. Energy Futures Market

My analysis is consistent with the approach of one of PSI’s members. On June 22, 2008, Senator Obama announced a plan that “fully closes the Enron loophole and restores common-sense regulation as part of my broader plan to ease the burden for struggling families today while investing in the future.” Governor Jon Corzine of New Jersey, a former Chairman of Goldman Sachs and former Senator from New Jersey, was Senator Obama’s principal spokesperson when the proposal was released and he expressly endorsed the proposal to close the Enron Loophole fully. In addition, Senator Nelson’s proposed legislation (S. 3134), whose cosponsors include Senator Obama, adopts the very legislative language that I had proposed in my June 3, 2008 testimony that is the subject of PSI staff criticism. Similarly, I have been informed that another member of the PSI committee has joined as a co-sponsor of S. 3205, the 2008 PUMP Act, which also completely closes the Enron Loophole by requiring all U.S. energy futures and swaps trading to be done on U.S. regulated markets.

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Just three days after Senator Obama issued his proposal to fully close the Enron loophole, Senator John McCain stated: “We must purge the market of the reckless speculation, unrelated to any kind of productive commerce that has inflated the price of gasoline -- at the expense of working men and women across our country. . . I intend to assure integrity in oil-futures trading, and to protect the public interest.”4

As your invitation to testify at your Committee’s July 9-11 hearings makes clear, there are many members of both the House and Senate who do want to return to the regulatory environment in effect before the Enron Loophole was passed and promptly bring all U.S. traded energy futures under the CEA’s requirements for a CFTC approved contract market. The concept underlying that legislation has been endorsed by the many corporate consumers of crude oil and its derivatives that are in serious financial distress because of skyrocketing fuel prices, many of whom are now strongly and explicitly urging Congress to completely close the Enron Loophole.5

Seven Examples of Errors in the PSI Staff Analysis

I will respond below in detail to the substantive critique of the PSI staff on my June 3, 2008 testimony. As a preface to that discussion, however, I want to highlight quickly seven examples of a series of errors within that PSI staff document.

1. The PSI staff criticizes me (at 11) for concluding that prior PSI studies about energy markets deregulated by the Enron Loophole focused on manipulation of those markets. While much could be extracted from those reports to prove my point, perhaps the clearest support comes from the PSI Chairman who states, for example, that the 2006 report pertaining to Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat, “recommended new laws to increase market oversight and stop market manipulation.”6

2. On page 10, the PSI states that that I am in error about CFTC approval of the Dubai Mercantile Exchange (“DME”) trading the WTI contract: “The CFTC has yet to grant the DME permission to use trading terminals in the United States for the trading of its WTI contract . . .” Yet, Dr. James Newsome, president of NYMEX (a DME founder and its partner in establishing DME’s U.S. terminals) and a DME board member, clearly stated on May 16, 2008: “A cash settled contract on the WTI has been approved by the CFTC.” On June 23, 2008, before a House Energy subcommittee, Dr. Newsome elaborated: “Although the DME does not yet list a WTI

financial futures contract, the DME has received a no action letter from CFTC staff for this contract . . . The DME is currently finalizing a launch date for that contract. 7

3. On page 4, the PSI states that “[t]he CFTC has not made any statements or provided any indication of the number of commodities or contracts” ultimately to be covered by the Farm Bill amendment. Yet, CFTC reports and testimony repeatedly have limited the implementation focus of that statute to the ICE Henry Hub natural gas futures contract: “In the CFTC report that accompanied [Acting Chair] Lukken’s testimony, the only ICE contract [cited] as serving a significant price discovery function is the one that settles on the closing price of the Henry Hub futures contract.” 8 On December 12, 2007, Acting Chair Lukken further testified: “Testimony from the Commission’s hearing and staff analysis on this subject led us to conclude that one ECM contract on the Intercontinental Exchange (ICE) is serving a significant price discovery role . . .” 9 It was because of these CFTC statements that I said in my written June 3 testimony that the CFTC had asserted that “crude oil, gasoline, and heating oil” will not be affected by the legislation since ICE is the major unregulated energy futures exchange trading those contracts. The PSI analysis concludes on this point: “[I]nformed observers indicate multiple contracts are likely to qualify for CFTC oversight.” No support is cited for that proposition and certainly there could be none as authoritative as those of the Acting Chair of the CFTC in reports and testimony presented to committees of Congress. If “multiple contracts” are going to be regulated under new enactment, they would, under the CFTC’s analysis, have to be outside of the ICE umbrella. The only candidates would be the swaps dealers’ energy index funds. 10 And, neither the CFTC nor the PSI staff has argued that swaps dealers, such as Goldman Sachs, should be regulated under the Farm Bill amendment.

4. On pages 5-6, the PSI asserts: “Prior to the Commodity Futures Modernization Act (CFMA), large traders trading financial instruments like collateralized debt obligations, credit default swaps, and energy swaps were eligible for the hybrid and swaps exemption from the requirement that all futures contracts be traded on a regulated futures exchange. See, e.g., 17 C.F.R. Part 35 (Exemption of Swaps Agreements).” However, as the regulation cited by PSI staff and the academic commentary on it makes clear, those exemptions only applied “if all contracts were negotiated as to their material terms (unlike futures contracts, where terms are standardized) and if all contracts were held to maturity (rather than traded rapidly, as futures

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8 CFTC calls on Congress to legislate oversight of exempt energy derivatives markets, Platts Inside FERC (October 29, 2007) (emphasis added) [hereinafter Platts Inside FERC].
are.)”11 As the leading treatise in this area provides, the 1992 statute cited by the PSI staff which authorized the swaps exemptions only permitted exemptions for swaps that are not “‘standardized as to their material economic terms, to the extent that such agreement may be regarded as subject to the Act,’” i.e., futures contracts.12 As the PSI staff has concluded elsewhere: “A futures contract is a standardized contract,” because “standardized contracts can be more easily traded than individually negotiated contracts. They can be traded many, many times to many different people.” 13 The liquidity needed to trade most credit default swaps, collateralized debt obligations, and the energy swaps at issue (e.g., those index funds sold by swaps dealers such as Goldman Sachs) mean that they cannot be held until maturity nor can they be standardized as to their material terms. It was for that reason that the swaps dealers, inter alia, lobbied for the passage of the CFMA, i.e., to free these products, which are not individually negotiated as to each material economic term, from pre-2000 regulated exchange trading requirements.

5. The PSI staff asserts (at 7-8) that based on their reading of the law: “Futures contracts traded from within the [U.S.] on a foreign exchange are, thus, excluded by statute from the requirement that futures contracts traded in the [U.S.] be traded on a futures exchange regulated by the CFTC.” Yet, a June 17, 2008 CFTC staff letter to ICE Futures Europe substantially undercut the PSI assertion that foreign exchanges cannot be required to register as fully regulated U.S. contract markets.14 In that June 17 letter, the CFTC staff applied four new conditions to the 1999 no action letter under which ICE is allowed U.S. trading terminals within the U.S. without having to register as a CFTC regulated contract market. The CFTC staff concluded that letter by stating that, if ICE satisfies the new conditions, the CFTC staff “will not recommend that the [CFTC] institute enforcement action against [ICE] based upon [ICE’s] failure to seek contract market designation or registration as a DTEF [--a U.S. regulated contract market--] under Sections 5 and 5a of the Act.”15 Of course, if the conditions are not complied with the obverse would be true, i.e., the CFTC staff would recommend an enforcement action for failure to register as a U.S. regulated exchange. In short, in contrast to the above quoted assertion by the PSI staff about the limited CFTC authority over foreign exchanges with U.S. trading terminals, that agency itself clearly believes that, in the absence of complying with the conditions it imposes on those foreign exchanges to permit avoidance of full U.S. contract market regulation, that agency has complete statutory power to order those foreign boards of trade with U.S. trading terminals to register as a U.S. contract market.

11 Mark Jickling, Regulation of Energy Derivatives, CRS REPORT FOR CONGRESS (Updated April 21, 2006).
6. In its analysis, the PSI staff frequently quotes my June 3 oral testimony by sometimes using ellipses, misleading bracketed PSI additions or both, which takes my statements out of context. For example, on page 6 of its analysis, the PSI staff quotes me as saying in response to a question: “Overnight [prohibiting the trading of energy commodities in Exempt Commercial Markets] will bring down the price of oil, I believe, by 25%.” First, the PSI staff did not quote my following sentence: “Now, there has to be a grace period . . . ,” which I have recommended be 6 months. Second, my answer to that question was not limited as the bracketed material inserted by the PSI staff suggests to simply re-regulating ECMs; the answer was directed to closing all of the loopholes associated with these markets, including those afforded the multi-billion dollar energy futures trading of swaps dealers and foreign exchanges trading U.S. energy futures on U.S. terminals, such as ICE Futures Europe, which trades @ 30% of the U.S. WTI benchmark futures contract. Indeed, when Senator Pryor asked me at that hearing what the financial impact would be “if we did all the fixes you are recommending,” which also included the beginning of an FTC investigation of these markets – a key subject in the FTC’s Senate committee of jurisdiction -- I made clear that my 25% estimate of the price drop was just that – an estimate. Indeed, in the 2006 PSI staff report recommending putting “the cop back on the beat,” the PSI favorably noted: “Several analysts have estimated that speculative purchases of oil futures have added as much as $20-$25 per barrel to the current price of crude oil, thereby pushing up the price from $50 to approximately $70 per barrel,” or well over 25% of the price of crude oil at the time. Compared to this PSI estimate, my own on June 3 was quite conservative. More recent hearings have borne out the conclusion that my estimate was quite conservative compared to oil market experts who predicted, upon proper regulation of these markets, the price of a barrel would drop to at least $70.

7. Moreover, the PSI staff criticizes (at 6) my oral June 3 statement that “there are no speculation limits in these markets that are unregulated.” The staff then cites a June 16, 2008 CFTC statement saying for the first time that it would impose conditions on ICE Futures Europe “to implement speculation limits.” While I testified on June 23 about the inadequacy of that new June 16 CFTC condition, the point here is that on June 3, 2008 I did not have the CFTC announcement of thirteen days later in front of me. Similarly, I am criticized by the PSI staff (at

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17 Id. at 89.
19 Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation? – Part II: Hearing Before the Subcommittee on Oversight and Investigations of the United States House (June 24, 2008) (Mr. Masters stated that if Congress enact legislations adopting [necessary] regulatory changes, the price of retail gasoline will go down to $65 or $70 within 30 days); (Mr. Krapels stated that the price would go down more quickly than Masters’ estimate to $65 or $70); (Mr. Diwan stated that the price would be slightly higher than Masters’ estimates); (Mr. Gheit stated that the price would be around between $45 and $60).
20 See June 23, 2008 Testimony, supra note 14 at 19-25.
10) for not taking into account in my June 3, 2008 testimony legislation introduced nine days later on June 12, 2008.\textsuperscript{21}

**Why Congress Should Now Require That All U.S. Energy Futures Contacts Be Traded on U.S. Registered Contract Markets**

As mentioned earlier, my view that the Farm Bill amendment must be revised, especially as viewed from the present and immediate crisis crippling our economy, is premised on the need to return energy futures regulation to where it was before the Enron Loophole was enacted on December 20, 2000. The PSI staff is therefore correct when it asserts at page 5 that I want to “return to the legal framework for commodity trading prior to the [“Enron Loophole”], by requiring “energy and metal commodities to be traded the same way as agricultural commodities; . . .” As the leading treatise on futures regulation makes clear, prior to the passage of that 2000 statute, “all futures activity would be confined by law (and eventually subject to criminal activity to [CFTC regulated] exchanges alone.”\textsuperscript{22} And, in this regard, I now support the legislation that would return to this fundamental principle for energy futures contracts.\textsuperscript{23}

Before I answer the PSI staff’s criticism of returning to regulatory format in existence immediately prior to the Enron Loophole, I want to answer its contention that the Farm Bill amendment in today’s urgent circumstances adequately provides for reregulation of all critically important energy futures contracts. In this regard, the PSI staff states (at 2) that the Farm Bill amendment “regulates all types of energy and metal commodities on Exempt Commercial Markets without exception, including crude oil, gasoline, and heating oil, if the relevant contracts perform a significant price discovery function.” Moreover, it states (at 3) that “the law explicitly gives the CFTC the ‘discretion’ to determine which contract perform significant price discovery functions and are subject to CFTC oversight.”

While these statements are true, my concern about the scope of the Farm Bill amendment, especially when viewed in light of the present crippling surge in gas and heating oil prices, is that, rather than putting all energy contracts under CFTC supervision, as was the case before the Enron Loophole passed, now the CFTC has the “discretion” to decide on a contract-by-contract basis to which of the manifold unregulated contracts perform “a significant price discovery function.” In that regard, the PSI staff itself has stated that “the primary purposes of futures contracts are to allow market participants to protect themselves against future price changes and provide a market based mechanism for price discovery.”\textsuperscript{24} Therefore, all futures contracts serve a price discovery function, but only those which can meet the Farm Bill’s heightened definition of “significant” will now be regulated.

\textsuperscript{21} 110 CONG REC. S.5592 (daily ed. June 12, 2008) (S.3129 introduced). While the staff only states that S. 3129 was introduced “[i]n June” without giving a date, that bill was in fact introduced on June 12, 2008, or nine days after I testified.
\textsuperscript{22} PHILIP McBride Johnson & Thomas Lee Hazen, Derivatives Regulation 27 (Cumm. Supp. 2008).
\textsuperscript{24} June 2007 Report supra note 13, at 28.
Again, as I have stated above (and despite the PSI staff’s argument to the contrary), the CFTC has repeatedly said that only ICE’s Henry Hub natural gas futures contract will satisfy its application of the “significant price discovery function” statutory standards.25

Moreover, the PSI staff implies (at 3) that “significant price discovery function” decisions will be carried out with a sense of urgency under the Farm Bill amendment, by emphasizing that those decisions must be made “within 180 days of promulgation setting forth the criteria to be considered” for determining “significant price discovery” contracts. What the staff does not say, however, is that under the Farm Bill amendment the CFTC initially has 270 days (or 9 months) to “set forth” by rulemaking “the criteria to be considered” to apply the “significant price discovery function” test,26 and, only then will the 180 days given for implementation begin to run, thereby allowing 450 days to pass before the CFTC is required to implement that statute.

**Decisions Made Under the Farm Bill Amendment Will Be Subject to Administrative Procedures and Judicial Review**

Challenging my assertion to the contrary, the PSI staff contends (at 3) that there will be no other delay (other than the prospect of the above mentioned statutorily established implementation period of up to 15 months) imposed on the CFTC in making its “significant price discovery function” determinations, because none of it actions are subject to the requirements of the Administrative Procedures Act (“APA”); nor can the CFTC be challenged judicially in its decision-making in this regard.

There is not a word in the statute that expressly exempts the CFTC from complying with the APA or exempts it from judicial review. The PSI staff argues (at 3) that because the statute gives the CFTC “discretion” to decide which energy futures contracts will be reregulated, “formal administrative hearings are not required and judicial challenges are not permitted.”

However, the Farm Bill amendment expressly requires that the standards governing the "significant price discovery function" be implemented by a rulemaking.27 Therefore section 553 (c) of the APA’s informal notice and comment rulemaking requirements must be followed.28 The CFTC does not have discretion to avoid that, because the informal rulemaking provision “requires”29 all rules (except those exempted for reasons not at issue here) to follow the express procedures of section 553 (c).30

Once section 553 (c) applies, the CFTC must afford notice, a meaningful opportunity to comment, and a meaningful response to the comments filed.31 Moreover, once section 553 (c) is

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25 *See supra* pages 2, 5, 9.
triggered, the decision is subject to the judicial review standards of the APA.\(^{32}\) Under that review, the agency must have complied with specific statutory criteria in its governing statute, which in this case has detailed standards\(^{33}\) to control the imposition of the significant price discovery function, and the development and application of those criteria cannot be arbitrary and capricious.\(^{34}\) Finally, under section 501 of the APA defining a rule, that implementation of a rule itself requires rulemaking.\(^{35}\) Therefore, once the general rulemaking is completed, implementation of the rule to energy futures contracts must itself be governed by section 553 (c).

Moreover, even if section 553 (c) did not apply, it is clear that, even if the agency has discretion, if the court has "law to apply" to ensure that that discretion is exercised consistent with Congressional requirements, that discretion is reviewable by a court.\(^{36}\) The "laws to apply" here are the exacting specific criteria within section 13201 (b) of the Farm Bill, which must be applied by the CFTC in developing and exercising its significant price discovery function determinations. These are the very kind of "intelligible principles" against which courts traditionally judge whether the agency’s exercise of discretion satisfies the statute.\(^{37}\)

Again, if the agency action is governed by specific statutory criteria, as is true of section 13201 (b), then the exercise of agency discretion is wholly reviewable in the courts and cannot be arbitrary and capricious.\(^{38}\)

Moreover, in this case, the CFTC, acting pursuant to the Farm Bill amendment, may either move previously unregulated exchanges and contracts to regulated markets; or it may reject the arguments of industrial consumers of energy, such as the airlines, to reregulate futures contracts upon which that industry’s economic survival may very well depend. These are self evidently constitutionally protected property interests and, even if not directly required by the APA, the courts have made it clear that there is a Constitutional due process right to notice and comment here independent of the APA.\(^{39}\)

Moreover, it is equally unavailing for the PSI staff to rely on the following statement made by a Senate draftsman during the Senate debate: “[T]his determination is not intended to be subject to formal challenge through administrative proceedings.” (Emphasis added.) That proposition only restates the obvious, i.e., that significant price discovery function decision-

\(^{35}\) 5 U.S.C. § 551(4)-(5) (2008);
\(^{36}\) See Webster v. Doe, 486 U.S. 592, 599-600 (1988) (quoting Heckler v. Chaney, 470 U.S. 821, 830 (1985) (holding that "review is not to be had if the statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion.").
\(^{37}\) Drake v. FAA, 291 F.3d 59, 72 (D.C. Cir. 2002); see, e.g., J.W. Hampton, Jr., & Co. v. U.S., 276 U.S. 394, 409 (1928).
making is not subject to the formal “on the record” rulemaking or adjudication requirements of the APA, which require a full trial type proceeding.\textsuperscript{40} Therefore, that comment by the Senator does not mean that the CFTC decision would escape the notice and comment requirements of the APA for informal agency action under section 553 (c) or judicial review thereof. Courts do not lightly infer that Congress has terminated judicial review.\textsuperscript{41} “[C]lear and convincing” evidence must be presented that Congress forbade judicial review.\textsuperscript{42} That evidence is not found within the Farm Bill amendment; nor within the single sentence cited by the PSI staff in the legislative history – a sentence that does not say anything about judicial review, but only refers to the kind of administrative procedure to be employed.

Finally, it cannot possibly be that each of the many parties (including the many financial institutions trading on unregulated exchanges or industrial consumers, such as airlines, seeking reregulation of energy futures contracts as a matter of economic survival) adversely affected by a CFTC decision at issue here would idly accept that result without vigorously seeking the full protection of the APA’s notice and comment procedures or without judicial review of CFTC’s action. With so much at stake pertaining to the national economy in this decision-making context, it is also hard to imagine a court allowing such a decision to be made without proper procedural protections or judicial review ensuring that that important decision was not “arbitrary and capricious.”

Again, if Congress were to now require that all U.S. energy futures contracts be regulated, as was the case prior to the Enron Loophole, there would be virtually nothing to challenge judicially. Any challenge would have to be lodged directly against the statute itself, because there would be no agency action to be reviewed under the APA’s arbitrary and capricious standard. Moreover, such a statute would self evidently fall within Congress’ Commerce Clause powers, thereby making it quite difficult for traders and exchanges to challenge its legality in light of the exceedingly rational basis for imposing transparency on these critically important markets.\textsuperscript{43} The “rational basis” standard is well understood to be very difficult for a plaintiff challenging a federal statute to meet.\textsuperscript{44} Needless to say, U.S. energy consumers would have no cause to challenge judicially a statute requiring all energy futures contracts to be within the regulatory ambit of the CFTC.

\textsuperscript{40} 5 U.S.C. §§ 553 (c), 554, 556 (2008). See also Richard J. Pierce, Jr., Administrative Law Treatise 415 (4th Ed. 2002) (describing formal rulemaking procedures in which the agency must conduct a full evidentiary hearing).

\textsuperscript{41} Socop-Gonzalez v. INS, 208 F.3d 838, 843 (9th Cir. 2000); Helgeson v. Bureau of Indian Affairs, 153 F.3d 1000, 1003 (9th Cir.1998) (quoting Traynor v. Turnage, 485 U.S. 535, 542 (1988) (holding that there is a “strong presumption that Congress intends judicial review of administrative action.”)).

\textsuperscript{42} Board of Governors of the Fed. Reserve Sys. v. MCorp Fin., 502 U.S. 32, 44 (1991); e.g., Socop-Gonzalez, 208 F.3d at 843; Helgeson, 153 F.3d at 1003.

\textsuperscript{43} Even in the Supreme Court’s most cabined view of Congress’ Commerce Clause powers, it made clear that Congress can regulate “those activities that substantially affect interstate commerce.” Lopez v. United States, 514 U.S. 549, 559 (1995). It is well understood that the Nation’s futures markets have such an effect and therefore Congress would be acting within its Constitutional “wheelhouse” with regard to reregulation of these markets.

Requiring Swaps Dealers to Trade on a Regulated Exchange Will Heighten Much Needed Transparency in the Energy Futures Markets

The PSI analysis critiques (at 5) my proposal to “return to the legal framework prior to the enactment of the “Enron Loophole,” because that “approach would prohibit energy traders from trading financially settled swaps instruments on electronic exchanges that are not futures exchanges, . . .” If the PSI staff means that standardized energy swaps trades will have to be conducted on contract markets approved by the CFTC, their analysis of my desired result is correct. As has been mentioned above, there has been substantial criticism of the adverse effect swaps dealers have had in raising substantially both energy and food prices through their encouragement of speculative trading on energy and agricultural commodity markets.45

I would also add that the CFMA’s easing of contract markets registration requirements would also make it practical for swaps dealers to register their electronic facilities as regulated U.S. contract markets.46 They therefore would not be required to leave the energy swaps market exclusively to the existing regulated U.S. exchanges.

The PSI staff analysis is incorrect (at 5), however, when it states that requiring all trading of standardized swaps contracts be regulated would “permit” swaps dealers to trade in an “unregulated” environment, such as “through voice brokers . . . using telephones and fax machines.” If futures trading is conducted by telephone or fax machines, it does not escape the CEA’s registration requirements. The sweep of the definition of futures contract47 does not stop at the door of a telephone conversation or a fax. If the agreements being reached by phone or by fax are the execution standardized contracts deriving their value from the price of an energy commodity, they, too, constitute futures trading which must be conducted on a regulated contract market.

The fact of the matter is that telephones and fax machines are simply too time consuming to create the needed real time liquidity in these markets that can be accommodated only by the speed of electronic trading. Therefore, even if voice brokers or telephone or fax trading were not covered by the Act, economic reality would prevent those devices from being a conventional and effective way of doing a futures business with the requisite liquidity needed by today’s traders.

Finally, I have addressed above the PSI staff contention (at 5-6) that prior to the passage of the Enron Loophole, energy swaps were authorized by the CEA. As I mentioned above, the very statutory provision under which the 1993 energy swaps regulation was promulgated by its express terms did not allow such swaps to be standardized in any of its material terms.48 The

45 See generally June 23, 2008 Testimony of Michael Masters, supra note 10.
47 Futures trading is well understood to encompass any “contract for sale of a commodity for future delivery,” and “the CFTC has made clear its intent to construe very broadly the meaning of” that phrase. PHILIP McBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION 23-24 (2004).
48 See supra at page 5.
1993 energy swaps exemption carefully followed the restrictions within that 1992 statute.\textsuperscript{49} It was the very limited scope of that 1993 energy swaps exemption that led Enron to push for passage of the Enron Loophole, which authorized standardized energy futures contracts to be traded on an electronic trading facility.

**Foreign Exchanges Accommodating Trades on U.S. Terminals Are Subject to the Commodity Exchange Act**

The PSI staff argues (at 7-8) that, because of the 4(a) (registration requirements do not apply to any exchange “located outside the United States”) and 4(b) of the Act (CFTC cannot apply CFTC rules that “govern in any way” foreign exchanges), ICE Futures Europe’s trading of the WTI contract on U.S. trading terminals is correctly viewed as being outside the reach of the Act’s jurisdictional scope.

However, even if the PSI staff were right about their reading of those section 4 provisions (and I show below they are not), why could Congress not have amended section 4 when it passed the Farm Bill in order to clearly extend the scope of that statute to trading on U.S. terminals of futures contracts premised on the price of U.S. delivered commodities by foreign exchanges?

Moreover, even if the PSI were right about section 4’s protection of foreign exchanges, the trading on ICE can not in any rational sense be deemed “foreign.” In this regard, the PSI staff refuses to give any weight to its own analysis (at 9) that ICE Futures Europe is one of ICE’s “wholly owned subsidiaries” or that “ICE is a Delaware corporation located in Atlanta, Georgia. ICE pays U.S. taxes, uses U.S. employees and operates an exempt commercial market” in the U.S. Beyond the PSI staff’s acknowledgement of ICE’s substantial ties to the U.S., ICE Futures Europe has trading terminals in the U.S.; its trading engines are in Chicago, Illinois; and it trades @ 30% of the U.S. WTI crude oil futures market. Whatever protection section 4 has for exchanges “located outside the United States,” ICE is self evidently very much located here.

And, as I have made clear on June 3, the underlying premise of the no action letter on which ICE and all other foreign exchanges rely is that, but for the no action letter, they are fully subject to U.S. CFTC regulation when they bring their trading terminals into the U.S. That was true when the no action letters were first issued in 1999,\textsuperscript{50} when the CFTC issued its 2006 Policy

\textsuperscript{49} See *supra* at page 5.

\textsuperscript{50} As their plain language made clear when they were first issued in 1999, the foreign exchange no action letters originated from a rulemaking proceeding, that by it very terms, provided that permission to put terminals in the U.S. derived from Section 4(c)’s exemption from U.S. contract market registration requirements and not from any statutory prohibition from regulating foreign exchanges “outside the United States.” See LIFFE Administration & Management, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 38, 4-5 (July 23, 1999); Access to Automated Boards of Trade (proposed rules), 64 Fed. Reg. 14,159, 14,174 (Mar. 24, 1999). As the proposed rules explained: Section 4(c) of the Act provides the Commission with authority “by rule, regulation, or order” to exempt “any agreement, contract or transaction” from the requirements of Section 4(a) of the act if the Commission determines that the exemption would be consistent with the public interest, that the contracts would be entered into solely by appropriate persons and that the exemption would not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act. *Id.* (internal citations omitted).
Statement upon which the PSI staff mistakenly relies; and it is true today as evidenced by the CFTC staff’s June 17, 2008 letter to ICE Futures Europe expressly stating that the failure to comply with the four new conditions the CFTC imposed at that time on that “foreign” exchange would lead to a recommendation to “institute enforcement action against [ICE] based on [ICE’s] failure to seek contract market designation or registration as a DTEF under Sections 5 and 5a of the Act.”

The CFTC’s stance in its June 17 letter to ICE Futures Europe is in keeping with a host of federal cases and CFTC enforcement actions making it clear that the prohibitions upon which the PSI staff rests within section 4 pertaining to foreign exchanges only applies when foreigners trade foreign futures contracts in foreign countries on foreign exchanges that do not significantly impact U.S. markets. I incorporate by reference my extensive analysis of these cases and orders in my June 23, 2008 testimony to the House Energy Subcommittee.

The Substantial Role of ICE and the CFTC in Establishing the Framework of the “Close the Enron Loophole”

Finally, the PSI staff challenges (at 1-2) my assertion that the existing “Close the Enron Loophole” amendment found its genesis in the work of ICE, the principal party to be regulated, and the CFTC. In this regard, one only has to compare the CFTC’s legislative proposal as forwarded and endorsed by the PWG in a November 13, 2007 letter to Senator Crapo, with the final version of the Farm Bill amendment. These documents with a few (and in certain circumstances, as I show below, may be unhelpful) adjustments in the enacted version have a substantially identical regulatory format. Most importantly, the essential statutory structure of requiring that the CFTC to prove that a contract should be reregulated based on “a significant price discovery function” standard is derived from the CFTC proposal. Again, this is in contravention of the principle of returning to the regulatory format in existence prior to the Enron Loophole, i.e., when all energy futures contracts were regulated. In fact, the adoption of the CFTC’s burden shifting device (i.e. it must be proved that an individual energy contract should be regulated) was done when it was by that time made a matter of record before Congress by the CFTC that of all of ICE’s “thousands” of contracts, only ICE’s Henry Hub natural gas contract would be eligible for reregulation.

Moreover, two of the principal changes added to the CFTC version of the Farm Bill made immediate and effective implementation of reregulation of energy futures contracts harder. First

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51 “In the absence of no-action relief, a board of trade, exchange or market that permits direct access by U.S. persons might be subject to Commission action for violation of, among other provisions section 4 (a) of the CEA, if it were not found to qualify for the exclusion from the CDM designation or DTEF registration requirement. Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 Fed. Reg. 64,443, 445 n.23 (Nov. 2, 2006).

52 See June 17, 2008 CFTC Staff Letter, supra note 15.

53 See the extensive discussion of relevant cases at pages 9-12 of my June 23, 2008 Testimony, supra note 14.

54 Id.


was the change that the CFTC need not fully implement the statute until 15 months after enactment or by September 2009. The CFTC’s own proposal, by not including an effective date provision, suggested a willingness to immediately implement the “significant price discovery function” process upon enactment. Second, under the CFTC proposal it was required by the legislative language to deregulate a contract if it satisfied the “significant price discovery function” test. The final enactment left re-regulation “in [the CFTC’s] discretion.”

ICE’s substantial influence in shaping the “Close the Enron Loophole” amendment is also a matter of public record. For example, the CFTC’s legislative proposal that formed the framework for the Farm Bill Amendment was presented to Congress on October 24, 2007. That very day, in an Atlanta, Georgia issued press release, ICE’s Atlanta based Chairman and CEO Jeffrey Sprecher asserted: “The spirit of [the CFTC and the PWG’s] recommendations is largely consistent with the views we have expressed in several testimonies this year. . . . We will continue to engage in dialog with regulators, the industry and Congress, and look forward to effectively resolving this long-standing matter.”

Contemporaneous with a late October hearing before the House Agriculture Committee on the CFTC’s proposed legislation, ICE was reported to have “said it supports the proposal put forth by the CFTC. “The proposal is largely consistent with the testimony that we have given this year,” said ICE spokeswoman Kelly Loeffler.” It’s our view that we’ve arrived at recommendations that are workable given the complexities of the OTC market. . . .[Jeffrey] Sprecher said [in his testimony] that applying a standard regulatory regime more broadly to all swaps contracts traded on ICE, either through application of principles ill-suited for illiquid trading markets, or by elimination exemptions altogether, would be a serious mistake.”

On December 12, 2007, the day before the “Close the Enron Loophole” amendment was added as a rider in the Senate to the Farm Bill, ICE’s Atlanta-based Vice President and Chief Operating Officer Charles A. Vice testified:

Over the past several months, ICE has been working with members of Congress to create an enhance but appropriate level of oversight over [over-the-counter] energy markets that . . . serve a price discovery function themselves . . . By appropriate, ICE means that any regulatory changes that are made need to reflect the varying nature of ICE’s many OTCE markets and the key difference between contracts on ICE that serve a significant price discovery function and those that do not. . . .

ICE is complete agreement [with the CFTC proposal] and has been working with Congress and . . .the President’s Working Group, for some months now on

57 See supra page 3.
58 See supra pages 1-3, 9.
59 CFTC proposal may apply to one ICE swap, Platts Gas Market Report (November 2, 2007).
61 Platts Inside FERC, supra note 8 (emphasis added).
additional regulation for ECM’s . . . for contracts that are determined significant price discovery contracts. And those are determinations that the CFTC for the most part has drafted and feel comfortable with . . .”62

Moreover, ICE had recommended that the CFTC apply any new legislation only to its Henry Hub contract in a public forum as early as September 18, 2007 during the CFTC’s one day public meeting to discuss the status of the Enron Loophole. At that time, ICE’s Chairman and CEO Jeffrey Sprecher, acknowledged that “a heightened level of DCM regulation, . . . may be appropriate for . . . our Henry Hub natural gas swap,” which was one of “a thousand products that trade on our platform.”63 Needless to say, taking its lead from this limited ICE acknowledgement, Mr. Lukken soon thereafter made clear to Congress that only ICE’s Henry Hub contract would fall under the Farm Bill amendment’s auspices.64

In sum, notwithstanding the largely undocumented protestations of the PSI staff, there can be little doubt of ICE’s quite substantial input into the CFTC crafting of that agency’s proposal that ultimately became substantial framework for the “Close the Enron Loophole” Amendment.

Conclusion

Finally, I want to emphasize that, for purposes of testifying on the issues addressed in this letter, I am acting solely in my own capacity as a professor of law as my disclosure forms have made clear. I am engaging in this debate because I sincerely believe that at least some of the incredibly high prices being paid for crude oil are crippling our economy and are completely unnecessary in that they are not being driven by market fundamentals.

In sum, I want to thank you for the opportunity you have given me to respond in writing to the PSI staff analysis. I will also forward this letter to PSI staff members.

Sincerely yours,

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University of Maryland School of Law

63 Commodity Futures Trading Commission, Public Hearing On Exempt Commercial Markets 113 (Sep. 18, 2007) (unpublished manuscript, on file with Anderson Court Reporting).
64 See supra pages 2, 5, 9.