



Testimony of

Michael Greenberger
Law School Professor
University of Maryland School of Law
500 West Baltimore Street
Baltimore, MD 21201

Before the Subcommittee on Oversight and Investigations of the United States House
Committee on Energy and Commerce

Regarding

Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?

Wednesday, December 12, 2007
9:30 a.m.
2123 Rayburn House Office Building

One Page Summary of Testimony

1. One of the fundamental purposes of futures contracts is to provide price discovery in the “cash” or “spot” markets. Those selling or buying commodities in the “spot” markets rely on futures prices to judge amounts to charge or pay for the delivery of a commodity.
2. Since their creation in the agricultural context decades ago, it has been widely known that, unless properly regulated, futures markets are easily subject to distorting the economic fundamentals of price discovery (*i.e.*, cause the paying of unnecessarily higher or lower prices) through excessive speculation, fraud, or manipulation. The Commodity Exchange Act (“CEA”) has long been judged to prevent those abuses.
3. Accordingly, *prior* to the hasty and last minute passage of the Commodity Futures Modernization Act of 2000 (“CFMA”), “all futures activity [was] confined by law (and eventually to criminal activity) to [CFTC regulated] exchanges alone.” Johnson & Hazen, *Derivatives Reg.* (2008 Cum. Supp.) at p. 27.
4. At the behest of Enron, the CFMA authorized the “stunning” change to the CEA to allow the option of trading energy commodities on deregulated “exempt commercial markets,” *i.e.*, exchanges exempt from CFTC, *or any other* federal or state, oversight, thereby rejecting the contrary 1999 advice of the President’s Working Group on Financial Markets. *Id.* This is called “the Enron Loophole.”
5. Two prominent and detailed bipartisan studies of the Permanent Subcommittee on Investigations (“SPI”) staff represent what is now conventional wisdom: hedge funds, large banks and energy companies, and wealthy individuals have used “exempt commercial energy futures markets” to drive up needlessly the price of energy commodities over what economic fundamentals dictate, adding, for example, what the SPI estimated to be @ \$20-\$30 per barrel to the price of crude oil.
6. The SPI staff and others have identified the Intercontinental Exchange (“ICE”) of Atlanta, Georgia as an unregulated facility upon which considerable exempt energy futures trading is done. For purposes of facilitating exempt natural gas futures, ICE is deemed a U.S. “exempt commercial market” under the Enron Loophole. For purposes of its facilitating U.S. WTI crude oil futures, the CFTC, by informal staff action, deems ICE to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter alia*, @ 30% of trades in U.S. WTI futures. That staff informal action may be terminated instantly by the CFTC under existing law.
7. Virtually all parties now agree the Enron Loophole must be repealed. The simplest way to repeal it is to add two words to the Act’s definition of “exempt commodity” so it reads: an exempt commodity does “not include an agriculture *or energy* commodity;” and two words to 7 U.S.C. § 7 (e) to make clear that “agricultural *and energy* commodities” must trade on regulated markets. An “energy commodity” definition must be then be added to include crude oil, natural gas, heating oil, gasoline, heating oil, metals, etc. In the absence of quick CFTC action permitted by law, the statute should also be amended to forbid an exchange from being deemed an unregulated foreign entity if its trading affiliate *or* trading infrastructure is in the U.S.; *or* if it trades a U.S. delivered contract within the U.S. that significantly affects price discovery.
8. Legislative proposals now seriously under consideration are problematic. They do not address ICE’s exemption from U.S. regulation as a “U.K.” entity; and they put the burden on the CFTC and the public to prove in complicated contract-by-contract bureaucratic proceedings, that regulation is needed for an individual energy contract, rather for an exempt trading facility. It will also lead to traders using regulatory arbitrage to move to unregulated contracts not found to be subject to regulation. The CFTC will always be trying to catch up to uncovered speculative and harmful trading.

Introduction

My name is Michael Greenberger.

I want to thank the subcommittee for inviting me to testify on the important issue that is the subject of today's hearings.

After nearly 24 years in private legal practice, I served as the Director of the Division of Trading and Markets ("T&M") at the Commodity Futures Trading Commission ("CFTC") from September 1997 to September 1999. In that capacity, I supervised approximately 135 CFTC personnel in CFTC offices in DC, New York, Chicago, and Minneapolis, including lawyers and accountants who were engaged in overseeing the Nation's futures exchanges. During my tenure at the CFTC, I worked extensively on regulatory issues concerning exchange traded energy derivatives, the legal status of over-the-counter ("OTC") energy derivatives, and the CFTC authorization of computerized trading of foreign exchange derivative products on computer terminals in the United States.

While at the CFTC, I also served on the Steering Committee of the President's Working Group on Financial Markets ("PWG"). In that capacity, I drafted, and oversaw the drafting of, portions of the April 1999 PWG Report entitled "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management," which recommended to Congress regulatory actions to be taken in the wake of the near collapse of the Long Term Capital Management ("LTCM") hedge fund, including Appendix C to that report which outlined the CFTC's role in responding to that near collapse. As a member of the International Organization of Securities Commissions' ("IOSCO") Hedge Fund Task Force, I also participated in the drafting of the November 1999 IOSCO Report of its Technical Committee relating to the LTCM episode: "Hedge Funds and Other Highly Leveraged Institutions."

After a two year stint between 1999 and 2001 as the Principal Deputy Associate Attorney General in the U.S. Department of Justice, I began service as a Professor at the University of Maryland School of Law. At the law school, I have, *inter alia*, focused my attention on futures and OTC derivatives trading, including academic writing and speaking on these subjects. I have also served as a media commentator on the role of unregulated financial derivatives in recent major financial scandals, including the failure of Enron; the now infamous Western electricity market manipulation of 2001-2002 caused by the market manipulation of Enron and others; the collapse of one of the Nation's largest futures commission merchants, Refco, Inc., the then eighth largest futures commission merchant in the 14th largest bankruptcy; the collapse of the hedge fund, Amaranth Trading Advisers, LLC.; and the present subprime mortgage meltdown, which is substantially premised upon OTC derivatives contracts deregulated by statute in 2000 by Congress.

Besides addressing these issues in a variety of commercial and financial regulatory law courses, I have designed and now teach a course entitled "Futures,

Options, and Derivatives,” in which the United States energy futures trading markets are featured as a case study of the way in which unregulated or poorly regulated futures and derivatives trading cause dysfunctions within those markets and within the U.S. economy as a whole, including causing the needlessly high prices which energy consumers now pay because of excessive speculation and illegal manipulation and fraud within those markets.

The Soaring Price of Energy Commodities Despite Stable Supplies

In examining the questions relating to the high price of energy to American consumers, it is useful to remember that as of January 2002, the cost of crude oil was @ \$18 a barrel;¹ by the end of 2005, it had risen to @ \$50;² and, as of today, the price, which has recently flirted with a record high \$100 a barrel, now rests at @ \$88 per barrel.³ In early 2004, the average retail price of gasoline of which crude is a major component was @ \$1.50 per gallon.⁴ As of today, the average price of gas is slightly below \$3 per gallon, with substantial speculation that it will soon soar to over \$4.00.⁵ Since March 31, 2007, or the “close” of last winter’s heating season, the wholesale price of heating oil has risen 32%, from \$1.88 per gallon to a record high of \$2.77 per gallon.⁶ As I show below, these soaring price rises continue despite the fact that supplies of oil both in the U.S. and worldwide remain relatively stable.⁷

Moreover, as recently as January 2002, the spot price of natural gas was approximately \$3 MMBtu.⁸ By December 2005, the cost of natural gas had “float[ed] to a [record] high near \$14 MMBtu.”⁹ Following a Republican sponsored floor amendment that would have imposed new regulatory restrictions on the deregulated natural gas futures market, the price of natural gas quickly dropped by one third.¹⁰ By late July, 2006, the futures price of natural gas to be delivered in October 2006 had risen to a yearly high of \$8.45 MMBtu. After Amaranth collapsed in September 2006, the futures price dropped “to just under \$4.80 per MMBtu . . . , the lowest level for that contract in two and

¹ Jad Mouawad & Heather Timmons, *Trading Frenzy Adds to Jump in Price of Oil*, N.Y. TIMES, Apr. 29, 2006, at A1.

² *Id.*

³ Commodities & Futures Overview, Crude Oil Lt Sweet Pit (Nymex) January 2008, WALL STREET J. ONLINE, available at http://online.wsj.com/mdc/public/page/mdc_commodities.html.

⁴ Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT 10 (June 27, 2006) [hereinafter Permanent Subcomm. June 2006 Report].

⁵ Clifford Krauss, *Unseasonably Higher, Gas Prices Add to Strain on U.S. Consumers*, N.Y. TIMES, Nov. 8, 2007, available at <http://www.nytimes.com/2007/11/08/business/08gas.html?fta=y>.

⁶ See U.S. No. 2 Heating Oil Wholesale/Resale Price, Petroleum Navigator, ENERGY INFORMATION ADMINISTRATION, available at <http://tonto.eia.doe.gov/dnav/pet/hist/whowsus4w.htm>.

⁷ See API Energy Data: Weekly Snapshot, WALL STREET J. ONLINE, Dec. 7, 2007, available at http://online.wsj.com/mdc/public/page/2_3020-oilstats.html.

⁸ Henry Hub Natural Gas Daily Spot Prices: 2001-2007 (Dec. 7, 2007), available at <http://www.ferc.gov/market-oversight/mkt-gas/overview/2007/ngas-ovr-hh-pr-rg.pdf> [hereinafter Market Overview] (from Federal Energy Regulatory Commission (FERC)).

⁹ 151 CONG REC. H11553-01 (daily ed. Dec. 14, 2005) (statement of Rep. Pombo).

¹⁰ See, e.g., AM. PUB. POWER ASS’N, LONG-TERM STRATEGIES ARE KEY IN ACHIEVING STABLE NATURAL GAS PRICES 6 (2006), available at <http://www.appanet.org/files/PDFs/NaturalGasPriceOutlook306.pdf>.

one-half years. . . The Electric Power Research Institute described this price collapse as ‘stunning . . . one of the steepest declines ever.’ . . . Throughout this period, the market fundamentals of supply and demand were largely unchanged.”¹¹ As recently as the end of June, 2007, natural gas rose to over \$10 per MMBtu.¹² On June 25, 2007, the Congressional investigations of natural gas futures dysfunction began in earnest with attendant discussions of new regulatory structures, including aggressive FERC investigations.¹³ The price therefore spiked at the end of June and today is at the lower, but still relatively high, price of about \$7 per MMBtu.¹⁴

The Two Bipartisan PSI Staff Reports on Distortions in Energy Markets Caused by Unregulated Futures Trading

The 2006 PSI Bipartisan Staff Report on Crude Oil and Natural Gas Speculation. In June 2006, the staff of the Permanent Subcommittee on Investigations (“PSI”) of the Senate Homeland Security and Government Affairs Committee issued a bipartisan report making clear that the dramatic increases in commodity prices described above were not attributable (as conventional wisdom insisted at the time) on problems of supply/demand. Instead, price spikes were caused by dysfunctionality in the recently deregulated energy futures markets and in the maladministration by the CFTC of its no action process pertaining to purported “foreign boards of trade.” In that report, *The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat*,¹⁵ the staff showed, for example, that “U.S. oil inventories are at an eight year high and OECD inventories are at a 20 year high,”¹⁶ and that the “last time crude oil inventories were that high in May 1998 – at about 347 million barrels – the price of crude oil was about \$15 a barrel.”¹⁷

The staff noted that, in the analysis of one of the Nation’s leading energy economists, Philip Verleger, the “reason for this divergence [between adequate supplies and soaring prices] is that purchases of long-term crude oil futures contracts have pushed up the longer-term futures prices by so much that it is more profitable for [speculators] to store the oil and then sell it at a later date than sell it today, even at record spot prices.”¹⁸ The 2006 Report concluded that with the then price of oil at @ \$70 per barrel (as opposed to @ \$90 now), anywhere from \$20-30 of that price was caused by excessive speculation or manipulation, rather than by supply/demand.¹⁹

¹¹ STAFF OF THE S. PERM. SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REPORT ON EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET 1-2 (2007) [hereinafter 2007 Report].

¹² Commodities & Futures Overview: Nat. Gas Henry Hub Pit (Nymex) January 2008, WALL STREET J. ONLINE, available at http://online.wsj.com/mdc/public/page/mdc_commodities.html [hereinafter Nat. Gas Henry Hub Pit].

¹³ See generally 2007 Report, *supra* note 11; Statement of FERC Chairman Joseph T. Kelliher, Subcomm. on Oversight and Investigations of House Comm. On Energy and Commerce, Dec. 12, 2007.

¹⁴ Nat. Gas Henry Hub Pit, *supra* note 12.

¹⁵ Permanent Subcomm. June 2006 Report, *supra* note 4.

¹⁶ *Id.* at 1.

¹⁷ *Id.* at 2.

¹⁸ *Id.* at 25.

¹⁹ *Id.* at 2, 23.

In this vein, Abdalla al-Badri, OPEC's secretary general announced early this month that OPEC will not lift oil production to reduce prices charged to consumers out of the futility such an action, saying: "The market is not controlled by supply and demand . . . It is totally controlled by speculators who consider oil as a financial asset."²⁰

The June 2006 bipartisan staff report recommended ending the deregulation of energy futures contracts brought about by the so-called Enron Loophole passed in December 2000²¹ and having the CFTC alter staff no action letters that now allow U.S.-owned exchanges trading U.S. crude oil futures in the U.S. to remain regulated by British regulators under a regulatory scheme that fails to protect the American consumers from excessive speculation and manipulation of "spot" crude oil, gasoline, and heating oil prices.²²

The 2007 PSI Bipartisan Staff Report on Excessive Natural Gas Speculation. The authors of that June 2006 Report were quick to recognize, that that report was based only on publicly available information and that the staff therefore had "gaps in available market data."²³ Those gaps were eliminated with regard to natural gas futures trading in the bipartisan report released by the PSI staff on June 25, 2007: "*Excessive Speculation in the Natural Gas Market.*"²⁴ That report is the result of accessing all encompassing data pertaining to the natural gas futures and derivatives markets, including the analysis of "millions of natural gas transactions from trading records" and "numerous interviews of natural gas market participants."²⁵

That bipartisan 2007 Report is not only a thorough analysis of the destabilization in the natural gas markets caused by a lack of adequate regulation; it is the most complete and scholarly description of the way in which futures and derivatives markets operate as a whole and the critical role appropriate regulation plays in allowing those markets to operate consistent with basic free market principles.

The 2007 Report on natural gas speculation makes clear that the failure to regulate these markets properly has distorted and sabotaged free market principles. It has cut those markets off from the moorings of economic fundamentals. It has turned them into nothing more than casinos serving neither those who need them to hedge for commercial purposes nor those who wish to speculate based on honest fundamentals.²⁶

²⁰ Robin Pagnamenta, *OPEC rejects rise in output but prepares for review*, TIMESONLINE, Dec. 6, 2007, available at http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article3007105.

²¹ See 2007 Report, *supra* note 11, at 8, 119-20.

²² Permanent Subcomm. June 2006 Report, *supra* note 4, at 49.

²³ *Id.* at 6.

²⁴ Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET, (June 25, 2007) [hereinafter June 25 Report].

²⁵ *Id.* at 2.

²⁶ Today's report is also fully corroborated by a sophisticated economic study conducted during the 2006 natural gas futures market destabilization period. See ROBERT J. SHAPIRO & NAM D. PHAM, AN ANALYSIS OF SPOT AND FUTURES PRICES FOR NATURAL GAS: THE ROLES OF ECONOMIC FUNDAMENTALS, MARKET

The 2007 PSI Report's Basic Findings. The basic findings of the SPI 2007 Report on natural gas speculation are:

First, even though these markets were established principally to afford commercial hedging, the natural gas futures markets from sometime in 2004 through at least mid-September 2006 were overwhelmingly dominated by a single institution, which had no commercial stake in natural gas. The staff dramatically describes the dominance of a single hedge fund, Amaranth, as follows:

“[T]he CFTC defines a ‘large trader’ . . . in the natural gas market as a trader who holds at least 200 contracts; . . . Amaranth held as many as 100,000 natural gas contracts in a single month, representing 1 trillion cubic feet of natural gas, or 5 % of the natural gas used in the entire United States in a year. At times Amaranth controlled 40% of all of the outstanding contracts on NYMEX [(one of the two major exchanges on which natural gas is traded in the U.S.)] for the winter season (October 2006 through March 2007), including as much as 75% of the outstanding contracts to deliver natural gas in November 2006.”²⁷

Second, Amaranth's dominance of this market caused extensive price volatility. As recently as January 2002, the spot price of natural gas was approximately \$3 MMBtu.²⁸ By late July, 2006, the futures price of the October 2006 natural gas contract was at a yearly high of \$8.45 MMBtu. After Amaranth collapsed in September 2006, the futures price dropped “to just under \$4.80 per MMBtu . . . , the lowest level for that contract in two and one-half years. . . The Electric Power Research Institute described this price collapse as ‘stunning . . . one of the steepest declines ever.’ . . . Throughout this period, the market fundamentals of supply and demand were largely unchanged.”²⁹

Third, the staff makes clear that “[t]he price of natural gas directly affects every segment of the U.S. economy, from individual households to small businesses to large industries. ‘Natural gas is used in over sixty million homes. Additionally, natural gas is used in 78% of restaurants, 73% of lodging facilities, 51% of hospitals, 59% of offices, and 58% of retail buildings.’”³⁰

Fourth, because of the heavy correlation between futures and spot prices (*i.e.*, the prices actually paid for natural gas), “end users were forced to purchase natural gas at inflated prices,” *i.e.*, “they were forced to purchase contracts to deliver natural gas in the [2006] winter months at prices that were disproportionately high when compared to the plentiful supplies in the market.”³¹

STRUCTURE, SPECULATION, AND MANIPULATION (August 2006), *available at* http://www.pulp.tc/Nat_Legal_Policy_Center_Gas_Manip_August_29_2006.pdf.

²⁷ June 25 Report, *supra* note 25, at 2.

²⁸ Market Overview, *supra* note 8.

²⁹ 2007 Report, *supra* note 11, at 1-2 (citations omitted).

³⁰ *Id.* at 11 (internal citations omitted).

³¹ *Id.* at 114.

Fifth, as reflected in substantial commentary presented to the PSI staff by end users of natural gas, including, *inter alia*, the Minnesota Municipal Utilities Association, the staff concluded that “the lack of transparency in the over-the-counter (OTC) market for natural gas and the extreme price swings surrounding the fallout of Amaranth have, in their wake, left bona fide hedgers reluctant to participate in the markets for fear of locking in prices that may be artificial[ly high].”³²

Sixth, the Commodity Exchange Act (“CEA”) bars excessive market speculation or the “sudden or unreasonable fluctuations or unwarranted changes” in the price of commodities traded on a regulated exchange.³³ However, the PSI staff aptly concluded that there are two critical problems in enforcing that prohibition. First, the PSI staff found that the CFTC’s enforcement of that prohibition has been very limited in its focus and “the CFTC and energy exchanges need to reinvigorate the CEA’s prohibition against excessive speculation.”³⁴ Second, even to the extent that the limited enforcement of the excessive speculation ban was applied to Amaranth in August 2006 by the NYMEX exchange, “Amaranth moved those [NYMEX] positions to [the Intercontinental Exchange or “ICE”].”³⁵ Because of the infamous “Enron loophole”³⁶ enacted in December 2000 as part of the Commodity Futures Modernization Act, “ICE, [unlike NYMEX,] operates with no regulatory oversight, no obligation to ensure its products are traded in a fair and orderly manner, and no obligation to prevent excessive speculation.”³⁷ “As a result, NYMEX’s instructions to Amaranth did nothing to reduce Amaranth’s size, but simply caused Amaranth’s trading to move from a regulated market to an unregulated one.”³⁸ Thus, “[a]lthough both NYMEX and ICE play an integral role in natural gas price formation, the two exchanges are subject to vastly different regulatory restrictions and government oversight under current federal law”³⁹ even though “NYMEX and ICE are functionally equivalent markets.”⁴⁰

Seventh, the bipartisan 2007 staff report recommends that: (1) the “Enron loophole” be abolished and that the similarly situated NYMEX and ICE exchanges both be subject to the protections afforded hedgers and other traders under the CEA; (2) the excessive speculation ban within the CEA be upgraded and be applied vigorously to both NYMEX and ICE; and (3) CFTC staffing and technological resources be upgraded to meaningfully apply the protections of the CEA.⁴¹

Observations on the 2007 PSI Staff Report. I would add only the following few comments to the comprehensive 2007 Report:

³² *Id.* (internal citation omitted).

³³ 7 U.S.C.A. § 6a(a) (2006).

³⁴ 2007 Report, *supra* note 11, at 120.

³⁵ *Id.*

³⁶ *Id.* at p. 119; *see* 7 U.S.C.A. § 2(g), (h)(3) (2006).

³⁷ 2007 Report, *supra* note 11, at 119.

³⁸ *Id.* at 3.

³⁹ *Id.* at 40.

⁴⁰ *Id.* at 3.

⁴¹ *Id.* at 119-32.

Poorly Considered Enron Loophole. First, it should be emphasized that the “Enron loophole” – which allows energy futures trading facilities to choose to be unregulated even though they are functionally equivalent to those exchanges which are regulated – was far from a carefully considered legislative measure. The loophole was added at the last minute to a 262 page Senate bill, which was itself belatedly and quite suddenly attached in a lame duck session on the Senate floor by then Senate Finance Chairman Gramm to an 11,000 page consolidated appropriation bill for FY 2001.⁴² Over the express and emphatic opposition of the President’s Working Group on Financial Markets (including Fed Chairman Alan Greenspan, Treasury Secretary Lawrence Summers, and SEC Chairman Arthur Levitt),⁴³ the Enron loophole exempted OTC energy derivative markets (even though functionally equivalent to the regulated exchanges) from CFTC and all other federal regulation.⁴⁴

This exemption was called the “Enron loophole” because Enron (upon whose board, Wendy Gramm, Senator Gramm’s wife, then sat) at that time was seeking to authorize retroactively its now defunct Enron Online energy trading facility, which began operation even in advance of the passage of the CFMA.⁴⁵ While this legislation retained CFTC authority to investigate fraud and manipulation (but not excessive speculation) in OTC energy markets,⁴⁶ the CFTC, as a practical matter, read this legislation as generally constricting its authority to call for regular OTC energy reporting in the absence of pre-existing demonstrative evidence of fraud or manipulation. Needless to say, given the last minute nature of this amendment, there were no hearings, committee reports, or floor debates justifying this legislation or the reason it should have been passed over the contrary guidance of Messrs. Greenspan, Summers, and Levitt. As the leading commentators on derivatives regulation have stated:

“[The CFMA] moved fitfully through the Congress, having been declared dead on several occasions only to be resurrected at the last minute and enacted by members of Congress prepared to recess for the Christmas holidays. The most stunning procedural feature of the CFMA was its lack of legislative history [to] help resolves ambiguities in legislative drafting. . . .”⁴⁷

The Enron Loophole and Western States Electricity Crisis. The “Enron loophole” almost immediately caused havoc in energy markets. It is now beyond doubt that manipulation of futures and derivatives contracts pursuant to that loophole dramatically

⁴² See Sean Gonsalves, Opinion, *Enron Exemplifies ‘Genius of Capitalism’*, SEATTLE POST-INTELLIGENCER, Jan. 22, 2002, at B5; PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, COMMODITIES REGULATION § 1.01 (3d ed. Supp. 2002).

⁴³ See PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, OVER-THE-COUNTER DERIVATIVES MARKETS AND THE COMMODITY EXCHANGE ACT 16 (1999), available at <http://www.ustreas.gov/press/releases/reports/otcact.pdf>.

⁴⁴ Edward J. Rosen & Geoffrey B. and Goldman, *SWAPS & Other Derivatives in 2001*, in THE COMMODITY FUTURES MODERNIZATION ACT OF 2000, 581-88 (2001).

⁴⁵ See Jeff Gosmano, *Electronic Trading Could Change; Enron Situation Rolls Markets*, NATURAL GAS WEEK, Nov. 12, 2001 (noting Enron Online’s launch in November 1999).

⁴⁶ Rosen & Goldman, *supra* note 44, at 585.

⁴⁷ PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION (2008 Cum. Supp.) at 1.17, p. 27.

increased the market price of electricity in the Western United States during 2001-2002. This resulted in needless widespread and rolling blackouts, along with a surge in corporate bankruptcies during that time period.⁴⁸ Enron and others, using such unregulated trading facilities as Enron Online, “gamed” the energy derivatives markets to drive up the cost of electricity in a manner that bore no relationship to underlying economic fundamentals.

Between 1999 and 2001, California’s electricity bill rose by more than \$40 billion.⁴⁹ Because the explanation at that time – as it often is today with the price of oil and natural gas – was that this sudden and highly disruptive price spike was caused by economic fundamentals, California and other Western states, as well as energy dependent public authorities and industries within those states, entered into long term supply contracts. These contract prices vastly exceeded what history would prove was the market’s fundamental equilibrium: *e.g.*, long term supply contracts costing \$700 million during the electricity crisis would only cost \$350 million by March 2002.⁵⁰

Only after internal Enron memos that outlined manipulation strategies were uncovered in unrelated proceedings did the CFTC begin serious investigations into the then recently deregulated OTC energy derivatives market. The CFTC ultimately assessed hundreds of millions of dollars in damages and fines for what it found to be widespread, devastating, and costly futures and derivatives market manipulation in this otherwise unregulated market.⁵¹

The Enron Loophole’s Premium Price. In addition to malpractices in the Western United States electricity markets, the 2006 bipartisan PSI staff report corroborated independent economic analysis demonstrating that excessive speculation on unregulated OTC energy trading facilities has caused (and almost certainly is causing) an estimated unnecessary \$20-30 per barrel increase in the cost of crude oil at the time crude oil was @ \$70 a barrel.⁵² One can only guess as to what speculation has added to the price of crude oil now that it is within striking range of \$100. That speculation is enough to prevent OPEC from increasing production only to sell their product into a market where that increased production only leads to higher prices because of excessive speculation.⁵³

⁴⁸ See Press Release, Feinstein, Cantwell Press for Public Release of Enron Evidence, Citing Implications for Oil Markets (May 2, 2006), available at <http://feinstein.senate.gov/06releases/r-enron-evidence.pdf>.

⁴⁹ Peter Navarro & Michael Shames, *Aftershocks—And Essential Lessons—From the California Electricity Debacle*, 24 ELECTRICITY J. 2003, at 24.

⁵⁰ 148 CONG. REC. S2018-03 (daily ed. Mar. 19, 2002) (statement of Sen. Cantwell); Senators Propose Bill Regulating OTC Markets, ENERGY COMPASS, Feb. 14, 2002; see also, *e.g.*, Navarro & Shames, *supra* note 49, at 24 (“[T]he state remains saddled with almost \$40 billion of long-term contracts that are roughly twice the actual market value of the electricity and that will institutionalize high electricity rates in the state for years to come.”). Similarly, the rising cost of natural gas in the summer of 2006 caused utility companies to hedge at inflated costs; these costs were then passed on to consumers. See *supra* text accompanying notes 8-9.

⁵¹ U.S. GENERAL ACCOUNTING OFFICE, REPORTS & TESTIMONY NO. GAO-04-420T, NATURAL GAS: FACTORS AFFECTING PRICES AND POTENTIAL IMPACTS ON CONSUMERS 21 (2006), available at <http://www.gao.gov/new.items/d06420t.pdf>.

⁵² See *supra* notes 2-3 and accompanying text.

⁵³ See Pagnamenta, *supra* note 20.

The overwhelming influence of Enron on these unregulated markets is evidenced by the 2007 PSI report's finding that when Amaranth in 2002 "added energy trading to its slate of strategies" to boost its earnings, "it hired several former Enron traders to its staff."⁵⁴ Doubtless those former Enron traders were well educated in the school for scandal that constituted the Western United States electricity manipulation.

In short, there is every indication that the hastily enacted and poorly examined Enron loophole has done nothing but add billions of dollars to prices charged the American consumers for such important everyday commodities as electricity, heating oil, natural gas, and gasoline. As the PSI staff has recommended, the Enron loophole should be repealed.

House Republican Efforts to Reregulate Natural Gas Futures Markets

The bipartisan nature of the 2007 PSI staff report is reflective of the widespread adverse impact the high price of natural gas has had on all sectors of the economy all over the Nation. In this regard, on December 14, 2005, the then Republican-controlled House led by Republican Congressman Sam Graves of Missouri, passed, at the behest of the farming community then suffering from all time record high natural gas prices, a version of the CFTC Reauthorization Act of 2005 (H.R. 4473), which included a Title II,⁵⁵ mandating an aggressive regulatory posture by the CFTC in overseeing "any contract market" engaged in the trading of natural gas futures and derivatives. At that time, the cost of natural gas had "float[ed] at a high near \$14 MMBtu."⁵⁶ Even though the CFTC reauthorization has yet to make it through Congress, the spot price of natural gas dropped by roughly one third after Congressman Graves' December 2005 action and there was considerable analysis at that time that the mere threat of aggressive regulation of natural gas futures markets by a Republican controlled House may have been responsible for that price decline.⁵⁷

"Foreign Boards of Trade" Run by U.S. Companies Facilitating Unregulated Trading in U.S. Crude Oil Contracts

Besides the deregulatory effect of the CFMA and that statute's contribution to the opaqueness of the deregulated energy futures transactions, there is an informal CFTC staff process that has evolved into a further obstacle to controlling excessive speculation and manipulation in energy futures markets: that is, the CFTC staff no action letter process permitting Foreign Boards of Trade ("FBOT's") the right to trade energy futures products on computer terminals located in the U.S., but be exempt from direct U.S. regulation.

⁵⁴ 2007 Report, *supra* note 11, at 57.

⁵⁵ 151 CONG. REC. H11554 (daily ed. Dec. 14, 2005).

⁵⁶ 151 CONG. REC. H11553-01 (daily ed. Dec. 14, 2005) (statement of Rep. Pombo).

⁵⁷ *See, e.g.*, AM. PUB. POWER ASS'N, LONG-TERM STRATEGIES ARE KEY IN ACHIEVING STABLE NATURAL GAS PRICES 6 (2006), available at <http://www.appanet.org/files/PDFs/NaturalGasPriceOutlook306.pdf>.

The 1996 German Exemption. In February 1996, the CFTC Division of Trading and Markets (“T&M”), in what appeared at the time to be an action of little consequence, authorized the German futures exchange, then called the Deutsche Terminbörse (DTB), to allow trading of DTB foreign delivered contracts on computer terminals within the U.S.⁵⁸ In what was a surprise to almost everyone, the privilege granted to DTB for U.S. terminals resulted in a substantial upsurge in that exchange’s business. Shortly thereafter, virtually all the world’s major FBOT’s desired exemptions from U.S. regulation for the U.S. trading of foreign delivered futures contracts.

Recognizing the substantial trading that would be done under this kind of exemption, the CFTC first tried to establish a Commission rule that would govern regulatory exemptions for these foreign exchanges.⁵⁹ When the Commissioners could not promptly agree on such a rule and because of the need quickly to level the playing field in terms of giving other foreign exchanges the rights given to DTB, it was decided that T&M would oversee these approvals through a no action letter process.⁶⁰

The Original Limited Staff No Action Process for FBOT’s. As a result, on July 23, 1999, I signed a no action letter that permitted the principal U.K. futures exchange, LIFFE, the same rights that had earlier been afforded to DTB.⁶¹ There followed a series of similar no action letters (almost all signed after I left the Commission in September 1999) for other foreign exchanges, including the exchange most relevant to the present enquiry: the U.K.’s International Petroleum Exchange (“IPE”),⁶² subsequently purchased by the U.S.-based Intercontinental Exchange (“ICE”) in 2001.⁶³

These no action letters were filled with uniform standard conditions carefully confining the regulatory right afforded. Each of the FBOT’s had to be regulated by a foreign governmental entity whose regulatory format was akin to that of the CFTC.⁶⁴ Assurances had to be received from the FBOT that meaningful information about trades would be provided the CFTC, especially in situations where there was a concern about market manipulation. Information sharing arrangements had to be in place assuring the CFTC that the foreign regulatory authority overseeing the FBOT would provide relevant information to the CFTC promptly upon request.⁶⁵ Even more important, a condition was written into these no action letters that the FBOT itself would “provide, upon the request of the [CFTC], the . . . Department of Justice, . . . , prompt access to original books and records maintained at their United States offices . . .”⁶⁶ Moreover, in these no action

⁵⁸ Access to Automated Boards of Trade, 64 Fed. Reg. 14,159 (Mar. 24, 1999) (to be codified at 17 C.F.R. pts. 1, 30).

⁵⁹ *Id.*

⁶⁰ *Id.*; see also Access to Automated Boards of Trade, 64 Fed. Reg. 32,829 (June 18, 1999) (withdrawing March 24, 1999, proposed rules).

⁶¹ LIFFE Administration & Management, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 38, 59-60 (July 23, 1999).

⁶² IPE, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 152, 53 (Nov. 12, 1999).

⁶³ See IPE, CFTC No-Action Letter, 2002 CFTC Ltr. LEXIS 90, 3 fn.3 (July 26, 2002).

⁶⁴ See LIFFE Administration & Management, CFTC No-Action Letter, *supra* note 61, at 65-66.

⁶⁵ *Id.* at 68-71.

⁶⁶ *Id.* at 68-69.

letters, “the [CFTC’s] ability to bring appropriate action for fraud or manipulation” was retained.⁶⁷ Finally, the CFTC authority was **“retain[ed] to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in [the agency’s] discretion.”**⁶⁸

FBOT U.S.-Delivered Contracts Exempt from Prior CFTC Staff Approval. The no action letters also specified the precise contracts that could be traded under the approval.⁶⁹ Until quite recently, those contracts were always **foreign** based and not in direct conflict with U.S. futures contracts traded on U.S. exchanges. Under the original “no action” template, the FBOT had to seek affirmative approval of T&M before it could list new contracts.⁷⁰ In July 2000, that policy was changed to allow FBOT’s to list new contracts simply by giving notice to the CFTC.⁷¹ On the basis of that action, FBOT’s no longer needed prior CFTC staff approval to list new contracts.

FBOT Approval Was Not for U.S. Controlled Exchanges or U.S. Contracts. When the no action approval process was instituted in July 1999, there was an intent not to undercut U.S. exchanges that were fully compliant with, and under the regulatory control of, the CFTC. By requiring the foreign exchange to list the contracts it would market under the no action letter and by further requiring the exchange to receive the express approval of the CFTC if it wanted to add contracts, it was fully understood that the T&M would not allow a foreign exchange to market contracts that were U.S. denominated or delivered and directly competitive to those offered by U.S. exchanges. Second, **it was well understood that the FBOT no action process was for exchanges that were organized in foreign countries.** It was **never** contemplated that the no action process would apply where a foreign exchange was owned by a U.S. entity.

Therefore, under the original FBOT no action process, both the introduction of products that were in direct competition with U.S. exchanges or the purchase of an exempt foreign exchanges by U.S. entities **were understood to trigger the immediate revocation of the no action approval and the requirement that those previously exchanges register as a U.S. regulated market under the direct auspices of the CFTC.**

CFTC Staff Continues FBOT Exemption Even After a U.S. Company Purchases IPE. Unfortunately, when the IPE was purchased by the Atlanta-based ICE in 2001, CFTC staff, despite considering four post-acquisition ICE no action letter amendments, never required that exchange after the acquisition to become a U.S. regulated contract market. Indeed, this is so even though it is my understanding that ICE has transferred the

⁶⁷ *Id.* at 64.

⁶⁸ *Id.* at 73.

⁶⁹ *Id.* at 60-62.

⁷⁰ *Id.* at 62.

⁷¹ 65 Fed. Reg. 41,641, Notice of Statement of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that Have Received Staff No-Action Relief to Place Electronic Trading Devices in the United States (July 6, 2000); *see also supra* note 58, describing the CFTC’s recent repeal of this regulation and assertion of a more aggressive stance toward the review of new contract designations by a FBOT.

bulk of its oil trading platform from the U.K. to computerized trading infrastructure now located in Atlanta.⁷²

CFTC Staff Continues FBOT Exemption Even After FBOT Facilitates U.S. WTI Trading. Moreover, in February 2006 by merely serving notice on CFTC staff, ICE began trading U.S. based futures contracts in direct competition with what had theretofore been Nymex's signature and exclusive oil futures contract: the United States West Texas Intermediate crude oil contract ("WTI"). As of October 2007, ICE had garnered over 33% market share of WTI volume, a futures contract based on crude oil delivery in the United States.⁷³ ICE now also trades U.S. gasoline and home heating oil contracts.⁷⁴

Regulatory Arbitrage Caused by U.S. Owned FBOT's. As the 2006 PSI staff report so aptly concluded: "This type of unregulated trading of [] U.S. commodit[ies] from within the United States undermines the very purpose of the Commodity Exchange Act and the central mission of the CFTC – to prevent manipulation or excessive speculation of commodity prices 'to the detriment of the producer or the consumer and the persons handling the commodities.'"⁷⁵ According to the most recent public report that could be obtained, while the CFTC has entered into new (and duplicative) information sharing arrangements with the U.K. and ICE to conduct surveillance on ICE's influence on U.S. commodity markets, "[s]o far, the CFTC has sought only data that are tied to the [Nymex] natural gas contract" – not to possibly excessively speculative trading taking place with regard to the U.S. WTI contracts.⁷⁶

Simple Proposal to End the Enron Loophole

1. The Simplest Enron Loophole Fix. The quickest, most effective way to end the Enron Loophole is to simply go back to the *status quo ante* before the Loophole was passed in December 2000, *i.e.*, treat "energy commodities" the way the CFMA treats "agricultural commodities," 7 U.S.C. § 7 (e), and explicitly exclude "energy commodity" (as the CFMA does for an "agricultural" commodity) from the definition of an "exempt commodity,"⁷⁷ 7 U.S. C. § 1a (14), thereby removing energy commodities from the umbrella of 7 U.S.C. § 2(h)'s deregulatory ambit and make such trading subject to Designated Contract Markets ("DCMs") regulation (as the PWG unanimously recommended in November 1999).⁷⁸ This calls for a two word change to two sections of

⁷² See Gerelyn Terzo, *A Battle Royal: A Sleek Upstart and an Entrenched Giant Are Waging All-Out War for the Soul of the Energy Trading Market*, INVESTMENT DEALERS DIGEST, May 1, 2006, available at www.iddmagazine.com; Kevin Morrison, *Nymex 'Disadvantaged' by Future Rules*, FINANCIAL TIMES, Apr. 18, 2006, at 35.

⁷³ *Id.*; CFTC, WTI Crude Oil: Futures Volume & ICE Market Share, chart (2007).

⁷⁴ Permanent Subcomm. June 2006 Report, *supra* note 4, at 49.

⁷⁵ *Id.*

⁷⁶ Greenberg Traurig, Private Funds Weekly Roundup, Feb. 5, 2007, available at <http://www.gtlaw.com/pub/alerts/2007/0205a.pdf>.

⁷⁷ 7 U.S.C. § 1a(14) would be changed to say: "The term 'exempt commodity' means a commodity that is . . . not an agricultural *or* energy commodity." A new definitional term of "energy commodity" would then be added to the definitional section of the statute to include crude oil, natural gas, metals, heating oil, gasoline, construction materials, propane gas, and other fuel oils.

⁷⁸ See PRESIDENT'S WORKING GROUP, *supra* note 43.

the Act, i.e., an “exempt commodity” in § 1a (14) of the Act would exclude “an agriculture *or energy* commodity”⁷⁹; and “agricultural *and energy*” commodities must be traded on regulated markets. 7 U.S.C. § 7 (d).

2. The “Safety Valve” of Statutory Exemptive Authority. Under § 4(c) of the Act, the CFTC may create exemptions from Nymex-like or DCM regulation if it finds any proposed exemption by a contract market consistent with the public interest and purposes of the act and the exemption will not have a materially adverse effect on the ability of the CFTC to discharge regulatory or self regulatory responsibilities. This statutory safety valve will allow the CFTC to alter Nymex-like regulation in transparent and public agency proceedings where appropriate.

3. Statutory Regulatory Requirements of a DCM. To the extent trading in OTC energy commodities becomes part of the Designated Contract Markets (“DCMs”) process, as is true of agricultural products defined in §1a (14), under the existing Commodity Exchange Act, those DCMs will adhere, as does Nymex, to the CFMA’s Core Principles,⁸⁰ designed to prevent, *inter alia*, excessive speculation, manipulation or fraud. Alternatively, the contract market can apply for the lesser (but still protective) regulation applied to a Derivatives Transaction Execution Facility (“DTEF”) (7 U.S.C. § 7a) if it chooses to only permit trading by sophisticated investors and institutions. Again, general exemptions from any regulation may be allowed by the CFTC under § 4 (c) of the Act.

4. FBOT’s Should Neither Be Affiliated with A U.S. Entity Nor Trade U.S. Delivered Contracts Significantly Affecting Price Discovery. Finally, a new § 2 (j) should be added to provide expressly:

“No entity or subsidiary of an entity that: (i) is incorporated or has its principal place of business in the United States; or (ii) facilitates agreements, contracts, or transactions that serve a significant price discovery function within the United States shall be eligible for status as an approved Foreign Board of Trade.”

5. Grace Period. Finally, the bill’s effective date should provide a grace period of 180 days to existing trading facilities that must apply for status as Contract Designated Market under the new legislation, or for those trading facilities that have applied and are awaiting approval for that status or a statutory exemption from DCM status.

ANALYSIS OF EXISTING LEGISLATION TO CLOSE THE ENRON LOOPHOLE

1. No Pending Legislation Designed to End the Enron Loophole Addresses ICE’s and Its Subsidiary’s Status as a U.K. Regulated Entity for Purpose of West Texas Intermediate Crude Oil Trading. As the June 2006 SPI report makes clear that are at present only two major contract markets trading the all important WTI futures contracts:

⁷⁹ See *supra* note 77.

⁸⁰ 7 U.S.C.A. § 7(a)-(d) (West 2006 & Supp. 2007).

Nymex, which is fully regulated by the CFTC, and ICE's subsidiary which is regulated by the U.K. even though its corporate parent is located within the U.S.; its trading infrastructure is within the U.S.; and it has @ 30% of the contract market in a contract that indisputably affects the price of, *inter alia*, crude oil. If "ending the Enron Loophole" does not impact ICE for purpose of its facilitating WTI crude oil trades, a major component of the excessive price paid by U.S. citizens and businesses will be totally unaffected by newly enacted legislation.

2. The ICE WTI Loophole Could Be Ended Immediately by the CFTC without Any Legislation. Since the FBOT exemption under which ICE evades U.S. regulation is the product of a CFTC staff no action letter, and since that no action letter includes absolute rights of termination by the CFTC, the CFTC needs no legislative authority to fix this loophole, but could immediately ask ICE to show cause why it should not register as a fully regulated DCM, as is true of Nymex, in order to keep trading the U.S. WTI contract. Again, because ICE is a U.S. company, with a *U.S. trading infrastructure, and because the WTI contract significantly affects price discovery in a U.S. market, the CFTC would be fully within *existing* statutory authority to insist that ICE register either as a DCM (or a DTEF) or seek an appropriate exemption from such regulation under the public and transparent procedures of § 4 (c) of the Act.

3. The Legislation Proposed by the CFTC (and the PWG) to End the Enron Loophole Puts the Burden on that Agency and the Public through Highly Bureaucratic Procedures to Stop Soaring Commodity Prices. The CFTC and the President's Working Group has only recommended regulating otherwise deregulated futures contracts if an individual contract "serve[s] a significant price discovery function in order to detect and prevent manipulation."⁸¹ The proposed definition of a "significant price discovery function" is narrow and it has been widely reported that, under the CFTC and PWG analysis, it would only cover a single natural gas contract presently traded by ICE.

4. The CFTC Proposes Lengthy Administrative Proceedings in Which It and the Public Would Bear the Burden of Proof. Whether its proposed definition of "significant price discovery function" is broad or narrow, the CFTC under that proposal would have to engage in a lengthy administrative procedure in which the burden would be on it or other government or private parties to prove a "significant price discovery function," thereby causing self evident agency and litigation-related delays before any anti-manipulation controls could be put in place. This regulatory approach differs from the template underlying the Commodity Exchange Act, *i.e.*, that all futures contracts are automatically covered by the Act's protections (*i.e.*, the very nature a publishing the prices of futures contract is to provide price discovery) unless (1) the proponent of the contract demonstrates to the CFTC that lesser or no regulation is required under § 4 (c) of the Act; or (2) the proponent is able to obtain a full statutory exemption, *e.g.*, the Enron Loophole.⁸² Of course, virtually everyone agrees that the absolute statutory exemption afforded by the Enron Loophole must be ended. In short, it is far preferable to just end that exemption, rather than to play contract-by-contract gamesmanship, and to have those

⁸¹ Letter of the President's Working Group on Financial Markets to Sen. Michael D. Crapo, at 1.

⁸² See JOHNSON & HAZEN, *supra* note 47, at 26-34.

who believe that they are entitled to regulatory relief bear the burden of proving that entitlement to the CFTC in a § 4 (c) proceeding.

5. The CFTC Proposal Will Lead to Further Regulatory Arbitrage. Of course, under the CFTC's proposed statutory structure, it will not be just the CFTC that will bear the burden of proving a "significant price discovery function," but it will be other federal and state consumer protection agencies and U.S. consumers of the commodity that will have to join with it (or perhaps even fight it) to prove that point. The CFTC's structure of imposing on itself and the public the burden of proving "significant price discovery," will be tantamount to a lawyers' relief act for those who can afford the lawyers to prove this arcane point. Finally, once lengthy administrative proceedings and related litigation are ended proving that an individual contract has a "significant price discovery function," traders will then employ regulatory arbitrage and they will simply move their trading to those contracts that remain exempt from regulation as Amaranth did when Nymex imposed position limits and that hedge fund just moved its trading ICE.

6. The Original Levin Legislation Comes Closest to Effectively Ending the Enron Loophole. On September 17, 2007, Senator Levin introduced S. 2058,⁸³ the "Close the Enron Loophole Act." It does not purport to resolve the CFTC's dealing with U.S.-based ICE as an entity regulated by the U.K. when trading U.S. WTI contracts. S. 2058 does offer a considerable improvement over the CFTC legislative proposal, because it calls for regulating the entire contract market (not just the contract itself) if the market facilitates contracts performing a "significant price discovery function."⁸⁴ S. 2058 also has a more developed definition of the "term significant price discovery function;" creates a self regulatory process for the electronic trading facility on a regulated contract market; and expressly empowers the CFTC to enforce the closing of the Enron Loophole.⁸⁵ Finally, S. 2058 also puts the burden on the contract market to apply for regulated status, rather than relying upon the CFTC to prove that that market or the any contracts on it should be regulated.⁸⁶ In other words, a contract market would run the risk of violating Senator Levin's proposed statute and of suffering substantial sanctions if it was found not to have properly registered with the CFTC. This regulatory approach relieves the CFTC and U.S. commodity consumers from having to bear the expensive burden of proving that there should be regulation.

7. The Levin/Feinstein Compromise. On October 31, 2007, Senator Feinstein circulated a draft of legislation entitled the "Prevention of Fraud and Manipulation in Energy Markets Act." That legislation included many "reporting" requirements pertaining to deregulated energy futures contracts, and further provided that an "exempt commercial market upon which any price determining [energy] contract is presently executed" shall "be designated as a qualified electronic trading facility" ("QETF").⁸⁷ That proposal does not make clear what entity does that designating or the consequences of

⁸³ S. 2058, 110th Cong. 2007.

⁸⁴ *Id.* at § 2(a)(14) (defining a new "energy trading facility").

⁸⁵ *Id.* at § 2(a)-(c).

⁸⁶ *Id.* at § 2(j)(1)-(4).

⁸⁷ Prevention of Fraud and Manipulation in Energy Markets Act (unintroduced draft 2007), § 2(b).

failing to be designated as a QETF. Once designated, a QETF would have to comply with certain core principals, but far fewer than those required of a designated contract market under the existing statute, such as those with which Nymex complies.

In any event, in order to ready legislation of this nature as an amendment to Senate consideration of the Farm Bill, Senators Levin and Feinstein circulated a compromise version of their legislation on November 14, 2007.⁸⁸ That compromise adopts the CFTC's process of making contract-by-contract determinations of whether an unregulated contract is a "significant price discovery contract."⁸⁹ There is no provision for regulation of an entire contract market. That tact once again puts the burden back on the CFTC and the public to prove that there should be regulation with all the attendant bureaucratic delay and litigation. The contract-by-contract designation would be lengthy and would encourage regulatory arbitrage. The Levin/Feinstein compromise does give the CFTC powers to enforce the proposed statute's provisions.

8. The Easiest Course to End the Enron Loophole Has Not Been Chosen. None of the pending legislation takes the easiest tact: *i.e.*, return to the *status quo ante* prior to passage of the Enron Loophole. First, simply redefine an "exempt" commodity, as the PWG in 1999 would have done, as not including an energy commodity. With a simple two word change in two sections of the Act to join "energy" with "agricultural" commodities, all energy futures trading (as is now true of all agricultural futures trading) would be done on regulated exchanges unless the contract market demonstrates the need for a legitimate regulatory exemption to CFTC under § 4 (c) of the Act. Second, provide that no contract market would be eligible to trade U.S. energy futures contracts as a foreign board of trade if it is affiliated with a U.S. entity; has its trading engines within the U.S.; *or* trades U.S. futures contracts in the United States that have a significant effect on U.S. energy prices.

⁸⁸ Leg. Proposal for Significant Price Discovery Contracts on ECMs (unintroduced draft to amend 7 U.S.C.A. §§ 1-27), Nov. 14, 2007.

⁸⁹ *Id.* at § 1(a).