UPDATE ON THE DODD-FRANK ACT

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Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") is intended to provide a comprehensive framework for the regulation of over-the-counter ("OTC") derivatives.[1] The obligations of companies transacting in swaps in the natural gas and power markets have been shaped by recent court cases and by multiple final rules, no-action letters, and interpretive guidance and policy statements of the Commodity Futures Trading Commission (the "CFTC"). This paper identifies and discusses some of the developments in those areas arising since late 2012, with particular emphasis given to those developments that most impact end users.

I. FINAL RULES AND ORDERS

From late 2012 through 2013, the CFTC has proposed rules, responded to comments, provided policy statements, and promulgated final orders. This section summarizes recent orders exempting certain transactions between government and cooperatively-owned electric utilities, transactions in certain regional transmission organization ("RTO") or independent system operator ("ISO") markets, the CICI-number requirement, the clearing exemption for swaps between affiliates, and a policy

1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1641 (2010) [hereinafter Dodd-Frank Act] (codified in scattered sections of 7, 15 U.S.C. (2012)).

statement regarding the CFTC's interpretation of certain antidisruptive trading practice rules.

A. Exemption for Transactions between FPA 201(f) and Similar Entities

Section 201(f) of the Federal Power Act ("FPA") exempts certain government and cooperatively-owned electric utilities ("201(f) Entities") from the Federal Energy Regulatory Commission's ("FERC") jurisdiction.[2] Similarly, Dodd-Frank provides the CFTC the discretion to exempt from the Commodity Exchange Act ("CEA") certain transactions between 201(f) Entities if the exemption is consistent with public interest and the CEA's purpose.[3] In April 2013 the CFTC adopted a final order that exempts specific non-financial energy derivative transactions between 201(f) Entities and/or other similar entities from most of Dodd-Frank's amendments to the CEA, including: (1) Electric Energy Delivered transactions; (2) Generation Capacity transactions; (3) Transmission Services transactions; (4) Fuel Delivered transactions; (5) Cross-Commodity Pricing transactions; or (6) other goods and services transactions related to sharing the costs and benefits of construction, operation, and maintenance of generation or transmission facilities.[4]

The order's exemption is not absolute. The CFTC explicitly reserves its general anti-fraud and anti-manipulation authority, enforcement authority, and its general authority to inspect books and records.[5] Further, the exemption requires both an eligible entity and an eligible transaction. To be exempt, the *entity* must not be a "financial entity" according to the provisions of the CEA[6] and must fit within one of the following categories:

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2. Federal Power Act § 201(f), 16 U.S.C. § 824(f) (2012).

3. Commodity Exchange Act § 4(c)(6)(C), 7 U.S.C. § 6(c)(6)(C) (2012).

4. CFTC Order Exempting Certain Transactions Between Entities, 78 Fed. Reg. 19,670, 19,688 (Apr. 2, 2013).

5. *Id.*

6. The term "financial entity" means: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool; (vi) a private fund (as defined by 15 U.S.C. § 80b-2(a)); (vii) an employee benefit plan (as defined by 29 U.S.C. § 1002(3), (32)); and (viii) a person predominantly engaged in activities that are in the business of banking, or in activities that are

1. A 201(f) government-owned electric utility or facility;
2. A cooperative-owned electric utility or facility that either
   a. Receives financing from the Rural Utilities Service, or
   b. Sells less than four million megawatts of electricity per year;
3. An electric utility or facility owned by a small non-profit cooperative that does not otherwise qualify under FPA Section 201(f); or
4. A federally-recognized Indian tribe-owned electric utility or facility.[7]

Additionally, any contemplated *transaction* must:

1. Be entered into for the purpose of managing supply and/or price risk arising from the entities' existing or anticipated public service obligations to physically generate, transmit, and/or deliver electric energy to customers;
2. Not be cleared;
3. Be associated with an obligation to make or take physical delivery and not be used for speculation; and
4. Not reference or be based on any financial asset class of a commodity.

B. *Exemption of Specified Transactions in Regional Transmission Organization or Independent System Operator Markets*

In April 2013, the CFTC approved a final order that provides it the ability to exempt transactions from certain provisions of the CEA and Dodd-Frank.[8] The CFTC has exempted these transactions and left the door open for future additional exemptions because it recognizes that FERC or Public

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financial in nature (as defined by 12 U.S.C. § 1843(k)). Commodity Exchange Act § 2(h)(7)(C), 7 U.S.C. § 2(h)(7)(C).

7. CFTC Order Exempting Certain Transactions Between Entities, 78 Fed. Reg. at 19,688.

8. CFTC Order to Exempt Specified Transactions Authorized by FERC or PUCT Tariff, 78 Fed. Reg, 19,879 (Apr. 2, 2013).

Utility Commission of Texas ("PUCT") regulation of the exempted transactions would cause any CFTC regulations to be unnecessary and redundant.[9]

If transactions can be shown to have been entered into and regulated on a RTO or ISO market pursuant to a FERC or PUCT approval tariff, the order exempts the following transactions from Dodd-Frank's requirements: (1) Financial Transmission Rights and Congestion Revenue Rights; (2) energy transactions in day-ahead and real-time markets; (3) forward capacity transactions; and (4) reserve or regulation transactions.[10]

Additionally, to qualify for an exemption, a transaction offered or sold in a RTO or ISO market must be entered into by either (i) an "appropriate person," (ii) an "eligible contract participant" ("ECP"), or (iii) a "person who actively participates in the generation, transmission, or distribution of electric energy."[11] Importantly, bilateral transactions between RTO or ISO market participants are not included in this exemption and may be swaps subject to Dodd-Frank.[12]

C. Legal Entity Identifiers and the CICI Number Requirement

The CFTC adopted a final rule regarding Legal Entity Identifiers ("LEI") in January 2012.[13] That rule provides that each counterparty to any swap subject to the CFTC's jurisdiction must be identified in all recordkeeping and data reporting by a

9. *See id.* at 19,890.

10. *Id.* at 19,912–13.

11. *Id.* at 19,913. For the definition of the term "appropriate person," see Commodity Exchange Act § 4(c)(3)(A)–(J), 7 U.S.C. § 6(c)(3)(A)–(J). For the definition of an "eligible contract participant," see 7 U.S.C. § 1a(18)(A); 17 C.F.R. 1.3(m) (2013). The order itself defines a "person who actively participates in the generation, transmission, or distribution of electric energy" as a "person that is in the business of: (1) [g]enerating, transmitting, or distributing electric energy or (2) providing electric energy services that are necessary to support the reliable operation of the transmission system." CFTC Order to Exempt Specified Transactions Authorized by FERC or PUCT Tariff, 78 Fed. Reg. at 19,914.

12. *See* CFTC Order to Exempt Specified Transactions Authorized by FERC or PUCT Tariff, 78 Fed. Reg. at 19,880.

13. CFTC Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136 (Jan. 13, 2012) (codified at 17 C.F.R. pt. 45).

single LEI issued pursuant to the CFTC's rules.[14] The Department of Market Oversight ("DMO") and Office of Data and Technology also issued a reminder that all swap participants that are not either a swap dealer ("SD") or major swap participant ("MSP") were required to have obtained an LEI (currently termed a CFTC Interim Compliance Identifier or "CICI") by April 10, 2013.[15] CICI numbers may be obtained, and CICI status may be confirmed, through the CICI Utility web portal.[16]

D. Clearing Exemption for Swaps Between Certain Affiliates

In April 2013, the CFTC amended 17 C.F.R. part 50 to except certain inter-affiliate swaps from the general clearing requirement established by CEA section 2(h)(1)(A).[17] By promulgating the new rule, the CFTC recognized that inter-affiliate transactions "provide an important risk management role within corporate groups . . . and . . . if properly risk-managed, may be beneficial to the entity as a whole."[18] It further concluded that the exemption is "appropriate for the transactions at issue, promotes responsible financial innovation and fair competition, and is consistent with the public interest."[19] Pursuant to the rule, effective June 10, 2013, clearing is not required if:

1. The counterparties report their financials on a consolidated basis;
2. One party owns the other, or they are owned by a common third party;

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14. CFTC Swap Data Recordkeeping and Reporting Requirements, 17 C.F.R. § 45.6.

15. Press Release, CFTC, CFTC's Division of Market Oversight and Office of Data and Technology Issue Advisory Reminding All Swap Counterparties of April 10 Deadline to Obtain a CICI Identifier (Mar. 15, 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6535-13. Note that swap dealers ("SD"), swap data repositories ("SDR"), designated contract markets ("DCM"), and derivatives clearing organizations ("DCO") had earlier deadlines.

16. *See* CICI Utility, http://www.ciciutility.org (last visited Feb. 10, 2014).

17. CFTC Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21,750, 21,783 (Apr. 11, 2013) (codified at 17 C.F.R. § 50.52).

18. *Id.* at 21,754.

19. *Id.*

3. Both parties comply with the relevant rule provisions;
4. The swap is subject to a centralized risk management program that is reasonably designed to monitor and manage the risks associated with the swap;
5. One of the parties reports the trade information to a swap data repository ("SDR"); and
6. If one of the affiliates is located in a foreign jurisdiction, certain other requirements are met.[20]

E. Policy Statement on Anti-Disruptive Trading Practices[21]

1. Pre-Dodd-Frank: Price Manipulation

Before Dodd-Frank, the CFTC was responsible for determining and enforcing the CEA's prohibitions on price manipulation. Courts variously applied the following four-part test to determine price manipulation by a market participant:

a. The person had the ability to influence market prices;
b. The person had the specific intent to create a price that does not reflect supply and demand;
c. Artificial prices existed; and
d. The person caused the artificial prices.[22]

2. Post-Dodd-Frank: Price Manipulation and Fraud

Dodd-Frank has expanded the CFTC's authority to include fraud in commodity sales as well as market manipulation.[23] A

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20. *Id.* at 21,750 (effective date); CFTC Exemption for Swaps Between Affiliates, 17 C.F.R. § 50.52 (conditions).

21. Note that "interpretive rules" and "general statements of policy" generally lack binding effect. *See* 5 U.S.C. § 553(b)(3)(A) (2012). While interpretive rules and policy statements are persuasive, absent a statutory grant courts have generally declined to find that an agency acted improperly when it engages in adjudication contrary to such guidance. *See, e.g.*, Consol. Edison Co. v. Fed. Energy Regulatory Comm'n, 315 F.3d 316, 323 (D.C. Cir. 2003) ("'Policy statements' differ from substantive rules that carry the 'force of law,' because they lack 'present binding effect' on the agency.").

22. *In re* Natural Gas Commodity Litig., 337 F. Supp. 2d 498, 507 (S.D.N.Y. 2004), *cited with approval in* Hershey v. Energy Transfer Partners, L.P., 610 F.3d 239, 246 (5th Cir. 2010).

23. Dodd-Frank Act § 747, 7 U.S.C. § 6(c)(1); CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. 41,398, 41,399 (July 14, 2011).

new test for market manipulation of swaps and physical commodity contracts was added as well as a prohibition on trading on material non-public information in breach of a pre-existing duty.[24] The CFTC's new authority is set forth in 17 C.F.R. part 180 and Dodd-Frank sections 747 and 753.[25]

a. 17 C.F.R. § 180.1

Rule 180.1 is intended to be a broad catchall clause capturing intentional or reckless misconduct.[26] While rule 180.1 is virtually identical to section 10(b) of the Securities Exchange Act of 1934 ("'34 Act"),[27] the CFTC stated it will merely be guided—not controlled—by prior section 10(b) precedents.[28] Thus while some precedent exists under section 10(b) as to how the CFTC might enforce this rule, it is unclear at this time the extent to which the CFTC will deviate from such precedent when enforcing rule 180.1.

The rule focuses on conduct involving manipulation or deception and is intended to supplement, not relax, the

24. CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. at 41,402.

25. Dodd-Frank Act §§ 747, 753, 7 U.S.C. §§ 6c(a)(5)–(7), 9(1); CFTC Prohibition Against Manipulation, 17 C.F.R. part 180.

26. CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. at 41,403. Rule 180.1 makes it unlawful to "(1) [u]se or . . . attempt to use . . . any manipulative device, scheme, or artifice to defraud; (2) [m]ake, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; (3) [e]ngage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or, (4) [d]eliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate." CFTC Prohibition on the Employment of Manipulative Devices, 17 C.F.R. § 180.1.

27. *Compare* Securities Exchange Act § 10(b), 15 U.S.C. § 78j (2012), *with* CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 180.1.

28. *See* CFTC Antidisruptive Practices Authority Interpretive Guidance and Policy Statement Notice, 78 Fed. Reg. 31,890, 31,895 (May 28, 2013).

anti-fraud provisions found in CEA section 6.[29] It does not require a showing that any market or price was affected as a result of the wrongful conduct.[30]

Rule 180.1 requires scienter, and the scienter requirement may be established with a showing of at least recklessness on the part of the market participant.[31] According to the CFTC, "recklessness" means an act or omission that "departs so far from the standard of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing," and a showing of recklessness does not require proof of knowledge.[32] The civil penalty for violating rule 180.1 is equal to the greater of $1 million or triple the monetary gain realized by the market participant as a result of the misconduct for each violation. Importantly, it is not a violation of rule 180.1 to withhold information unless the market participant has a duty to disclose the information or if it obtained the information unlawfully.[33] However, half-truths can be fraudulent under the rule.[34]

i. In the Matter of: JPMorgan Chase Bank, N.A.

On October 16, 2013, the CFTC issued an order and accepted a $100 million settlement offer from JPMorgan Chase Bank, N.A. ("JPMorgan") with respect to its finding that on February 29, 2012, "JPMorgan, through its [Synthetic Credit Portfolio] traders, recklessly used or employed manipulative devices and contrivances in connection with swaps in violation of Section 6(c)(1) of the [CEA], 7 U.S.C. § 9 (2012), and Regulation 180.1, 17 C.F.R. § 180.1 (2012)."[35] At issue was JPMorgan's "aggressive trading strategy" concerning a particular type of

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29. CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. at 41,401.

30. *Id.*

31. CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. at 41,404.

32. *Id.* (quoting Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988)).

33. *Id.* at 41,402.

34. *Id.* at 41,403.

35. JPMorgan Chase Bank, N.A., CFTC Docket No. 14-01, 2013 WL 6057042, at *12 (CFTC Oct. 16, 2013).

credit default swap known as "CDX."[36] Specifically, at the end of February 2012, JPMorgan's Synthetic Credit Portfolio ("SCP")[37] traders traded large and concentrated volumes of a specific CDX in the same direction as their existing positions.[38] The large size of the SCP's position meant that "relatively small favorable or adverse movements in the spreads at which the underlying product was traded in the market produced significant mark-to-market profits or losses on the positions."[39]

The CFTC's legal analysis focused on Section 6(c)(1) of the CEA and Rule 180.1(a).[40] Section 6(c)(1) provides, among other things, that it is unlawful for any person "to employ, or attempt to use or employ, in connection with any swap . . . any manipulative or deceptive device or contrivance, in contravention of [Commission rules and regulations]."[41]

The CFTC held that the SCP traders' actions on February 29, 2012, during which they sold large volumes of the specific CDX in a very short period of time at month-end constituted a manipulative device in connection with swaps.[42]

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36. *Id*. at *2.

37. JPMorgan established the SCP in 2007 to protect the firm against adverse credit events affecting its available-for-sale portfolio of fixed-income securities, and included positions in CDX and CDX tranches. *Id*. at *3.

38. *Id*. at *5–*6. The SCP traders' pattern of trading was most evident on February 29, 2012, when the SCP's volume of CDX protection sold "made up greater than 90% of the net market volume for the day, and accounted for approximately 15% of the net volume trader by the entire market for the entire month of February and approximately three times the average daily market volume." *Id*. at *4–*6.

39. *Id*. at *4.

40. The CFTC's order also included a discussion on its supervision and control rules. *See id*. at *6–*8. The CFTC's discussion focused on Regulations 23.600-.607, 17 C.F.R. § 23.600–.607, including: 23.600(b)(1) requiring swap dealers to establish, document, maintain, and enforce a system of risk management policies and procedures that comply with the Commodity Exchange Act; 23.600(b)(5) requiring that a firm's risk management unit have sufficient authority, personnel and resources to carry out a risk management program; and 23.600(d)(3) and (4) requiring that swap dealers and major swap participants establish specific quantitative and qualitative limits for traders and monitor each trader throughout the day to prevent the trader from exceeding those limits. *Id*. The regulations, however, did not become effective until June 2, 2012, after the offending conduct, and the CFTC did not make any finding as to whether JPMorgan violated any of the rules. *Id*. at *6 n.8.

41. 7 U.S.C. § 9 (2012); *see also* discussion *supra* note 26.

42. *Id*. at *11 (citing SEC v. Kimmes, 799 F. Supp. 852, 858–59 (N.D. Ill. 1992)

The SCP traders' actions and attempt to defend its position was held to be reckless.[43] The CFTC held that the size and timing of the SCP traders' transactions during the concentrated period was designed to "defend" its position or "fight" other market participants, and fell squarely within the prohibitions of Section 6(c)(1) and Rule 180.1.[44] The CFTC ordered JPMorgan to, among other things, cease and desist from violating Section 6(c)(1) and Rule 180.1, and to pay a civil monetary penalty in the amount of $100 million.[45]

ii. In the Matter of: Coöperative Centrale Raiffeisen-Boerenleenbank B.A.

On October 29, 2013, the CFTC issued an order and accepted a $475 million settlement offer from Coöperative Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank") with respect to its finding that "Rabobank violated Sections 6(c), 6(d) and 9(a)(2) of the Commodity Exchange Act, 7 U.S.C. §§ 9, 13b and 13(a)(2) (2006)."[46] The order focused on a period of approximately six years—from at least mid-2005 through early 2011—during which Rabobank, through the acts of certain traders and managers located throughout the world, engaged in hundreds of manipulative acts that undermined the integrity of the London Interbank Offered Rate ("LIBOR") and the Euro Interbank Offered Rate ("Euribor").[47] The LIBOR and Euribor are fixed each day based on rates submitted by a select panel of banks that are to make an honest assessment of the costs of

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aff'd sub. nom., SEC v. Quinn, 997 F.2d 287 (7th Cir. 1993); SEC v. Ficeto, 839 F. Supp. 2d 1101, 1104 (S.D.N.Y. 2011) (describing similar scheme in securities context)).

43. *Id.*

44. *Id.* at *11–*12. The CFTC found it difficult to believe that the SCP traders were not aware of the possible consequences of their actions, which amounted to a reckless disregard to obvious dangers to legitimate market forces. *Id.* at *12.

45. *Id.* at *13.

46. Coöperative Centrale Raiffeisen-Boerenleenbank B.A., CFTC Docket No. 14-02, 2013 WL 5872872, at *37 (CFTC Oct. 29, 2013). Rabobank was held to be liable for the acts, omissions and failures of its traders, managers, and submitters pursuant to Section 2(a)(1)(B) of the CEA. *Id.* at *36 (citing Rosenthal & Co. v. CFTC, 802 F.2d 963, 966 (7th Cir. 1986); Dohmen-Ramirez & Wellington Advisory, Inc. v. CFTC, 837 F.2d 847, 857–58 (9th Cir. 1988)).

47. *Id.* at *1.

borrowing funds in the relevant markets.[48]

The banks' honest assessment of the costs of borrowing funds "does not include factoring consideration of what rates would be beneficial to the derivatives and cash trading positions of the banks."[49] However, "Rabobank derivatives and cash traders frequently asked Rabobank's LIBOR and Euribor submitters to submit preferential rates in attempts to manipulate U.S. Dollar and Yen LIBOR, Euribor, and on occasion, Sterling LIBOR, to benefit Rabobank traders' cash and derivatives trading positions that were tied to these benchmark interest rates."[50] Rabobank's LIBOR and Euribor submitters often accommodated the derivatives and cash traders requests and made false submissions reflecting the requested rate, and also aided other banks' attempts to manipulate the Yen LIBOR and Euribor.[51]

The CFTC's legal analysis focused on Sections 9(a)(2), 6(c), and 6(d) of the CEA. Section 9(a)(2) makes it unlawful for any person "knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce . . . false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce . . . ."[52] The CFTC found that Rabobank transmitted electronic spreadsheets and delivered its U.S. Dollar, Yen, and Sterling LIBOR and Euribor submissions through the mail and that these spreadsheets and submissions contained market information that affected or tended to affect the prices of commodities in interstate commerce.[53] Therefore, Rabobank's submissions that were based in whole or in part on impermissible and illegitimate factors, specifically Rabobank's traders' cash and derivatives

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* The CFTC's Order contains numerous examples of requests for beneficial rates. *See, e.g.*, *id.* at *7–*9; *id.* at *11–*15; *id.* at *17–*18.

52. *Id.* at *32 (quoting 7 U.S.C. § 13(a)(2) (2006); United States v. Brooks, 681 F.3d 678, 691 (5th Cir. 2012); United States v. Valencia, 394 F.3d 352, 354-55 (5th Cir. 2004); CFTC v. Johnson, 408 F. Supp. 2d 259, 267 (S.D. Tex. 2005)).

53. *Id.*

trading positions, conveyed false, misleading or knowingly inaccurate information in violation of Section 9(a)(2) of the CEA.[54]

The CFTC also found that Rabobank manipulated the Yen LIBOR in violation of Sections 6(c), 6(d), and 9(a)(2) of the CEA. Section 6(c) authorizes the CFTC to impose civil monetary penalties if it "has reason to believe that any person . . . is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce . . . ."[55] Manipulation under the CEA is the "intentional exaction of a price determined by forces other than supply or demand[,]"[56] and requires a showing, by a preponderance of the evidence, that the four elements identified in Section E.1., *supra*, are met.[57] "Intent is the essence of manipulation" and requires a showing that Rabobank "acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand."[58] The CFTC found that Rabobank's false, misleading or knowingly inaccurate Yen LIBOR submissions were intended to affect and manipulate the Yen LIBOR for certain tenors and commodities in violation of Sections 6(c), 6(d), and 9(a)(2) of the CEA.[59]

Finally, the CFTC found that Rabobank attempted to manipulate, and aided and abetted traders at other banks' attempts to manipulate, the U.S. Dollar, Yen and Sterling

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54. *Id*.

55. *Id*. at *33 (quoting 7 U.S.C. § 9 (2006)). "Section 6(d) of the [CEA] is substantially identical to Section 6(c)." *Id*. (quoting 7 U.S.C. § 13b (2006)).

56. *Id*. (quoting *Frey v. CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991)).

57. *Id*. The test for manipulation must show: (1) the respondent had the ability to influence market prices; (2) the respondent specifically intended to do so; (3) artificial prices existed; and (4) the respondent caused an artificial price. *Id*. (citing Cox, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 34,061 (CFTC July 15, 1987)).

58. *Id*. (quoting Indiana Farm Bureau Cooperative Ass'n, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,282–83 (CFTC Dec. 17, 1982)). The CFTC has observed that "intent must of necessity be inferred from the objective facts and may, of course, be inferred by a person's actions and the totality of the circumstances." *Id*. (quoting Hohenberg Bros., [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,477 (CFTC Feb. 18, 1977)).

59. *Id*. at *34–*35.

LIBOR and Euribor. Attempted manipulation requires proof of "(1) an intent to affect the market price[,] and (2) an overt act in furtherance of that intent."[60] Liability as an aider and abettor requires proof that "(1) the Act was violated; (2) the aider and abettor had knowledge of the wrongdoing underlying the violation; and (3) the aider and abettor intentionally assisted the primary wrongdoer."[61] The CFTC held that Rabobank's submissions based on its derivatives traders' requests for beneficial LIBOR and Euribor submissions, and its intentional assistance of other banks' traders' attempts to manipulate the LIBOR and Euribor rates, violated Sections 6(c), 6(d), and 9(a)(2) of the CEA.[62] For these and all other violations of Section 6(c), 6(d) and 9(a)(2) of the CEA, the CFTC ordered Rabobank to, among other things, cease and desist from further violations and to pay a civil monetary penalty in the amount of $475 million.[63]

b. 17 C.F.R. § 180.2

Rule 180.2 makes it unlawful for any person, "directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity."[64] In the CFTC's discussion of rule 180.2, it disclosed its intent to analyze price-manipulation cases using the traditional four-part test applied by most courts under CEA section 6(c).[65] The CFTC further determined that, in contrast to rule 180.1, a violation of rule 180.2 requires specific intent to manipulate the market, not mere recklessness. Like rule 180.1, rule 180.2 carries a civil penalty equal to the greater of $1 million or triple the monetary gain for each violation.[66]

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60. *Id.* at *35 (citing Hohenberg Bros., ¶ 20, 271, at 21,477).

61. *Id.* (citing Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129, at 49,888 n.28 (CFTC May 12, 2000)).

62. *Id.* at *35–*36.

63. *Id.* at *37.

64. CFTC Prohibition on Price Manipulation, 17 C.F.R. § 180.2.

65. CFTC Prohibition on the Employment of Manipulative and Deceptive Devices, 76 Fed. Reg. at 41,407. *See* discussion *supra* Section I.E.1.

66. *Id.*

c. Dodd-Frank Section 747: Disruptive Practices

Dodd-Frank section 747 significantly expanded the scope of the CFTC's role in investigating wrongdoing, going beyond its traditional policing of market manipulation. It provides the CFTC the authority to ensure that certain disruptive practices that do not necessarily rise to the level of market manipulation do not occur.[67]

The new CEA sections apply to exchange-traded swaps—*not* bilaterally negotiated, over-the-counter swaps—even if transacted on or through a swap execution facility ("SEF") or designated contract market ("DCM"). [68]

As specifically applicable in this area, new section 4c(a)(5) makes it unlawful for a person to engage in any of the following three forms of disruptive activities: (i) violating bids and offers; (ii) banging the close; and (iii) spoofing.

i. Violating Bids and Offers

Unlawful conduct occurs when a contract is purchased on a registered entity at a price that is higher than the lowest available offer price or sold on a registered entity at a price that is lower than the highest available bid price.[69] Violating bids or offers is a per se offense and does not require the intent to disrupt fair trading.[70]

The CFTC has expressed that it recognizes that parties to uncleared swaps may consider a number of factors in addition to price, such as counterparty risk, when determining how to best execute their trades and that lawful considerations may cause a transaction to be priced between the high and the low prices available in the market.[71] The CFTC further interprets the

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67. Dodd-Frank Act § 747. Section 747 effected this by adding CEA sections 4c(a)(5)–(7).

68. CFTC Antidisruptive Practices Authority Interpretive Guidance and Policy Statement Notice, 78 Fed. Reg. 31,890, 31,890–92 (May 28, 2013).

69. CFTC Antidisruptive Practices Authority Proposed Interpretive Order Notice, 76 Fed. Reg. 14,943, 14945–46 (Mar. 18, 2011).

70. CFTC Antidisruptive Practices Authority Interpretive Guidance and Policy Statement Notice, 78 Fed. Reg. at 31,893 (declining commenters' request that section 4c(a)(5) apply only where a person *intends* to disrupt fair and equitable trading).

71. *Id.*

prohibition on violating bids and offers as inapplicable to swaps that would be cleared at different clearinghouses, recognizing that parties may take into account factors such as the clearinghouses' cost, risk, and material closing features.[72] Consequently, for a violation to occur it must be based on wrongful conduct at the particular SEF or DCM being used.[73]

ii. Banging the Close

Generally, banging the close refers to any "trading, conduct, or practices occurring within the closing period that demonstrates an intentional or reckless disregard for the orderly execution of transactions during the closing period."[74] Contrary to pre-Dodd-Frank policy requiring a showing of specific intent to bang the close, the CFTC may now establish a violation by showing recklessness.[75]

The interpretive guidance clarifies that the prohibition on banging the close applies to conduct both inside and outside the closing period.[76] Bids and offers can trigger this violation even if they are not actually executed because the submission of bids or offers, even in the absence of the execution of such bids or offers, can send false signals to the market that influence trading behavior.[77] As with rule 180.1, the CFTC has stated that it will be guided, but not controlled, by judicial precedent applicable to the securities markets.[78]

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72. *Id.*

73. *Id.* at 31,894

74. *Id.* at 31,895. For example, a violation may occur "when a market participant accumulates a large position in a product or contract in the period immediately preceding the closing period with the intent (or reckless disregard) to disrupt the orderly execution of transactions during that product's, or a similar product's, defined closing period." *Id.*

75. *Id.*

76. CFTC Antidisruptive Practices Authority Interpretive Guidance and Policy Statement Notice, 78 Fed. Reg. at 31,895. Consistent with other scienter-based CEA violations, the CFTC considers "all of the facts and circumstances when determining whether a person violated CEA section 4c(a)(5)(B)." *Id.*

77. *Id.*

78. *See id.*

iii. Spoofing

Spoofing is making a bid or offer with the intent to cancel before execution.[79] Given the nature of bids or offers and the need to move in and out of positions as a reasonable business practice, a spoofing violation requires a demonstration of specific intent and not mere recklessness, and the CFTC has clarified that legitimate, good-faith cancellation or modification orders do not violate section 747.[80] There is no common definition of spoofing, and rather than defining the term the CFTC has stated that it will determine violations of this rule on a case-by-case basis by looking at the individual facts of each instance, including market context.[81] Spoofing can include submitting or cancelling bids or offers with the intent to (i) overload the quote system, (ii) delay the execution of another person's trade, (iii) create an appearance of false market depth, or (iv) create artificial price movement upwards or downwards.[82]

II. NO-ACTION LETTERS[83]

In addition to its published rules, the CFTC—in response to

79. *Id.* at 31,890.

80. *Id.* at 31,896.

81. *Id.* The CFTC recently issued its first enforcement order under the new Dodd-Frank anti-disruptive practice rules against Panther Energy Trading, LLC ("Panther") and Michael J. Coscia ("Coscia"). Press Release, CFTC, CFTC Orders Panther Energy Trading LLC and its Principal Michael J. Coscia to Pay $2.8 Million for Spoofing in Commodity Futures Contracts (July 22, 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6649-13. The settled charges asserted that Panther and Coscia engaged in spoofing by utilizing a computer algorithm to illegally place and quickly cancel bids and offers on CME Group's Globex trading platform. *Id.* The CFTC order requires Panther and Coscia to pay a $1.4 million civil penalty, disgorge $1.4 million in trading profits, and bans Panther and Coscia from trading on a CFTC-registered entity for one year. *Id.* CFTC Commissioner Bart Chilton disagreed with the settlement, stating that Panther and Coscia's conduct "warrants the imposition of a much more significant trading ban to protect markets and consumers." Christopher Tremulis, *CFTC, FCA Charge Energy Trader with 'Spoofing'*, Platts Gas Daily, July 23, 2013, at 8.

82. CFTC Antidisruptive Practices Authority Interpretive Guidance and Policy Statement Notice, 78 Fed. Reg. at 31,896.

83. Like interpretive rules and general policy statements, no-action letters are persuasive and provide guidance, but generally lack binding effect. *See supra* note 21; *see also* N.Y.C. Emps. Ret. Sys. v. SEC, 45 F.3d 7, 11 (2d Cir. 1995) (holding that an SEC no-action letter is interpretive in nature and not binding on the agency or the courts).

industry comment—has issued significant no-action letters during the covered period. The no-action letters discussed below relate to the definition of a "swap" for purposes of applying the ECP guarantee rules, exemptions for certain commodity options, and the extension of certain reporting requirement compliance dates for market participants that are not SDs or MSPs.

A. No-Action Letter 12-17 (October 12, 2012): Swap Guarantors as ECPs

Under Dodd-Frank it is unlawful for any person—other than an ECP—to enter into a swap unless the swap is traded on a registered swap exchange such as a DCM.[84] In No-Action Letter 12-17 the CFTC expanded the scope of this rule to state that the definition of "swap" expressly includes any "guaranty of [a] swap."[85] Consequently, as of March 31, 2013, it is unlawful for a non-ECP guarantor to guarantee a swap.[86]

This restriction creates risk for any swap counterparty that accepts guaranties as swap collateral. This risk is exacerbated when multiple guarantors jointly issue a guaranty as swap guaranties are unenforceable if any of the guarantors are not ECPs as of the date the swap is entered into. This is also problematic if a guaranty supports a transaction separate and in addition to a swap, because if the guaranty includes any non-ECP guarantors there is a risk that the entire guaranty could be rendered wholly unenforceable, even with respect to the non-swap transaction. This creates the risk for the secured entity that it may extend credit relying on a guaranty that is later unenforceable, and it similarly creates the risk for the posting party that the failure of the guaranty could place the posting party in default or require it to unexpectedly post replacement collateral in a very short timeframe.

B. No-Action Letter 13-08 (April 5, 2013): Trade Options

The CFTC published an interim final rule stating that a subset of commodity options, called "trade options," may be

84. *See* Dodd-Frank § 723(a)(2), 7 U.S.C. § 2(e).

85. CFTC No-Action Letter 12-17, 2012 WL 4919782, at *1 (Oct. 12, 2012).

86. *Id.* at *8.

exempt from most swap regulations.[87] Transactions qualifying for the Trade Option Exemption ("TOE") face less regulation than other swaps, and may also be exempt from some of the data reporting requirements in 17 C.F.R. part 45 ("Part 45").[88]

In April 2013, the CFTC issued a no-action letter providing end-users no-action relief from certain "trade option" reporting and recordkeeping obligations regulated under Dodd-Frank.[89] No-Action Letter 13-08 provides *reporting* relief to non-SD/MSP market participants where the transaction meets the following conditions:

1. All other TOE requirements are met;
2. The end-user counterparty reports the transaction on Form TO pursuant to17 C.F.R. § 32.3(b)(2);[90] and
3. The end-user notifies the CFTC's DMO "no later than 30 days after entering into trade options having an aggregate notional value in excess of $1 billion during any calendar year."[91]

No-Action Letter 13-08 further provides some non-SD/MSP market participants limited Part 45 *recordkeeping* relief if a transaction meets the following requirements:

1. All other TOE requirements are met;
2. The non-SD/MSP provides a CICI number to any SD/MSP option counterparty; and
3. The end-user notifies the DMO "no later than 30

87. CFTC Trade Options, 17 C.F.R. § 32.3.

88. CFTC No-Action Letter 13-08, 2013 WL 1461450, at *2 (Apr. 5, 2013). Note, however, that despite the exemption and no-action relief, the CFTC retains its antifraud and anti-manipulation enforcement ability. *See* CFTC Trade Options, 17 C.F.R. § 32.3.

89. *Id*.

90. Form TO, the "Annual Notice Filing for Counterparties to Unreported Trade Options," is the form that Non-SD/MSPs may use to report their unreported trade option activity, and requires filers to report: basic identifying information about their firm; the commodity categories of their trade options; and the approximate dollar value of the commodities they purchased or delivered in connection with the exercise of trade options during the previous calendar year, within broad ranges. Press Release, CFTC, CFTC Division of Market Oversight Responds to Frequently Asked Questions Regarding Commodity Options (Sept. 30, 2013) [hereinafter CFTC Response to FAQs], *available at* https://forms.cftc.gov/_layouts/TradeOptions/Docs/TradeOptionsFAQ.pdf.

91. CFTC No-Action Letter 13-08, 2013 WL 1461450, at *2. *See also* CFTC Response to FAQs, *supra* note 90, at 3.

> days after entering into trade options having an aggregate notional value in excess of $1 billion during any calendar year."[92]

No-Action Letter 13-08 replaces No-Action Letters 12-06 (August 4, 1012) and 12-41 (December 5, 2012) which provided similar relief but expired in late 2012 and in April of 2013, respectively.[93]

The CFTC's Division of Market Oversight has provided guidance on and responded to frequently asked questions regarding commodity options.[94]

C. No-Action Letter 13-10 (April 9, 2013): Relief with Respect to the Compliance Date of 4-10-13 for Reporting Obligations under Part 43, 45 and 46 of the CFTC's Regulations.

While No-Action Letter 13-08 provides continuing relief for certain reporting and recordkeeping requirements, No-Action Letter 13-10 merely provides temporary relief from certain swap reporting requirements found under 17 C.F.R. parts 43, 45, and 46 for non-SD/MSP parties.[95] The CEA, as amended by Dodd-Frank, establishes a broad regulatory structure for swaps that includes significant reporting requirements both for new swaps and for swaps entered into either (i) before Dodd-Frank was enacted or (ii) following the law's enactment but prior to the effective date for the reporting requirements applicable to new swaps.[96]

No-Action Letter 13-10 provided temporary relief for an

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92. CFTC No-Action Letter 13-08, 2013 WL 1461450, at *2–*3. *See also* CFTC Response to FAQs, *supra* note 90, at 2.

93. CFTC No-Action Letter 13-08, 2013 WL 1461450, at *1–*2.

94. *See generally* CFTC Response to FAQs, *supra* note 90. For example, the CFTC has responded to questions regarding how a commodity option qualifies for the TOE. The CFTC response provides that the commodity option must involve a physical commodity and must meet the following conditions: (1) be offered by either an ECP or a commercial participant; (2) be offered to a commercial participant; and (3) must be intended to be physically settled so that, if exercised, the option would result in the sale of an exempt or agricultural commodity for immediate or deferred shipment or delivery. *Id.* at 2 (citing 17 C.F.R. § 32.3(a); Commodity Options Final and Interim Final Rules, 77 F.R. 25,320, at 25,326 (Apr. 27, 2012)).

95. CFTC No-Action Letter 13-10, 2013 WL 1496933 (Apr. 9, 2013).

96. *See* Dodd-Frank Act §§ 723(a)(3), 729, 7 U.S.C. §§ 2(g), 6r.

end-user recordkeeper's requirement, under Part 45, to create "full, complete and systematic records, together with all pertinent data and memoranda" for each of its swaps.[97] This obligation includes the responsible end user retention of the records for the life of the swap and for five years after the termination of the swap in either an electronic record or in paper copies.[98] During the retention period the record must be retrievable within five business days and the records must be open to inspection upon request.[99]

In No-Action Letter 13-10, the CFTC recognized that non-SD/MSP counterparties could have more limited technological and operational capability than their SD/MSP counterparties.[100] The CFTC further recognized that both financial and non-financial swap counterparties can be non-SD/MSP counterparties.[101] As a consequence of that further distinction, the CFTC recognized that non-SD/MSP, non-financial swap counterparties could possess even further technological and operational limitations. As such, No-Action Letter 13-10 moves away from an analysis based on whether a party is an MSP or SD and instead indicates an extension of compliance dates for a broader set of transactions for non-financial swap counterparties than for financial swap counterparties.

The CFTC indicated its belief that financial swap counterparties had sufficient time to become compliant with the swap data reporting rules with respect to interest rate swaps and credit swaps. Accordingly, the no-action letter extended the reporting deadline to May 29, 2013, but only for equity, foreign exchange, and other commodity swaps. However, non-financial swap counterparties received an extension that was both longer

97. Swap Recordkeeping, 17 C.F.R. § 45.2(a).

98. *Id*. § 45.2(c)–(d).

99. *Id*. § 45.2(e).

100. CFTC No-Action Letter 13-10, 2013 WL 1496933, at *2.

101. *Id*. The term financial entity is defined by Commodity Exchange Act § 2(h)(7)(C), 7 U.S.C. § 2(h)(7)(C). The CFTC has the authority to exempt from that definition certain entities that otherwise meet its requirements. Commodity Exchange Act § 2(h)(7)(C)(ii), 7 U.S.C. § 2(h)(7)(C(ii). Such exempted entities are considered a non-financial swap counterparty for the purposes of No-Action Letter 13-10. CFTC No-Action Letter 13-10, 2013 WL 1496933, at *2 n.16.

than that received by financial swap counterparties and that covered a broader set of transactions. The relevant compliance dates for non-financial swap counterparties were extended as follows:

1. Interest rate swaps and credit swaps: July 1, 2013
2. Commodity, equity, or FX swaps: August 19, 2013
3. Historical swaps, all classes: October 31, 2013.[102]

No-Action Letter 13-10 does not modify the rules related to the reporting of swap creation data. Those rules provide that all swaps executed on a SEF or DCM satisfy the reporting requirements, provided that the particular SEF or DCM's rules are compliant with Part 45.[103] Off-facility swap reporting must be satisfied by the reporting party, and if both counterparties are end users, those counterparties must agree, in the swap, as to which party is the reporting party.[104]

Finally, while this no-action relief applies to non-SD/MSP reporting obligations, historical and future swap *recordkeeping* requirements were not delayed.[105]

D. No-Action Letter 13-22 (June 4, 2013): Relief from the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates

Under the CEA, if a swap is required to be cleared then it is unlawful for any person to engage in such swap unless that person submits the swap for clearing to a DCO that is registered or is exempt from registration under the CEA.[106] The CFTC has provided only limited exceptions and exemptions from clearing requirements, including an exception for end-users and an exemption for swaps between certain affiliates.[107] Thus, any person not able to claim an exception or an exemption would be

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102. CFTC No-Action Letter 13-10, 2013 WL 1496933, at *3–*4. Time of compliance on all discussed dates is 12:01 AM eastern time. *Id.*

103. Determination of Which Counterparty Must Report, 17 C.F.R. § 45.8(h).

104. *Id.* § 45.8(d).

105. CFTC No-Action Letter 13-10, 2013 WL 1496933, at *4.

106. CFTC No-Action Letter 13-22, 2013 WL 2457367, at *1 (June 4, 2013) (quoting CEA § 2(h)(1)(A), 7 U.S.C. § 2(h)(1)(A)).

107. *Id.* at *1–*2.

required to clear all swaps pursuant to applicable regulations.[108]

In No-Action Letter 13-22, the CFTC's Division of Clearing and Risk ("DCR") responded to market participants' requests for relief for swaps entered into by corporate affiliates ("treasury affiliates") that meet the definition of "financial entity" under Section 2(h)(7)(C)(i)(VIII) of the CEA because they may undertake hedging activities or act as treasury centers for non-financial affiliates within a corporate group.[109] These non-financial affiliates are typically eligible to elect the end-user exception from clearing, however, treasury affiliates often enter into swaps on behalf of the non-financial affiliates as principal to the swap and therefore cannot claim the end-user exception for agents as permitted by Section 2(h)(7)(D)(i) of the CEA.[110]

The DCR's no-action position applies to "eligible treasury affiliates," defined as persons that meet specific qualifications, including, among others, that (1) the person is directly, wholly-owned by a non-financial entity and is not indirectly majority-owned by a financial entity; (2) the person's ultimate parent must be able to identify all wholly- and majority-owned affiliates, a majority of which must qualify for the end-user exception; and (3) the person is a financial entity solely as a result of acting as principal to swaps with, or on behalf of, one or more affiliates.[111]

Further, the subject swap activity must meet specific, identified conditions, including, among others, that (1) the eligible treasury affiliate enters into the exempted swap for the sole purpose of hedging or mitigating an affiliate's risk; (2) neither any related affiliate that enters into swaps with the eligible treasury affiliate nor the eligible treasury affiliate enters into swaps with or on behalf of any affiliate that is a

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108. *Id*. at *1.

109. *Id*. at *2. Treasury affiliates are often used to hedge risks for the non-financial affiliates and often serve as the primary external market-facing entity for the corporate group. For example, treasury affiliates can aggregate similar risks from swaps and enter into one outward-facing swap, reducing transactional and record-keeping issues and providing an opportunity to reduce the total notional amount of outward-facing swaps that would result from each non-financial affiliate entering its own swap directly. *Id*. at *3.

110. *Id*. at *2 n.8.

111. *Id*. at *3 (containing other requirements).

financial entity; and (3) each swap that the eligible treasury affiliate enters into is subject to a centralized risk program that monitors and manages the risks associated with the swap.[112]

III. JUDICIAL DECISIONS

A. Challenge to the CFTC Position Limits Rule: ISDA v. CFTC

In December 2011, the International Swaps and Derivatives Association ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") filed suit against the CFTC, challenging CFTC rulemaking that set position limits on derivatives tied to twenty-eight physical commodities.[113] Interpreting Dodd-Frank's statutory amendment of the CEA broadly, the CFTC's final order asserted that it need not make a finding of necessity or attempt to quantify the consequences or costs of the rule on market participants or trading strategies.[114]

The thrust of ISDA and SIFMA's argument was that the CFTC "misinterpreted its statutory authority under the [CEA], as amended by Dodd-Frank."[115] ISDA and SIFMA argued that the relevant statutory sections were clear and unambiguous, and that the CFTC was required to make prior findings of necessity before promulgating the Position Limits Rule.[116]

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112. *Id.* at *4–*5 (containing other requirements).

113. Int'l Swaps & Derivatives Ass'n v. CFTC, 887 F. Supp. 2d 259 (D.D.C. 2012).

114. Dodd-Frank Act § 737, 7 U.S.C. § 6a(a)(1), 6a(a)(2)(A), 6a(a)(3)(B), 6a(a)(5) (2012) (amendment); Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626, 71,665 (Nov. 18, 2011) ("The Commission does not believe it reasonably feasible to quantify or estimate the costs from such changes in trading strategies."); *see also id.* at 71,672 ("[T]he Commission is unable to determine or estimate the number of entities that may need to alter their business strategies.").

115. Int'l Swaps & Derivatives Ass'n v. CFTC, 887 F. Supp. 2d at 261.

116. *Id.* at 266. The relevant portion of CEA section 6a(a)(1) states:

> For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person . . . under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs

The CFTC countered with a similar argument—that the statutory language was clear and unambiguous. The CFTC argued both that Congress left it no discretion *not* to impose position limits, and that it was not required to find that limits were necessary before imposing them.[117]

The district court agreed with ISDA and SIFMA, held that the CFTC did not have the discretion to promulgate the order without first finding necessity, and vacated the order and remanded it to the CFTC for further proceedings.[118]

On December 12, 2013, the CFTC issued a Notice of Proposed Rulemaking ("NPRM") to establish speculative position limits for twenty-eight exempt and agricultural commodity futures and options contracts, and economically equivalent physical commodity swaps.[119] The NPRM provided that Section 4a(a)(2) of the CEA required that the CFTC establish limits on the amount of positions that may be held by any person.[120] The limits are to be established based on several criteria, including (1) to diminish, eliminate, or prevent excessive speculation as described under this section, (2) to deter and prevent market manipulation, squeezes, and corners, (3) to ensure sufficient market liquidity for bona fide hedgers, and (4) to ensure that the price discovery function of the underlying market is not disrupted.[121]

Throughout the NPRM, the CFTC maintained its position that Congress required it to establish position limits and that it was not required to find that limits were necessary before imposing them.[122] "Nonetheless, out of an abundance of caution

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> a significant price discovery function with respect to a registered entity, as the Commission finds are necessary to diminish, eliminate, or prevent such burden.

7 U.S.C. § 6a(a)(1).

117. Int'l Swaps & Derivatives Ass'n, 887 F. Supp. 2d at 267.

118. *Id.* at 283–84.

119. Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75680 (Dec. 12, 2013).

120. *Id.* at 75,681 (citing CEA § 4a(a)(2); 7 U.S.C. § 6a(a)(2)).

121. *Id.*

122. *See, e.g.*, *id.* ("The [CFTC] concludes that, based on its experience and expertise, when section 4a(a) of the Act is considered as an integrated whole, it is reasonable to construe that section to mandate that the [CFTC] impose position limits."); *id.* at 75,682 ("The [CFTC] believes that it is reasonable to conclude from the

in light of the district court decision in *ISDA v. CFTC*, . . . the [CFTC] proposes, as a separate and independent basis for the proposed Rule, a preliminary finding herein that such limits are necessary to achieve their statutory purposes."[123]

Comments related to the NPRM and the proposed position limits were due on or before February 10, 2014.

B. Public Disclosure of Payments to Governments: API v. SEC

In October 2012, the American Petroleum Institute ("API") sued the Securities and Exchange Commission ("SEC"), challenging the SEC's final order implementing Dodd-Frank's amendment of '34 Act section 13. Dodd-Frank section 1504 amended the '34 Act by adding section 13(q), related to the disclosure of payments by resource-extracting issuers to both the U.S. and foreign governments.[124] The amendment's purpose is to combat the so-called "resource curse," where "oil money intended for a nation's poor ends up lining the pockets of the rich or is squandered on showcase projects instead of productive investments."[125] The SEC's final rule intended to increase transparency, and it required not only the annual, but also the *public* disclosure of payments to governments.[126] The rule made disclosure mandatory despite a foreign government's prohibition of such disclosure.[127]

Dodd-Frank amendments that Congress mandated limits and did not intend for the [CFTC] to make a necessity finding as a prerequisite to the imposition of limits."); *id.* at 75,682–83 ("Based on its experience, the [CFTC] concludes that Congress could not have contemplated that, as a prerequisite to imposing limits, the [CFTC] would first make the sort of necessity determination that the plaintiffs in *ISDA v. CFTC* argue . . . the [CEA] requires . . . .").

123. *Id.* at 75,685. The CFTC then proceeded to discuss a number of reports and case studies that illustrate the ways in which the proposed position limits could reduce or eliminate excessive speculation and market manipulation, including the Hunt Brothers' attempt to corner the silver market and Amaranth Advisors L.L.C.'s excessive speculation in the natural gas markets before stipulating the proposed rules, *Id.* at 75,685–96.

124. Dodd-Frank Act § 1504, 15 U.S.C. 78m(q) (2012).

125. 156 Cong. Rec. S3816 (daily ed. May 17, 2010) (statement of Sen. Richard Lugar).

126. Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365 (Sept. 12, 2012).

127. *Id.*

API argued that compelling public disclosure violated various provisions of the Administrative Procedures Act and restricted API's speech in violation of the First Amendment.[128] While not challenging the disclosure requirement itself, API argued that the SEC erroneously read the statute as requiring public disclosure, and that the statute's proper construction requires rules regarding public disclosure only "to the extent practicable."[129]

For its part, the SEC rejected API's reading of the statute, arguing instead that the statutory language provided it with no discretion to keep these annual filings confidential.[130]

Agreeing with API, the district court held that the SEC misread the statute to mandate public disclosure, and held that its decision to refrain from exempting disclosure where foreign governments prohibit it was arbitrary and capricious.[131] The court vacated the rule and remanded it to the SEC for further proceedings.[132] The SEC did not appeal the district court's decision.

IV. ISDA Compliance Documentation

In response to the CFTC's rulemaking efforts, interpretive guidance, general policy statements, and no-action letters, ISDA has formulated various provisions and protocols to ensure parties remain compliant with relevant regulation. This section summarizes those efforts with respect to swap guarantors as ECPs and the ISDA August 2012 and March 2013 Dodd-Frank Protocols (the "August Protocol" and "March Protocol" respectively). In an effort to make the ISDA Protocols easier for non-SD/MSP entities to understand and use, the International Energy Credit Association ("IECA") published amendments to the Protocols that are also discussed in this section.

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128. Am. Petroleum Inst. v. SEC, No. 12-1668 (JDB), 2013 WL 3307114, at *4 (D.D.C. July 2, 2013).

129. *Id.* at *4, *6.

130. *Id.* at *4; *see also* Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. at 56,401.

131. Am. Petroleum Inst., 2013 WL 3307114, at *8, *15.

132. *Id.* at *16.

A. Swap Guarantors as ECPs

In response to No-Action Letter 12-17, ISDA has produced two sets of provisions to address a guarantor not qualifying as an ECP. While neither the keepwell term nor the exclusionary provision (respectively, the "Keepwell Term" and "Exclusionary Provision") is a standalone agreement, either or both of them can be included in an ISDA Schedule or other transaction agreement or included in an amendment to an existing agreement. Further, the drafted product definitions are similar to those used in the ISDA Master Agreement, allowing parties to incorporate by reference or otherwise incorporate those definitions into an ISDA schedule with minimal modifications to either the new provisions or the existing Schedule.

1. Keepwell Term

The keepwell terms of the CEA state that an ECP includes a corporation, partnership, proprietorship, organization, trust or other entity, "the obligations of which under an agreement, contract, or transaction are guaranteed or otherwise supported by a letter of credit or keepwell support, or other agreement" by persons that otherwise qualify as ECPs.[133] Therefore, if the borrower's obligations under the loan documents include swap obligations and an ECP affiliate enters into a keepwell agreement with a guarantor affiliate, the ECP thereby confers ECP status on the non-ECP guarantors of the obligations and allows the non-ECP guarantors to provide enforceable guaranties.[134]

Parties can specify in the Keepwell Terms which participants to the transaction are the providers and recipients of keepwells. If the parties do not so specify, a default election provides that each corporate entity that is a guarantor of swap obligations and qualifies as an ECP provides a keepwell to each other non-ECP guarantor of the same obligations.[135]

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133. Commodity Exchange Act § 1a(18)(A)(v), 7 U.S.C. § 1a(18)(A)(v).

134. *See* CFTC No-Action Letter 12-17, 2012 WL 4919782, at *4.

135. Int'l Swaps & Derivatives Ass'n, ISDA Exclusionary Terms and Keepwell Terms Advisory Note 3 (2013), *available at* http://www2.isda.org/attachment/NTUyMg==/27697051_2_ISDAExclusionaryTerms_KeepwellAdvisory.pdf; *see also* Int'l Swaps &

2. Exclusionary Provision

The ECP swap guarantor rule states that guarantees cannot cover swap obligations to the extent the relevant guarantor is not an ECP.[136] The Exclusionary Provision addresses this by stating that guarantees provided in connection with a transaction do not cover swap obligations to the extent the relevant guarantor is not an ECP.[137] While this still removes the guaranty from the collateral estate supporting the swap, it eliminates the risk that the guaranty will also be unsupportable with regard to the other obligations that are not swaps.

B. ISDA Protocols

1. General Purpose

The August and March Protocols are ISDA-published standardized amendments that assist parties in updating their existing swap-relationship documentation to comply with Dodd-Frank.[138] The Protocols supplement the terms of existing ISDAs by adding notices, representations and warranties and covenants required to be provided by SDs and MSPs, but which also directly relate to non-SDs/MSPs.[139]

2. August Protocol

The August Protocol focuses on SD and MSP compliance with Dodd-Frank's external business conduct ("EBC") requirements. Its purpose is to supplement the terms of existing

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Derivatives Ass'n, ISDA ECP Guarantor and Keepwell Terms 1–2 (2013) (providing the Keepwell provision and defining the terms "Qualified Keepwell Provider" and "Supported Guarantor"), *available at* http://www2.isda.org/attachment/NTUyMA==/27618120_3_ISDAECPGuarantorKeepwellTerms.pdf.

136. *See* Dodd-Frank § 723(a)(2), 7 U.S.C. § 2(e); CFTC No-Action Letter 12-17, 2012 WL 4919782, at *1. *See also* discussion *supra* Section 2.A.

137. Int'l Swaps & Derivatives Ass'n, ISDA Non-ECP Guarantor Exclusionary Terms 1 (2013), *available at* http://www2.isda.org/attachment/NTUyMQ==/27666729_2_ISDANon-ECPExclusionaryTerms.pdf.

138. *About ISDA Protocols*, ISDA.org, http://www2.isda.org/functional-areas/protocol-management/about-isda-protocols/ (last visited Feb. 10, 2014).

139. *ISDA August 2012 DF Protocol*, ISDA.org, http://www2.isda.org/functional-areas/protocol-management/protocol/8 (last visited Feb. 10, 2014).

master agreements by adding notices, representations, and covenants that will comply with Dodd-Frank's requirements.[140] The August Protocol is comprised of five separate documents: (i) the August Protocol Agreement; (ii) the August Protocol Adherence Letter; (iii) the August Protocol Questionnaire and Addenda; (iv) the August Protocol Dodd-Frank Supplement and Schedules; and (v) the August Protocol Dodd-Frank Terms Agreement.

The August Protocol Agreement governs the mechanics through which a party can supplement those swap agreements that parties elect to supplement using the Protocols, referred to in the Protocol as its protocol covered agreements ("PCAs").[141]

The August Protocol Adherence Letter binds the signing party to the Protocol Agreement and requires the payment of a one-time five-hundred dollar fee.[142] It can be executed by a party or its agent and it allows a party to specify how it will receive Protocol Questionnaires from its counterparties.[143]

The August Protocol Questionnaire lists a party's legal status and contact information, and requires that party to make representations as to whether or not it is a commodity pool operator, ECP (including detailed questions regarding the satisfaction of the prongs of that definition), SD, MSP, or other type of entity, and to make statements or disclosures to satisfy the know-your-customer information requirements.[144] The August Protocol Questionnaire also contains an election of which provisions from the Dodd-Frank Supplement ("DF Supplement") will be incorporated into the August Protocol Agreement.[145]

The August Protocol Questionnaire may be submitted online via ISDA Amend's Markit platform which automates the

140. *Id.*

141. *ISDA August 2012 DF Protocol Agreement*, ISDA.org (Aug. 13, 2012), http://www2.isda.org/attachment/NDc5Mw==/ISDA%20August%202012%20DF%20Protocol%20Agreement_Publication.pdf.

142. *See ISDA August 2012 DF Protocol*, *supra* note 139.

143. *See ISDA August 2012 DF Protocol FAQ*, ISDA.org, http://www2.isda.org/functional-areas/protocol-management/faq/8/ (last visited Feb. 10, 2014).

144. *ISDA August 2012 DF Protocol Questionnaire*, ISDA.org (Aug. 13, 2012), http://www2.isda.org/attachment/NTA3Mg==/ISDA%20August%202012%20DF%20Protocol%20Questionnaire_Publication.doc.

145. *Id.*

information gathering process and allows agreements to be supplemented electronically.

The August Protocol Questionnaire contains two addenda providing a non-exclusive method to disclose certain additional information to counterparties, and to agree to additional representations and/or additional elections at law.[146] Addendum I addresses the regulatory distinction between an active fund and a commodity pool and addresses the party's status with regard to certain specified foreign exchange transactions.[147] Addendum II address the CFTC's requirements related to swap clearing, cross-border application of swap rules, and pre-trade market-to-market requirements.[148]

The August Protocol Dodd-Frank Supplement and Schedules is an operative document that contains substantive representations, disclosures, and terms that SDs and MSPs must receive and/or make in order to comply with Dodd-Frank's EBC requirements. It contains the following six schedules:

a. Schedule 1: Defined terms
b. Schedule 2: Agreements between an SD and any other party
c. Schedule 3: Institutional suitability safe harbors for non-Special Entities
d. Schedule 4: Safe harbors for non-ERISA Special Entities
e. Schedule 5: Safe harbors for ERISA Special Entities (Option 1)
f. Schedule 6: Safe harbors for ERISA Special Entities (Option 2).[149]

146. *Amended and Restated Addendum I to ISDA August 2012 DF Protocol Questionnaire*, ISDA.org (Dec. 13, 2012), http://www2.isda.org/attachment/NTMzNQ==/a.and.r.addendum.I.with.modified.questionnaire.doc [hereinafter *Addendum I*]; *Addendum II to ISDA August 2012 DF Protocol Questionnaire*, ISDA.org (Feb. 22, 2013), http://www2.isda.org/attachment/NTMzNw==/Addendum%20II%20to%20August%20Questionnaire.docx [hereinafter *Addendum II*].

147. *Addendum I*, *supra* note 146.

148. *Addendum II*, *supra* note 146.

149. *ISDA 2012 DF Supplement*, ISDA.org (Aug. 13, 2012), http://www2.isda.org/attachment/NDc5Mg==/ISDA%20August%202012%20DF%20Supplement_Publication.pdf.

The August Protocol Dodd-Frank Terms Agreement is used when parties do not have a previously executed ISDA in place and desire to apply selected provisions of the DF Supplement to their future swaps and trading relationships.[150] By executing the Terms Agreement, the parties automatically agree to Dodd-Frank Schedules 1 and 2 and, as applicable, can elect to agree to Schedules 3 to 6, as applicable.[151]

3. *March Protocol*

While similar to the August Protocol, the March Protocol focuses on SD and MSP compliance with Dodd-Frank's internal business conduct ("IBC") requirements and mandatory clearing of certain classes of interest rate swaps and credit default swaps.[152] Like the August Protocol it contains notice information, representations, and covenants required for Dodd-Frank compliance, however the March Protocol also contains provisions designed to address the end-user exception to mandatory clearing.[153] The March Protocol is comprised of three separate documents: (i) the March Protocol Agreement; (ii) the March Protocol Questionnaire; and (iii) the March Protocol Dodd-Frank Supplement and Schedules.

The March Protocol Agreement is a revised version of the August 2012 Protocol Agreement discussed above.[154] It adds and clarifies terms relating to scope, choice of law, netting, data reconciliation and conditions precedent to the agreement.[155]

The March Protocol Questionnaire contains substantive questions relating to IBC requirements that are significantly

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150. *ISDA August 2012 DF Terms Agreement*, ISDA.org, http://www2.isda.org/attachment/NDc5MA==/ISDA%20August%202012%20DF%20Terms%20Agreement%20_Publication.pdf.

151. *Id.*

152. *ISDA March 2013 DF Protocol*, ISDA.org, http://www2.isda.org/functional-areas/protocol-management/protocol/12 (last visited Feb. 10, 2014).

153. *ISDA March 2013 DF Protocol FAQ*, ISDA.org, http://www2.isda.org/functional-areas/protocol-management/faq/12/; *see also* End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,449 (July 19, 2012).

154. *ISDA March 2013 DF Protocol Agreement*, ISDA.org (Mar. 22, 2013), http://assets.isda.org/media/38756a02/7ecb18ba.pdf; *see also ISDA March 2013 DF Protocol*, *supra* note 122.

155. *ISDA March 2013 DF Protocol FAQ*, *supra* note 152.

different than the August 2012 Questionnaire's EBC requirements.[156] Information sought by those questions includes an election of which Supplement and Schedule, discussed below, will be used, and specific questions regarding the end-user exception.[157]

The March 2013 Protocol contains the following four schedules:

a. Schedule 1: Defined terms
b. Schedule 2: General terms and representations
c. Schedule 3: Calculation of risk valuations and dispute resolution
d. Schedule 4: Portfolio reconciliation.[158]

All parties must adhere to Schedules 1 and 2 but a party has the option of adhering to either or both of Schedules 3 and 4.[159] Under the Supplement and Schedules a party must designate information relating to the entity categories that apply to it, whether the end user exception to mandatory clearing applies to it, and, if so, whether it is an end user.[160]

4. IECA Publications Relating to ISDA Protocols

The IECA published an amendment to each Protocol to streamline and standardize negotiations between end users and SDs/MSPs in preparing the documentation required to comply with Dodd-Frank.

Under the Amendment Adopting, Incorporating and Amending the ISDA August 2012 Dodd-Frank Supplement, parties can elect to either adhere to the procedures in the Protocol Agreement (including the Adherence Letter and Questionnaire) or forego such procedures and simply use the IECA Amendment and attachments.[161] If the IECA Amendment

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156. *ISDA March 2013 DF Protocol Questionnaire*, ISDA.org (Mar. 22, 2013), http://assets.isda.org/media/38756a02/69534b19.doc.

157. *Id.*

158. *ISDA March 2013 DF Supplement*, ISDA.org (Mar. 22, 2013), http://assets.isda.org/media/38756a02/dc176cdb.pdf.

159. *Id.*

160. *Id.*

161. *Amendment Adopting, Incorporating and Amending the ISDA August 2012 DF Supplement*, IECA.net, http://www.ieca.net/sites/default/files/attachments/2012/

is used, it amends and is deemed to be incorporated into the covered agreements.[162] The Amendment clarifies certain terms and it was drafted with the intent to protect and benefit end users.[163]

5. *Other IECA Publications Relating to Dodd-Frank*

The IECA has also published an End User to End User Representations and Reporting Agreement as well as an Annual Information Report for End Users Electing the Exception to Clearing and User's Guide.[164]

a. *End User to End User Representations and Reporting Agreement*

The ISDA Protocols are designed to address SD and MSP compliance with the EBC and IBC requirements. However, if a swap is between two end users, then while adherence to the Protocol is not necessary the parties may still need to exchange certain information to ensure compliance with Dodd-Frank. The IECA's Representations and Reporting Agreement is intended to fill those gaps by adding definitions, additional representations, provisions for reporting party designation and interaction with SDRs, agreements for information exchanges requested for compliance purposes, notifications of life cycle events to ensure timely reporting, provisions regarding trade options, and

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IECA%20ISDA%20DF%20Protocol%20Amendment%20(11-30-12).doc.

162. *Id.*

163. *See IECA Publishes Amendment in Response to ISDA August 2012 DF Protocol*, IECA.net (Dec. 18, 2012), http://www.ieca.net/news/ieca-publishes-amendment-response-isda-august-2012-df-protocol.

164. *Dodd-Frank Act Representations and Reporting Amending Agreement*, IECA.net, http://www.ieca.net/sites/default/files/attachments/2013/ieca_doddfrank_act_representation_and_reporting_agmt_final_0.doc [hereinafter *Representations and Reporting Agreement*] (agreement); *Annual Information Report*, IECA.net, http://www.ieca.net/sites/default/files/attachments/2013/ieca_annual_info_report_for_end_user_exception_to_clearing_4-8-13_1.doc [hereinafter *Annual Report*] (annual report); *User's Guide/Instructions ("Instructions") IECA Form for Submission of Annual Information Report in relation to an Election to rely upon the End-User Exception to Clearing*, IECA.net, http://www.ieca.net/sites/default/files/attachments/2013/users_guide-ieca_annual_info_report_for_end_user_exception_to_clearing_4-8-13.doc [hereinafter *User's Guide*] (user's guide).

exhibits listing contact information and certain elections.[165]

b. Annual Information Report for End Users Electing the Exception to Clearing and User's Guide

If an end user elects not to clear its swaps, Dodd-Frank requires it to demonstrate to the CFTC how it otherwise meets its financial obligations under such non-cleared swaps.[166] The end user's demonstration must be made on an annual basis for any year in which the end user exception to mandatory clearing is elected.[167] Because the CFTC has not published a form for making this demonstration, the IECA has published a form Annual Information Report and related User's Guide for this purpose.[168] The Report requires the end user to give basic entity information and representations concerning its status as an end user and its satisfaction of Dodd-Frank requirements and to specify whether the end user may meet its financial obligations absent clearing by providing (i) a written CSA, (ii) pledged or segregated assets, (iii) a third-party written guaranty, (iv) end user's available financial resources, or (v) another method similar to those stated above. [169]

6. Why Use the Protocols With or Without IECA Amendments

a. Why Use the Protocols:

The ISDA Protocols provide a number of distinct advantages over alternative Dodd-Frank compliance regimes, including:

1) The Protocols provide a standardized process to implement industry-standard modifications and amendments to existing agreements.
2) The Protocols may be executed once and all adhering parties are covered. This feature prevents the adhering parties from incurring additional costs

165. *See Representations and Reporting Agreement*, *supra* note 164.

166. *See* CFTC Exceptions to the Clearing Requirement, 17 C.F.R. § 50.50.

167. *Id.* § 50.50(b)(2).

168. *See* sources cited *supra* note 164.

169. CFTC Exceptions to the Clearing Requirement, 17 C.F.R. § 50.50(b); *Annual Report*, *supra* note 164.

related to term renegotiation and amendment.

3) The existing provisions contemplate and reference future amendments, allowing the automatic incorporation of any future Protocol changes.
4) The parties to an ISDA Master Agreement have negotiated and contemplated future Protocol incorporation which reduces the need to negotiate in the future as the standardized process automatically incorporates those Protocols issued after the ISDA Protocols are adopted.
5) All SDs accept the Protocols, reducing the cost and time spent seeking an SD familiar with ISDA's process or completing the Dodd-Frank compliance process with counterparties.

b. Why Use the IECA Amendments

The IECA Amendments provide distinct advantages to ISDA's adherence process and documentation, including:

1) The IECA's simple bilateral approach simplifies the process for end users with fewer resources to understand and process the Protocols.
2) The IECA Amendments contain alternative provisions for various sections of the ISDA Protocols, allowing an end user to tailor the Protocol to its needs.
3) No fees are charged for the IECA Amendments' use.
4) Options in the recitals permit an end user to specify precisely which agreements are covered and which will be amended in the future, providing a degree of control over future incorporation.
5) The IECA Amendments were drafted by a wide swath of market participants and reflect a general understanding of what other market participants see as the industry standard approaches to certain Dodd-Frank requirements.

V. CONCLUSION

Dodd-Frank remains very much a work in progress. Its combination of rules, no-action letters and advisory statements have created an uncertain regulatory framework for those regulated by it, including end users, and many unanswered questions remain as to when rules will be issued from the CFTC on different topics and how to interpret the rules and other guidance that has been issued by the CFTC to date. What is apparent however, is that the CFTC shows no signs of narrowing the scope of Dodd-Frank, and therefore it appears Dodd-Frank will remain an important statute for energy commodity end users to monitor and comply with for years to come.

There exists an inherent tension between the CFTC's mandate under Dodd-Frank to regulate the swaps market and the need to avoid strangling that same market through over-regulation. The CFTC is experiencing significant turnover in 2014, including at the Chairman position, and it remains to be seen whether the CFTC under new leadership and membership will become more or less receptive to industry requests for regulatory relief relating to Dodd-Frank.

End users are advised to invest in an analysis of their activities to ensure they do not stray into the category of swap dealers for any transactions and to maintain institutional knowledge of both the transactions that are subject to Dodd-Frank and the reporting and recordkeeping obligations that apply to those transactions. In addition, the CFTC appears to be committed to its role as an enforcement agency and end users should scrutinize their commercial practices and train their personnel to ensure continued compliance with the CFTC's developing guidance as to impermissible market manipulation and price disruption activities. Most importantly, however, swap end users should monitor developments in the CFTC's implementation of Dodd-Frank as the regulatory landscape seems certain to continue to develop quickly in the near future.