NOT YET SCHEDULED FOR ORAL ARGUMENT

United States Court of Appeals for the District of Columbia Circuit

No. 12-5362

INTERNATIONAL SWAPS AND DERIVATIVES ASS'N; and SECURITIES INDUSTRY AND FINANCIAL MARKETS ASS'N,

Plaintiff-Appellees,

vs.

COMMODITY FUTURES TRADING COMMISSION,

Defendant-Appellant.

On Appeal from the United States District Court for the District of Columbia in Case No.1:11-CV-02146-RLW (Hon. Robert Leon Wilkins, Judge)

BRIEF OF *AMICUS CURIAE* COMMODITY MARKETS OVERSIGHT COALITION IN SUPPORT OF APPELLANT COMMODITY FUTURE TRADING COMMISSION IN FAVOR OF REVERSAL

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APRIL 22, 2013

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

A. Parties and Amici.

All parties, intervenors, and amici appearing before the district court are listed in the brief for Appellant Commodity Futures Trading Commission. Except for the following, all parties, intervenors, and amici appearing before this Court are also listed in the brief for Appellant Commodity Futures Trading Commission:

Representative Maxine Waters and Collin C. Peterson

Commodity Markets Oversight Coalition

Rule 26.1 Disclosure Statement.

The Commodity Markets Oversight Coalition ("CMOC" or "the Coalition") is an independent, non-partisan and non-profit alliance of organizations that represents commodity-dependent industries, businesses and end-users of commodities. CMOC was initiated in 2007 by two non-profit retail petroleum industry trade associations in response to what its members perceived as increasingly opaque, unpredictable and volatile commodity derivatives (i.e., futures, options and swaps) markets, and out of concern over excessive speculation and the possibility of manipulation in those markets. Its membership has increased substantially since then to include organizations that represent a broad spectrum of the American economy, including, among others, the air transportation, ground transportation, fuel, petroleum, heating oil, farming, energy, and food industries.[1] Although not required by D.C. Circuit Rule 26.1, a list of those members of CMOC who join in CMOC's participation in this appeal may be found attached as Addendum A to this Brief.

CMOC exists to promote its member organizations' interests in legislative, regulatory, and litigation matters related to the commodity markets because its members rely on functional, transparent, and competitive commodity derivatives markets as a hedging and price discovery tool. CMOC therefore advocates in favor of government policies that promote stability and confidence in the commodity markets; that seek to prevent fraud, manipulation and excessive speculation; and that preserve the interests of bona fide hedgers and consumers.

CMOC states that it is uncertain whether it is a "trade association," as that term is defined in D.C. Cir. Rule 26.1(b). *See id.* ("For purposes of this rule, a 'trade association' is a continuing association of numerous organizations or individuals operated for the purpose of promoting the general commercial, professional, legislative, or other interests of the membership."). CMOC is unincorporated and nonprofit, and neither its members nor any parent or publicly

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[1] When formed in late August of 2007, the entity was originally named the "Energy Markets Oversight Coalition." The coalition's name was changed to the Commodity Markets Oversight Coalition in January 2008 following an expansion of its mission that allowed for the inclusion of agricultural industry groups as members.

held company have an ownership interest in it. Pursuant to D.C. Cir. Rule 26.1(b), CMOC represents that no members of CMOC have issued shares or debt securities to the public.

B. Rulings Under Review.

All rulings under review are listed in the brief for Appellant Commodity Futures Trading Commission.

C. Related Cases.

All related cases are listed in the brief for Appellant Commodity Futures Trading Commission.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes and Rules

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*Authorities upon which we chiefly rely are marked with asterisks.

Other Authorities

Identity and Interest of CMOC

CMOC is an independent, non-partisan, and non-profit alliance of trade organizations that represent commodity-dependent industries, businesses, and end-users of commodities. CMOC was initiated in 2007 by two non-profit retail petroleum industry trade associations in response to what its members perceived as increasingly opaque, unpredictable and volatile commodity derivatives (i.e., futures, options and swaps) markets, and out of concern over excessive speculation and the possibility of manipulation in those markets. Its membership has increased substantially since then to include organizations that represent a broad spectrum of the American economy, including, among others, the air transportation, ground transportation, fuel, petroleum, heating oil, farming, energy, and food industries.

CMOC exists to promote its member organizations' interests in legislative, regulatory, and litigation matters related to the commodity markets because its members rely on functional, transparent, and competitive commodity derivatives markets as hedging and price discovery tools. CMOC therefore advocates in favor of government policies that promote stability and confidence in the commodity markets; that seek to prevent fraud, manipulation and excessive speculation; and that preserve the interests of bona fide hedgers and consumers.

Since its inception, CMOC and its affiliated entities have advocated actively for speculative position limits—*i.e.*, limits on the number of derivatives contracts that any person engaged in speculation may hold or control—to end, discourage, and prevent excessive speculation and market manipulation in commodity derivatives.[2] Representatives from CMOC and these entities described the harm that their industries and businesses had suffered due to these practices in Congressional hearings prior to and following the 2008 financial crisis. In addition, CMOC and its affiliated entities closely observed and were actively engaged in the legislative process leading to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) ("Dodd-Frank Act"). *See, e.g., Hearing to Review Derivatives Legislation Before the H. Comm. on Agriculture*, 111th Cong. 39 (2009)[3] [hereinafter *2009 Derivatives Legislation Hearing*] (Statement of Sean Cota, Co-Owner and President, Cota & Cota, Inc.; Treasurer, Petroleum Marketers Association of America; on behalf of New England Fuel Institute) (urging the committee to revise language in a precursor bill to Dodd-Frank to "mandate[e] aggregate speculative position limits on energy futures across all contract markets") (emphasis omitted); *id*. at 196 (Statement of Paul Cicio, President, Industrial Energy Consumers of America) ("strongly encourag[ing] the legislation

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[2] Derivatives are financial contracts whose value is derived from the value of something else, such as an asset, a rate, or a currency. Brief for Appellant Commodity Futures Trading Commission at 4.

[3] The hearing transcript is available at http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/testimony/111/111-1.pdf.

to require aggregate position limits" across trading exchanges). They also submitted numerous comments during the rulemaking process for the position limit rule the United States Commodity Futures Trading Commission ("CFTC") implemented at the direction of the Dodd-Frank Act, and that the District Court vacated. *See Int'l Swaps & Derivatives Ass'n, et al. v. United States Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

As both market participants and close Congressional observers, CMOC and its members have unique insights into the market conditions and trading practices that caused the 2007-2008 bubble in commodities, that contributed to the 2008 financial crisis, and that shaped the language of the Dodd-Frank Act. Furthermore, industries and businesses represented by CMOC member groups produce, refine, transport, market and/or consume the commodities being traded and/or utilize commodity derivatives markets for bona fide hedging.[4] CMOC therefore has a strong interest in seeing the District Court's judgment reversed and the CFTC rule reinstated. CMOC's insights and interests stand in stark contrast to those of the Appellees, whose membership consists largely of entities that view commodities as an asset class or investment opportunity, that sell commodity-linked financial products, or that otherwise benefit financially from the trading of derivatives and therefore opposed the rule at issue.

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[4] The purpose of bona fide hedging is "to offset price risks incidental to commercial cash or spot operations." 17 C.F.R. § 1.3(z) (2002).

Authority to File Separate Amicus Brief

CMOC files this separate amicus brief in accordance with this Court's Order of March 15, 2013.

Rule 29(c)(5) Statement

Pursuant to Fed. R. App. P. 29(c)(5), CMOC states that A) no party's counsel authored the brief in whole or in part; B) no party or party's counsel contributed money that was intended to fund preparing or submitting the brief; and C) no person–other than CMOC, CMOC's members, or CMOC's counsel–contributed money that was intended to fund preparing or submitting the brief.

Summary of the Argument

In the early 2000s, the volume of commodities trading "exploded" in U.S. markets. *Excessive Speculation in the Natural Gas Market*, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate (June 25, 2007) ("Natural Gas Report") at 122. The investment explosion was driven by hedge funds, pension funds, and other large institutions that began "pouring billions of dollars into the energy commodities markets," (*The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat*, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate, S. Prt. No. 109-65 (June 27, 2006) ("Oil and Gas Report") at 2), and began marketing commodity derivatives such as commodity index funds[5] "as a way to diversify portfolios and profit from rising commodity prices." *Excessive Speculation in the Wheat Market*, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, S. HRG. 111-155 (July 21, 2009) ("Wheat Report") at 5. In the commodity derivatives markets, hedge funds, pension funds, large financial institutions, and other similar traders function as "speculators," because they seek "to make a profit as a result of fluctuations in the market price of commodities covered by contracts for future delivery." *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 357 & n.11 (1982).

Since speculators provide necessary liquidity and are willing to assume risks that other market participants seek to avoid, (*Id.* at 359 & n.11), their increased presence in the markets was not per se harmful. For example, in futures contract[6] markets there are typically an insufficient number of commodity buyers with the need and ability to trade futures contracts compared to the number of sellers of such contracts. Wheat Report at 51. Speculators make up for the deficit of buyers. *Id.* While speculators provide necessary liquidity, "their participation does not

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[5] Commodity index funds are composed of selected commodity futures contracts with the value of a fund calculated according to the prices of its constituent contracts. Wheat Report at 2.

[6] A commodity futures contract is "a standardized agreement to buy or sell a fixed quantity, quality, and grade of an identified commodity at some specific time in the future." *Strobl v. N.Y. Mercantile Exch.*, 768 F.2d 22, 24 (2d Cir. 1985).

change the fundamental nature or purpose of these markets, which is to enable the producers, merchants, and users of the commodity to price the commodity efficiently and manage their price risks over time." *Id*. at 52.

But when speculation becomes excessive, as it did in the years leading up to the 2008 financial crisis, it does interfere with the markets' fundamental purpose by leading to market distortions, possible manipulation, unwarranted price volatility, and increased costs to bona-fide hedgers, end-users and consumers. *See 2009 Derivatives Legislation Hearing* at 9 (Statement of Tom Buis, President, National Farmers Union) ("when left unregulated and allowed to become excessive, the positive attributes that speculators bring to the markets undermine the legitimate price discovery and risk management functions these markets were designed to provide to commercial market participants"). Congressional interests in the rising price of commodities between 2000 and 2007, whether speculation influenced that rise, and whether the then-existing regulatory system was sufficient were addressed in numerous reports by the Government Accountability Office ("GAO"). *See* U.S. Gov't Accountability Office, GAO-08-25, *Commodity Futures Trading Commission: Trends in Energy Derivatives Markets Raise Questions about CFTC's Oversight* ("2007 GAO Report"), at 82 (listing eleven reports authored by the GAO between 2002 and 2006 related to commodity pricing and/or market regulation).

Parallel to the GAO investigations, Congress itself looked into the issue of excessive speculation and alleged manipulation in the commodity derivatives markets. Beginning in 2001, the Senate Permanent Subcommittee on Investigations launched a series of multi-year, bipartisan inquiries into the effects that increased speculation was having on the commodity markets. These inquiries were comprehensive, drawing on data from the CFTC and trading exchanges, academic literature and studies, as well as testimony and comments from both speculative traders like the Appellees' members, and commodity end-users and commercial traders,[7] including CMOC member organizations and their constituent businesses. *See, e.g., Excessive Speculation in the Wheat Markets Before the Permanent Subcomm. on Investigations of the Senate Comm. on Homeland Security and Governmental Affairs*, 110th Congr. 1, 10 (2008)[8] (statement of the American Bakers Association) (describing how the "true purpose" of the agricultural futures markets had been "skewed as new investment opportunities in agricultural commodities have arisen," and urging the extension of position limits to index funds). Ultimately, the Subcommittee issued three staff reports finding that excessive speculation was occurring in the oil, natural gas, and wheat markets,

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7 Commercial traders "are those entities that use the commodity as part of their business, and hence use the futures markets for hedging." Oil and Gas Report Appendix at 44.

8 A copy of the statement is available for download at http://www.hsgac.senate.gov/subcommittees/investigations/hearings/excessive-speculation-in-the-wheat-market.

and detailing the resulting harmful effects. *See* Section I.B, *infra*. As documented in the Subcommittee reports and in the record before the CFTC during the rulemaking at issue, CMOC's members and their customers were among the groups harmed by this excessive speculation. *See id*.

While bills designed to address the problems of excessive speculation and possible manipulation had been introduced prior to the 2008 financial crisis, (Wheat Report at 43-44), that crisis catalyzed Congress to action. As part of the Dodd-Frank Act passed in the aftermath of the financial crisis, Congress required the CFTC to impose position limits within a short time frame, either 180 or 270 days depending on the commodity, (7 U.S.C. §6a(a)(2)), and then to study the effects of these regulations and report back to Congress regarding the effects within a year. 15 U.S.C. §8307. Given the evidence gathered from CMOC members and others during the course of its investigations, there should be no doubt that Congress was mandating swift decisive action to end what it believed was a serious problem.

The District Court's opinion guts these swift action requirements and maintains the status quo. As a result excessive speculation has been allowed to continue unabated. Twenty-one pages into its twenty-five page opinion, the District Court asserts that there are two possible interpretations of the time limits and reporting requirements: the CFTC's interpretation that they create a mandate for swift action, and the then-Plaintiffs, now-Appellees' interpretation that the time limits for action require the CFTC to "gather evidence" about excessive speculation and then "impose position limits where appropriate to prevent an undue burden on the economy." *ISDA*, 887 F. Supp. 2d at 279-280. The District Court found that both interpretations were plausible, meaning that the statute was ambiguous as to Congressional intent under the first part of the two-part test of *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *Id.* Under the second part of the *Chevron* test, the District Court refused to defer to the CFTC's interpretation because it found that the CFTC erroneously believed its interpretation was compelled by Congress. *Id.* at 280-82. The District Court then remanded the rule so that the agency could "fill in the gaps and resolve the ambiguities." *Id.* at 282.

But, when properly viewed through the lens of the 2008 financial crisis and the long history of Congressional interest in excessive speculation, it is clear that the CFTC's interpretation was compelled by Congress and that the Appellees' interpretation was implausible. Congress had been gathering evidence for nearly a decade about excessive speculation and had already concluded that it constituted an undue burden on interstate commerce. *See* Wheat Report at 15 (finding excessive speculation in the wheat market to be an undue burden on interstate commerce). It was mandating action within 180 or 270 days to fix the problem, not duplication of its past investigations, which is what would occur under the Appellees' interpretation. If that action proved ineffective—or even if the cure proved worse than the illness—then Congress contemplated that additional Congressional review a year later, and not an order of a district court, would remedy the situation.

By failing to appreciate the background against which the Dodd-Frank Act was written, the District Court improperly "divorced [it] from the circumstances existing at the time it was passed, and from the evil which Congress sought to correct and prevent." *See United States v. Champlin Refining Co.*, 341 U.S. 290, 297 (1951). As a consequence, it misinterpreted clear Congressional intent and is due to be reversed.

Argument

I. The Rise of Speculative Traders in the Early 2000s Fundamentally Altered the Commodity Derivatives Markets to the Detriment of Commodities Users.

A. Investment in commodity derivatives increased dramatically, with most of the increase coming from speculative traders.

In the early 2000s, investment in commodity derivatives markets increased at a dramatic and unprecedented pace as shown by numerous indicators. Overall trading volume in commodity contracts quintupled to nearly 3 billion contracts per year in the decade leading up to 2007. Natural Gas Report at 122. Between 2002 and 2006, the trading volume for commodity futures and options contracts "roughly doubled." 2007 GAO Report at 17. The value of speculative investments in commodity index funds grew "exponentially," from $15 billion in 2003 to an estimated $200 billion in mid-2008. Wheat Report at 5, 94. Between July 2002 and December 2006, the crude oil futures and options contracts market experienced a "dramatic increase" in noncommercial traders, going from a daily average of 125 noncommercial traders to a daily average of 286 noncommercial traders. 2007 GAO Report at 27. Between 2000 and 2009, the ratio of hedgers to speculators as a total percentage of open interest in crude oil futures and options contracts reversed, with hedgers shrinking from 60 percent of open interest in 2000 to 40 percent of open interest in 2009. Letter from Richard B. Hirst, Senior Vice President and General Counsel, Delta Air Lines, to David A. Stawick, Secretary, CFTC (March 28, 2011) [hereinafter *Delta Comment Letter*] at 9.[9]

Large institutional speculators drove these huge upswings in derivatives trading. These speculators included "hedge funds, pension funds, and other large institutions" that purchased derivatives like commodity index funds "with the aim of diversifying their portfolios, obtaining some protection against inflation, and

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[9] This letter was part of the administrative record in the district court. *See International Swaps and Derivatives Ass'n and Securities Industry and Financial Markets Ass'n v. CFTC*, No. 1:11-CV-2146-RLW [hereinafter "District Court Proceeding], Dkt. 29. A copy of the letter is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33989&SearchText=delta.

profiting when commodity prices are high." Wheat Report at 5. As CFTC Commissioner Bart Chilton has summarized: "there are more speculators than ever before and they have brought more money into the futures markets than in any time in history." Bart Chilton, Commissioner, CFTC, Speech at the University of Notre Dame (Nov. 1, 2010).[10] He has also noted the presence of traders with such large investments "that they can move markets simply by having such hefty concentrations." *Id*.

Given the massive influx of capital and the sheer size of the new speculators' investments, questions quickly arose about their impacts on the markets. To answer these questions, beginning in 2001, Congress conducted a series of multi-year, bipartisan investigations that were comprehensive in scope and considered input from a broad range of interests, including CMOC member organizations and several of their constituent businesses. Those investigations culminated in three reports finding that excessive speculation had wreaked havoc in the oil, natural gas, and wheat markets. These reports are discussed in the section that follows.

[10] The speech text is available at available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-34.html.

B. <u>The Senate Permanent Subcommittee on Investigations found that excessive speculation existed in the oil, natural gas, and wheat markets and detailed the harmful effects flowing from that speculation in three staff reports.</u>

In 2001, the U.S. Senate Permanent Subcommittee on Investigations began examining the "structure and operation of U.S. energy markets" to determine whether rising energy prices were related to the increasing amount of speculative investment in the commodity markets. Natural Gas Report at 1. The examination included a series of investigations that reflected a "continuing concern over the sustained increases in the price and price volatility" of crude oil, gasoline, and natural gas, and, "in light of these increases, the adequacy of governmental oversight of the markets that set these prices." Oil and Gas Report at 1. The investigations were comprehensive, considering information from a variety of sources. The investigation into the natural gas market, for example, considered publicly available data about the overall level of financial investments in energy markets, publicly available data on energy prices and supplies, trading records from commodity exchanges, statutes and regulations, and "numerous interviews of natural gas market participants, including natural gas traders, producers, suppliers, and hedge fund managers, as well as exchange officials, regulators, and energy market experts." Natural Gas Report at 1-2. CMOC's members participated in this process, and the Subcommittee valued their input. *See id*. at 114-16 (quoting and discussing comments from CMOC members American Public Gas Association

("APGA"), Minnesota Municipal Utilities Association (member of APGA), Municipal Gas Authority of Georgia (member of APGA), New England Fuel Institute, and Industrial Energy Consumers of America).

These investigations culminated in the release of two staff reports. The first, entitled "The Rise of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat," was released on June 27, 2006. The second, entitled "Excessive Speculation in the Natural Gas Market," was released on June 25, 2007.

Parallel to its investigations into the energy markets, the Subcommittee also "examined how the activities of many traders, in the aggregate, have constituted excessive speculation in the wheat market." Wheat Report at 2. As with the energy markets investigations, the wheat market investigation was comprehensive, analyzing pricing and trading data, historical materials on the grain futures markets and on the development of relevant statutes, regulations, and guidance, as well as information on the application of position limits and the granting of exemptions from such limits. *Id*. at 3-4. It also included interviews with "numerous experts and persons familiar with the wheat markets, agricultural commodity markets as a whole, and commodity indexes," that ranged from farmers to grain merchants to financial institutions. *Id*. at 4. Several CMOC members and like-minded industry groups participated in this investigation and, as in the energy market investigations, their voices were heard and valued. *See id*. at 141-42 (quoting and discussing comments from American Bakers Association, National Corn Growers Association, American Cotton Shippers Association, and American Farm Bureau Federation).

The Subcommittee released its findings on the wheat market in a report entitled "Excessive Speculation in the Wheat Market" on June 24, 2009. That report, just like the Oil and Gas and Natural Gas Reports, meticulously documented both the presence of excess speculation and its harmful effects. The sections that follow summarize Congressional concerns, evident in these bipartisan reports, that speculation in commodity markets had become excessive and was harming the markets, as well as the input of CMOC members and others that led to these concerns.

1. The Oil and Gas Report found "substantial evidence" that excessive speculation had "significantly increased prices."

The Oil and Gas Report chronicles that between 2000 and 2006 crude oil prices rose from $25 to $30 per barrel to $60 to $75 per barrel. Oil and Gas Report at 1. According to the Report, this rise in crude oil prices was "a major reason for the record or near-record" prices for gasoline, heating oil, diesel fuel, and jet fuel. *Id*. The Report explained that supply and demand could not "fully account" for these price increases because, while global demand for oil increased during this time period, global oil supply increased by an even greater amount. *Id*. While the Report noted that political instability, foreign hostility towards the United States, and hurricanes might account for some of the increase in crude oil prices, it did not find them sufficient to explain the entire increase. *Id*. at 1-2.

Instead, the Report found "substantial evidence that the large amount of speculation in the current market has significantly increased prices." *Id.* at 2. While the Report stated that it was "difficult to quantify the effect of speculation on prices," it cited analysts who estimated the effect was between $7 and $30 per barrel. *Id*. at 2, 19.

According to the Report, one cause of this price increase was speculators creating added demand for oil through large purchases of futures contracts, leading to correspondingly higher prices for oil futures contracts. *Id*. at 2. As the Report explains, "the demand for a barrel of oil that results from the purchase of a futures contract by a speculator is just as real as the demand for a barrel that results from the purchase of a futures contract by a refiner or other user of petroleum." *Id*. This added demand resulted in a "fundamental change in the oil industry, such that the previous relationship between price and inventory no longer applie[d]." *Id*. at 14-15. Whereas in the past high oil inventories had resulted in lower oil prices, the added demand for futures contracts "provided financial incentives for companies to buy even more oil and put it into storage for future use, resulting in high prices despite ample inventories." *Id*. at 15-16.

These inflated prices resulted in massive profits for the speculators, (*see id*. at Table 1, p. 26-27), but higher costs for oil and gas users and consumers. A study by IHS Global Insight, cited in a comment to the CFTC during the rulemaking at issue, found that a $10 rise in the price of a barrel of oil raises gasoline pump prices by about 24 cents, resulting in U.S. consumers spending an extra $29.6 billion on an annual basis. Letter from Michael Greenberger, Professor University of Maryland School of Law, to David A. Stawick, Secretary, CFTC (Mar. 28, 2011) at 3.[11] Using the analysts' estimates of a $7 to $30 increase due to speculation, U.S. consumers would have paid between $20.72 and $88.8 billion more in gas prices on an annual basis based on this study.

Consumers and businesses also paid more as a result of increased business costs. Delta Airlines, a member company of CMOC member Airlines for America, has calculated that for every $1 per barrel rise in the price of oil, its annualized costs increase by $100 million. *Hearing to Review Proposed Legislation by the U.S. Department of the Treasury Regarding the Regulation of Over-the-Counter*

[11] This letter was part of the administrative record in the district court. *See* District Court Proceeding, Dkt. 29. A copy of the letter is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33850&SearchText=greenberger.

Derivatives Markets Before the H. Comm. of Agriculture, 111th Congr. 20 (2009)[12] (Statement of Richard B. Hirst, Senior Vice President and General Counsel, Delta Air Lines; on behalf of the Air Transport Association); *Delta Comment Letter* at 1-2. Undoubtedly, other businesses also faced higher costs and were forced either to raise prices or cut services as a result. In other words, the public paid for the speculators' profits.

2. The Natural Gas Report documented how a single hedge fund dominated the natural gas market in 2006, and singlehandedly "moved prices and increased price volatility" to the detriment of traditional market participants including CMOC's members.

In the Natural Gas Report, the Subcommittee documented how a single hedge fund, Amaranth Advisors LLC, dominated the natural gas market from early 2006 until it collapsed in September of that year, resulting in an $8 billion liquidation. Natural Gas Report at 1-2. According to the Report, during that time frame, 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." *Id*. at 2. Extrapolating further, the Report found that at times "Amaranth controlled 40% of the outstanding contracts on [the New York Mercantile Exchange] for natural gas in the winter season (October 2006 through March 2007), including as much as 75% of the outstanding contracts to

[12] The hearing transcript is available at available at http://democrats.agriculture.house.gov/testimony/111/111-29.pdf.

deliver natural gas in November 2006." *Id*. The Report relates that on August 29, 2006, alone, Amaranth lost $600 million trading in the natural gas markets, but it still finished with a net gain of $631 million for that month. *Id*. at 111.

The Report found that Amaranth's "massive trading distorted natural gas prices and increased price volatility." *Id*. at 119. For example, Amaranth's buying of contracts for natural gas delivery in winter months, in conjunction with its selling of contracts for delivery in summer months, "drove winter prices far above summer prices." *Id*. at 2. The differences in the prices were "far higher in 2006 than in previous years" until Amaranth's collapse, "when the price spreads returned to more normal levels." *Id*. at 2-3. The Report also found that on "several specific dates, Amaranth's massive trades were responsible for large jumps in the price differences between the futures contracts for March and April 2007." *Id*. at 3; *see also id*. at 65, Figure 29a (chart showing strong correlation between Amaranth trades and the price spread between November 2006 and January 2007 futures contract prices).

The Report confirms what CMOC's members already knew—that "Amaranth's trading did not take place in a vacuum" and that its "largely unregulated trading and price distortions harmed other market participants." *Id*. at 114. As summarized in the Report, some natural gas end-users "were forced to purchase natural gas at inflated prices," while others "were unable to hedge their natural gas expenses due to the unpredictability and volatility of the market." *Id*. Some users "suffered large losses." *Id*. Just as damaging, the Report records that some users "lost confidence in the ability of the futures market to provide a fair price," making them reluctant to invest in it. *Id*. at 119.

The Natural Gas Report includes specific examples of entities harmed by Amaranth's actions in these various ways. *See id*. at 114-18. For instance, during the winter of 2006-07, the Municipal Gas Authority of Georgia ("MGAG"), a member of CMOC member American Public Gas Association, incurred hedging losses of $18 million in the natural gas market that it attributed to excess speculation. *Id*. at 115. MGAG told the Subcommittee that "contrary to reports that no one was hurt by Amaranth's trading practices," its customers "were forced to pay millions of dollars in extra natural gas costs unrelated to fundamental supply and demand." *Id*. Another CMOC member, the New England Fuel Institute, captured the essence of the harm suffered by ordinary consumers due to Amaranth's manipulative trading: "when the prices of heating fuels are set by market players looking for a quick buck, people are left out in the cold." *Id*.

3. The Wheat Report found that excessive speculation by commodity index traders in the wheat market resulted in that market "no longer effectively serv[ing] the needs of many wheat growers or commercial wheat users."

The third Report released by the Subcommittee "examined in detail how commodity index traders affected the price of wheat contracts traded on the Chicago Mercantile Exchange." Wheat Report at 2. Relying on CFTC data, the Report found that "over the past three years, between one-third and one-half of all of the outstanding wheat futures contracts purchased … on the Chicago exchange are the result of purchases by index traders…." *Id.* For example, the Report noted that in July 2008 index traders held futures contracts calling for the delivery of over 1 billion bushels of wheat, while commercial wheat sellers held contracts calling for the delivery of about 800 million bushels. *Id*. at 9.

The Report found that there was "significant and persuasive evidence to conclude that these commodity index traders, in the aggregate, were one of the major causes of 'unwarranted changes' – here, increases – in the price of wheat futures contracts relative to the price of wheat in the cash market." *Id*. at 2. The Report explained that the futures market "provides potential buyers and sellers of the commodity with prices for the delivery of that commodity at specified times in the future," while the cash market "provides potential buyers and sellers with the price for that commodity if it is delivered immediately." *Id*. at 2-3. Ordinarily, the prices in these two markets converge as the time for delivery in the futures contract gets near. *Id*. at 3. But the Report found that in the Chicago wheat market futures contract prices "remained abnormally high" compared to the cash prices, and the relationship between the two sets of prices had become "unpredictable." *Id*.

The Report explained that this failure of convergence resulted in "turmoil in the wheat markets," and "severely impaired the ability of farmers and others in the grain business to use the futures markets as a reliable guide to wheat prices and to manage price risks over time." *Id*. The Report continued that the failure of the markets to serve as a reliable guide for pricing and risk management "significantly aggravated … economic difficulties and placed an undue burden on the grain industry as a whole." *Id*.

Grain industry participants "complained loudly about the soaring prices and breakdowns in the market" to the Subcommittee. *Id*. CMOC member American Bakers Association stated it was "concerned that traditional market participants are being pushed out of the market – in favor of more non-traditional, new market participants that are essentially using the commodities market as a financial instrument." *Id*. at 141. The president of MGP Ingredients stated that he did not know "how anyone goes about hedging in markets as volatile as this." *Id*. at 3. The Wheat Report also quoted the American Cotton Shippers Association as providing "a similar diagnosis of a number of pricing problems in the cotton futures market," stating that market was "now an investment vehicle for huge speculative funds that have created havoc in the market unimpeded by fundamentals or regulation." *Id*. at 142.

II. Congress Mandated the Swift Imposition of Position Limits to Deter, End, and Prevent the Excessive Speculation That It Found Was Wreaking Havoc in the Commodity Markets and Threatening the Wider United States Economy.

As just discussed, the Senate Permanent Subcommittee on Investigations found, based on the input of CMOC's members and many others, that excessive speculation existed in the commodity futures markets and that the speculation was harming end-users and consumers. Further, as stated in the Natural Gas Report, it also found that the harm from excessive speculation threatened the greater United States economy as well: "The health of the U.S. economy depends in part upon well-functioning capital markets, including the commodity markets that now play such a large part in determining U.S. energy prices. … Discredited markets, reluctant market participants, and ineffective pricing do nothing but harm U.S. economic and energy security interests." Natural Gas Report at 119. In other words, the Subcommittee believed that ending the harmful effects of excessive speculation was vital to protecting bona fide hedgers, commodity-dependent businesses and the wider American economy.

The vital importance of ending such speculation explains why Congress ultimately imposed the short, almost emergency, time limits for the CFTC to issue position limits rules in Title VII of the Dodd-Frank Act. Congress had studied and identified a serious crisis that it wanted remedied quickly. Against the backdrop of the Subcommittee's reports, and contrary to the District Court's opinion, it is simply implausible to read these provisions as mandating that the CFTC take quick action merely to duplicate Congressional efforts to investigate the issues.

Instead, a consistent theme among the three Subcommittee reports was the inadequacy of the current regulatory regime in relation to the excessive speculation problem. *See, e.g.*, *id*. at 119-20 (stating the current regulatory "systems [of checks and balances] are inadequate when it comes to energy trading," and calling for the closing of a loophole in the CEA, known as the Enron loophole, that allowed "look alike" energy swaps to be traded on exchanges that were not subject to position limits). Consequently, the Wheat Report recommended strengthening position limits and phasing out exemptions from such limits as key features of an updated regulatory regime. Wheat Report at 16 (recommending phasing out exemptions and then tightening position limits if problems persist after the phase out); *see also* Natural Gas Report at 8 (recommending that if CFTC was given additional legal authority it should monitor aggregate positions across exchanges, and that it and the exchanges should "strengthen their monitoring and oversight to prevent excessive speculation for all of the months in which contracts are traded….").

The Subcommittee's reports and other similar investigations ultimately informed Congressional attempts to reform regulation of the commodity derivatives markets in order to address the steep rise in commodity prices in the late 2000s, as shown by repeated references to them in the Congressional record. *See* Brief for Senators Levin, et al. as Amici Curiae in Support of Defendant Commodity Future Trading Comm'n, District Court Proceeding (Apr. 14, 2012), Dkt. 37, at 14 (quoting floor statements by Senators Levin, Snowe, and Feinstein). These same reports and investigations also led to the introduction of the Prevent Excessive Speculation Act of 2008, S. 3577, a forerunner of the Dodd-Frank Act. *See id*. at 14-15 (discussing introduction of Prevent Excessive Speculation Act and statements by its sponsors about its intended purposes). One of the bill's sponsors explicitly stated that it "would *require* the CFTC to set limits on the holdings of traders in all of the energy futures contracts traded on regulated exchanges to prevent traders from engaging in excessive speculation or price manipulation." 154 Cong. Rec. S9495 (daily ed. Sept. 25, 2008) (statement of Sen. Levin) (emphasis added). While the bill did not become law, section 6, which would have required the CFTC to act quickly to establish new position limits, formed a foundation for the position limits provisions of the Dodd-Frank that followed.[13]

Like the Prevent Excessive Speculation Act bill, the Dodd-Frank Act reforms the existing regulatory regime to address Congress' concerns about the rise in commodity prices caused by excessive speculation. Title VII of Dodd-Frank

[13] Similarly, in 2008, the House of Representatives passed another bill that ultimately did not become law but which contained a section that would have required the establishment of position limits. *See* 153 Cong. Rec. H 8415 (daily ed. Sept. 18, 2008) (text of Section 8 of the Commodity Markets Transparency and Accountability Act, H.R. 6604); *see also id*. at 8429 (showing passage by vote of 283-133).

strengthens the CFTC's authority to set position limits and obligates it to set such limits within 180 or 270 days of the statute's enactment. 7 U.S.C. § 6a(a)(2)(B). The Act's requirement that the CFTC study and report on the effects of the new limits within a year further emphasizes the importance Congress placed on the CFTC taking swift regulatory action. 15 U.S.C. § 8307. While the Subcommittee Reports found that excessive speculation existed and was having deleterious effects, the Reports did not quantify or attempt to quantify the precise level of speculation that would be acceptable. The Wheat Report acknowledged that there is "no widely accepted way to quantify what an acceptable level or percentage of speculation in a particular market might be." Wheat Report at 156, n.270. That same Report noted that the Commodity Exchange Act, the act that Title VII of the Dodd-Frank Act amended to strengthen the CFTC's position limit authority, did not define excessive speculation "but rather states that excessive speculation that causes 'sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity is an undue and unnecessary burden on interstate commerce in such commodity.'" *Id*. at 157. The Report adds that the Commodity Exchange Act "directs the CFTC to establish limits on trading" not merely to "diminish" or "eliminate," but also to "prevent this burden on commerce." *Id*.

Given the Subcommittee's finding that harmful speculation was occurring but acknowledgment that it was difficult to determine what position limits should be set to stop it, the follow-up reporting requirement of the Dodd-Frank Act was clearly meant to provide both Congress and the CFTC an opportunity to evaluate whether the position limits set by the CFTC in the exercise of its expertise were appropriate. The year-long period would allow the CFTC to gather data, judge whether the limits it set were working properly, and then present its findings to Congress for Congressional input. By requiring the study and limiting it to one year, Congress was ensuring that if the limits failed to stop the excessive speculation problem, or even created other problems of their own, then both it and the CFTC would be able to revisit them quickly. In fact, as demonstrated by the Senate amici in the district court, the reporting requirement was added by an opponent of mandatory position limits as a way to ensure that the limits were revisited if they were having negative economic effects. *See* Brief for Senators Levin, et al. as Amici Curiae, District Court Proceeding (Apr. 13, 2012), Dkt. 37, at 22.[14] The District Court may not have believed that this was the best or most prudent course of action, but it is the course of action that Congress chose and

[14] During a House Agriculture Committee hearing on the Derivatives Market Transparency and Accountability Act of 2009, H.R. 977, Sean Cota, a representative of CMOC members Petroleum Marketers Association of America and New England Fuel Institute, specifically urged the House Agriculture Committee to drop the reporting requirement unless Congress mandated position limits (as Congress ultimately did). *2009 Derivatives Legislation Hearing* at 39 (Statement of Sean Cota, Co-Owner and President, Cota & Cota, Inc.; Treasurer, Petroleum Marketers Association of America; on behalf of New England Fuel Institute). As shown by the House Amici, H.R. 977 would later become part of the Dodd-Frank Act's provisions requiring position limits. *See* Amicus Brief filed by Ranking Members Maxine Waters and Collin C. Peterson in Support of the Commodity Futures Trading Commission at 3-5 (discussing H.R. 977 as part of the legislative history of the position limit provisions of the Dodd-Frank Act).

courts cannot second guess clearly expressed Congressional intent. *See Lower Brule Sioux Tribe of S. Dakota v. United States*, 712 F.2d 349, 355 (8th Cir. 1983) *(*"when legislative intent is clearly expressed, it is not the function of the courts to question the wisdom of Congressional policy, or the ease of its administration").

The history of Congressional actions and investigations related to excessive speculation shows that Congress believed excessive speculation was an impediment to the proper functioning of the commodity derivatives markets and needed to be reined in. The District Court's reading of Title VII of the Dodd-Frank Act as only requiring the CFTC to study the excessive speculation problem is wholly inconsistent with this history. As a result, it misinterprets the unambiguous intent of Congress.

It also leaves commodities users, including CMOC's member organizations, their constituent businesses, and their customers unprotected from on-going harm resulting from excessive speculation. Congress intended for position limits to check the harm associated with excessive speculation. Due to the District Court's decision, these limits have not been put in place. Thus, the excessive speculation continues unabated and remains inadequately regulated.[15] The result, as captured by the American Cotton Shippers Association's description of the cotton market, is

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[15] *See, e.g.*, Kenneth J. Singleton, *Investor Flows and the 2008 Boom/Bust in Oil Prices* (Mar. 23, 2011), available on Social Science Research Network at http://ssrn.com/abstract=1793449 (presenting evidence there was "an economically and statistically significant effect of investor flows on futures prices") (Attachment 2 to *Delta Comment Letter*).

that inadequate safeguards exist to prevent the markets from becoming "overrun" by speculative traders whose massive positions and trading strategies result in markets "lacking an economic purpose – [markets] not contemplated by the Congress when it authorized futures trading…." Wheat Report at 142.

Conclusion

CMOC respectfully requests that this Court reverse the decision of the District Court.

Respectfully submitted,

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ADDENDUM A

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Airlines for America
American Bakers Association
American Feed Industry Association
American Public Gas Association
American Trucking Associations
California Independent Oil Marketers Association
California Service Station & Auto Repair Association
Colorado Petroleum Marketers & Convenience Store Association
Connecticut Energy Marketers Association
Empire State Petroleum Association
Fuel Merchants Association of New Jersey
Gasoline & Automotive Service Dealers of America
Illinois Association of Convenience Stores
Illinois Petroleum Marketers Association
Independent Oil Marketers Association of New England
Industrial Energy Consumers of America
Louisiana Oil Marketers and Convenience Store Association
Maine Energy Marketers Association
Massachusetts Oilheat Council
Mississippi Petroleum Marketers and Convenience Stores Association
Montana Petroleum Marketers and Convenience Store Association
NAFA Fleet Management Association
National Association of Shell Marketers
National Family Farm Coalition
National Farmers Union
National Grange
National Latino Farmers & Ranchers Trade Association
New England Fuel Institute
New York Oil Heating Association
Oil Heat Council of New Hampshire
Oilheat Institute of Long Island
Oilheat Institute of Rhode Island
Pennsylvania Petroleum Association
Petroleum Marketers & Convenience Stores of Iowa
Petroleum Marketers Association of America
Petroleum Marketers Association of Kansas
Rancher-Cattlemen Action Legal Fund (R-CALF) USA
Utah Petroleum Marketers and Retailers Association

Vermont Fuel Dealers Association
Washington Oil Marketers Association
West Virginia Oil Marketers and Grocers Association
Wyoming Petroleum Marketers & Convenience Store Association

CERTIFICATE OF COMPLIANCE

I certify that this Brief complies with Fed. R. App. P. 32(a)(7)(B). It is proportionally spaced, Times New Roman 14 point, and contains 6,757 words, as counted by the Microsoft Word 2010 word processing program.

/s/ Kenneth D. Sansom

United States Court of Appeals
for the District of Columbia Circuit

Intl' Swaps and Derivatives, et al. v. Commodity Futures Trading Comm,
No. 12-5362

CERTIFICATE OF SERVICE

I, Robyn Cocho, being duly sworn according to law and being over the age of 18, upon my oath depose and say that:

Counsel Press was retained by SPOTSWOOD, SANSOM & SANSBURY, LLC, Attorneys for Petitioner Amicus Commodity Markets Oversight Coalition to print this document. I am an employee of Counsel Press.

On **April 22, 2013**, Counsel for Amicus has authorized me to electronically file the foregoing BRIEF OF AMICUS CURIAE COMMODITY MARKETS OVERSIGHT COALITION IN SUPPORT OF APPELLANT COMMODITY FUTURE TRADING COMMISSION IN FAVOR OF REVERSAL with the Clerk of Court using the CM/ECF System, which will serve, via e-mail notice of such filing, to any of the following counsel registered as CM/ECF users:

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Unless otherwise noted, 8 paper copies have been filed with the Court on the same date via Express Mail.

April 22, 2013

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