

Senate Considers Clarifying FERC/CFTC Jurisdiction

March 11, 2010

On March 9, 2010, the Senate Committee on Energy and Natural Resources (the "Senate Committee") held a hearing to consider certain potential implications of the Wall Street Reform and Consumer Protection Act of 2009 (the "Financial Reform Bill" or "H.R. 4173"), which the House of Representatives passed on December 11, 2009. In particular, the Senate Committee sought to examine whether a corresponding Senate bill should include clarification regarding the respective jurisdiction of the Federal Energy Regulatory Commission ("FERC") and the Commodity Futures Trading Commission (the "CFTC"). While the Senate Banking and Agriculture Committees are considering financial reform legislation that may subject energy transactions to the CFTC's jurisdiction, the Senate Committee has oversight of FERC.

The issue of whether certain energy products, including those traded on FERC-regulated energy markets such as financial transmission rights ("FTRs"), and whether the centralized markets themselves fall within CFTC jurisdiction under the Commodity Exchange Act predates H.R. 4173. But the Senate may take this opportunity to attempt to clarify what many believe is overlapping jurisdiction that has been troubling the agencies for some time. A copy of the hearing and written testimony is available at:

http://energy.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing_ID=7b2e32f6-944f-f019-4fb8-f676653acb34

Senator Blanche Lincoln (D-AR), who chairs the Senate Agriculture Committee, which oversees the CFTC, emphasized at the hearing that duplicative regulations were not an option, and that the Senate Committee and agencies should cooperate to draft a compromise that respects the missions of both agencies. The two agencies have different statutory authority and accordingly, different "missions". The FERC is tasked with ensuring that consumers have reliable and adequate supply of power at just and reasonable prices, while the CFTC, in contrast, is tasked with ensuring that markets operate fairly. Senator Lincoln observed that "good fences make good neighbors," and appeared to favor a bright-line division of jurisdiction that would eliminate any jurisdictional ambiguity. Ranking Member of the Energy and Natural Resources Committee, Senator Lisa Murkowski (R-AK), noted that stakeholders were looking for certainty, and that Congress should avoid creating unintended consequences as it regulates derivatives.

Testimony before the Senate Committee included statements that the agencies have reached an honest but immutable disagreement regarding jurisdiction. FERC Chairman Jon Wellinghoff and former FERC Chairman Joseph Kelliher (testifying as an Executive Vice President of FPL Group, Inc. on behalf of the Edison Electric Institute and the Electric Power Supply Association), both acknowledged that the FERC/CFTC jurisdictional issues pre-date the house bill. Moreover, both former Chairman Kelliher and Chairman Wellinghoff also explained that although H.R. 4173 is not entirely clear, it does suggest that some authority would actually be transferred from FERC to the CFTC. A particular concern relates to the definition of swaps in H.R. 4173 that could include capacity contracts.

Wellinghoff and Kelliher, along with Chairman of the New York Public Service Commission Garry Brown, representing the National Association of Regulatory Utility Commissioners, urged the Senate to include clarifying language in its corresponding bill to make certain FERC has adequate jurisdiction to ensure just and reasonable rates and also to ensure reliability. Specifically, Kelliher testified that such clarification should: (1) include a specific energy end-user exemption from any mandate that over-the-counter derivatives clear or trade on CFTC-regulated exchanges; and (2) clarifying language that electricity products and services provided under a FERC-approved tariff and subject to regulatory oversight by FERC, such as FTRs and capacity markets, should be exempt from CFTC regulation. Wellinghoff also noted the need for clarification and requested that the Senate create bright lines in jurisdiction, but stated that an "exemption" was not necessary because FERC already fully regulates in the ISO/RTO area. Instead, his testimony sought to ensure that any improvements warranted in FERC-regulated markets be made by FERC rather than interposing a new regulator.

Gary Gensler, CFTC Chairman, testified in opposition to any energy-related exemptions from the new law. He explained in his testimony that as markets develop over time, unintended consequences might change even a carefully crafted exclusion, creating a "problem-filled" loophole. Such a loophole could undermine the effectiveness of comprehensive reform. He informed the Senate Committee that the CFTC and FERC have adequate tools to work cooperatively and that the CFTC did not identify overlaps as a concern. He referred to the Amaranth proceedings as an instance in which both agencies coordinated and successfully achieved their separate statutory missions in a coordinated fashion. With respect to FTRs, the current approach, as described by CFTC Chairman Gensler is that the CFTC provides advice and FERC takes the lead. Gensler emphasized, however, that it is impossible to predict how things will evolve over time and that standard transactions should be subject to CFTC jurisdiction. Chairman Gensler expressed concern that the CFTC should not be excluded from regulating FTRs and similar products,

because such bright-line exemptions have resulted in significant loopholes in the past.

H.R. 4173 includes a savings clause related to FERC and also contemplates that FERC and the CFTC would further define their respective jurisdictions in a Memorandum of Understanding. Former FERC Chairman Joseph Kelliher respectfully suggested that it might be best for Congress to decide jurisdiction rather than leave it to the agencies. He also suggested that disagreement on the agencies' respective authority will not be resolved unless courts or Congress resolves it.

With respect to electricity products and services provided under a FERC-approved tariff and subject to regulatory oversight by FERC that some argue could otherwise be regulated by the CFTC, such as FTRs and capacity markets, FERC Chairman Wellinghoff testified that FTRs need to be simultaneously possible on the ISO and are point specific. Similarly, Vincent P. Duane, the Vice President and General Counsel of PJM Interconnection, L.L.C., testified that FTRs are inextricably linked to both the locational-priced energy markets and the provision of firm transmission service by RTOs/ISOs. FERC Staff has explained in other contexts that FTRs are much less liquid or fungible than other commodities traded on exchanges and are more appropriately regulated by FERC.

The testimony of Wellinghoff and Kelliher also questioned whether there is a public policy imperative or other need for a change with respect to energy products, because energy products have not been a source of financial turmoil. Energy commodities do not pose the types of risk that Congress is presently concerned about and RTO/ISO markets are already highly regulated by the FERC. FERC Chairman Wellinghoff emphasized FERC's enforcement capabilities and the significant increase in its enforcement activities over the past several years.

Some of those testifying also highlighted the collateral issues that would be presented if certain products needed to be cleared on an exchange. In his testimony, Chairman Wellinghoff identified among his concerns the possible negative impacts of overlapping FERC and CFTC jurisdiction, such as higher rates for consumers and chilling of investment in the energy industry, including investments in green power and reliability projects. NYPSC Chairman Garry Brown also noted that requiring utilities to put up billions of dollars in additional collateral would divert those resources from other needed investment. Mr. Duane from PJM indicated that with respect to FTRs, collateral requirements could make them cost prohibitive and FTRs as a product could simply disappear, exposing customers to volatile prices. Kelliher suggested that any concerns regarding transparency could be addressed in an enhanced reporting requirement.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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We will continue to keep clients and friends of the firm updated on whether Congress further defines the respective jurisdiction of the CFTC and FERC.

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