

## Forward Energy Attribute Market Working Group

### FEAM JURISDICTION: CFTC JURISDICTIONAL ANALYSIS SUMMARY

#### 1. What type of governance structure can a CFTC-products regional market take?

A Designated Contracts Market (“DCM”), which is the most likely designation of the Forward Energy Attribute Market (“FEAM”), has the following governance requirements: 1) must have a “fitness standard” for its directors, members, and key personnel to screen out potential bad actors<sup>1</sup>; 2) make and enforce rules for minimizing and resolving conflicts of interest<sup>2</sup>; 3) “governance arrangements that consider the views of market participants<sup>3</sup>; and 4) recruit individuals from a broad and culturally diverse pool of qualified candidates to serve on its decision-making bodies.

##### a. Is there a prescriptive administration model?

The CFTC’s DCM regulations do not prescribe an *overall* administrative model, but they contain prescriptive requirements as to various administrative elements and units that any DCM administrative model must have. A few examples are listed below:

- A DCM must have compliance and enforcement unit(s) that either monitor the market, audit trades, and enforce market rules directly, or supervises the work of a third-party “regulatory services provider” that performs these functions for the DCM.<sup>4</sup>
- A DCM must have one or more disciplinary panels to adjudicate alleged rule violations, whose members must not also be members of a compliance and/or enforcement unit.<sup>5</sup>

##### b. What requirements does CFTC have for setting up a market?

CFTC regulations contain detailed requirements that DCMs must meet. Generally, CFTC requires DCMs to have capabilities and processes designed to detect, deter, and prevent various forms of market manipulation and abusive trading practices.<sup>6</sup> Establishing a DCM requires filing an application with CFTC that demonstrates the proposed DCM meets all applicable CFTC requirements.<sup>7</sup> Once an application is submitted, CFTC must grant or deny the application within 180 days, unless CFTC determines the application is materially incomplete.<sup>8</sup> If the Commission determines the application is

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<sup>1</sup> 7 U.S.C. § 7(d)(15); 17 C.F.R. § 38.800.

<sup>2</sup> 7 U.S.C. § 7(d)(16); 17 C.F.R. § 38.850.

<sup>3</sup> 7 U.S.C. § 7(d)(17); 17 C.F.R. § 38.900.

<sup>4</sup> See 17 C.F.R. § 38.154-155, 38.257.

<sup>5</sup> 17 C.F.R. § 38.702-710.

<sup>6</sup> See generally 17 C.F.R. § 38.150-1201.

<sup>7</sup> See 7 U.S.C. § 8(a); 17 C.F.R. § 38.3.

<sup>8</sup> 7 U.S.C. § 8(a)

materially incomplete, the running of the 180-day review period is stayed until a completed application is resubmitted, at which point CFTC has 60 days to decide whether to approve or deny the application.<sup>9</sup>

## **2. Can market rules under CFTC jurisdiction evolve?**

The CEA expressly provides for the right of DCMs to change their rules or list new types of products at any time.<sup>10</sup> Generally, a DCM can amend its rules or list a new product simply by filing a written certification that the new rule, rule amendment or product complies with the CEA and its implementing regulations with CFTC.<sup>11</sup> Absent action by CFTC, a new rule or product listing automatically takes effect 10 days after the certification is filed with CFTC.<sup>12</sup> However, CFTC can stay the implementation of a new rule for up to 90 days under certain conditions, to further explore the proposal. The proposed rule would then take effect at the end of the 90-day period unless the CFTC determines and informs the DCM that the proposed rule is inconsistent with the CEA or its implementing regulations.<sup>13</sup> The CEA explicitly requires CFTC to approve a proposed rule, rule amendment, or new product unless it finds that the proposed rule, rule amendment, or new product would violate the Act or its implementing regulations.<sup>14</sup>

### **a. How do CFTC processes compare to FERC formal process?**

Notably, this process shares significant similarities with how an RTO changes its market rules via a Federal Power Act Section 205 filing:

- Similar to a 205 filing, a DCM can file with CFTC to change its rules or list a new product at any time, and absent any action from the regulator the changes take automatic effect.
- Similarly to how an RTO just needs to show its proposed rule is consistent with the statutory just and reasonable standard, a DCM only needs to show that its proposal does not violate the standards or requirements of the CEA and its implementing regulations.

## **3. Can CFTC change their mind down the line?**

CFTC's regulatory remit is to prevent market manipulation and abusive trading practices. Consequently, CFTC could revoke or suspend a FEAM's status as a DCM *only* if it can prove that the FEAM was failing to enforce rules necessary to prevent such behavior, or otherwise violating the CEA or its implementing regulations. More specifically, CFTC can only revoke or

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<sup>9</sup> *Id.*

<sup>10</sup> *See* 7 U.S.C. § 7a-2(c).

<sup>11</sup> 7 U.S.C. § 7a-2(c)(1).

<sup>12</sup> 7 U.S.C. § 7a-2(c)(2).

<sup>13</sup> 7 U.S.C. § 7a-2(c)(3).

<sup>14</sup> *See* 7 U.S.C. § 7a-2(c)(5)(A) (“The Commission shall approve a new rule, or rule amendment . . . unless the Commission finds that the new rule, or rule amendment, is inconsistent with this subtitle (including regulations).”); 7 U.S.C. § 7a-2(c)(5)(B) (“The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this Act (including regulations).”).

suspend a market’s designation as a DCM “on a showing that the [DCM] is not enforcing or has not enforced its rules of government” or on a showing that the DCM “or any director, officer, agent, employee thereof, is violating any of the provisions of [the CEA] or any of the rules, regulations, or orders of the [CFTC] thereunder.”<sup>15</sup> And as noted above, CFTC must allow the trading of any product on a DCM unless the trading of that product would violate the CEA or its implementing regulations.<sup>16</sup>

#### **4. Interaction with FERC for a CFTC-jurisdictional market.**

##### **a. Do we need FERC’s permission to go build the model?**

FERC’s permission is not needed to build a CFTC jurisdictional model. The RTO Exemption Order noted the CFTC’s exclusive jurisdiction “agreements, contracts or transactions traded pursuant to FERC- or state-approved tariff or rate schedules.”<sup>17</sup> But even in the presence of the CFTC’s jurisdiction over these subject matters, the underlying jurisdiction of FERC and state commissions remained.<sup>18</sup> Thus, the CFTC defined its waiver on the condition that “[t]he agreement, contract, or transaction is offered or sold pursuant to a Requesting Party’s Tariff and that Tariff has been approved or permitted to take effect by: (1) In the case of the Electricity Reliability Council of Texas (“ERCOT”), the Public Utility Commission of Texas (“PUCT”), or (2) In the case of all other Requesting Parties, [FERC].”<sup>19</sup> This is critical, because the CFTC was deferring jurisdiction to the entity that would have had jurisdiction absent the preemption contained in the CEA. As examined by previous analyses, we do not believe forward transactions for the delivery of attributes would be FERC-jurisdictional, and so reversion to FERC is unlikely.

#### **6. What is the process for obtaining a waiver of CFTC jurisdiction, should the states pursue such option?**

The Commodity Exchange Act (“CEA”) authorizes the CFTC to “exempt any agreement, contract, or transaction (or class thereof)” as well as “any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction” from most of the requirements of the CEA following “notice and [an] opportunity for hearing.”<sup>20</sup> A party seeking an exemption from CFTC begins the

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<sup>15</sup> 7 U.S.C. § 8(b).

<sup>16</sup> *See* 7 U.S.C. § 7a-2(c)(5)(B).

<sup>17</sup> RTO Exemption Order, 78 Fed. Reg. at 19881.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 19913.

<sup>20</sup> 7 U.S.C. § 6(c)(1). Moreover, the provisions of the Act for which the CFTC cannot provide exemptions appear to be limited to provisions applicable to financial commodities and entities involved in their trading. *See id.* § 6(c)(1)(A) (listing various provisions for which CFTC cannot issue exemptions). As CFTC has ruled that “renewable energy credits are nonfinancial commodities,” presumably an FEAM trading only futures for RECs and similar products would not be subject to any of these provisions in the first place. Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap

process by filing a petition with CFTC.<sup>21</sup> CFTC then issues a proposed order either granting, potentially subject to conditions, or denying the exemption and solicits public comment on it.<sup>22</sup> It then reviews the public comments and issues a final order either granting or denying the exemption.<sup>23</sup>

Strictly speaking, such exemptions do not constitute a waiver of jurisdiction and as such technically there is no “grantee” of CFTC’s jurisdiction. That said, a DCM likely needs to be subject to the regulatory oversight of another federal or state agency to secure an exemption from the CEA:

- In order to grant an exemption, the CFTC must first determine that the relevant “requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought and that the exemption would be consistent with the public interest and the purposes of [the CEA].”<sup>24</sup>
  - According to the CFTC, the relevant public interest lies in “providing a means for managing and assuming price risk, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”<sup>25</sup> The purpose of the CEA is to serve these interests and to create a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals . . . to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.<sup>26</sup>
- Based on the RTO exemption Order, one general rule can be discerned: the CFTC may require another state or federal regulator to be exercising some form of jurisdiction or oversight over any futures market to which it grants an exemption. The CFTC therefore stressed it was an “important factor” that the granted exemptions

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Agreement,” Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,207, 48,317 (Aug. 13, 2012) (to be codified at 17 C.F.R. pt. 1, 230, 240, & 241).

<sup>21</sup> See, e.g., Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas from Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act, 78 Fed. Reg. 19880, 19892 (Apr. 2, 2013) (“RTO Exemption Order”).

<sup>22</sup> See, e.g., *id.* at 19892, 19894.

<sup>23</sup> See, e.g., *id.* at 19880, 19912-15.

<sup>24</sup> 7 U.S.C. § 6(c)(2)(A).

<sup>25</sup> RTO Exemption Order, 78 Fed. Reg. at 19894 (citing 7 U.S.C. § 5(a)).

<sup>26</sup> *Id.* (quoting 7 U.S.C. § 5(b)).

were “explicitly limited” to transactions “taking place on markets that are monitored by either an independent [market monitoring unit], a market administrator (the RTO, ISO, or ERCOT), or both, *and* a government regulator (FERC or [the Public Utility Commission of Texas]).”<sup>27</sup>

- The CFTC must determine that only “appropriate persons” will enter into an “agreement, contract, or transaction” subject to the requested exemption.<sup>28</sup> The CEA lists various entities that constitute “appropriate persons,” including but not limited to any federal, state, or local government or agency thereof, as well as any “corporation, partnership, proprietorship, organization, trust, or other business entity with a net worth exceeding \$1,000,000 or total assets exceeding \$5,000,000.”<sup>29</sup> Business entities that do not meet either the net worth or total asset requirements can still qualify as an “appropriate person” if their obligations under any exempted transaction “are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement.”<sup>30</sup>
- The CFTC must determine that any “agreement, contract, or transaction” subject to the requested exemption “will not have a material adverse effect on the ability of the [CFTC] or any [DCM] or derivatives transaction execution facility to discharge its regulatory or self-regulatory duties.”<sup>31</sup>

Securing a exemption will likely take significantly longer than submitting an application for DCM status. It took 14 months for the RTOs to receive their requested exemption, whereas CFTC must act on a DCM application within 6 months.

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<sup>27</sup> *Id.* (emphasis added).

<sup>28</sup> 7 U.S.C. § 6(c)(2)(B)(i).

<sup>29</sup> 7 U.S.C. § 6(c)(3).

<sup>30</sup> 7 U.S.C. § 6(c)(3)(F).

<sup>31</sup> 7 U.S.C. § 6(c)(2)(B)(ii).