

CFTC Letter No. 99-44

September 15, 1999

Interpretation

Division of Trading & Markets

Re: Rule 4.14(a)(1) -- Relief from Registration as a Commodity Trading Advisor for a Firm Involved in Providing Energy Management Services

Dear :

This is in response to your letter dated June 9, 1998 to the Division of Trading and Markets (Division) of the Commodity Futures Trading Commission (Commission), as supplemented by your letter dated August 20, 1998, by which you requested the Division s opinion concerning the availability of the exemption from registration as a commodity trading advisor (CTA) set forth in Commission Rule 4.14(a)(1) to X .

Based upon the representations made in your correspondence, we understand the facts to be as follows. X is an independent gas marketing company based in Ohio. It supplies natural gas to residential, commercial and industrial customers by purchasing natural gas from producers and/or other marketing companies and transporting the natural gas along interstate pipelines to the receipt facilities of its customers or to storage facilities. X also provides various services for its natural gas customers which allow customers more easily to buy natural gas from an independent marketer, such as X , rather than from the local utility. X further will analyze a customer s usage of natural gas to help the customer identify its future needs for supplies.² X does not provide customers with advice on using futures or options contracts to hedge price risk as part of this service. There is no additional charge or fee for any of these services. Many of X s customers choose to buy from X because it can provide its customers with one-stop shopping, thereby minimizing the work that the customer must do in order to purchase from an alternate gas supplier rather than a local utility.³

Previously, all X s contracts for delivery of natural gas were based upon spot market prices. To remain competitive, X now offers more flexible pricing options. X therefore may recommend to customers, or customers may request, that a fixed price contract be used, rather than using a contract in which the price varies with the monthly spot price. Under these circumstances, X generally tries to secure an order from a producer or other

marketer for physical supplies at the same fixed price less a profit margin. Although X does not currently use commodity interests in any capacity, X may decide to enter into a commodity interest contract to lock in X's profit margin on fixed price transactions.⁴ X will be entering into these contracts for its own account. X does not, nor does it intend to, enter into commodity interest transactions on behalf of customers.⁵ Nevertheless, you are concerned that X's use of commodity interests for hedging purposes or to lock-in its profit margins on flexible-price transactions entered into with customers will constitute an indirect means of providing commodity trading advice to those customers and thus, will require X to register as a CTA with the Commission.

The Act defines a CTA as any person who:

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

(II) any commodity option authorized under section 4c; or

(III) any leverage transaction authorized under section 19; or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

Section 4m(1) of the Act⁶ generally requires each person who comes within the CTA definition to register as a CTA with the Commission.

Thus, in order for X's activities to bring it within the statutory definition of a CTA and the attendant registration requirement, X would be required to be offering advice to its customers on the value or advisability of trading or using commodity futures or option contracts in return for some form of direct or indirect compensation.

Based upon your representations, the Division understands that X intends to trade commodity interests to hedge price risk arising from its own commercial dealings, specifically its purchases or sales of natural gas. This activity would not, in the Division's opinion, implicate the statutory definition of a CTA. Thus, it does not appear necessary for X to register as a CTA in order to trade commodity interests for its own account, as

described above.⁷

This letter is applicable to X solely with respect to its trading of commodity interests for its own account, as described above. It does not excuse X from compliance with any other applicable requirements contained in the Act or the Commission's rules. For example, X remains subject to all antifraud provisions of the Act and the large trader reporting requirements of Parts 15, 18 and 19 of the Commission's rules.

This letter, and the interpretation provided herein, are based upon the representations that you have made to us. Any different, changed or omitted material facts or circumstances might render this interpretation void. In this regard, we request that you notify us immediately if the activities or operations of X change in any material way from those represented to us.

This letter represents the views of this Division only. It does not necessarily reflect the views of the Commission or any other office or division of the Commission. If you have any questions concerning this correspondence, please contact me or Thomas E. Joseph, an attorney on my staff, at (202) 418-5450.

Very truly yours,

I. Michael Greenberger

Director

¹ Rule 4.14(a)(1) exempts from registration as a CTA any person who is a dealer, processor, broker, or seller in cash market transactions of any commodity (or product thereof) and the person's commodity trading advice is solely incidental to the conduct of its cash market business.

² Among other things, X will: (1) submit a recommended monthly nomination; (2) confirm nominations and shipment schedules to pipelines; (3) confirm gas flows with producers, pipelines and local utilities; (4) monitor gas consumption and perform a mid-month analysis of customer usage and adjust flows of gas as required; (5) perform a cost of gas analysis and show savings to customers; (6) reconcile deliveries with producers, pipelines and local utilities; and (7) represent a customer's interest at the state utility commission. X provides these services under a program named Y, for which X has established a trademark.

³ X currently also acts a wholesale marketer between electric utilities and other marketing companies for the purchase and sale of electric power. X has been issued a power marketing license by the Federal Energy Regulatory Commission (FERC) to engage in this activity. X is reviewing its electricity wholesale operation, and the future direction of this operation is uncertain. By this letter the Division is not providing any opinion as to whether X's activities in the electricity market would implicate any

provisions of the Commodity Exchange Act (the Act) or the Commission s rules issued thereunder.

⁴ It is our understanding that X will enter into commodity interests traded on designated contract markets.

⁵ Further, it is our understanding that the prices X receives under its new contracts will not be linked to the prices at which X s futures or options trades are executed. For example, in trading futures or options, X will not link a futures or options trade to a contract signed with a customer, or a supplier, such that the price paid by the customer, or the price that X pays to a supplier, would change as the value of the corresponding futures or option transaction changes. Contracts that have a price element linked to a specific futures or option transaction may raise issues under the Act that were not addressed in X s original request and, therefore, are not being addressed by this letter.

⁶ 7 U.S.C. § 6m(1) (1994).

⁷ Since the Division does not believe that the activities described in your letter would bring X within the statutory definition of a CTA and the attendant registration requirement, it is not necessary for us separately to consider whether X is exempt from registration as a CTA pursuant to Rule 4.14(a)(1).