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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038-AD64

Retail Commodity Transactions Under Commodity Exchange Act

AGENCY: Commodity Futures Trading Commission.

ACTION: Interpretation.

SUMMARY: On December 14, 2011, the Commodity Futures Trading Commission (“Commission” or “CFTC”) issued in the Federal Register an interpretation (“Interpretation”) regarding the meaning of the term “actual delivery,” as set forth in the Commodity Exchange Act. The Commission also requested public comment on whether the Interpretation accurately construed the statutory language. In response to the comments received, the Commission has determined to clarify its Interpretation.

DATES: Effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).¹ Title VII of the Dodd-Frank Act² amended the Commodity Exchange Act (“CEA”)³ to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

In addition, section 742(a) of the Dodd-Frank Act amends section 2(c)(2) of the CEA to add a new subparagraph, section 2(c)(2)(D) of the CEA,⁴ entitled “Retail Commodity Transactions.” New CEA section 2(c)(2)(D) broadly applies to any agreement, contract, or transaction in any commodity that is entered into with, or offered to (even if not entered into with), a non-eligible contract participant or non-eligible commercial entity on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

² Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

³ 7 U.S.C. 1 *et seq.*

⁴ 7 U.S.C. 2(c)(2)(D).

basis.⁵ New CEA section 2(c)(2)(D) further provides that such an agreement, contract, or transaction shall be subject to CEA sections 4(a),⁶ 4(b),⁷ and 4b⁸ as if the agreement, contract, or transaction was a contract of sale of a commodity for future delivery.⁹

New CEA section 2(c)(2)(D) excepts certain transactions from its application. In particular, new CEA section 2(c)(2)(D)(ii)(III)(aa)¹⁰ excepts a contract of sale that results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved.¹¹

On December 14, 2011, the Commission issued an Interpretation inviting public comment on whether its stated interpretation of the term “actual delivery,” as used in new CEA section 2(c)(2)(D)(ii)(III)(aa), accurately construes the statutory language.¹² The Commission received several public comments on the Interpretation. After thoroughly reviewing those comments, the Commission has determined to clarify its Interpretation in response to the comments received.

⁵ 7 U.S.C. 2(c)(2)(D)(i).

⁶ 7 U.S.C. 6(a) (prohibition against off-exchange contracts of sale of a commodity for future delivery).

⁷ 7 U.S.C. 6(b) (regulation of foreign boards of trade with United States participants).

⁸ 7 U.S.C. 6b (prohibition against fraud).

⁹ 7 U.S.C. 2(c)(2)(D)(iii).

¹⁰ 7 U.S.C. 2(c)(2)(D)(ii)(III)(aa).

¹¹ The Commission has not adopted any regulations permitting a longer actual delivery period for any commodity pursuant to new CEA section 2(c)(2)(D)(ii)(III)(aa). Accordingly, the 28-day actual delivery period set forth in this provision remains applicable to all commodities.

¹² Retail Commodity Transactions Under Commodity Exchange Act, 76 FR 77670 (Dec. 14, 2011).

II. Summary of Comments

A. Comments Generally

The Commission received 13 comments in response to its Interpretation.¹³ The comments included 11 comment letters that addressed the Interpretation. These 11 comment letters were submitted by entities representing a broad range of interests, including a self-regulatory organization,¹⁴ precious metals dealers and depository companies,¹⁵ law firms,¹⁶ trade associations comprised of energy producers and suppliers,¹⁷ and electricity and natural gas suppliers.¹⁸

Of the 11 comment letters addressing the Interpretation, two voiced general support for the Interpretation. For example, NFA stated:

NFA fully supports the Commission’s proposed interpretation of the term [actual delivery] and believes that it is consistent with the statutory language.

The comment letter submitted by DGG expressed its appreciation of the Commission’s efforts to “curtail any fraudulent retail commodity transactions occurring by unscrupulous actors.” DGG further urged the Commission to consider delivery of precious metals to affiliates of the seller, but not to the seller itself, as constituting actual delivery under new CEA section 2(c)(2)(D)(ii)(III)(aa), stating that “[w]hile we understand the CFTC’s desire to ensure, among other things, that the seller actually has

¹³ The comment file may be accessed at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1124>.

¹⁴ National Futures Association (NFA).

¹⁵ Dillon Gage Group (DGG) and Monex Deposit Company and its affiliate (MDC).

¹⁶ J.B. Grossman P.A. (JBG), Greenberg Traurig, LLP (GBT), and Rothgerber Johnson & Lyons LLP (RJL).

¹⁷ National Energy Markets Association (NEM), Retail Energy Supply Association (RESA), and Commercial Energy Working Group (CEWG).

¹⁸ Constellation NewEnergy, Inc., Green Mountain Energy Company, Direct Energy Services, LLC, Exelon Energy Company, Reliant Energy Retail Holdings, LLC, Liberty Power Corporation, and Champion Energy Services, LLC.

the commodity to deliver, an affiliate of one of the limited types of depositories described in Example 2 [of the Interpretation] are unlikely to be the seller ‘fraudsters’ Senator Lincoln had in mind.”

Two of the comment letters submitted by law firms generally did not support the Interpretation. GBT stated that neither the Dodd-Frank Act nor its legislative history indicated Congress’s desire to limit the depositories to which actual delivery could be made, and JBG voiced its view that delivery in the context of precious and industrial metals requires only transfer of title to metal, not physical delivery of metal.

The third comment letter submitted by a law firm, RJL, was submitted on behalf of precious metals dealers. RJL requested clarification of when the Commission will consider the 28 days in new CEA section 2(c)(2)(D)(ii)(III)(aa) to begin and urged the Commission to allow for delivery of precious metals to additional depositories beyond those described in the Interpretation. RJL also requested clarification, as did MDC, a retail precious metals dealer, of whether the offset of a precious metals purchase prior to transfer of title to the customer and delivery of the precious metals to a depository within 28 days would cause the original purchase to become a prohibited transaction under new CEA section 2(c)(2)(D).

Finally, four of the comment letters were submitted by energy suppliers or trade associations comprised of energy producers and suppliers, and they generally requested clarification of whether new CEA section 2(c)(2)(D) and/or its exceptions apply to the sale and delivery of physical energy commodities, such as electricity and natural gas, to industrial, commercial, and/or retail customers on a recurring basis. For example, NEMA requested:

that the Commission clarify that the type of transactions which its retail energy marketer members typically enter into with residential and commercial customers, in which they contract with the customer to provide physical energy supply (electricity or natural gas) for terms that regularly in the course of business contemplate delivery of the physical energy commodity in excess of 28 days, were not intended and should not be interpreted to constitute ‘retail commodity transactions’ under the Act.

B. Specific Comments

1. Functional Approach and Relevant Factors

Significantly, no commenters criticized, expressed disagreement with, or questioned the underlying foundation for the Commission’s approach in determining whether “actual delivery” has occurred, as set forth in the Interpretation: “the determination of whether ‘actual delivery’ has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa) requires consideration of evidence regarding delivery beyond the four corners of contract documents;” and “in determining whether actual delivery has occurred within 28 days, the Commission will employ a functional approach and examine how the agreement, contract, or transaction is marketed, managed, and performed, instead of relying solely on language used by the parties in the agreement, contract, or transaction.”¹⁹ Further, no comment letters criticized, expressed disagreement with, or questioned the relevant factors the Commission enumerated in the Interpretation: ownership, possession, title, and physical location of the commodity purchased or sold, both before and after execution of the agreement, contract, or transaction; the nature of the relationship between the buyer, seller, and possessor of the commodity purchased or sold; and the manner in which the purchase or sale is recorded and completed.²⁰ Accordingly, the Commission will assess whether any given

¹⁹ 76 FR 77670, 77672 (Dec. 14, 2011).

²⁰ *Id.*

transaction results in actual delivery within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa) by employing the functional approach and considering the factors set forth in the Interpretation.

2. When the 28-Day Period Begins

In response to the comment from RJL, the Commission is clarifying when it will consider the 28-day period in new CEA section 2(c)(2)(D)(ii)(III)(aa) to begin. The Commission has determined that the most practical point at which to begin counting the 28 days is the date on which the agreement, contract, or transaction is entered into. This approach is consistent with the functional approach the Commission will take in determining whether actual delivery has occurred, and it should provide industry participants and the public with a readily ascertainable date for determining whether actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa).

3. Interpretation Examples

The Interpretation included five examples to illustrate how the Commission would determine whether actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa), and several comment letters urged the Commission to allow for delivery of commodities to depositories beyond those described in Example 2 or expressed disagreement with any limitation imposed on acceptable depositories or the precise form of delivery. The Commission has considered these comments and has determined to clarify the intent behind these examples.

The examples are non-exclusive and are included to provide the public with guidance on how the Commission will apply the relevant factors enumerated in the

Interpretation in making its determination of whether actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa). Examples 1 and 2 do not encompass all scenarios in which the Commission may determine that actual delivery has occurred, nor do Examples 3, 4, and 5 encompass all scenarios in which the Commission may determine that actual delivery has not occurred. Specifically, with regard to Example 2, the Commission may determine that actual delivery has occurred if a commodity is delivered to an affiliate of the seller or is already physically located at a depository, so long as the commodity is otherwise delivered in accordance with the methods described in Example 2, if a careful consideration of the other relevant factors enumerated in the Interpretation demonstrates that the purported delivery is not simply a sham and that actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa). Conversely, the Commission may determine that actual delivery has not occurred if a commodity is purportedly delivered to an affiliate of the seller, but the Commission is unable to obtain sufficient assurances within a reasonable period of time that the purported delivery is not simply a sham.

4. Offsetting of Transactions

Two commenters, in response to Example 5 of the Interpretation, requested clarification of whether the offset of a precious metals purchase prior to transfer of title to the customer and delivery of the precious metals to a depository within 28 days would cause the original purchase to become a prohibited transaction under new CEA section 2(c)(2)(D). After careful consideration of this comment, the Commission has determined that Example 5 accurately illustrates the Commission's views of whether actual delivery will have occurred under the circumstances described in Example 5. However, the

Commission recognizes that a customer may request to cancel a purchase of a commodity prior to actual delivery of the commodity within 28 days due to extraordinary market circumstances. Accordingly, the Commission will not prosecute a seller for permitting such a cancellation, provided that the seller does so only on limited occasions and at the customer's request, and further provided that the customer does not enter into a subsequent transaction within three business days of such cancellation.

5. Energy Producers and Suppliers

Four comment letters requested clarification of whether new CEA section 2(c)(2)(D) and/or any of its exceptions apply to the sale and delivery of physical energy commodities to industrial, commercial, and/or retail customers on a recurring basis. Specifically, under the scenario described in these comment letters, energy firms enter into fixed price contracts with customers to supply electricity or natural gas to the customer's residence or business for a period of one or more years. The customer consumes the electricity or natural gas and subsequently pays for that usage, along with all applicable taxes, on a periodic basis. The Commission is not of the view that new CEA section 2(c)(2)(D) applies to this scenario, particularly in light of the fact that the customer regularly receives delivery of and consumes the physical energy commodity over the term of the contract and periodically pays for that usage.

III. Commission Interpretation of "Actual Delivery"

In consideration of the foregoing, the Commission issues the following interpretation to inform the public of the Commission's views as to the meaning of the term "actual delivery" as used in new CEA section 2(c)(2)(D)(ii)(III)(aa) and to provide the public with guidance on how the Commission intends to assess whether any given

transaction results in actual delivery within the meaning of the statute. This interpretation does not address the meaning or scope of new CEA section 2(c)(2)(D)(ii)(III)(bb)²¹ or any exception to new CEA section 2(c)(2)(D) other than new CEA section 2(c)(2)(D)(ii)(III)(aa). Similarly, this interpretation does not address the meaning or scope of contracts of sale of a commodity for future delivery, the forward contract exclusion from the term “future delivery” set forth in CEA section 1a(27),²² or the forward contract exclusion from the term “swap” set forth in CEA section 1a(47)(B)(ii).²³ Nor does this interpretation alter any statutory interpretation or statement of Commission policy relating to the forward contract exclusion.²⁴

In the view of the Commission, the determination of whether “actual delivery” has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa) requires consideration of evidence regarding delivery beyond the four corners of contract documents. This interpretation of the statutory language is based on Congress’s use of the word “actual” to modify “delivery” and on the legislative history of new CEA section 2(c)(2)(D)(ii)(III)(aa) described above. Consistent with this interpretation of the statutory language, in determining whether actual delivery has occurred within 28 days of the date the agreement, contract, or transaction is entered into, the Commission will employ a functional approach and examine how the agreement, contract, or transaction is marketed, managed, and performed, instead of relying solely on language used by the parties in the agreement, contract, or transaction. This approach best accomplishes Congress’s intent

²¹ 7 U.S.C. 2(c)(2)(D)(ii)(III)(bb).

²² 7 U.S.C. 1a(27).

²³ 7 U.S.C. 1a(47)(B)(ii).

²⁴ *See, e.g.*, Statutory Interpretation Concerning Forward Transactions, 55 FR 39188 (Sept. 25, 1990) (“Brent Interpretation”).

when it enacted section 742(a) of the Dodd-Frank Act and gives full meaning to Congress's term "actual delivery."

Relevant factors in this determination include the following: ownership, possession, title, and physical location of the commodity purchased or sold, both before and after execution of the agreement, contract, or transaction, including all related documentation; the nature of the relationship between the buyer, seller, and possessor of the commodity purchased or sold; and the manner in which the purchase or sale is recorded and completed. The Commission provides the following non-exclusive examples to illustrate how it will determine whether actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa). The Commission may also determine that actual delivery has occurred in circumstances beyond those described in the first two examples if it can readily determine within a reasonable period of time that the purported delivery is not simply a sham and that actual delivery has occurred within 28 days within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa).

Example 1: Actual delivery will have occurred if, within 28 days, the seller has: (1) physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, into the possession of the buyer; and (2) has transferred title to that quantity of the commodity to the buyer.

Example 2: Actual delivery will have occurred if, within 28 days, the seller has: (1) physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, whether in specifically segregated or fungible bulk form, into the possession of a depository other

than the seller and its parent company, partners, agents, and other affiliates, that is: (a) a financial institution as defined by the CEA; (b) a depository, the warrants or warehouse receipts of which are recognized for delivery purposes for any commodity on a contract market designated by the Commission; or (c) a storage facility licensed or regulated by the United States or any United States agency; and (2) has transferred title to that quantity of the commodity to the buyer.²⁵

Example 3: Actual delivery will *not* have occurred if, within 28 days, a book entry is made by the seller purporting to show that delivery of the commodity has been made to the buyer and/or that a sale of a commodity has subsequently been covered or hedged by the seller through a third party contract or account, but the seller has not, in accordance with the methods described in Example 1 or 2, physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, and transferred title to that quantity of the commodity to the buyer, regardless of whether the agreement, contract, or transaction between the buyer and seller purports to create an enforceable obligation on the part of the seller, or a parent company, partner, agent, or other affiliate of the seller, to deliver the commodity to the buyer.

Example 4: Actual delivery will *not* have occurred if, within 28 days, the seller has purported to physically deliver the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing,

²⁵ Based on Examples 1 and 2, an agreement, contract, or transaction that results in “physical delivery” within the meaning of section 1.04(a)(2)(i)-(iii) of the Model State Commodity Code would ordinarily result in “actual delivery” under new CEA section 2(c)(2)(D)(ii)(III)(aa), absent other evidence indicating that the purported delivery is a sham. See Model State Commodity Code § 1.04(a)(2)(i)-(iii), Comm. Fut. L. Rep. Archive (CCH) ¶ 22,568 (Apr. 5, 1985). Conversely, an agreement, contract, or transaction that does not result in “physical delivery” within the meaning of section 1.04(a)(2)(i)-(iii) of the Model State Commodity Code is highly unlikely to result in “actual delivery” under new CEA section 2(c)(2)(D)(ii)(III)(aa).

in accordance with the method described in Example 2, and transfer title to that quantity of the commodity to the buyer, but the title document fails to identify the specific financial institution, depository, or storage facility with possession of the commodity, the quality specifications of the commodity, the identity of the party transferring title to the commodity to the buyer, and the segregation or allocation status of the commodity.

Example 5: Actual delivery will *not* have occurred if, within 28 days, an agreement, contract, or transaction for the purchase or sale of a commodity is rolled, offset, or otherwise netted with another transaction or settled in cash between the buyer and the seller, but the seller has not, in accordance with the methods described in Example 1 or 2, physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, and transferred title to that quantity of the commodity to the buyer, regardless of whether the agreement, contract, or transaction between the buyer and seller purports to create an enforceable obligation on the part of the seller, or a parent company, partner, agent, or other affiliate of the seller, to deliver the commodity to the buyer.

Issued in Washington, DC, on August 20, 2013, by the Commission.

Christopher J. Kirkpatrick,
Deputy Secretary of the Commission.

**Appendix to Retail Commodity Transactions Under Commodity Exchange Act –
Commission Voting Summary**

On this matter, Chairman Gensler and Commissioners Chilton, O’Malia, and Wetjen voted in the affirmative. No Commissioners voted in the negative.

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