CFTC Letter No. 01-64
June 14, 2001
Interpretation
Division of Trading and Markets

Re: Rule 4.14(a)(9) – Request for CTA registration no-action position for developer of a weather prediction software program who markets the system to bulk purchasers and sellers of natural gas.

Dear :

This is in response to your letter dated April 24, 2001, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by telephone conversations with Division staff. By your correspondence, you request, on behalf of "X" confirmation that the Division will not recommend that the Commission commence any enforcement action against "X" based on failure to register as a commodity trading advisor ("CTA") pursuant to Section 4m(1)[1] of the Commodity Exchange Act (the "Act")[2] in connection with the marketing of a software program designed to demonstrate the possible impact of long-range weather forecasts on natural gas prices. Large commercial buyers and sellers of natural gas would use the program to assist in hedging against natural gas price changes and in optimizing the prices at which they buy or sell natural gas for commercial purposes.

Based upon the representations contained in your correspondence, we understand the facts to be as follows. "X" specializes in long-range weather forecasting and in measuring the weather's impact on a wide array of supply-chain goods and services. "X" has placed its "Y") software program on its Internet website and has begun to market the use of "Y" to large commercial buyers and sellers of natural gas for use in hedging against price changes in natural gas and in optimizing the prices at which they buy or sell natural gas for commercial purposes.

"X's" clients who subscribe for the "Y" service must be commercial purchasers or sellers of natural gas. The service will not be provided to non-commercial clients. In return for payment of a fee, commercial clients are given access to "Y" via the Internet. The "Y" program makes recommendations with respect to natural gas purchases or sales over the next twelve months. These recommendations are not client-specific (*i.e.*, the same recommendation is made to every client). The program considers long-range weather forecasts as well as a variety of historical weather and natural gas inventory and price data, together with current information on gas inventory and natural gas futures contract prices.[3] By comparing the current price levels for futures contracts on the NYMEX for each of the next twelve expiration months with possible settlement price levels projected by the program, "Y" generates recommendations as to each of the months on whether to buy now or wait until settlement as to clients who are purchasers (or whether to sell now or wait until settlement for clients who are sellers).

You represent that, due to the deregulation of the natural gas industry and resultant gas price volatility, risk management has become a very important aspect of businesses that have a commercial need to purchase or sell large quantities of natural gas, and that weather has historically been an important factor in pricing natural gas. Accordingly, “X” believes that there is a need for the “Y” service among large commercial buyers and sellers of natural gas.

In addition to the recommendations (available on a daily or weekly basis at the client’s choice), “Y” also provides an optional calculator function. The client inputs the volume of physical natural gas (or the number of natural gas derivative contracts) that the client plans to buy or sell (the “Goal”) for each of the following twelve months. The calculator divides the Goal by the number of days remaining before the expiration of the particular month’s futures contract. The result is shown by the calculator as the quantity that should be bought, sold or waited upon (on a daily or weekly basis as the client may have chosen). The calculator function works entirely mathematically. The amount arrived at by the calculator does not change depending on the strength of the recommendation (to buy, sell or wait).

The client also may (optionally) input information about the purchases, sales and decisions to wait until settlement that it undertakes. The program records the information and subtracts the client’s position from the Goal when performing the calculator function.

None of the information input by the client alters the recommendations made by the program. The client’s input simply allows it to use the calculator function to determine how many contracts to buy, sell or wait on any given day.

A final feature of the “Y” program allows the client to keep a running record of its transactions and permits the client to calculate mark-to-market information if the client wishes to do so. Data input by the client can be displayed through a spreadsheet function and marked to market through interaction with the live NYMEX feed. The client can compare its actual positions with the results that it would have achieved if it had followed all of the recommendations made by the “Y” program. The client can also see all of its transactions in a particular contract month, and all transactions for the past year in chronological order.

“X” does not, and will not, direct the trading of any clients, nor does it transmit the client’s order to facilitate the client’s trading. If a client contacts “X” concerning the client’s trading, “X” does not and will not discuss with the client the client’s own situation or the advisability of particular trades. “X” will only discuss technical issues concerning the client’s use of the program (*e.g.*, whether the screen is freezing up). No person at “X” considers a client’s Goals or positions or advises a client about them.

Requested Relief

You request variously that the Division confirm it will not recommend that the Commission commence any enforcement action against "X" for failure to register as a CTA under Section 4m(1) of the Act, or an interpretation of Rule 4.14(a)(9) to exempt "X" from the requirement to register as a CTA. Under the facts as represented in your correspondence, we believe that "X" should be eligible for the exemption provided in Rule 4.14(a)(9).

Rule 4.14(a)(9) provides an exemption from the requirement to register as a CTA for those advisors who neither direct client accounts nor provide commodity interest trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients. As you have described "X's" "Y" service, all clients will receive the same standardized advice about the advisability of buying futures contracts, selling, or waiting. The system's recommendations will be the same from one client to the next, regardless of the particular attributes of each client. The additional optional functions of the system are available to and operated by the client. They appear to be strictly computational devices for which the client provides the inputs. The results are produced by simple mathematical operations upon the numbers supplied by the client, with no review, advice, or other input by "X" or its personnel. The information entered by a client in using the optional calculation functions in no way affects or changes the recommendations made by the "Y" system. Thus, the commodity interest trading advice provided by "X" will be standardized in all instances and will not be determined based upon the individual client's circumstances. The client will, however, be able to make calculations to aid it in determining how to use the system's recommendations to achieve the client's (client-selected) Goal.

Based upon the representations that you have made, the Division believes that the proposed activities of "X" would come within the terms of Rule 4.14(a)(9). Accordingly, "X" need not register as a CTA in order to operate the "Y" service in the manner described.

This letter does not excuse "X" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "X" remains subject to the antifraud provisions of Sections 4b and 4o of the Act,[4] to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's rules, and to all otherwise applicable provisions of Part 4.

This letter is based upon the representations made to us. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. The Division requests that you notify it immediately in the event that the operations or activities of "X", or the "Y" program change in any respect from those as represented to us. Furthermore, this letter represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours

John C. Lawton
Acting Director

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[1] 7 U.S.C. § 6m(1) (1994).

[2] 7 U.S.C. § 1 *et seq*. (1994), as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"), Pub. L. No. 106-554, 114 Stat. 2763 (to be codified as amended in scattered sections of 7 U.S.C.).

[3] The "Y" program makes use of a historical price/weather data analysis, a historical natural gas inventory/weather data analysis, a historical price/inventory/weather data analysis, a live feed from the New York Mercantile Exchange ("NYMEX") on the Henry Hub natural gas futures contracts expiring during the next twelve months, weekly natural gas inventory data from the American Gas Association, future long-range weather forecasts, future natural gas inventory change forecasts, and certain proprietary algorithms.

[4] 7 U.S.C. § 6b and 6o (1994).