Before the
FEDERAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	Project No. PO82900
Market Manipulation Rulemaking	)	

COMMENTS OF THE

NATIONAL PETROCHEMICAL AND REFINERS ASSOCIATION

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I. NPRA's INTERESTS

The National Petrochemical and Refiners Association (NPRA) has more than 450 members that own or operate virtually all U.S. petroleum refining capacity and include most of the nation's petrochemical manufacturers. The FTC's proposed rule would apply to many, if not most, of NPRA's members, and its enforcement would have a significant impact on thousands of commercial transactions each day in the wholesale petroleum sector. Because NPRA's members must be prepared to comply with any new FTC rule as soon as it becomes effective, they have carefully analyzed the proposed rule in an effort to understand its potential application to their business practices. NPRA provides these comments to alert the Commission to ways in which the proposed rule as currently drafted could impede the competitive and cost-effective operation of wholesale petroleum markets without any benefits to consumers to offset those losses. These comments also suggest alternative ways for the Commission to achieve the statutorily mandated and laudable goal of prohibiting market manipulation and still preserve desirable industry efficiencies that serve consumer welfare.

II. EXECUTIVE SUMMARY

The FTC's Notice of Proposed Rulemaking (NPRM)[1] states that the Energy Independence and Security Act of 2007 (EISA)[2] "targets manipulative and deceptive conduct in the petroleum markets, thereby seeking to eliminate conduct which serves no legitimate purpose and may in fact harm the market to the detriment of market participants and consumers."[3] The Commission has determined that "it would be appropriate for it to propose a rule targeting fraudulent or deceptive conduct in wholesale petroleum markets" based on its new authority under EISA.[4] As the model for that Rule, the FTC proposes to use Securities and Exchange Commission (SEC) Rule 10b-5.[5]

NPRA endorses the FTC's determination that implementation of the EISA should be accomplished through a rule against fraud and deception that harms the competitive functioning of wholesale petroleum markets and, ultimately, consumers. The SEC-based rule proposed by the FTC in the NPRM, however, is not an appropriate or workable model for an FTC market manipulation rule that applies to wholesale petroleum markets.

First, the underlying rationale for Rule 10b-5 does not fit wholesale petroleum markets. The foundation for SEC Rule 10b-5, Section 10(b) of the Securities and Exchange Act (SEA), was adopted to protect investors. The fundamental purpose of Rule 10b-5 is to remedy the informational imbalance between "insiders" and investors through a regulatory scheme based on fiduciary and other duties that do not, and should not, apply to arms-length transactions between sophisticated participants in wholesale petroleum markets.

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1 73 Fed. Reg. 48317 (Aug. 19, 2008).
2 Pub. L.. No. 110-140, *codified at* 42 U.S.C. §§ 17001-17386.
3 73 Fed. Reg. at 48321.
4 *Id.*
5 *See* 73 Fed. Reg. at 48321-22.

Second, the proposed Rule falls far short of the Commission's goal to adopt a rule that would "prohibit manipulative and deceptive conduct *without discouraging pro-competitive or otherwise desirable market practices*."[6] Careful study and consideration reveal that, as drafted, the language of the proposed rule instead would prompt corporate compliance systems that would impair the procompetitive and cost-efficient functioning of wholesale petroleum markets. Market participants believe they will need to implement conservative compliance systems due to the uncertainty created by the Commission's proposal to apply SEC precedent to enforcement of the Rule, the harsh penalties associated with the Rule, and the potential for the proposed Rule to be misused by third parties in private actions in which insufficient consideration may be given to how competitive markets operate to benefit consumers.

Nonetheless, NPRA believes that the FTC has already laid the groundwork for a more effective regulatory approach to achieve the EISA's mandate. Specifically, the FTC's NPRM provides an operational definition of a "manipulative or deceptive act" as "one that injects information that is materially false, misleading, or deceptive into the marketplace."[7] As developed in this Comment, NPRA believes this operational definition, with some modification and combined with other elements from Rule 10b-5 and from EISA itself, can provide a sound footing for the FTC's proposed rule.

III. SEC RULE 10b-5 ASSUMES FIDUCIARY AND OTHER DUTIES THAT DO NOT EXIST BETWEEN BUYERS AND SELLERS IN WHOLESALE PETROLEUM MARKETS.

The FTC has asked for comments on "whether using SEC Rule 10b-5 as a model is appropriate." For the reasons explained below, NPRA submits that it is not.

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[6] 73 Fed. Reg. at 48323 (emphasis supplied).

[7] 73 Fed. Reg. at 48328.

The underlying rationale for Rule 10b-5 does not fit wholesale petroleum markets. Section 10(b) of the SEA and SEC Rule 10b-5 were adopted to protect investors in the wake of the 1929 stock market crash and to ensure public confidence in the integrity of the stock market in the future. The fundamental purpose of Rule 10b-5 is to remedy informational imbalances between "insiders" and thousands of individual investors through a regulatory scheme based on fiduciary and other duties that require full disclosure before a transaction may be undertaken.[8] These concepts do not currently apply -- nor should they apply -- to arms-length transactions between sophisticated participants in wholesale petroleum markets.

A. The Treatment of Insider Trading as Fraud under SEC Rule 10b-5 Has the Purpose to Cure Violations of Fiduciary and Other Duties.

The best known use of rule 10b-5 has been in insider trading cases.[9] In the course of increasing penalties for insider trading through legislation in 1983, the House of Representatives issued a Report that explained the background of insider trading legislation:

> The United States securities markets are liquid, efficient and fair. The prices of the vast majority of actively traded securities reflect available public information about companies and the economy. Capital formation and our nation's economic growth and stability depend on investor confidence in the fairness and integrity of our capital markets.
>
> Insider trading threatens those markets by undermining the public's expectations of honest and fair securities markets where all participants play by the same rules. . . .
>
> * * * *
>
> The abuse of informational advantages *that other investors cannot hope to overcome through their own efforts is unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets where all participants play by the same rules.* Noting that insider trading prohibitions 'rest on considerations of equity,' one commentator explained that:

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[8] *See Basic Inc. v. Levinson*, 485 U.S. 224, 234 (1988)(*Basic)*; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963); *accord*, *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977).

[9] Gary M. Brown, SODERQUIST ON SECURITIES LAWS § 12.1 at 12-3 (5th ed. 2006).

> *The inability of a public investor with whom an insider transacts on inside information ever lawfully to erode the insider's informational advantage generates a sense of unfairness . . . . The unfairness is not a function of merely possessing more information -- outsiders may possess more information than other outsiders by reason of their diligence or zeal -- but of the fact that it is an advantage that cannot be competed away since it depends upon a lawful privilege to which [other investors] cannot acquire access.*[10]

To remedy the inherent informational disadvantage between public investors and those who hold material, non-public information about a company to which others cannot lawfully gain access, the courts have relied on the existence of fiduciary and other duties to require such "insiders"[11] either to abstain from trading or disclose such information to public investors.[12] The Supreme Court repeatedly has stated that the fundamental purpose of the 1934 Act is to apply a philosophy of full disclosure in securities markets.[13]

This requirement of full disclosure derives from the existence of fiduciary or other duties based on a relationship of trust or confidence. In *Chiarella v. United States*, for example, the Supreme Court explained that "the duty to disclose arises [in those circumstances] when one party has information 'that the other [party] is entitled to know because of a fiduciary or other

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[10] Donald C. Langevoort, 18A INSIDER TRADING: REGULATION, ENFORCEMENT, & PREVENTION APP. A at A-67, HOUSE REPORT ON INSIDER TRADING SANCTIONS ACT OF 1983 (H.R. 559), and at A-70-71, *citing* Brudney, *"Insiders, Outsiders and Informational Advantages under the Federal Securities Law*," 93 HARV. L. REV. 322, 346 (1979)(emphasis supplied).

[11] The courts and the Securities and Exchange Commission have interpreted the persons potentially liable under Section 10b-5 to include many persons beyond corporate insiders, such as officers, directors, and major stockholders. For example, even a "tippee" -- that is, a person to whom material, nonpublic information has been given by another -- can be liable under Rule 10b-5, no matter how many parties the information traveled through before it reached the "tippee." *See* Thomas Lee Hazen and David L. Ratner, SECURITIES REGULATION § 19 at 169 (9th ed. 2005). That liability, however, is premised on the tippee's "role as a participant after the fact in *the insider's breach of a fiduciary duty*." *Chiarella v. United States*, 445 U.S. 222, 228 (1980)(emphasis supplied)(*Chiarella)*.

[12] *See generally* Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:8 at 1-20 (2008).

[13] *See, e.g., Santa Fe Industries, Inc. v. Green*, 430 U.S. at 476-477; *accord, SEC v. Zandford*, 535 U.S. 813, 819 (2002).

similar relationship of trust and confidence between them,"[14] including where there is a "necessity of preventing a corporate insider from . . . [taking] unfair advantage of the uninformed minority stockholders.'"[15] A person also "commits a fraud in connection with the purchase or sale of a security when he secretly converts information given to him for legitimate reasons by trading on the basis of it for personal benefit, in violation of a fiduciary or similar duty to refrain from such benefit."[16]

Full disclosure is not required, however, unless there is a duty to disclose based on a fiduciary or other relationship of trust and confidence. The Supreme Court has refused to "recogniz[e] a general duty between all participants in market transactions to forgo actions based on material, nonpublic information . . . . [where] such a broad duty [] departs radically from the established doctrine that duty arises from a specific relationship between two parties . . . ."[17] As a leading commentator has explained, "[a]fter *Chiarella*, it can safely be said that a person violates Rule 10b-5 by trading on material nonpublic information without disclosing that information to the marketplace -- the essence of the abstain or disclose theory -- if (and

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[14] *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (citation omitted).

[15] *Chiarella*, 445 U.S. at 228-29 (citation omitted)

[16] Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:9 at 1-21 - 1-22 (2008). This theory was endorsed by the Supreme Court in United States v. O'Hagan, 521 U.S. 642 (1997). Under this theory, "the fraud is not on the person with whom the defendant trades, but rather on the person who gave him access to the information and to whom the defendant owed the fiduciary duty -- typically his employer or his employers' clients." Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:9 at 1-21 - 1-22 (2008).

There is only one source of insider trading liability that does not require a breach of a fiduciary duty, and that liability must be based on SEC Rule 14e-3, which prohibits any person who is in possession of material nonpublic information relating to the commencement of a tender offer, acquired directly or indirectly from either the bidder to the target company, from trading in target company securities. *See* Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:10 at 1-23 (2008).

[17] *Chiarella*, 445 U.S. at 233. For example, the Court refused to impose liability under Rule 10b-5 where a market analyst had informed his customers of corporate information that he had obtained *through his own investigative efforts* and the customers traded on the basis of that knowledge; there, no misappropriation existed. *Dirks v. SEC*, 463 U.S. 646 (1983).

presumably only if) he owes a fiduciary duty to marketplace traders."[18]

B. The Absence of Fiduciary and Other Duties between Sophisticated Market Participants Renders the Basic Rationale of Rule 10b-5 Inapplicable to Transactions between Them.

It would be unsupportable and bad public policy to apply analogous liability to purchasers or sellers in wholesale petroleum markets. Neither a buyer nor a seller in wholesale petroleum markets owes fiduciary or other duties to a counterparty, and certainly neither has a duty to disclose to a counterparty the types of material, nonpublic information about its own company with which Rule 10b-5 is concerned. No language in EISA imposes such duties. Moreover, even under Rule 10b-5, "the law is quite clear that a person can properly profit from *his own* private information."[19]

In addition, to the extent that the material, nonpublic information possessed by a buyer or seller in a wholesale petroleum market involves market conditions, rather than intra-company information, market participants currently compete to obtain such information and should continue to do so. Buyers and sellers in wholesale petroleum markets compete, in part, on the basis of independent research and analysis of market conditions. They use separate and distinct views of market conditions to pursue transactions that are in each company's interest. The freedom to use independently obtained market information solely for one's own benefit is a principle that also applies in securities markets. "Someone doing extensive research into issuers or their securities may well generate insights that are significant, and upon discovery would

[18] Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:8 at 1-20 - 1-21 (2008) (citation omitted).
[19] *Id.* § 1:12 at 1-24.

cause other traders to buy or sell. Since the law wants to encourage such research -- the product of one's own skill, diligence, or expertise -- it does not make its exploitation illegal."[20]

C. The Application of Rule 10b-5 and its Legal Precedent to Transactions between Sophisticated Buyers and Sellers Would Likely Distort Competition in Wholesale Petroleum Markets.

The FTC has explained it hoped to benefit market participants that will have to comply with the FTC's new rule by "leverag[ing] the significant body of legal precedent interpreting [Rule 10b-5]."[21] As shown above, however, to apply the existing legal precedent under Rule 10b-5 would create significant confusion as to the application and interpretation of the FTC's proposed Rule. "There are over 10,000 federal case citations to Rule 10b-5 (with many cases having more than one citation, of course)."[22] The most common use of Rule 10b-5 is in insider trading cases, which, as demonstrated above, are not analogous to transactions between sophisticated buyers and sellers in wholesale petroleum markets. Other types of fraudulent conduct attacked under SEC Rule 10b-5 involve misstatements or omissions of material information in corporate documents[23] and manipulative conduct in the securities markets,[24]

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[20] Donald C. Langevoort, 18 INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1:12 at 1-24 - 1-25 (2008).

[21] *See* 73 Fed. Reg. at 48322.

[22] Gary M. Brown, SODERQUIST ON SECURITIES LAWS § 12.1 at 12-3 n. 8 (5th ed. 2006).

[23] Some examples include: failure to disclose in company's quarterly report contingent liabilities that represented a potentially large financial loss, *SEC v. Fehn*, 97 F. 3d 1276 (9th Cir. 1996); misrepresentations and omissions by company concerning adequacy of loan collateral and accuracy of accounting for loan losses, *Marra v. Tel-Save Holdings, Inc.*, 1999 WL 317103 (E. D. Pa.); and failure to reveal fully the nature and extent of risks attendant to hedging activities where company said it was not engaged in speculation, *In re Ashanti Goldfields Securities Litigation*, 184 F. Supp. 2d 247 (E.D.N.Y. 2002).

[24] Some examples of manipulative conduct include: a fraudulent promise to sell a specified number of units of public offering in the future in order to encourage purchase of corporation's stock, *Pelletier v. Stuart-James Co. Inc.*, 863 F. 2d 1550 (11th Cir. 1989); placing of orders for purchases of securities with a broker without disclosing that payment would not be made for the securities if they declined in value, *A. T. Brod & Co. v. Perlow*, 375 F. 2d 393 (2d Cir. 1967); and factoring and securitization of worthless invoices, where such arrangements created the

which also do not provide relevant analogies to identify manipulative or deceptive conduct in wholesale petroleum markets.

Even if there may be cases within the 10,000 federal case citations under Rule 10b-5 that do provide reasonable analogies to situations the FTC may want to challenge, companies covered by the Rule cannot know in advance which of those cases the FTC would consider as a reasonable basis for a challenge. The level of confusion and concern created by the use of Rule 10b-5 precedent in connection with the FTC's market manipulation Rule would undermine the fundamental objective of the Rule, which is to provide clear guidance for future conduct. This uncertainty provides ample justification for the FTC to adopt a different approach to a market manipulation rule than to rely on Rule 10b-5 and the precedent thereunder, and this comment will propose an alternate route, as discussed at a later point.

Nevertheless, if the FTC does not choose an alternative approach, NPRA wishes to alert the FTC to how companies' efforts to comply could distort competition in wholesale petroleum markets.

1. Requirements for Full Disclosure to Competitors Could Result in Anticompetitive Information Sharing.

The imposition of any duties in wholesale petroleum markets to disclose material, nonpublic information to a counterparty would have a potential to harm competition in some circumstances. Such markets operate on the basis of mutual recognition that both buyers and sellers have incomplete information, differing views of likely future market conditions, and distinct business objectives that do not involve relationships of trust and confidence. In these markets, buyers and sellers both are likely to have private information that they do not, and should not, disclose to each other. A significant portion of commercial transactions in wholesale

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appearance of a conventional factoring or securitization operation to disguise a loan, *In re Parmalat Securities Litigation,* 376 F. Supp. 2d 472 (S. D. N. Y. 2005).

petroleum markets involve parties who compete with one another, as well as buy from or supply to one another. They transact with one another in different roles at various points along the value chain for wholesale petroleum products. It would be inconsistent with established antitrust law for a market manipulation rule to have the perverse effect of requiring competitors to disclose to each other a wide range of competitively sensitive information such as the availability of supply or transport capacity, expectations for future supply, or forecasts of supply and price changes. Any notion that participants in wholesale petroleum markets should consider themselves in a relationship of "trust and confidence" with each other could encourage tacit or explicit collusion —a result that standard antitrust theories tell us will have a tendency to raise prices or reduce output to consumers. NPRA recognizes that Section 811 is intended to supplement antitrust laws in some respects, but the statute did not call for a departure from established antitrust principles, and we urge the FTC not to apply it in a way that undermines important elements of antitrust law.

2. A "Full Disclosure" Rule Would Distort Companies' Decisions about Whether to Disclose Information that May Be Incomplete.

Compliance with any regulation promulgated by the FTC pursuant to EISA will require legal counsel to develop simple rules that can be followed by dozens or hundreds of personnel with no legal training. These rules will govern what can be said and what actions can be taken by refinery staff, traders, and others dealing with wholesale petroleum markets on behalf of a company.

Two examples illustrate a few of the many compliance questions raised by the FTC's proposed Rule. NPRA does not believe that either of these examples should be challenged as market manipulation under the FTC's proposed Rule. Nevertheless, absent the FTC choosing an alternative market manipulation rule or providing substantial additional guidance about how it

would plan to apply its proposed Rule, companies could not be sure that these very commonplace, everyday events would not result in legal challenge. The examples involve situations that NPRA members experience on a regular basis.

a. Could Bargaining Be Challenged as Market Manipulation?

Purchasers and suppliers bargain with each other to obtain the best deal possible for themselves, based on their individual assessments of the material nonpublic information that each has. The bargaining that continually takes place between sophisticated market participants in wholesale petroleum markets may, in the light of hindsight, result in prices that appear to have been either too high or too low. The first hypothetical suggests what could happen if a seller with subsequent remorse were permitted to claim a Rule violation because there had not been full disclosure by the buyer.

Hypothetical 1

Refiner A calls Refiner B in a not-too-distant market, seeking gasoline to meet Refiner A's contractual commitments. Refiner B offers a certain volume to Refiner A at a price that A considers too high. In the bargaining that follows, Refiner A tells B that A could buy the same volume at a lower price elsewhere. It is true that A could buy from other sources at lower prices, but A may not be able to arrange transport for the supplies if the relevant pipelines are full.

Analysis of Hypothetical 1

There are many reasons why this scenario should not be of concern to the FTC, including that it involves an isolated transaction between one buyer and one seller. Nonetheless, counsel for Refiner A could have genuine concern that this situation would trigger a complaint by Refiner B. Under the FTC's draft rule 317.3(b), Refiner A's initial statement qualifies as a true statement of a material fact -- that is, A could purchase the same volume from sources elsewhere at a lower price. But Refiner B might challenge that statement for omitting "a material fact

necessary in order to make the statement[] made, in light of the circumstances under which [it] was made, not misleading[,]" because Refiner A did not reveal that it might run into difficulty in finding transportation for the cheaper gasoline.

If so, then Refiner A could not bargain for a lower price without simultaneously acknowledging to B its uncertainty about transportation for the cheaper supplies. Should Refiner A have a duty to inform B of A's potential difficulties in obtaining transportation for alternate sources of supply? Such a duty is not necessary to protect the integrity of the wholesale petroleum market, since participants in that market are well-aware that each participant must protect its own interests. Indeed, to protect its interests, Refiner B might perform its own check on the availability of pipeline transportation from alternative sources to Refiner A before offering a lower price in response to A's statement.

Such a duty also would not reliably protect consumers from higher prices in the marketplace. To the contrary, application of the FTC's proposed rule to impose such a duty could increase transaction costs by undermining the bargaining process. If the FTC's rule obligated Refiner A to reveal its transportation difficulties to Refiner B (or, more likely, deterred A from bargaining on that basis), Refiner A would pay the higher price required by Refiner B, and that higher price ultimately could be reflected in prices to consumers. Counterexamples, of course, can be developed in which one refiner's non-disclosure of information would result in higher, not lower, prices.

The point, however, is not that a requirement for full disclosure would always result in either higher or lower prices. Rather, the point is that application of the FTC's proposed rule could distort bargaining between sophisticated buyers and sellers in wholesale petroleum

markets and encourage exchanges of competitively sensitive information that antitrust enforcers historically have discouraged.[25]

b. To Avoid Potential Liability for Insufficient Disclosures, Companies Could Discourage *Any* Disclosure.

An FTC rule applied to impose liability for truthful statements that are insufficiently caveated – accompanied by substantial fines for non-compliance and the risk of liability in private litigation -- could lead corporate counsel to advise against making any statements in the first place.

Hypothetical 2.

A refiner regularly sells gasoline under bilateral contracts and in the spot market. The refiner has an outage and realizes that, while repairs are made, it can only meet its contractual obligations and does not have sufficient supply to sell in the spot market. One of the companies that occasionally buys from the refiner in the spot market asks when the refiner will start selling in the spot market again. The refiner truthfully responds that, based on prior experience, its best estimate is that the refinery repairs will take three weeks. In the past, the refiner's estimates have been generally accurate. Accordingly, the spot market purchaser buys supplies sufficient for three weeks at a price higher than usual, due to the lessened supply because of the refiner's outage.

The refiner subsequently is able to repair the damage within one week, because it develops a new technique that speeds the repair work. The spot market purchaser then complains to the FTC that the refiner "omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading,"

[25] There is a further question whether imposition of a duty to disclose under an FTC market manipulation rule would conflict with each company's duty to its stockholders to pursue the best interests of the company, not its competitors or other parties with which it conducts business.

because the refiner did not emphasize that its estimate was tentative. The spot market purchaser might further allege that the refiner already knew it was going to try a new repair technique when it responded to the purchaser's question, so the refiner's initial response was misleading.

Analysis

Defenses under the FTC's proposed final rule -- such as the absence of any evidence of *scienter*, the fact that the statement was a truthful estimate, the nature of estimates as merely representing one's best prediction, and the fact that the refiner in no way benefitted from the spot market purchaser's need to pay a higher price -- would be available to the refiner. But the existence of those defenses may not reassure companies that they should continue to relay reasonable repair estimates to market participants. In this example, for instance, an inquiry into whether the refiner knew it was going to adopt a new repair technique could be required to establish that the estimate was truthful.

A far more practical way to avoid potential liability under an FTC market manipulation rule would be to instruct refinery staff not to issue any estimates of the likely time for repair work. This approach would not require the time consuming and detailed factual inquiry that otherwise would be necessary to determine the degree of diligence that should be exercised in fact checking prior to making a statement. As a result, market participants would have less information on which to base purchase or sale decisions, and the absence of information about a refiner's likely repair time could slow supply adjustments in the market.

NPRA understands that the FTC may consider this example highly unlikely ever to occur, because the FTC plans to use its limited resources to pursue significant cases, not to respond to individual buyers that believe they paid too high a price but have no significant evidence of market manipulation. Nevertheless, NPRA is concerned that the FTC's reliance on Rule 10b-5 legal precedent could unjustifiably increase the risk that a court would imply a private right of

action under Section 811 of EISA and that the FTC's Rule would be misconstrued to cover, and allow a complaining purchaser to sue in, circumstances such as those described above.

As the FTC is aware, there is no express private right of action under EISA. But courts have implied private rights of action under SEC 10(b) and Rule 10b-5.[26] Indeed, private enforcement actions based on Rule 10b-5 by far outweigh the number of actions brought by the SEC itself. Thus, corporate efforts to comply with Rule 10b-5 are driven as much by the threat of private actions as by the potential for SEC investigations. The greater the emphasis on SEC authorities as a source of the Commission's Rule, the greater the likelihood that courts would follow the SEC model to imply a private right of action under EISA as well. Moreover, the FTC's reliance on SEC Rule 10b-5 legal precedent could lead to the misimpression that the FTC's Rule was intended to cover individual disputes such as the one described above.

The potential for litigation with private plaintiffs to replace the sophisticated enforcement knowledge of the FTC could further chill information disclosures by refiners. The FTC has extensively studied the workings of petroleum markets over the past three decades. The FTC's knowledge and experience will enable it to better understand whether a particular practice has "injected materially false or deceptive information in the market" than would a district court with no background in wholesale petroleum markets and no relevant legal precedent to call upon to evaluate a plaintiff's allegations.

IV. REVISED ELEMENTS OF PROOF COULD PROVIDE A SOUND FOOTING FOR AN FTC RULE.

The FTC states that the language of Section 811 of EISA suggests the FTC should model its market manipulation rule on SEC Rule 10b-5.[27] But Section 811 does not require the FTC to

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[26] *Kardon v. National Gypsum*, 69 F. Supp. 512 (E.D. Pa.1946); *accord*, *Superintendent v. Bankers Life*, 404 U.S. 6 (1971).

[27] *See* 73 Fed. Reg. at 48322.

do so, and the statute's explicit direction that the Commission prescribe a rule "as necessary or appropriate in the public interest or for the protection of United States citizens"[28] in fact precludes the FTC from using Rule 10b-5 as a model. As shown above, a blanket transfer of the language and precedent of Rule 10b-5 from securities markets to wholesale petroleum markets would likely create significant confusion and discourage procompetitive activity. An FTC Rule with such effects would be neither "necessary" nor "appropriate" in the public interest.

Nevertheless, NPRA believes that some of the language of Rule 10b-5 -- detached from securities law precedent and with modifications relevant to wholesale petroleum markets -- can assist in the development of an effective FTC Rule. This language should be combined with other elements of proof in order to achieve the Commission's goal of outlawing market manipulation in wholesale petroleum markets without deterring legitimate business conduct.

The FTC's NPRM describes the elements of proof that it would require in enforcing its current proposed Rule and states that "[t]hese elements track the elements that courts have prescribed under SEC Rule 10b-5."[29] These elements are: (1) a showing of manipulative conduct; (2) a showing of scienter; and (3) a showing that a person engages in conduct "in connection with the purchase or sale of a covered commodity at wholesale" so as to establish a nexus between the manipulative conduct and the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale.[30]

These three basic elements, rather than the specific language of Rule 10b-5, provide a better starting point for the development of an FTC rule, although each still requires some modification to avoid the deterrence of legitimate competitive activity in wholesale petroleum

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[28] 42 U.S.C. § 17301.

[29] 73 Fed. Reg. at 48327-28.

[30] *See* 73 Fed. Reg. at 48328-29.

markets. Moreover, to prove these elements alone should not be sufficient to establish liability. Rather, additional elements, not present in Rule 10b-5, also would be necessary, given the statutory focus of EISA on the manipulation of "markets," not on common law fraud in an isolated transaction.

NPRA proposes the following language for an FTC rule under EISA that would capture the elements that should be required to prove market manipulation under Section 811 of EISA:

It shall be unlawful for any person, with specific intent, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline or petroleum distillates at wholesale[31]

> **(a) to inject into the market materially false or deceptive information about important aspects of market supply or demand**
>
> **(b) to profit by virtue of an effect on the market reasonably expected to result from such false or deceptive information.**

The following section explains the bases for this proposal.

A. The FTC Should Articulate a "Specific Intent" Requirement Tailored to Fit the Circumstances To Be Challenged under a Market Manipulation Rule.

In the Rule proposed in the FTC's NPRM, the Commission proposes to define scienter based on the Supreme Court's requirement for scienter under Rule 10b-5: "a mental state embracing intent to deceive, manipulate, or defraud."[32] Under this definition, a showing of "recklessness" would satisfy the scienter element.

NPRA agrees that a showing of intent should be required, but believes that the FTC's proposed definition should be modified to require that a violation be based on a specific intent to perform the prohibited conduct. This approach would give specific guidance to industry and

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[31] NPRA believes the FTC should modify its definition of wholesale. *See* discussion of the proper definition of "wholesale" *infra,* Section V.B.1.

[32] 73 Fed. Reg at 48328, *citing Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 127 S. Ct. 2499, 2507 (June 21, 2007) (*quoting Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193-94 (1976)).

provide FTC staff with objective evidence to which it can look to prove market manipulation, Moreover, for the sake of clarity, NPRA believes this language should be in the final Rule itself, not in an accompanying Statement of Basis and Purpose.

We review below the reasoning behind NPRA's objection to the broad scienter approach that the FTC is proposing and NPRA's proposal to define the intent that is required as specific intent to perform the prohibited conduct.

1. "Recklessness" Should Not Be Sufficient to Show "Specific Intent" under an FTC Market Manipulation Rule.

As the FTC itself acknowledges, "the Courts of Appeals have adopted a number of different formulations as to precisely what constitutes recklessness,"[33] and the Supreme Court has not addressed this issue under SEC Rule 10b-5. To address the question of what standard of recklessness would apply, the Commission states its belief that "a recklessness standard as articulated by the Seventh and District of Columbia Circuits would be adequate to establish scienter for any future violation."[34] NPRA believes that a recklessness standard for scienter does not make sense for wholesale petroleum markets, would impose an unacceptable compliance burden on industry, and would not help the FTC implement effective enforcement of a market manipulation rule.

As applied to conduct in the 10b-5 context, "recklessness" has been interpreted to encompass a wide range of behavior that can include honest mistakes and errors or incompetent management. The application of a "recklessness" standard may make sense in a securities context where parties owe each other fiduciary duties or are in other relationships of trust or confidence. In the securities context, for example, the "recklessness" standard imposes liability

[33] 73 Fed. Reg. at 48329.
[34] *Id.*

if a broker has misstated a material fact to an investor through carelessness that rose to the level of "extreme departure from the standards of ordinary care."[35] Indeed, the Seventh Circuit definition of "reckless" conduct that the FTC proposes to use also relies on "an extreme departure from the standards of ordinary care" as a touchstone for its analysis.

In wholesale petroleum markets, however, it is not at all clear what would be considered "standards of due care" between sophisticated market participants, much less what would qualify as an "extreme departure" from such standards. The application of a "recklessness" standard in that context would create confusion and concern about how to control and monitor the thousands of wholesale petroleum transactions that take place every day to ensure that honest mistakes and errors, and even incompetent management at times, are not misinterpreted to reflect an intent to manipulate a market. This effort could impose significant compliance costs on industry, while yielding the FTC no benefit in terms of identifying schemes truly intended to manipulate a market. The use of "specific intent" instead of a scienter standard that includes "recklessness" will avoid Type 1 enforcement errors that would sweep in behavior that is unintentional.

2. The Requirement of "Specific Intent" Should Appear in the FTC's Rule and Be Connected to the Type of Conduct to Be Prohibited.

The FTC's final market manipulation Rule should contain a "specific intent" requirement in the Rule itself. In its NPRM, the Commission explains that its proposed language in Section 317.3(c) "is to be read consistently with securities law precedent, meaning that there can be no law violation without a showing of scienter."[36] As explained in detail above, however, the FTC's final market manipulation Rule should *not* be read consistently with securities law precedent, for to do so would create significant confusion and risk chilling procompetitive

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[35] *See* 73 Fed. Reg. at 48329.

[36] *See* 73 Fed. Reg. at 48327, *citing* 71 Fed. Reg. at 4252.

activity. Accordingly, because the FTC's rule should not rely on precedent under SEC Rule 10b-5, the FTC's final Rule should itself contain a requirement to show "specific intent."

The type of "specific intent" that the FTC market manipulation rule should require is a specific intent to perform the conduct that is prohibited under the Rule. Thus, the requirement of "specific intent" should appear at the beginning of the rule, so that it modifies the later portions of the rule that describe prohibited conduct. For example, NPRA's proposed rule would require specific intent (a) to inject into the market materially false or deceptive information about important aspects of market supply or demand, and specific intent (b) to profit by virtue of an effect on the market reasonably expected to result from such false or deceptive information. As noted in succeeding sections, to tie the required specific intent with the prohibited conduct will clarify compliance guidelines for companies and the types of objective evidence potentially of interest in an FTC investigation of market manipulation.

B. Definition of "Manipulative or Deceptive" Conduct.

The FTC has defined a "manipulative or deceptive act [as] one that injects materially false, misleading, or deceptive [information] into the marketplace."[37] NPRA agrees with the fundamental thrust of this definition -- i.e., injecting "materially false or deceptive information into the marketplace" cannot have an efficiency justification and is not procompetitive. In particular, NPRA agrees that the information must be "materially" false or deceptive, not simply untrue as to an insignificant detail.[38] Indeed, in NPRA's opinion, this FTC language can provide a sound basis for companies to issue operational compliance guidelines and for FTC staff to identify relevant objective evidence. Accordingly, for the sake of clarity, NPRA proposes that the FTC use its own language defining "a manipulative or deceptive act," with slight modification, as part of the rule itself.

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[37] 73 Fed. Reg. at 48328.

[38] *See also* NPRA discussion of correct definition of "material,' *infra* at Section V.B.1.

The first modification that NPRA proposes is to further define the type of "materially false or deceptive" information that should not be injected into the market. The rule should specify that the materially false or deceptive information must be "about important aspects of supply or demand." This addition would focus the rule on conduct that has a potential to manipulate a market because it concerns the kind of information that could be used to manipulate -- information related to supply and demand -- and it would avoid trivial matters by focusing the inquiry on "important" aspects of supply or demand. The proposed qualification is not overly restrictive, because many types of information may involve important aspects of supply or demand. Yet it would assist companies in providing compliance guidance that requires company personnel to consider whether particular information relates to important aspects of supply and demand, as well as whether the information could be viewed as "materially false or deceptive." In sum, with respect to subsection (a), NPRA's proposed approach would ask whether an entity: (1) had a specific intent (2) to inject into the market materially false or deceptive information (3) about important aspects of supply or demand.

The second change that NPRA proposes is that this definition should *not* include the injection of "misleading" information into the marketplace. The use of the term "misleading" would introduce uncertainty that could distort conduct in wholesale petroleum markets by raising questions similar to those addressed in Hypotheticals 1 and 2 above. It is unclear what content the word "misleading" adds beyond that already provided by the term "deceptive." Would it be considered "misleading" for a refiner to state it could obtain supplies elsewhere at a lower price but not reveal uncertainty about its ability to obtain transportation for those supplies? Would it be considered "misleading" to provide a good faith estimate that turns out to be wrong? The use of this term, without further clarification of the types of statements to which it would apply, has a potential to chill competitive conduct.

If the FTC wishes to include the term "misleading," NPRA respectfully requests that the Commission explain the parameters of "misleading" in this context by providing examples of statements that would or would not be considered "misleading." The FTC traditionally has used examples in its competition guidelines, as well as in its Hart-Scott-Rodino ("HSR") rules, to illustrate the meaning of a particular enforcement statement. These examples have guided many company decisions about how to enforce compliance with those antitrust guidelines and rules. Such examples would be extremely useful in this context in enabling in-house counsel to develop more tailored compliance guidelines for the FTC's market manipulation rule.

C. An FTC Rule Should Further Assess Whether There Was:

"A Specific Intent to Profit by Virtue of an Effect on the Market Reasonably Expected to Result from Such False or Deceptive Information."

1. The FTC's Rule Should Concentrate on Intent to Profit from *Market* Manipulation, Rather than Deceit of an Individual.

The FTC proposes to use a definition that typically applies to fraud between parties in individual transactions that may or may not have an effect on a market. Thus, the focus of the Rule 10b-5 inquiry is on whether the defendant had an "intent to deceive, manipulate, or defraud"[39] another person. A market manipulation rule, by contrast, should concentrate on whether the defendant intended to "defraud" the market, not just one other individual. As the Commission noted in its NPRM, the type of fraud with which it is concerned is that which involves "*intentional acts that obstruct or impair wholesale petroleum markets.*"[40]

Thus, NPRA proposes to define the "specific intent" relevant to subsection (b) as a specific intent to profit *by virtue of an effect on a market,* not an intent to benefit through fraud

[39] 73 Fed. Reg at 48328, *citing Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2507 (June 21, 2007) (*quoting Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193-94 (1976)).

[40] *See* 73 Fed. Reg. at 48326 (emphasis supplied).

directed at one entity. This language would assist in distinguishing market manipulation from common law fraud on individuals. Under this language, a specific intent to defraud an individual in circumstances where the price to that individual could not affect prices in a relevant market would be captured by state law, not the FTC's market manipulation rule. Potential complainants about isolated examples of common law fraud could not invoke the FTC's jurisdiction and thereby deplete the FTC's limited resources with matters more appropriately addressed through litigation between private parties.

2. An Assessment of the Profitability of the Conduct in Question, and the Reasons for Profitability, Would Allow the FTC to Focus on Objective, not Subjective, Evidence.

Moreover, NPRA's proposal that the FTC examine whether a party had a specific intent *to profit* by virtue of an effect on a market would allow the agency to concentrate its efforts on analyzing objective evidence about the economics of particular conduct and the likely market effects of materially false or deceptive information. This question directs the inquiry toward objective evidence of profitability -- for example, would certain conduct make economic sense absent an intent to affect the market overall through fraud?

The language would further direct an inquiry into whether there was a specific intent to profit by virtue of an effect on the market *reasonably expected to result from such materially false or deceptive information.* This analysis would connect the required specific intent with the question of whether profits could reasonably be expected from the insertion of materially false or deceptive information about important aspects of supply or demand into the market. In particular, this language would assist in distinguishing whether particular market effects resulted from the insertion of materially false or deceptive information into the market as opposed to resulting from superior business acumen, superior commercial performance, or other

procompetitive activity. The "specific intent" inquiry under this portion of the definition would invoke the FTC's expertise in evaluating likely competitive effects from particular types of conduct.

In sum, to achieve the Commission's purpose of eliminating deliberate manipulation and deception -- and to provide practical guidance for companies -- NPRA respectfully suggests that the Commission adopt the objective standard for prohibited conduct that is outlined above.

D. Additional Guidance Is Critical to Avoid Unintended Adverse Consequences.

Even if the FTC were to adopt the language proposed by NPRA above, misunderstandings about the scope of the FTC's rule still could arise that would discourage wholesale market participants from undertaking procompetitive or otherwise desirable market activity. To ensure that ordinary, commonplace market practices that pose no danger of market manipulation are not deterred by the FTC's adoption of a market manipulation rule, companies need guidance to identify the types of activities they can continue to undertake without risking an investigation into potential non-compliance with the FTC's rule.

To clarify the types of market practices that the FTC does not wish to prevent, the FTC should include language along the lines of that proposed below in the Statement of Basis and Purpose for any rule it adopts. In addition, the FTC also should provide examples of business conduct that would not pose problems under the rule. NPRA provides some examples below for the FTC's consideration.

Proposed Language for Preamble:

The FTC is adopting a broad Rule that will enable the Commission to police against manipulation and deception intended to affect wholesale petroleum markets through fraud. This

provision addresses conduct by a person who, with specific intent, inserts into the market materially false and deceptive information about important aspects of supply or demand in order to profit by virtue of an effect on the market reasonably expected to result from such false or deceptive information. Such conduct is presumed to harm consumers and to lack efficiency justifications.

This provision is not intended to reach every act that happens to affect wholesale petroleum markets. The Commission has provided examples below of conduct that affects wholesale petroleum markets but would not violate the FTC's Rule.

Proposed Examples:

A. Performing contractual obligations to supply existing customers.

Supplier A refines premium gasoline that it sells primarily through bilateral contracts to supply all or most of its counterparties' requirements. Supplier A has a significant market share of premium gasoline within a relevant market and has also sold it on the spot market on occasion.

Supplier A experiences significant increases in the price of inputs needed to produce premium gasoline. It concludes that it will cease production of premium gasoline and instead purchase it from Supplier B, who is able to sell at a price that enables Supplier A to meet its contractual obligations without reducing its margins or increasing price to its requirements customers. Supplier A makes no public announcement about its decision to cease production of premium gasoline. Supplier A's purchases from Supplier B result in a shortage of premium gasoline on the spot market.

Analysis: Supplier A did not inject any materially false or deceptive information into the market and had no specific intent to profit by virtue of an effect on the market from such information. Rather, Supplier A intended to maintain its ability profitably to serve its customers. Therefore, this example does not raise any potential market manipulation issues.

B. Decisions on the amount of product sold to a particular customer at a particular time.

A refiner has supply difficulties and ultimately puts its contract customers on an allocation system and withdraws from selling in the spot market. No customer is happy with its allocated share, and spot market customers complain about a shortage of supply.

Analysis: This example illustrates why, to maintain profitability, a refiner must be able to manage its supply decisions without second-guessing under an FTC rule. Customers sometimes complain, but that does not mean that any "materially false or deceptive information" has been injected into the marketplace with a specific intent to profit thereby through an effect on the market.

C. Investments in facility maintenance or facility upgrades.

A refiner truthfully announces it is investing millions of dollars in refinery maintenance/upgrades. As times goes on, however, the project becomes bogged down in environmental permitting, the likely profitability of a refinery expansion changes due to an economic slowdown, and new regulatory hurdles appear. The refiner does not cancel the project entirely, but reports that it has been scaled back when required to do so in its 10Q filing with the SEC.

Analysis: The refiner has not injected any materially false or deceptive information into the market place; its announcement about refinery maintenance/upgrades was truthful when made. It would not be reasonable for a sophisticated market participant to believe that such as statement would necessarily still apply months later. The refiner made a public statement about its plans when required to do so by the SEC, and the FTC should not impose any additional requirements. Rather, if wholesale market participants plan to invest based on such an announcement, they should be responsible for checking with the company on an ongoing basis to ascertain the status of its plans.

D. Day-to-day operational decisions including:

1. Choice of mix of products to refine.

A refiner has a large refinery in the Midwest that manufactures both gasoline and diesel fuel. The refinery can adjust production percentage allocations between the two commodities. Peak gasoline demand begins in May and runs through early September. In July, the refinery determines it would be more profitable to reduce gasoline production and increase diesel production, due to current diesel shortages in the Gulf Coast. The refinery reduces its gasoline production and increases its diesel production. It ships the increased diesel production via barge to the Gulf Coast.

Analysis: The refiner has not injected any "materially false or deceptive information" into the marketplace. Refiners should not be second-guessed on their individual decisions to switch refinery runs to produce more or less of a particular product.

2. Choice of where to send product.

A refiner has good pipeline connections to markets in both Ohio and Pennsylvania. It makes decisions about where to send its gasoline based on, among other things, supply forecasts and forecasts of profitability in the different markets. This typically results in the refiner sending its supply to markets where gasoline prices are highest.

Analysis: The refiner has not inserted any materially false or deceptive information into the marketplace, nor has it evidenced any specific intent to profit thereby from an effect

on the market. This type of conduct can help alleviate price spikes and, as the FTC already has recognized, should be encouraged, not discouraged.[41]

E. Establishment and management of product inventory levels.

Wholesale gasoline prices have risen in a particular market due a shortage of gasoline caused by an outage at Refinery A. Refiner B also has a refinery in that market, but is already producing at capacity at that refinery. Refiner B does have inventory stored along a pipeline that connects to the area of the shortage, but does not want to use that inventory to respond to this shortage. Wholesale prices rise during Refinery A's outage, which lasts for a week, but then subside.

Analysis: If an FTC rule were interpreted to require a refiner to use all available inventory in response to any price spike, that would disrupt the ability of refiners to manage inventory in response to interruptions of unpredictable duration. The fact that, in hindsight, prices might have been lower if the refiner had depleted its inventory is irrelevant. The fact that the refiner expected to earn greater returns from its inventory management is also irrelevant. If refiners cannot profit from a favored position in times of shortage, they will have no incentive to incur the cost of maintaining inventory in the first place – and future spikes will be even more severe.

F. Good faith efforts to comply with regulatory obligations or to cooperate with government agencies in connection with supply disruption events.

A refinery is damaged during a hurricane. The Department of Energy (DOE) and local governments call to ask for the refiner's best estimate of likely repair time so they can gauge how much additional gasoline supply the area affected by the hurricane is likely to need in the near future. The refiner estimates it will take one week to repair the damage, but runs into unexpected problems that cause the repairs to take almost a month.

Analysis: The refiner has not injected any materially false or deceptive information into the marketplace, because its estimate was truthful when made. Such a good faith attempt to cooperate with government agencies in a time of emergency should not result in liability under an FTC market manipulation rule. Moreover, DOE and local governments are free to request as broad a scope of information as they wish and to request additional information at any time if they believe that would be useful.

V. IF THE FTC DECIDES TO USE SEC RULE 10b-5 AS A MODEL FOR ITS MARKET MANIPULATION RULE, THE COMMISSION SHOULD MODIFY THE LANGUAGE AS SHOWN BELOW TO AVOID ADVERSE CONSEQUENCES.

For all of the reasons discussed above, NPRA believes the FTC should reconsider the use of Rule 10b-5 as a model and adopt the language suggested above. If, however, the Commission

[41] *See Gasoline Price Changes: The Dynamics of Supply, Demand, and Competition,* Executive Summary at ii-iii, Ch. 1 at 9-10, Federal Trade Commission (2005).

is wedded to a Rule 10b-5 approach, we here suggest some changes that could reduce the potential for adverse consequences from implementation of the rule.

A. The Commission Should Adopt Only the Language of, But Not the Legal Precedent under, SEC Rule 10b-5.

For all of the reasons outlined above, the NPRA believes the Commission should not incorporate the legal precedent under SEC Rule 10b-5 as applicable to the FTC's rule, even if the Rule has the same language as SEC Rule 10b-5. That legal precedent, with its reliance on fiduciary and other duties based on relationships of trust and confidence, makes no sense in the context of wholesale petroleum markets. Instead, the FTC should use its authority to implement its own interpretation of the language of Rule 10b-5 in the very different context of wholesale petroleum markets. There is no question that the FTC has the authority to do so.

B. The Commission Should Modify the Language of Rule 10b-5 to Better Fit Circumstances It May Wish to Challenge as Market Manipulation in Wholesale Petroleum Markets.

1. Definitions - § 317.2

First, the FTC should add to the proposed rule its own definition of a "manipulative or deceptive act" as one that "injects materially false or deceptive information into the marketplace."

Second, the FTC should add a correct definition of a "material fact." There is a no doubt unintentional, but nonetheless important mistake in the NPRM concerning the definition of "material." The NPRM states that "[c]onsistent with securities law, a fact is material if there is a substantial likelihood that a reasonable market participant would consider it in making its

decision to transact because the material facts significantly alters the total mix of information available."[42]

The Supreme Court case that provided this definition states that "a fact is material if there is a substantial likelihood that a reasonable market participant would consider it ***important*** in making its decision to transact because the material fact significantly alters the total mix of information available."[43] Thus, it is not enough that a reasonable market participant would "consider" the fact in making its decision to transact; rather, a reasonable market participant must consider the fact *important* in making its decision to transact. To clarify any possible misunderstanding that the FTC was intending to adopt a somewhat different standard than that applied by the Supreme Court, the FTC should add a definition of "material fact" to the proposed Rule that tracks precisely the Supreme Court's language.

Third, the FTC should change the definition of "wholesale" to exclude transactions at the rack and at or below the terminal. The joint comment of the NPRA and the API in response to the FTC's ANPR urged the Commission to exclude "rack" transactions, dealer tankwagon sales to dealers, and other terminal-level sales.[44] In the NPRM, the Commission indicates it is inclined to include such transactions within the scope of the proposed Rule, because DOE's Energy Information Administration defines "wholesale price" to include rack prices and with reference to the definition of "wholesale" provided in an online dictionary.[45] For the reasons explained in those joint comments, NPRA urges the FTC to exclude transactions at the rack and at or below the terminal.

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[42] 73 Fed. Reg. at 48326.

[43] *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976); *accord, Basic, Inc. v. Levinson*, 483 U.S. 224, 231-32 (1988).

[44] *See* Comments of the American Petroleum Institute and the National Petrochemical and Refiner Association, filed June 23, 2008, in FTC Market Manipulation Rulemaking, at 24-25.

[45] *See* Fed. Reg. at 48326.

NPRA's reasons for urging the Commission to exclude rack and other below-the-terminal transactions from the scope of the Rule were not definitional, but rather were based on public policy concerns.

- Rack pricing decisions are qualitatively different than those that arise in market-based bulk transactions. They are set by the rack supplier and tend to remain in effect for a period of time and apply to a variety of different purchasers. The pricing for sales to individual brand dealers (dealer tank wagon price) is even further removed from a commodities "market price" for bulk spot transactions.
- The rack price published by a petroleum supplier does not necessarily reflect the price available to all wholesale customers at a particular terminal. Incentive prices or alternate competitive price formulas may also be available. Imposing the proposed Rule at the terminal rack level could jeopardize the ability of wholesale suppliers to respond to market conditions and offer incentives or alternative price formulas due to the legal uncertainty imposing the Rule at the terminal level would create.
- The Commission has conducted numerous investigations over the past ten years and in none of these investigations has the Commission noted a problem at the wholesale rack level which would suggest a regulatory remedy is required.[46]
- The rule as proposed by the Commission at 317.3(b) would have the practical effect of chilling pro-competitive communications between rack sellers and buyers without providing any corresponding benefit to consumers.
- The Commission already has an effective wholesale price monitoring program.

The above rationale remains sound. Moreover, extending the reach of the proposed Rule to the thousands of below-the-terminal transactions that occur each day in the United States would impose tremendous compliance burdens on industry and could demand substantial enforcement resources from the Commission, but would produce little, if any, benefit to consumers or the U.S. economy in terms of combating market manipulation.

NPRA recommends for the Commission's consideration a definition of "Wholesale" as follows: "Wholesale" means bulk purchases or sales in contract quantities of

[46] There are over 1400 wholesale rack price locations in the United States. Wholesale rack prices are limited to a relatively small geographic area. Considering the large number of rack prices in the United States, their limited geographic scope, and the lack of any identified problem that the Rule would remedy, it does not make sense for the Commission to expend resources on enforcement efforts directed to the wholesale rack markets.

20,000 barrels or more, delivered or received via pipeline, marine transport or rail at or near a location for which a price publication firm publishes a reference price. Wholesale transactions do not include sales at the terminal rack or downstream of the terminal rack or retail gasoline or petroleum distillate sales to consumers."

2. Prohibited practices -- § 317.3.

The NPRA believes the following changes, at a minimum, would be necessary to identify more precisely the types of conduct that the FTC may target as market manipulation and to avoid the unintended chilling of procompetitive conduct.

Proposed Revision:

"It shall be unlawful for any person, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale <u>and with the specific intent to affect the market through fraud,</u>

(a) To use or employ any <u>manipulative or deceptive</u> device, scheme, or artifice to defraud;

(b) To make any untrue statement of a material fact [<u>delete the following: or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading</u>], or

(c) To engage in any <u>manipulative or deceptive</u> act, practice, or course of business that operates or would operate as a fraud or deceit upon <u>the market [delete: any person].</u>

First, a focus on fraudulent manipulation of a market, not common-law fraud that misappropriates funds from an individual, needs to be added to the language of the proposed Rule. This can be done by adding "and with the specific intent *to affect the market* through fraud" at the end of the first paragraph (emphasis supplied). A further change is required in paragraph (c) to implement this concept; the type of business conduct on which the FTC should focus would operate as a "fraud or deceit upon the market," not just upon a particular person. Whether certain conduct would operate as "fraud or deceit upon the market" should be evaluated

in terms of whether it would make economic sense absent an affect upon market prices, as explained in Section IV.

Second, the FTC's intention to require *scienter* as an element of the violation should be laid out in the proposed Rule. As explained above, the NPRA urges the FTC to adopt "specific intent" as the *scienter* requirement under the proposed Rule. In addition to the reasons identified above, use of "specific intent" would harmonize the FTC's proposed Rule with the Commodities Futures Trading Act rule under which certain conduct could be challenged by both the FTC and the CFTC. The FTC's adoption of a specific intent requirement could be added, as indicated, through language at the end of the first paragraph that requires "*a specific intent* to affect the market through fraud" as an element of the violation.

Third, the FTC should clarify that it is prohibiting conduct undertaken with a specific intent to affect the market *through fraud*, not through vigorous competition, improved products and services, or better business acumen. Again, this clarifying language could be added at the end of the first paragraph.

Fourth, "manipulative or deceptive" should be added to modify the language in subsections (a) and (c) to clarify the type of conduct that is of concern to the FTC -- that is, conduct that inserts materially false or deceptive information into the marketplace. In the absence of this modifier, those subsections appear to have the potential to cover a wide variety of legitimate business conduct. This is especially true when there is no legal precedent on which companies can rely to limit the coverage under those subsections. To provide guidance to companies about what they should not do, the Commission should add the terms "manipulative or deceptive" in subsections (a) and (c).

Fifth, the Commission should delete the language in subsection (b) that would create liability for omissions of "a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." For all of the reasons explained above, the use of this language would tend to chill procompetitive information disclosures due to a fear of liability for having made an incomplete or insufficiently caveated, not to mention simply mistaken, statement.

Finally, the "in connection with" language should have a narrower scope. The FTC's NPRM has some internal inconsistencies. At one point the NPRM states that "the proposed Rule . . . does not regulate supply decisions . . . . ."[47] At another point, the NPRM states that "any conduct that is done in connection with the wholesale purchase or sale of a [wholesale petroleum product] -- including . . . making supply decisions related to [wholesale petroleum products] -- could be subject to the proposed Rule."

The NPRA believes that any FTC rule should not apply to supply decisions through which refiners decide how much of which type of product to produce and how much of that product to supply to which purchasers in which markets. As shown by the examples given above, such decisions, by definition, do not in and of themselves "inject materially false or deceptive information" into the market. Moreover, any possibility of liability under an FTC rule for such decisions could seriously distort refiners' decision making and disrupt competitive activity in petroleum markets.

[47] 73 Fed. Reg. at 48322.