Before the
Federal Trade Commission

Prohibition on Market Manipulation	**)**	
In Subtitle B of Title VIII of the Energy	**)**	**RIN 3082-AB12**
Independence and Security Act of 2007	**)**	

COMMENTS OF THE CONSUMER FEDERATION OF AMERICA

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Introduction

The Consumer Federation of America (CFA) appreciates the opportunity to file comments on the revised notice of proposed rulemaking in the above captioned proceeding. A cornerstone of a truly democratic society is the principle that the people write the rules under which they live. In a representative, mass democracy administrative agencies inevitably play a large role and rulemaking is the core of their function. Allowing public comment on specific proposed rules is crucial to effective participation in the administrative process. The FTC is to be applauded for adopting the procedure here of allowing comment on the actual content of the final rule.

For too long, too many agencies have issued Notices of Proposed Rulemaking that lack specificity, barely rising to the level of a decent Notice Inquiry, then leap to final rules on which the public has had little if any opportunity to comment. Unfortunately, under the

Administrative Procedures Act the courts have allowed this denial of due process. It will be difficult if not impossible to change the jurisprudence without a change in legislation.

However, an administration and independent agencies with a commitment to transparency and democratic participation can change the norms and expectations of administrative practice. They can adopt the practice of putting actual rules out for comment in the Notice of Proposed Rulemaking and always allowing comment on revised proposed rules when there is substantial or significant modification of the noticed proposed rules.

This is likely one of the first proposed rules issued since the change of administration and it can set an important precedent. We encourage the FTC to follow the practice of allowing comment on revised rules whenever the revisions are significant or substantial. We encourage other agencies to adopt a similar practice. Indeed, if all executive branch and independent agencies adopt this approach and apply it consistently over a number of years, the new norm will take root and make it easier to alter the jurisprudence.

Protecting the Public from Fraud and Deception In Petroleum Markets

CFA was generally supportive of the proposed rule and we believe the Commission has done a good job in its revisions. Above all, it has kept the primary purpose of the law to protect the public interest in mind and resisted the entreaties of the industry to weaken the rule. We focus our comments on the major issues. In so doing, it will be obvious what our answers to the individual questions posed in the notice would be.

As the extent of the collapse of market fundamentalism has become clearer over the past six months, CFA has called on policymakers to abandon the view that sees regulation as the *ex post* clean up after the occasional market failure and return to the view of regulation as

the *ex ante* prophylaxis to prevent market failure.[1] In the Market Manipulation rulemaking the Federal Trade Commission has resisted the push from industry to gut the rule. Though there are areas where we would have preferred a more aggressive rule, the FTC has made an admirable start in addressing the market imperfections and failures that afflict the petroleum markets in the United States.

These markets have been plagued by manipulation and excessive speculation over the past decade and this rule will send a signal to market participants to clean up their act.[2] While the statutory authority given to the FTC limited its actions to market manipulation, the recklessness standard that it has adopted will give market participants cause to think carefully about and reform how they behave in this markets.

The rule sends a clear signal that market participant must not engage in acts of commission or omission that are fraudulent or deceptive or could mislead to such an extent that they distort market conditions. Combining the rule with its definitions and the court precedent to which the FTC refers, the FTC has drawn a line by defining the recklessness standard to demarcate illegal behavior as follows:

> It shall be unlawful for a person to engage in a highly unreasonable act or omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care such that the person knew or must have been aware that the act would operate as a fraud or deceit or intentionally fail to state a material fact that under the circumstances renders a statement made by such person misleading, provided that such omission distorts or tends to distort market conditions for any such product.

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[1] Mark Cooper and Barbara Roper, *Financial Market Reform,* Consumer Federation of America, April 2009 for a general discussion of the collapse of market fundamentalism and a detailed discussion of financial markets; Mark Cooper "State Regulators, Commodity Markets, and the Collapse of Market Fundamentalism," Joint Session of the Consumer Affairs and Gas Committees on "Excessive Speculation in Natural Gas Markets: How to Safeguard Consumers," Annual Meeting National Association of Regulatory Utility Commissioners, February 17, 2009

[2] Mark Cooper, "The Failure of Federal Authorities to Protect American Energy Consumers From Market Power and Other Abusive Practices," *Loyola Consumer Law Review,* 19:4 (2007); The Role of Supply, Demand, Industry Behavior and Financial Markets in the Gasoline Price Spiral (Prepared for Wisconsin Attorney General Peggy A. Lautenslager, May 2006)

Intent is not the Issue

The alternative proposition that the industry is pressing would find lawful departures from standards of ordinary care even though the person knew or must have known that the act would operate as a fraud or deceit, as long as the person did not intend to defraud or deceive. In other words the industry would lower the standard to allow market participants to engage in careless conduct that they know or must be aware would operate as fraud or deceit, as long as they did not intend to do so. We believe that the standard chosen by the FTC is much more appropriate to protect the public and is entirely consistent with the act. Market participants should be held to the higher standard.

The FTC's approach draws the line in the correct place. This approach requires the participants to exercise some self-control and to self-regulate their behavior. It requires them to take care, to think what the impact of their behavior will be, to avoid acts that would operate as a fraud or deceit.

Intent was not Required by the Statute

The FTC's proposed rule promotes the public interest and is perfectly consistent with the legislative language. Section 811 reads as follows.

> 811. Prohibition on Market Manipulation
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> It is unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil, gasoline or petroleum distillates at wholesale, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Federal Trade Commission may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens.

It is clear that Congress wanted the FTC to issue rules that prohibit actions if a person "knew or must have been aware" that an act or omissions would operate as a "manipulative or deceptive device or contrivance." By including the phrase directly or indirectly, making no

mention of intentionality or effect, and citing only the public interest, the Congress clearly invited the agency to write the rule as it has and reject the inclusion of a finding of intent in order to find unlawful conduct.

If Congress had intended for the FTC to include intent as a requisite for unlawful conduct, it could have done so. It chose not to. This is all the more evident when one compares the language of Section 811 to the next section. Section 812, which contains a prohibition on reporting of false information to the government, included an intentionality condition for a finding of unlawful behavior.

> 812. Prohibition on False Information
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> It is unlawful for any person to report information related to the wholesale price of crude oil gasoline or petroleum distillates to a Federal department or agency if—
>
> 1) the person knew, or reasonably should have known, the information to be false or misleading;
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> (2) the information was required by law to be reported; and
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> (3) the person intended the false or misleading data to affect data compiled by the department or agency for statistical or analytical purposes with respect to the market for crude oil, gasoline, or petroleum distillates.

Clearly, Congress understood that intent could be a condition, but chose not to include one in Section 811

The Purpose of the Act is to Protect the Public

The Revised Notice of Proposed Rulemaking has correctly refused to bend to the arguments of the industry to severely narrow the types of conduct the FTC would consider a violation because of the possibility that a strong rule will "chill legitimate, desirable pro-competitive business practices." The agency has been charged with preventing behavior that is fraudulent, deceptive or misleading. The definition of recklessness provided by the FTC in

the rule by citing the Court of Appeals for the Seventh Circuit poses no threat to “legitimate,” or “desirable” practices. The line is clear

If there is any doubt that an act or omission would violate this standard, the person should not engage in it. If individuals or firms believe that this standard does not provide a sufficiently clear guide by which they can regulate their business practices, they should go into another line of work. The market will be no worse off for the absence of such conduct and firms and the public will be better off because it will have been protected from a plague of fraud, deceit and market distorting omissions of material information.

All of the public interest commenters, public interest groups, and attorneys general, urged the agency not to narrow the rule and include the “scienter” standard that the industry wants.[3]

Because Fraud and Deceit are Not in the Public Interest, Harm Need not be Shown

The Commission has correctly rejected the argument that in order for conduct to be unlawful, it must be shown to have a price effect. The Commission’s reasoning is impeccable: where there is no economic justification for an act, the requirement that harm be shown is a smokescreen that can only lead to harm that goes undetected

> The Commission continues to believe that a showing of price effects should not be required to establish a rule violation because there is no economic justification for fraudulent or deceptive conduct in any market. Requiring a showing of price effects – and imposing the concomitant additional burdens upon the Commission – would introduce an unnecessary risk that conduct detrimental to the integrity of the market would escape successful challenge.[4]

[3] Notice, p. 18306, note 23; p. 18307, note 28, p. 18308, notes 47 an 48.
[4] Notice, p. 18322.

Here the state attorneys general, whose experience in enforcement reinforces the FTC conclusion, agree "a price effect requirement would make it difficult to prove a rule violation even where price effects occurred, potentially encumbering law enforcement efforts."[5]

The Lack of a Fiduciary Responsibility in Oil Markets Makes a Recklessness Standard More Appropriate, not less

The industry puts arguments put forward to try to convince the FCC not to adopt the recklessness approach because the FTC borrows from the approach taken by the Securities Exchange Commission (SEC).[6] The claim is off base. The argument is that since the securities market is different from the oil market because the participants in the market have fiduciary obligations to one another, the oil market participants can be held to a lower standard, since their conduct does not violate the preexisting norm. This argument is exactly backwards.

This is a statute enacted specifically to deal with a vital commodity that has been subject to frequent abuse. If the objective is to protect the public from abuse and the prevailing norms in the market are weaker, then the standard should be more aggressive in altering behavior, not less. The absence of the stronger norm means the anti-manipulation rule should be stronger, not weaker. That the FTC has borrowed the concepts from existing SEC practice is the least it could have done and affords the industry the benefit of being held to standards that are well articulated in law and practice.

The FTC Should Exercise the Independent Authority Congress has Given it

The argument that the FTC should not follow the SEC approach, but should follow the Commodity Exchange Act and the claim that the FTC should not apply the antifraud rules to

[5] Notice, p. 18322.
[6] Notice, p. 18309, note 49.

futures markets because the Commodities Futures Trading Commission (CFTC) has authority over these practices and markets is completely off-base. If the Congress had only wanted the CFTC or its practices to govern this space, there would have been no need for legislation. Enacting a statute strongly suggests that the Congress is interested in a new approach. Using language that is derived from the organic language of the statute of the new agency being given jurisdiction reinforces this conclusion.

The FTC Unnecessarily Narrowed the Scope of the Rule

The FTC has decided to narrow the rule in a number of ways that is not in the public interest.

- The FTC could have considered the exercise of market power[7] and excessive speculation as manipulation.[8]

These decisions unnecessarily narrow the scope of protection afforded to the public. Market power and excessive speculation are like fraud and deceit in that they have no economic justification, but hey can distort the market. The FTC could have included them under such a standard.

- The FTC could have extended the rule to futures markets, which clearly affect oil markets.[9]

There is no doubt that futures markets can have a major impact on commodity markets. The rationale given for not extending the rule to that market – i.e. the CFTC already regulates it – is not availing. The CFTC's lax oversight of the commodity market led the Congress to enact this legislation. Its regulation of futures markets is no better and Congress certainly did not preclude this regulation.

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[7] Notice, p. 18307, note 32.
[8] Notice, 18307, note 32.
[9] Notice, n. 34; Notice, n. 77.

- The FTC did not have to add an intentionality standard to the standard for omission of material information.[10]

The FTC has given great weight to the claim that applying the same standard to errors of omission as errors of commission will have a negative effect on the willingness of market participants to report data to commercial reporting agencies. The statute makes a sharp distinction between reporting commercial and governmental entities, adding the intentionality criteria to governmental reporting only. The recklessness standard would have been adequate and struck the proper balance.

To its credit, the FTC has said it will monitor the impact of these choices and consider revising them.

[10] Notice, p. 18321.