SUTHERLAND

1275 Pennsylvania Avenue, NW
Washington, DC 20004-2415
202.383.0100 Fax 202.637.3593
www.sutherland.com

ATLANTA
AUSTIN
HOUSTON
NEW YORK
TALLAHASSEE
WASHINGTON DC

PETER H. RODGERS
DIRECT LINE: 202.383.0883
E-mail: peter.rodgers@sutherland.com

June 23, 2008

VIA ELECTRONIC SUBMISSION AND U.S. MAIL

Federal Trade Commission
Market Manipulation Rulemaking
P.O. Box 2846
Fairfax VA 22031-0846

Re: Market Manipulation Rulemaking, P082900

To the Commission:

We are pleased to respond to the Federal Trade Commission's ("FTC" or "the Commission") May 1, 2008 invitation for comment upon an Advance Notice of Proposed Rulemaking (the "Notice")[1] with respect to the Commission's responsibilities under Section 811 of Subtitle B of Title VIII of the Energy and Independence and Security Act of 2007 ("EISA"). Pub. L. 110-140, 121 Stat. 1723 (December 19, 2007), Title VIII, Subtitle B, *to be codified at* 42 U.S.C. §§ 17301-17305. These statutory provisions create prohibitions upon the use of manipulative or deceptive practices in the petroleum markets.

Sutherland represents over a dozen crude oil, petroleum product and liquefied petroleum gas ("LPG") importing, processing, marketing and trading companies in commercial, regulatory and energy policy matters. Among the law firm's clients are foreign-based and domestic oil marketing and trading companies, several offshore refiners that produce petroleum products for U.S. consumption and a number of firms that hold ownership or leasehold interests in petroleum and LPG pipeline, distribution and storage facilities. All of these companies are physical oil and/or LPG buyers and sellers, and most participate in the financial energy markets, principally for price risk management (*i.e.*, hedging) purposes. The companies endorsing these comments

[1] Market Manipulation Rulemaking, P082900, 51 Fed. Reg. 25614 (proposed May 7, 2008) (to be codified at 16 C.F.R. pt. 317).

are referenced in the margin, although the views expressed in this letter are those of Sutherland, based upon its thirty years of experience representing clients in the energy markets.[2]

The FTC has played an important and salutary role in assuring competition in the petroleum markets. Applying both the antitrust and consumer protection principles embodied in the Federal Trade Commission Act, 15 U.S.C. §§ 41-58, and in other federal laws, the FTC has helped level the playing field in the oil markets and deter deceptive trade practices. We believe that the Commission can build effectively upon this long experience when applying the new authority that Congress has provided it under EISA. However, in fashioning regulations under Section 811, the FTC needs to ensure that it does not deter important and economically efficient business activities that are fundamental to the energy markets. Overzealous and costly regulation will drive marginal competitors from these markets, enlarge the market shares of the most powerful companies and increase consumer energy prices in an already overheated market – just the opposite of what the statute seeks to achieve. In the discussion that follows, we explain our concerns and endeavor to respond to specific questions presented by the Commission in its Notice.

1. The Trading Community Performs a Vital Role in the Energy Markets

Although it is customary to think of the U.S. petroleum markets as consisting of a combination of integrated major oil companies, independent refiners and infrastructure companies (*e.g.*, pipelines and terminal operators), the U.S. oil markets also depend upon a global network of physical and financial energy marketers and traders that intermediate the distribution of oil. These companies are vital marginal suppliers of both crude oil and petroleum products to the United States, moving oil and petroleum products from nearby and distant sources in response to market conditions. They also provide sophisticated financial support, including important price risk management services, for energy producers and consumers.

Sutherland's energy clients operate throughout the world, identifying incremental supplies of crude oil and refined petroleum products that are essential to meet U.S. demand. In this way, they allow Americans to access the cheapest sources of petroleum in an otherwise expensive market and dispose of the products made here that have greater value elsewhere. Many of these companies also are active in the U.S. storage market, formulating strategies that support term supplies for oil refiners, retail distributors and consumers. Some are blenders of gasoline and middle distillates designed to meet tough but essential U.S. environmental standards.

Oil marketing and trading companies additionally provide financial leverage for consumers and producers. Some hedge and finance the energy needs of major oil buyers like airlines; others help oil producers secure stable revenue streams that allow them to finance oil exploration and

[2] Colonial Oil Industries, Inc.; George E. Warren Corp., Neste Oy, Statoil Marketing & Trading (USA), Inc.; Trafigura AG; and Vitol, Inc.

production activities. Oil marketers and traders also provide liquidity in the futures and over-the-counter energy derivatives markets, which in turn are the country's most important sources of oil price discovery.

At a time when there has been much discussion of the impact of speculators upon energy prices, it is important to emphasize that marketers and traders use the financial energy markets primarily for hedging and thus balance speculative interests, moderating rather increasing oil market price volatility. By virtue of all of these activities, oil marketing and trading companies contribute to economic efficiency, add value and enhance competition despite having little market share.

2. Deterring Market Manipulation Does Not Require Prescriptive Market Behavior Rules

Sutherland's clients understand the importance of government oversight to assure a level playing field for all competitors. Inasmuch as they rarely if ever enjoy market power, oil marketers and traders often are the first victims of unfair business practices. They, therefore, support efforts by Congress to deter manipulation and the use of deceptive devices. However, addressing EISA's mandate to root out manipulation and deceit should not lead the Commission to adopt rules that substitute governmentally created norms for the rules of the marketplace.

It is worth recalling that in past decades the U.S. government repeatedly sought to regulate the oil markets, using a variety of government tools, including production quotas, trade barriers and direct price and allocation controls.[3] These measures uniformly failed in their intended purpose of protecting consumers from price increases and supply shortages. By way of contrast, since President Ronald Reagan abolished oil price controls in 1981, the emergence of functioning spot markets, ease of entry and the development of vigorous energy commodity markets all have created economic efficiency, enhanced transparency and ensured the supply of petroleum to consumers when needed. Thus, since decontrol, whenever the FTC has examined the oil markets in response to price spikes or infrastructural concerns, it has reach the same conclusion: The U.S. oil markets fundamentally are competitive and generally free of manipulation.[4]

---

[3] As a means to ensure price stability, state regulators like the Texas Railroad Commission imposed production quotas that operated as price floors through much of last century. In the 1950s, the Eisenhower Administration inaugurated quotas on oil imports, *see* Presidential Proclamation No. 3279, 24 Fed. Reg. 1781 (Mar 10, 1959) (establishing quotas), and in 1972, President Nixon ordered an economy-wide wage and price freeze, followed by the introduction of petroleum price and allocations controls. *See, e.g.*, Presidential Proclamation No. 4210, 38 Fed. Reg. 9645 (Apr 19, 1973) (establishing fee program); *see also* Economic Stabilization Act of 1970 (ESA), Pub. L. No. 91-379, 84 Stat. 799 (1970) (expired 1974); Emergency Petroleum Allocation Act of 1973 (EPAA), Pub. L. No. 93-159, 87 Stat 627 (1973) ("To authorize and require the President of the United States to allocate crude oil …") (expired 1981).

[4] *See, e.g.*, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases Report to Congress," Federal Trade Commission, pp. 188-189, n.17 (Spring 2006) (noting that available storage capacity for refined products would undermine attempts to affect price by withholding supply); "Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition," Federal Trade Commission (2005) (finding no evidence of

In developing business behavior rules under the EISA mandate, the FTC needs to keep these repeated findings in mind and take great care not to chill legitimate market activities. Competition means the freedom for energy market participants to respond to supply and demand conditions. Accordingly, absent collusion and/or evidence of an intent to manipulate or deceive (and the power to do so), an energy market participant's decision to buy, to sell, to build inventories, to release inventories and numerous other customary business behaviors should not become the province of regulators and their investigators.

The Commission has asked whether market manipulation standards established for regulated industries (*e.g.*, securities trading and the activities of utilities regulated by the Federal Energy Regulatory Commission ("FERC")) are useful precedents for the rules it must draft under EISA.[5] Our answer is that, as a rule, they are not. While Congress, in fashioning Section 811, used language similar to that used in the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), (sections 315 and 1283 amending the Natural Gas Act and Federal Power Act, respectively), which in turn drew upon the securities laws, applying these statutory standards to a market that is not subject to direct economic regulation requires a different approach.

For example, under the securities laws, the U.S. Securities and Exchange Commission must apply anti-manipulation and fraud standards in the context of a highly regulated environment. In so doing, it addresses issues relating to deceptive practices in relation not only to the anti-fraud provisions but a myriad of other regulations applicable to broker-dealers. There are no comparable prescriptive rules with respect to the physical oil markets and those who do business in them.

Likewise, FERC administers a highly regulated industry in which power generators and transmission system operators are licensed entities subject to tariffs, as are interstate gas pipelines and storage facilities.[6] To cite one example, tariffs governing the operations of certain power generators in some cases require the generators to offer *all* available energy to the market.[7] In the oil markets, there are no *a priori* rules as to how much a market participant must sell at any given time. It is worth noting that even in the context of the highly regulated electricity markets, FERC has refused to impose a generic prohibition on economic withholding and has instead adopted such "must offer" requirements only in extreme circumstances.[8] Surely,

---

manipulation); "The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement," Federal Trade Commission (August 2004) (same).

[5] 51 Fed. Reg. at 25620.

[6] We assume arguendo that the SEC's Rule 10b-5 model is appropriate for FERC, but see, *e.g.*, Comments of the International Swaps and Derivatives Association, Inc., FERC Docket No. RM06-3-000 (filed Nov. 17, 2005) (distinguishing SEC markets from FERC markets).

[7] PJM Interconnection, L.L.C., FERC Electric Tariff, Sixth Rev. Vol. No. 1, Section 1.10.1A(d), Fifth Rev. Sheet No. 357 (Effective Feb. 24, 2006).

[8] *Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 759 (2007) (refusing to impose "an across-the-board 'must offer' requirement"), *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268 (2008).

therefore, a decision not to sell petroleum products, absent evidence of collusion, is not in and of itself a manipulative or deceitful act.

The FTC seeks specific comment on the circumstances, if any, under which a firm's unilateral decision concerning supplying a market (including whether to reduce, increase or maintain unchanged the amount it supplies) should be considered manipulative or deceptive. The short answer to this question is that we can imagine none, unless there is both evidence of a specific intent to manipulate a properly defined market and the clear power to do so.[9]

In crafting the Section 811 regulations, the Commission should recognize that crude and petroleum products are purchased and sold in a global marketplace and that the tools of that marketplace serve American consumers. When petroleum is in relatively short supply in the United States, prices rise, signaling suppliers to redirect available oil here as opposed to other markets. The same principles work within the United States. To cite a common example, many of Sutherland's clients customarily supply customers in the U.S. Northeast and Gulf Coast. However, when prices rise in places like California, they redirect cargoes to the West Coast instead, alleviating what might otherwise be shortage conditions. Accordingly, the fact that a supplier may have served a given marketplace during one year and then redirects its supply to a different market in another year is not in and of itself evidence of a manipulative or deceitful purpose, but a salutary response to supply and demand conditions. A true emergency may necessitate governmental actions to direct supply in order to avoid hardship conditions or meet security concerns. However, in the extraordinary case of a natural disaster or national emergency, we are confident that ample authority exists without supplementary involvement by the FTC.[10]

The Notice asks how the Commission might respond to so-called "price spikes." Perhaps the first issue to be considered is how to define that politically charged term. Because the U.S. energy markets are characterized by relatively inelastic demand, oil prices inherently are volatile and, as has been seen in recent weeks, crude oil and product prices can move up or down or both by several dollars per barrel in a single day. Thus, the dollar increase that might have been a wild "spike" just a few months ago appears to be the norm today. As noted, price changes, while disruptive and politically unpopular, are the signals that help direct crude oil and oil products to the places that need them most. Our clients are concerned that unwarranted threats of investigations prompted by price volatility as opposed to clear evidence of price manipulation or deceit will make it impossible for them to do business in the U.S. market.

---

[9] We note that the Commission is much more qualified than other regulators to properly define relevant markets, given its long experience under the antitrust laws.

[10] *See, e.g.*, Defense Production Act of 1950, 50 U.S.C. § 2061, *et seq.* (2008) (authorizing the President, or his designee, to prioritize contracts or orders to maximize domestic energy supply).

We also note that the Commission seems not to have taken into account the fact that the industry customarily hedges its oil purchases, sales and inventories. This follows from the fact that suppliers typically must finance their oil purchases using lenders that do not allow them to take large market risks, particularly when the cost of a barrel of oil moves by several dollars in a single day. Nevertheless, commentary in the Notice suggests that an oil owner invariably should have an incentive to sell in a rising market. In fact, a hedged oil owner – which is the norm – has no such incentive, as its profits on any sale of physical inventory in a rising market would be given backs in hedge losses. This is the necessary corollary to the fact that in a falling market, the hedged owner's potential losses are balanced by gains in the hedge.

Even in the absence of hedging, we think that the Commission should refrain from interfering with the basic business decision of when and whether to sell inventory. To decide otherwise effectively would resurrect the discredited oil allocation rules of the 1970s, pursuant to which the government told oil market participants when, to whom and how much they must sell. Suffice it to say that the allocation program was one of the major contributors to the infamous gas lines of that period and did not help reduce price shocks.

To mandate inventory releases would distort the U.S. oil markets and is contrary to the healthy structure of the markets. Oil companies store petroleum in response to market signals. In a so-called "carry" market, in which prompt prices typically are lower than forward prices, market conditions tell traders that there may be a higher return in investing inventories; conversely, a "backward" market, in which prompt prices are higher than forward prices ordinarily encourages disposition of inventories. However, the genius of the free market is that it allows given participants to pursue their own market views. Thus, in a backward market, the wisest trader may decide to hold inventory, because he believes that the market may become more backward as time passes. If the trader is right, the effect of this "hold" is to save those inventories until the market signals that they are needed even more. Another example of inventory management is the process known as 'heating oil" summer fill, pursuant to which a marketer buys oil in the summer then places the product in inventory for use when consumers need it in the winter months. Selling off such inventories in response to high summer prices would effectively push consumer prices higher than necessary in the winter and may lead to shortage conditions.

While not specifically addressed in the Notice, we think it important that the Commission send a clear signal that unilateral decisions to own or lease storage either on a short or long term basis shall not be considered evidence of market manipulation, absent overwhelming evidence to the contrary. Storage investment decisions are vitally important in terms of creating industry infrastructure, particularly in the oil products distribution system, which has experienced significant stress due to a proliferation of product grades required by environmental rules. More broadly, storage investments help moderate price volatility and create a physical means of hedging against price changes. Consumers benefit from these activities both in the short and long term. To cite one example, trading companies often lease storage space in support of long term supply contracts pursuant to which they deliver a predetermined volume to customers each

month. These term arrangements provide logistical and economic efficiencies, which would be discouraged if the marketplace were faced with the possibility that the government might impose rules that would require companies to dispose of inventories in a rising market, despite contractual obligations to the contrary.[11]

3. The FTC Should Model Its Anti-Manipulation Standards After Its Antitrust Experience and Commodity Exchange Act Precedent

The Notice correctly invokes the Commission's considerable experience under the antitrust and consumer protection laws as a proper frame of reference for the development of regulations under EISA. We strongly encourage the FTC to use the "prism" of its experience under the Sherman Act, the Clayton Act and Section 5 of the Federal Trade Commission Act to help it breath life into the statutory concept of a "manipulative or deceptive device or contrivance."

We also believe that, in fashioning regulations under Section 811, the Commission should draw upon the significant precedent developed under the Commodity Exchange Act ("CEA").[12] The federal courts have determined a claim of market manipulation under Section 9(a) of the CEA requires proof that: (1) the defendant was able to influence market prices; (2) an artificial price existed; (3) the defendant caused the artificial price; and (4) the defendant specifically intended to cause the artificial price. *In re Crude Oil Commodity Litigation*, 2007 U.S. Dist. LEXIS 47902 (S.D.N.Y. 2007) (citing *In re Natural Gas Commodity Litigation*, 337 F.Supp.2d 498, 507 (S.D.N.Y. 2004)); *CFTC v. Enron Corp.* 2004 U.S. Dist. LEXIS 28794 (S.D. Tex. 2004). Applying comparable standards under Section 811 will allow the Commission to distinguish between anticompetitive behaviors that have serious implications for oil consumers and market participants and those that do not.

Similarly, we urge the Commission to follow the CEA example of requiring proof of *specific intent* as a condition precedent to the prosecution of market manipulation cases. We are concerned that a general *scienter* standard could demonize ordinary market behavior in the otherwise unregulated oil markets. For example, one might find *scienter* in a trader's decision to hold inventory in a rising market in the sense that the trader knowingly made a decision not to sell, but such a finding should not lead the Commission to conclude that the trader intended to manipulate the market.

In the recent market manipulation cases that have raised serious concerns, the CFTC and FERC invariably have discovered ample evidence of specific intent to manipulate prices. For example, in *BP Products North America,* the CFTC produced extensive evidence of specific intent to manipulate the price of physical propane, which included tape recorded conversations during

[11] Even if the FTC were to take into account long-term contracts, the increased regulatory risk associated with a rule that the government could force companies to dispose of inventories in a rising market could have a significant chilling effect on investment in infrastructure.
[12] 7 U.S.C. § 1, *et seq.* (2008)

which traders discussed the scheme and their intent to "control the market at will."[13] Likewise, FERC has found evidence of specific intent in the two investigations that have resulted in market manipulation allegations since it gained new enforcement authority in 2005.[14]

4. The FTC Should Recognize the CFTC's Exclusive Authority With Respect to the Futures Markets and Develop Rules That Will Protect Market Participants from Duplicative Investigations

We urge the FTC to recognize the CFTC's exclusive jurisdiction with respect to the futures markets and other areas of the CFTC's jurisdiction. Private parties should not be forced to defend multiple enforcement actions by federal agencies examining identical facts or suffer double jeopardy in terms of fines and disgorgement orders. We thus respectfully disagree with FERC's position in the pending *Amaranth* proceedings that Congress gave it authority to sanction entities for futures market misconduct whenever it affects a FERC-jurisdictional activity and do not believe comparable logic should be applied to the oil markets.[15]

Indeed, given that the CFTC recently has aggressively pursued alleged manipulative conduct in the physical oil markets (including cases in which there is no meaningful allegation that the futures markets are implicated), we urge the FTC and the CFTC to develop clear rules as to which agency will assume jurisdiction when the futures and financial market conditions are not in issue. This is not merely a question of making sure that the FTC and the CFTC cooperate, but goes to fundamental fairness and the inevitable burden that would be imposed upon those who otherwise may be investigated by both agencies.

5. Conclusion

While we strongly support efforts to deter market misconduct, we are hopeful that the FTC will avoid the lure of overzealous regulation. Regulations that amount to economic controls hurt consumers. The FTC should continue its tradition of guarding competition by making sure that all market participants play by the same rules. It should not instruct their behavior and should not create conditions that increase costs for marginal competitors, deter market entry or lead to the entrenchment of the most powerful market participants

---

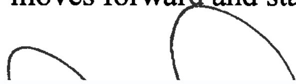
[13] *See BP Products North America*, Consent Order for Permanent Injunction and Other Relief, PP12-18, Civil Action No. 06-C-3503 (Oct. 25, 2007) *approved by* Order Approving Consent Order for Permanent Injunction and Other Relief (Oct. 25, 2007).

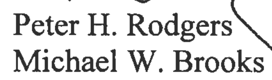
[14] *See Energy Transfer Partners, L.P.*, Order to Show Cause and Notice of Proposed Penalties, 120 FERC ¶ 61,086, at PP 51-54 (July 26, 2007) (providing transcripts of conversations allegedly showing intent); *Amaranth Advisors L.L.C.*, Order to Show Cause and Notice of Proposed Penalties, 120 FERC ¶ 61,085, at P 70 (2007) (same).

[15] *See Amaranth Advisors*, 120 FERC, at 61,085 (proposing penalties for futures market misconduct).

*   *   *

We look forward to participating in the Section 811 rulemaking process as the Commission moves forward and stand ready to answer any questions that the FTC may have.





Peter H. Rodgers
Michael W. Brooks

PHR/p