

**FEDERAL TRADE COMMISSION  
16 CFR Part 317**

**Prohibitions on Market Manipulation and False Information in Subtitle B  
of the Energy Independence and Security Act of 2007**

**Advance notice of proposed rulemaking; request for public comment.**

**STATEMENT OF THE NAVAJO NATION, RESOLUTE NATURAL RESOURCES  
COMPANY, AND  
NAVAJO NATION OIL AND GAS COMPANY**

Submitted  
June 23, 2008

Before the  
**FEDERAL TRADE COMMISSION**  
Washington, D.C.

In the Matter of

Market Manipulation Rulemaking )

Project No. PO8290

**I. INTRODUCTORY STATEMENT**

The Navajo Nation,<sup>1</sup> Resolute Natural Resources Company and its affiliate companies (“Resolute”), and Navajo Nation Oil and Gas Company (“NNOG”)<sup>2</sup> (collectively, the “Rule Proponents”) are pleased to submit comments in response to the Advance Notice of Proposed Rulemaking, “Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007” (“ANPR”), issued on May 1, 2008.

Section 811 of Subtitle B of the Energy Independence and Security Act of 2007, Pub. L. 110-14-, 121 Stat. 1723, tit. VII, subtit. B, to be codified at 42 U.S.C. §§ 17301-05 (“EISA”), makes it unlawful for:

Any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil . . . , 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 the United States.

Violations of Federal Trade Commission (the “FTC” or the “Commission”) rules developed to implement this provision of the EISA are to be treated as “unfair or deceptive acts or practices” under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The ANPR seeks public comment on “whether, and if so, in what manner, the Commission should promulgate a rule” to implement this new anti-manipulation authority so that it “carries out the objectives of the

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<sup>1</sup> The Navajo Nation is a federally recognized Indian Nation. See *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195 (1985).

<sup>2</sup> NNOG is a federal corporation organized under section 17 of the Indian Reorganization Act, 25 U.S.C. § 477, and wholly owned by the Navajo Nation.

statute” and “benefits the public interest.” ANPR at 7. In particular, the Commission has requested comment on, *inter alia*, “whether a denial of access to a non-regulated terminal may be an act of market manipulation subject to Section 811.” ANPR at 31. The Commission states that such denials of access have led to an inability of prospective shippers to place product on common carrier pipelines. *Id.* In response to this aspect of the ANPR, the Rule Proponents submit that the Commission’s inquiry should also include circumstances in which access to common carrier pipelines may be denied by the pipelines themselves for anticompetitive reasons.

Resolute and NNOG are engaged in the business of developing, producing, and supplying crude oil from the Paradox Basin in southeastern Utah, a region from which production has declined significantly in recent years. In response to current and projected increases in demand needed to serve crude oil buyers in West Texas and southeastern New Mexico (referred to together as “West Texas”) and the Four Corners area (the area where the states of Arizona, Utah, Colorado, and New Mexico intersect), Resolute and NNOG have begun a significant investment designed to redevelop the previously declining Greater Aneth Field (the “Field”) in southeastern Utah with the aim of bringing to market a significant long-term source of additional crude oil supply that is now economically recoverable in light of current and projected crude oil price levels.

Today’s crude oil markets offer unambiguous signals that additional domestic production is needed in the short and long run. America’s dependence on foreign oil harms the economy and threatens the national security. Statement by President George W. Bush upon signing the EISA (December 19, 2007), U.S.C.A. Stat. Supp. at S25-26 (West, February 2008). Nonetheless, while the need to increase domestic output has never been greater, Resolute and NNOG have encountered substantial barriers of an anticompetitive character that discourage

investment and thus undermine the parties' incentives to increase oil output from these fields and their ability to bring competitively priced supplies to potential purchasers in West Texas. The practices described below should be treated as unlawful market manipulation because: (i) they have the effect of denying purchasers the benefit of competitively priced crude oil supplies delivered to markets in need of such supplies and (ii) there are no offsetting price or other benefits for either crude oil producers or purchasers that can result from the denial of access.

At a time when demand for crude oil is very high, it is both necessary and appropriate that the FTC use all the enforcement authority within its ambit, including Section 811 of the EISA, to discourage and punish business practices that prevent or have the significant potential to prevent economically viable expansion of domestic crude oil output. With respect to crude oil pipelines, the FTC's enforcement effort should be designed to eliminate anticompetitive practices or conduct that restrains the flow of crude supplies. The rule should seek to eliminate anticompetitive practices that the Federal Energy Regulatory Commission (the "FERC") may have determined are beyond its jurisdiction over common carrier crude oil pipelines to the extent that such practices:

- (a) impede, for other than legitimate business reasons, the flow of competitively priced crude oil supplies to markets;
- (b) reduce incentives for efficient and timely investment in domestic crude oil production to meet market demand; or
- (c) unreasonably restrain the ability of crude oil producers to bring competitively priced supplies of crude oil to willing purchasers in a timely fashion in response to market signals.

In sum, the Rule Proponents submit that the FTC should adopt a rule to implement Section 811 that will specifically prohibit practices or conduct that create artificial restraints (*i.e.*, restraints not dictated by physical or environmental limitations on a common carrier pipeline) on the flow of crude oil supplies to the market.

## **II. THE PROPOSED RULE**

In brief, the Rule Proponents urge the adoption of a rule prohibiting an owner-operator of an interstate pipeline from denying a request for either actual physical transportation or exchange transportation on the pipeline when the owner-operator or its affiliate is an actual or potential purchaser or consumer of the crude oil supplied by the requesting party. The Proposed Rule includes a number of defenses to protect the owner-operator when a request is denied for legitimate business reasons rather than for the purpose of manipulating crude oil wholesale prices. The text of the Proposed Rule, which the Rule Proponents assume would be part of a more comprehensive rule or set of rules, is as follows:

**§ X01.01      Manipulative or deceptive device or contrivance in connection with the purchase or sale of crude oil at wholesale.**

(a) This rule is promulgated pursuant to Section 811 of Subtitle B of Title VIII of The Energy Independence and Security Act of 2007, Pub. L. 110-140, 121 Stat. 1723 (December 23, 2007), *to be codified at* 42 U.S.C. § 17301 (the “Act”). The conduct proscribed herein constitutes the use or employment, in connection with the purchase or sale of crude oil at wholesale, of a manipulative or deceptive device or contrivance for purposes of section 811 of the Act.

(b) When used in this rule –

(1) *Affiliate.* The term *affiliate* as applied to any owner-operator means any other person directly or indirectly controlling or controlled by or under direct or indirect common control with such owner-operator. The term *control* (including the terms *controlling*, *controlled by* and *under common control with*) means the power to direct or cause the direction of the management or policies of a person, whether through ownership of securities, by contract or otherwise. Any person who directly or indirectly has the right to vote 25 percent or more of the

voting securities, or is entitled to 25 percent or more of the profits, of another person is presumed to control that person.

(2) *Exchange transportation.* The term *exchange transportation* means non-physical transportation on a pipeline accomplished by the displacement of offsetting volumes rather than physical movement and is sometimes referred to as delivery by displacement or backhaul or pipeline exchange.

(3) *Owner-operator.* The term *owner-operator* means a person or persons who own or operate a pipeline.

(4) *Pipeline.* The term *pipeline* means a pipeline and associated storage and related facilities used to transport crude oil in interstate commerce.

(5) *Requesting party.* The term *requesting party* means any person requesting access to a pipeline for transportation of crude oil for ultimate sale.

(6) *Transportation.* The term *transportation* means transportation of crude oil over a pipeline and includes exchange transportation.

(c) It shall be unlawful for an owner-operator to deny a request for transportation over a pipeline that it owns or operates, or to impose economically unreasonable terms and conditions on such transportation, where the owner-operator or its affiliate is an actual or potential purchaser, marketer or consumer of crude oil provided by the requesting party, unless the owner-operator can establish a defense under subsection (d).

(d) An owner-operator shall not be deemed to have violated this section if it establishes by a preponderance of the evidence any of the following:

(1) That the pipeline that is the subject of the request lacks capacity to accommodate any portion of the request during the time period(s) specified, taking into account reasonable demand-based prorationing, *provided* that this defense shall not apply if the requesting party offers to bear the reasonable direct capital cost<sup>3</sup> of increasing the pipeline capacity and the owner-operator fails to increase capacity necessary to fulfill the request in a reasonable and timely manner;

(2) That fulfilling the request would require a violation of United States Department of Transportation or applicable state regulations, *provided* that this defense shall not apply if the requesting party offers to bear the reasonable direct capital cost of addressing any regulatory compliance issues and the owner-

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<sup>3</sup> If the owner-operator takes title to the facilities that are constructed or expanded, appropriate arrangements for the requesting party to recoup the costs described in the provisos to subsections (d)(1)-(3) shall be worked out by the parties.

operator fails to address regulatory compliance issues necessary to fulfill the request in a reasonable and timely manner;

(3) That fulfilling the request would require the construction of substantial new facilities or substantial expansion of existing facilities, *provided* that this defense shall not apply if the requesting party offers to bear the reasonable direct capital cost of any required construction of new facilities or expansion of existing facilities;

(4) That the requesting party has one or more economically reasonable and practical alternative means of transporting the crude oil that is the subject of the request to the requested point of delivery; or

(5) That a tariff duly issued by the Federal Energy Regulatory Commission by its express terms permits the requested transportation and that the requesting party's request was not substantially consistent with the terms of the tariff.

(e) The defenses set forth in subsections (d)(1), (d)(2), and (d)(3) shall not apply to the extent that the owner-operator can lawfully fulfill any portion of a request.

### **III. RATIONALE FOR THE PROPOSED RULE**

The Proposed Rule addresses market manipulation when the owner-operator of an interstate pipeline, or its affiliate, also is a purchaser or refiner of crude oil. In those circumstances, the owner-operator may seek to use its control over the pipeline to manipulate the availability of supply to the detriment of consumer interest in prices and output levels that would otherwise result from competitive market forces. The Rule Proponents provide a case study illustrating such manipulative conduct and then provide further economic and legal analysis.

#### **A. The Western Refining Case Study.**

The Field, located within the Paradox Basin in southeastern Utah, once was one of the most prolific oil-producing fields in the United States producing, at its peak, approximately 100,000 barrels of crude oil per day ("bpd"). Over the years, production from the Field steadily decreased to about one-tenth of peak production (10,200 bpd), at a time when the United States faces historically high crude oil prices. (Crude oil production in the entire Four Corners area

currently totals approximately 25,000 bpd.) However, an ongoing joint effort by Resolute and NNOG<sup>4</sup> holds the promise of redeveloping the Field to provide an important long-term additional source of secure domestic supply.

In 2006, Resolute and NNOG initiated a \$720 million development plan designed to nearly double production from the Field to more than 19,000 bpd and to develop 68 million barrels of currently undeveloped reserves. Resolute proposed an initial public offering (“IPO”) to strengthen its capital position and support its development program. Resolute had nearly completed the registration process for the IPO when the manipulative actions of Western Refining, Inc. and its affiliates (“Western”), described below, contributed to the postponement of the IPO in February, 2008.

As background, for many years production in the Four Corners Area was served by several independently owned and operated local refineries and by the TexNew Mex Pipeline, which made it possible to move substantial volumes of Four Corners crude oil to additional refineries located in West Texas. *See* map attached as Exhibit 1. However, several developments radically altered the competitive environment. In 1982, Western’s predecessor, Giant Industries, Inc. (“Giant”), acquired one of the two major refineries in the area, the Ciniza Refinery near Gallup, New Mexico, and simultaneously shut down its Farmington, New Mexico refinery. In 1995, Giant acquired the second major refinery located in Bloomfield, New Mexico. By the time Resolute assumed operations in the Field in 2004, other refineries had closed so that Giant controlled the only two refineries remaining in the entire Four Corners area – the Ciniza and Bloomfield Refineries (the “Four Corners Refineries”). The next closest refineries are located several hundred miles away in West Texas and Salt Lake City, Utah. *Id.*

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<sup>4</sup> Resolute and NNOG lease oil and gas rights in the Field from the Navajo Nation and others. The Navajo Nation depends heavily on profits earned by NNOG and on royalties it earns on production on its leased lands for the welfare of its people.



The TexNew Mex Pipeline was idled in the late 1990s, but remained a potential source of transportation of crude oil out of the Four Corners area to West Texas refineries. It thus remained a potential alternative outlet to selling crude oil to the Four Corners Refineries. As a result, from the time Resolute assumed operations in the Field (in 2004) through 2007 Resolute/NNOG production was sold to Giant at prices comparable to those in West Texas, with a reasonable transportation differential. Specifically, Resolute/NNOG entered into evergreen contracts with Giant that priced the crude oil at an average differential to the West Texas NYMEX price for West Texas light sweet crude oil (referred to here as the “NYMEX price” or “NYMEX”) of approximately \$2.50 per barrel delivered at the Field. Resolute/NNOG and Giant agreed that this price range was fair to both parties and approximated West Texas pricing for super-sweet crude oil comparable to that produced from the Field less reasonable transportation costs over the TexNew Mex Pipeline.

In the meantime, Giant acquired the TexNew Mex Pipeline in 2005 with the intent of reversing the direction of its flow. This would enable Giant to transport higher cost West Texas supplies to its Four Corners Refineries, so that those refineries could operate at capacity. Reversing the flow of the pipeline also would eliminate the only economically viable means for Four Corners producers to move their crude oil to any other refineries. By taking control over the TexNew Mex Pipeline and the only two refineries in the area, Giant also gained the opportunity to drive down the prices it would pay the Four Corners producers. Giant could do this because it was able to prevent those producers from moving their supplies to alternative markets where they could receive competitive prices.

Soon after Western acquired Giant in 2007, the pipeline flow turnaround process was completed, and higher cost crude oil supplies from West Texas began to be transported on the

pipeline to the Four Corners Refineries. Even though this new source of crude oil was substantially more expensive than Four Corners crude (because it was purchased at approximately the NYMEX price and involved additional costs to reach the Four Corners Refineries), Western almost immediately announced that it would terminate the existing competitively priced contracts with Resolute/NNOG effective April 30, 2008. Western also informed Resolute and NNOG that it would be willing to enter into new contracts, but only on price terms drastically more favorable to Western and below rates that comparable quality crude commands in alternative markets, taking into account a reasonable transportation differential.

Specifically, Western demanded a \$5.50 per barrel price cut, a 7.8% reduction from Resolute/NNOG's average price in 2007. These price cuts and the potential for further cuts have contributed to uncertainty and delay in Resolute's and NNOG's plans to increase desperately needed domestic production from the Field. Resolute and NNOG responded with a request for exchange transportation (sometimes referred to as displacement or backhaul transportation or pipeline exchange) over the TexNew Mex Pipeline to alternative markets in West Texas.

Exchange transportation would permit Resolute/NNOG to exchange a specified number of barrels that it would deliver to Western at Bisti, New Mexico (the western delivery point on the TexNew Mex Pipeline) for a like number of barrels that Western would otherwise have to transport over the TexNew Mex Pipeline.<sup>5</sup> Western flatly refused this request even though it would not have altered Western's operation or use of the TexNew Mex Pipeline and would have permitted Western's pipeline affiliate to earn incremental revenues through a transportation fee.

In addition, Western then filed a tariff with the FERC establishing an unreasonably high rate of

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<sup>5</sup> Resolute cannot effect a private exchange or "swap" with a West Texas producer because Western purchases and takes title to the crude oil in West Texas and then ships it over the TexNew Mex Pipeline. Thus, all of the crude oil physically shipped on the TexNew Mex Pipeline belongs to Western. Through exchange transportation, Western would be relieved of the obligation of physically shipping the displaced volumes, but would receive the transportation fee. The differences between a private exchange and a pipeline exchange are illustrated in Exhibit 2.

\$7.57 from Midland, Texas to Bisti, New Mexico in the Four Corners area. That tariff appears to be designed to prevent exchange transportation, even though a tariff previously filed (and subsequently withdrawn) by Giant for the TexNew Mex Pipeline permitted exchange transportation.<sup>6</sup> Western provided no explanation or support for refusing to provide exchange transportation.

Currently, under an interim short-term agreement, Western pays Resolute and NNOG an effective price at Bisti in northwestern New Mexico of approximately NYMEX *less* \$5.35 per barrel for crude oil produced in the Field, while the cost to Western of crude oil produced in West Texas delivered to Bisti is approximately NYMEX *plus* \$7.57.<sup>7</sup> As a result, Western pays \$12.72 per barrel *more* for West Texas super-sweet than it pays to Resolute and NNOG for comparable quality crude oil. Western is able to offer prices to Resolute and NNOG that are insulated from competition from refiners that purchase supplies in West Texas. By virtue of Western's control of the only two refineries in the Four Corners area and the only pipeline that could transport crude oil out of the Four Corners area to other refineries, Western has established monopoly control over the flow of crude supply from the Four Corners area. It protects this monopoly position through its refusal to allow exchange transportation on that pipeline, which is a policy that would be economically irrational for an independent pipeline (and only makes economic sense in this case because it enables Western to (a) drive down the prices it pays for

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<sup>6</sup> As discussed below, the FERC takes the position that it lacks authority or jurisdiction to compel a crude oil pipeline to provide exchange transportation, but it has accepted tariffs permitting exchange transportation when submitted by pipelines.

<sup>7</sup> The price of super-sweet crude oil in West Texas, comparable to the super-sweet crude oil produced in the Field, is approximately equal to the NYMEX price. The transportation cost from West Texas to Bisti under Western's Tariff is \$7.57. The Rule Proponents believe a reasonable transportation cost would be substantially less, but even if the cost was nearly zero, Western would still be paying in excess of \$5.00 per barrel more for crude oil that it buys in West Texas and ships to Bisti than the effective price it currently pays to Resolute and NNOG at the same location.

Four Corners crude and (b) prevent Four Corners crude from being sold to alternative markets at competitive prices).

Pipeline operators generally welcome exchange transportation, since they are paid for accomplishing two transportation hauls when in fact no long haul physical movement of barrels occurs. The most the operator must do is handle the minor operational or, more likely, the purely accounting activity of facilitating an exchange of barrels from one party to another at a single delivery and receipt point on the pipeline. Any operational or accounting expense that is required to effect the exchange is more than fully compensated by the double profit from the transaction, and the operator would be entitled to charge for the extra service. The only conceivable explanation for Western's refusal to provide exchange service is to maintain control over the flow of supplies from the Four Corners area. This is classic exclusionary conduct – sacrificing short-term profits in order to maintain anticompetitive pricing. Western is able to recoup the sacrificed profits by purchasing Four Corners area supplies at prices below those that prevail in the West Texas market.

Without access to other refineries, Resolute and other Four Corners producers are unable economically to sell their crude oil production to any buyer other than Western. When Western terminated its contract and demanded a dramatic price cut, it brazenly drove this point home by sending Resolute and NNOG a map that shows trucking costs to other refineries. A copy of the map is attached as Exhibit 3. The map estimates trucking costs to range from over \$9.00 per barrel to Salt Lake City to approximately \$10.70 to southeastern New Mexico.<sup>8</sup> Recently, these costs have increased over those shown on Exhibit 2. These costs are prohibitive and uneconomical, even assuming that the 180 trucks and 360 drivers necessary to transport the

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<sup>8</sup> There are no railroad terminals in the area for shipment of crude oil out of the Four Corners area. Also, there is no crude oil pipeline connecting the Four Corners area with Salt Lake City.

crude oil to these refineries could be secured. Transportation by truck over long distances also would have potentially undesirable and costly environmental impacts and would negatively impact the infrastructure of the highways over which they would travel. Moreover, it would take several years and require enormous capital to build a competing refinery or pipeline. Western's actions suggest that its ultimate goal is to set the purchase price of Four Corners crude oil at a point just marginally better than what producers would receive if they shipped their product out of the Four Corners area by truck.

Western has made clear that it does not plan to pass on these crude oil price cuts to purchasers of gasoline at the pump. Indeed, there is no evidence that retail gas stations owned by Western have reduced their prices in proportion to Western's wholesale price manipulation. Rather, Western intends to retain for itself all of the benefits from the price reductions resulting from its manipulative conduct.

On the other hand, the effect of Western's practices on market conditions is demonstrably adverse. First, Western's conduct has made it economically impractical to ship Four Corners crude oil to West Texas, where it could be sold to other purchasers and refined at other refineries. Instead, at a time of unprecedented crude oil and gasoline prices, Western has created an uneconomic barrier to crude oil transportation that isolates Four Corners crude oil from other markets, thus consolidating a monopoly position that will enable Western to manipulate crude oil prices and adversely impact future crude oil production availability.

In addition, Western's conduct – putting the future price of crude oil to be paid to Resolute and NNOG in the hands of a single, affiliated purchaser – has interfered with and delayed the plans of Resolute and NNOG to expand production and reserves in the Field. This

illustrates the manner in which manipulative conduct prohibited by the Proposed Rule reduces incentives for investment and expansion of output.

The Proposed Rule would resolve this situation simply and without the need for protracted and costly agency enforcement proceedings or private antitrust litigation that inevitably delays a remedy. Under the Rule, it would be unlawful for Western to deny the request of Resolute, NNOG, or any other Four Corners producer for exchange transportation over the TexNew Mex Pipeline. Application of the Proposed Rule would therefore have the effect of reconnecting the Four Corners area production to other, more competitive, crude oil markets. The basic condition precedent is present because the company that owns the Pipeline is a subsidiary of Western, and a different subsidiary of Western is the actual purchaser of crude oil provided by Resolute and NNOG.

Further, none of the defenses would apply to this conduct. First, Western's TexNew Mex Pipeline does not have in place contracts for exchange transportation or otherwise that would permit it to make a claim of lack of capacity to accept the Resolute/NNOG request. Because the exchange would be essentially a paper or accounting transaction and does not require additional physical transportation, it would not result in the violation of any environmental, safety or other regulations. There should be no need to construct or expand pipeline facilities, but if there were the Rule Proponents would be willing to pay the direct capital cost of such facilities. As Western's own map establishes, Resolute and NNOG have no economically reasonable or practical alternative means of transportation. Finally, the requested transportation is not covered in Western's tariff, which appears designed to exclude exchange transportation.<sup>9</sup>

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<sup>9</sup> Significantly, tariffs originally filed by Giant in July 2007 permitted exchange transportation on the TexNew Mex Pipeline. *See* Item No. 115 of the tariff filed FERC IS07-388-000, which recognizes that permissible Intrasystem Transfers included exchanges. (These tariffs were cancelled because the pipeline was represented as not likely to be used by parties not affiliated with the pipeline owner.) The tariffs now in effect, which take the opposite tack and do

The Proposed Rule would not be inconsistent with the FERC's regulation of the TexNew Mex Pipeline. While the FERC possesses authority to accept tariffs that provide for exchange transportation and has in fact done so,<sup>10</sup> the FERC has held that it does not have jurisdiction to require that exchange service be provided. *Western Refining Pipeline Co.*, 122 FERC ¶ 61,120 at 8 (March 7, 2008).<sup>11</sup> The Commission can plug this regulatory void with the Proposed Rule under Section 811.

**B. Analysis.**

**1. The Rule Would Prohibit a Harmful Manipulative Device or Contrivance.**

The purpose of the proposal is to prevent an owner-operator of a crude oil pipeline from using that facility to enable an affiliate refiner or purchaser to manipulate crude oil prices by interfering with the flow of competitively-priced supply to markets. At a time when the nation is striving to maximize available domestic supplies of crude oil, it is vital to eliminate artificial restraints that impede the flow of crude oil to buyers or areas where it is valued more highly, since interference with the workings of the competitive market's "invisible hand" will lead to

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not appear to provide for exchange transportation, were filed by Western only after Resolute and NNOG requested such transportation.

<sup>10</sup> For example, F.E.R.C. No. 555 of Butte Pipe Line Company states that "[s]ervice to Belle Fourche Pipeline's Seller Station may be provided through displacement and will be limited to six-thousand five hundred (6,500) barrels per day, provided there are sufficient offsetting nominations." Similarly, F.E.R.C. Nos. 107 and 108 of Belle Fourche Pipeline Company permit service by displacement. Such tariffs have been accepted only when the pipeline owner/operator has offered to provide exchange service.

<sup>11</sup> The Rule Proponents filed protests with the FERC asking it to require that the TexNew Mex Pipeline tariffs filed by Western's pipeline affiliate provide for exchange transportation from Bisti to Jal, New Mexico. The FERC disallowed the protests primarily on standing and jurisdictional grounds and accepted the tariffs. The FERC also denied the Rule Proponents' requests for rehearing, holding again that "the Commission cannot compel Western to offer an exchange transportation service" because it lacks jurisdiction to order a pipeline to provide new services. *Western Refining Pipeline Co.*, 123 FERC ¶ 61,271 at 4-5 (June 19, 2008), citing *Chevron Pipeline Co.*, 64 FERC ¶ 61,213 (1993). The FERC also stated that it lacks jurisdiction to consider allegations of anticompetitive conduct by Western with respect to crude oil in the Four Corners area. *Id.* at 5. In dicta, the FERC erroneously commented that the prices that Resolute and NNOG receive from Western may be reduced due to competition from crude oil shipped on the TexNew Mex Pipeline from Texas. *Id.* at 3 and 5. In fact, the undisputed evidence before the FERC established that Western's Four Corners Refineries pay substantially *more* for the Texas crude oil than for the crude oil produced by Resolute/NNOG. See discussion at page 11 above. Western is able to impose the lower prices on Resolute/NNOG by virtue of its controlling the only refineries in the Four Corners area and the only pipeline that could transport Four Corners crude oil to other markets.

inefficient exploitation of a vital natural resource. In particular, when a refiner or other purchaser or user of crude oil that faces little or no competition from other buyers in an oil-producing area also controls, either directly or through an affiliate, the only pipeline that can move the crude oil to other markets, that party has the power to reduce the flow of supply to markets in a way that can distort market performance in both the short run and long run. It can exercise that power by denying use of capacity on its pipeline (whether in the form of physical or exchange transportation) to producers without economic alternatives to transport the crude oil to other markets.

Market manipulation that causes prices to diverge from competitive levels leads to misallocation of resources in the form of deadweight social losses – holding market output at artificially low levels. For example, when prices are depressed below competitive levels by a monopsonistic buyer, suppliers will be discouraged from making investments in their businesses which they would have made if prices were higher, thus slowing market growth.

Prohibition of market manipulation is particularly appropriate when certain factors are present, such as the absence of efficiency justifications for the manipulative behavior accompanied by a clear sacrifice of short-run profits; commercial practices that are aimed primarily at achieving market power, not through innovative behavior, but rather through acquisitions (for example, Giant's acquisitions of the only two refineries in the Four Corners area and the only pipeline providing transportation out of that area); and the use of anticompetitive strategies (such as refusals to deal) that would not be implemented but for the benefits to be gained by foreclosure of potential sales to a competitor. When, as in the Western case study,



these factors are present, there is no legitimate reason to permit the pipeline owner to continue its conduct.<sup>12</sup>

The Rule Proponents believe that the Commission should be particularly attentive to manipulation of crude oil markets when a common carrier crude oil pipeline that could be used to transport crude oil out of an area (either by physical shipment or by supporting shipment by displacement, backhaul or exchange<sup>13</sup>) is owned by a local refiner. The problem is especially acute when the refiner is the only available purchaser to whom local crude supplies can be sold if access to the pipeline is denied. Under these circumstances, the local refiner has an incentive to use its control over the pipeline to limit the options open to the local producers, since this tactic likely depresses the price that the refiner pays for local crude oil, enabling it to benefit from the differential it is able to impose without any corresponding benefit to the consumer.

The Commission has previously taken action to preserve crude oil suppliers' access to pipelines in the face of anticompetitive conduct. For example, in *Texaco Inc.*, 104 F.T.C. 241 (1984), Texaco's acquisition of Getty Oil raised concerns similar to those discussed above. Both companies owned heavy crude oil pipelines in California. The Commission alleged that the merger would likely increase Texaco's incentives and ability to deny non-integrated refiners access to the pipelines formerly owned by Getty. The matter was resolved by consent order, pursuant to which Texaco was required, for a period of ten years, to offer access to one of Getty's California crude oil pipelines to any customer using that pipeline in 1983 on terms and

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<sup>12</sup> An important economic analysis, Janusz A. Ordover and Robert D. Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 YALE LAW JOURNAL 8, 26 n.49, 29 n.57 (1981), suggests that one can distinguish procompetitive and anticompetitive activity by determining if the activity would be profitable absent the foreclosing effect on rivals.

<sup>13</sup> See, e.g., *Nornew Energy Supply, Inc.*, 98 FERC ¶ 61,018 at n. 13 (2002) (a backhaul is a form of transportation service by displacement or exchange where the transportation service would otherwise be in a direction opposite to the aggregate physical flow of the gas in the pipeline); *AGA v. FERC*, 428 F. 3d 255, 261-263 (D.C. Cir. 2005); *INGAA v. FERC*, 285 F. 3d 18, 40, 41 (D.C. Cir. 2002) (explaining backhaul service on natural gas pipelines).

conditions that were in effect in 1983, subject to certain inflation adjustments. *Id.* (¶ VI of Order).

Similarly, the Commission has acted when necessary to ensure that a pipeline is not used to manipulate energy prices. In *Entergy Corp.*, [1997-2001 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 24,863 (January 31, 2001), Entergy Corporation and Koch Industries, Inc. formed a joint venture that would own, among other things, Koch's Gulf South natural gas pipeline. Entergy owned the local natural gas utility in New Orleans and Baton Rouge, which was served by the Gulf South pipeline. The Commission alleged that because Entergy would in effect have a 50% interest in the Gulf South pipeline (and the profits generated), it would have the incentive and ability to pay the joint venture above-market prices for natural gas transportation. Because it would be difficult for state regulators to ferret out whether the amounts paid for natural gas transportation were excessive, it was thought to be likely that Entergy could pass on the inflated costs in the form of above-market prices for natural gas charged to consumers. To prevent such price manipulation, the consent order required Entergy to employ a public bidding process for natural gas and transportation. *Id.*

Other regulatory agencies have addressed similar concerns about the exercise of market power by pipelines to favor affiliates. For example, FERC regulations recognize that natural gas pipelines and electric utilities may manipulate markets by favoring other parties, particularly affiliates. Thus, FERC Order No. 497 requires pipelines, *inter alia*, to provide equal treatment to shippers in areas such as scheduling, transportation, and speed of service. *Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, Order No. 497, F.E.R.C. Stats. & Regs. ¶ 30,820, 53 Fed. Reg. 22,139 (1988). This authority was upheld in *TennecoGas v. FERC*, 969 F.2d 1187, 1197 (D.C. Cir. 1992) ("marketing affiliates may not

receive preferences on such matters as scheduling, balancing (correcting for deviations in planned capacity), transportation, storage, and speed of service”). *See also Endicott Pipeline Company*, 55 FERC ¶ 63,028 (1991) (a pipeline cannot impose “unjust and unreasonable rates” to reduce netbacks (prices paid) to producers who lack alternatives).

Further, to implement Section 4A of the Natural Gas Act and Section 222 of the Federal Power Act, which prohibit the use of manipulative or deceptive devices or contrivances, the FERC has adopted regulations that prohibit market manipulation of natural gas and electric energy markets. *Prohibition of Energy Market Manipulation*, Order No. 670, 114 FERC ¶ 61,047, 77 Fed. Reg. 4244 (2006). Since the FERC’s regulations adopted in Order No. 670 were not explicitly made applicable to the crude oil market, the Proposed Rule would complement the FERC’s anti-manipulation rule.

In sum, market manipulation that causes prices to diverge from competitive levels leads to deadweight losses either because sales prices are too high (monopolistic pricing) or because purchase prices are too low (monopsonistic pricing). These losses occur both in the short run (because current production is reduced) and in the long run (because firms under-invest in the industry). In the case of the oil industry, market manipulation is a particularly significant threat when pipeline affiliates may benefit from the market distortions resulting from a manipulative denial of access to pipelines that could move crude oil to other unaffiliated refineries, thus denying those refineries of needed supplies.

## **2. The Proposed Rule Is Authorized by Section 811.**

The Proposed Rule falls well within the parameters of Section 811 because the proposal specifically addresses a manipulative device or contrivance used in connection with the purchase and sale of crude oil at wholesale. The “in connection with” element of Section 811 is satisfied

because the prohibited conduct involves manipulation of the prices at which crude oil is purchased and sold and limiting the parties to whom crude oil may be sold.

The Proposed Rule meets the scienter standards discussed in the ANPR. In order to be found to violate the Proposed Rule, the owner-operator, which directly or through an affiliate is an actual or potential purchaser, marketer or consumer of crude oil, must deny a request for physical or exchange transportation of crude oil. A denial, of course, can only occur intentionally. This is particularly the case with exchange transportation, where the owner-operator can earn a rate for transportation under its tariff without physically transporting any crude oil (and incurring the incremental costs associated with such physical movement of crude oil) because it effects the transportation by displacement only. Therefore, a denial of a request for exchange transportation, where the owner-operator rejects a profit-making transaction in order to make possible its affiliate's ability to dictate noncompetitive prices, clearly manifests an anticompetitive intent. *See Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 610-11 (1985) (defendant's willingness to sacrifice short-run benefits in exchange for long-run impact held to evidence exclusionary intent where no regulatory jurisdiction exists to mandate access). Moreover, Subsection (d) of the Proposed Rule provides ample opportunity for the owner-operator to establish legitimate business justifications for the denial, negating any manipulative intent. Thus, it would not be possible to violate the Proposed Rule through negligence.

The manipulation that would be banned by the Proposed Rule fits the definition of "market manipulation" adopted by the Supreme Court in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940), and quoted in the ANPR at 20:

an artificial stimulus applied to (*or at times a brake on*) market prices, a force which distorts those prices, a factor which prevents the determination of those prices by free competition alone.

(Emphasis added). The denial of access the Proposed Rule seeks to ban is an artificial stimulus, force, or factor that distorts the market and market prices by preventing prices to be determined by free competition alone. In the absence of the denial, crude oil could be made available at other locations along the pipeline. The denial further enables the affiliate to depress prices, thus reducing output and discouraging investment to expand output.

The ANPR also requests comments on potentially overlapping jurisdiction between the FTC and other federal agencies with anti-manipulation authority. The Proposed Rule avoids any such issues. Although the FERC possesses authority to *accept* tariffs providing for exchange transportation of crude oil and has in fact accepted such tariffs, *see* footnote 10 above, the FERC has ruled that it lacks jurisdiction to *compel* a crude oil pipeline to provide exchange transportation. *Western Refining Pipeline Co.*, 122 F.E.R.C. ¶ 61,210 at 7 (March 7, 2008). *See also* discussion in footnote 11 above. Accordingly, an FTC rule under Section 811 requiring a crude oil pipeline to provide such transportation would not overlap or conflict with FERC jurisdiction. The Proposed Rule recognizes FERC jurisdiction to accept crude oil transportation tariffs and does not interfere with or supersede that authority. In fact, subsection (d)(5) expressly provides a defense when a requesting party does not substantially meet the terms of a tariff duly issued by the FERC that permits the requested transportation. Therefore, an owner-operator may comply with the Proposed Rule by obtaining a FERC-accepted tariff that provides for the transportation requested.

If the Commission were to find a violation of the Proposed Rule, it would not establish the terms and conditions under which the requested service would be provided. This would be left to the FERC with its statutory authority to regulate pursuant to approval of any necessary

tariff, including the determination of rates that are just and reasonable. Thus, the FTC's enforcement of the Proposed Rule would supplement and not overlap FERC jurisdiction.

#### **IV. CONCLUSION**

Demand for increased supplies of domestic crude oil has never been greater. Congress enacted Section 811 to provide the necessary tools for the Commission to eliminate manipulative devices and contrivances that would cause market distortions that adversely affect crude oil prices and output. The Proposed Rule provides a simple method to prevent pipelines from being used for such manipulative purposes. The Rule Proponents therefore respectfully ask that the Commission include the Proposed Rule in the final rules that it adopts pursuant to Section 811.

# Four Corners Area - Oil Facilities

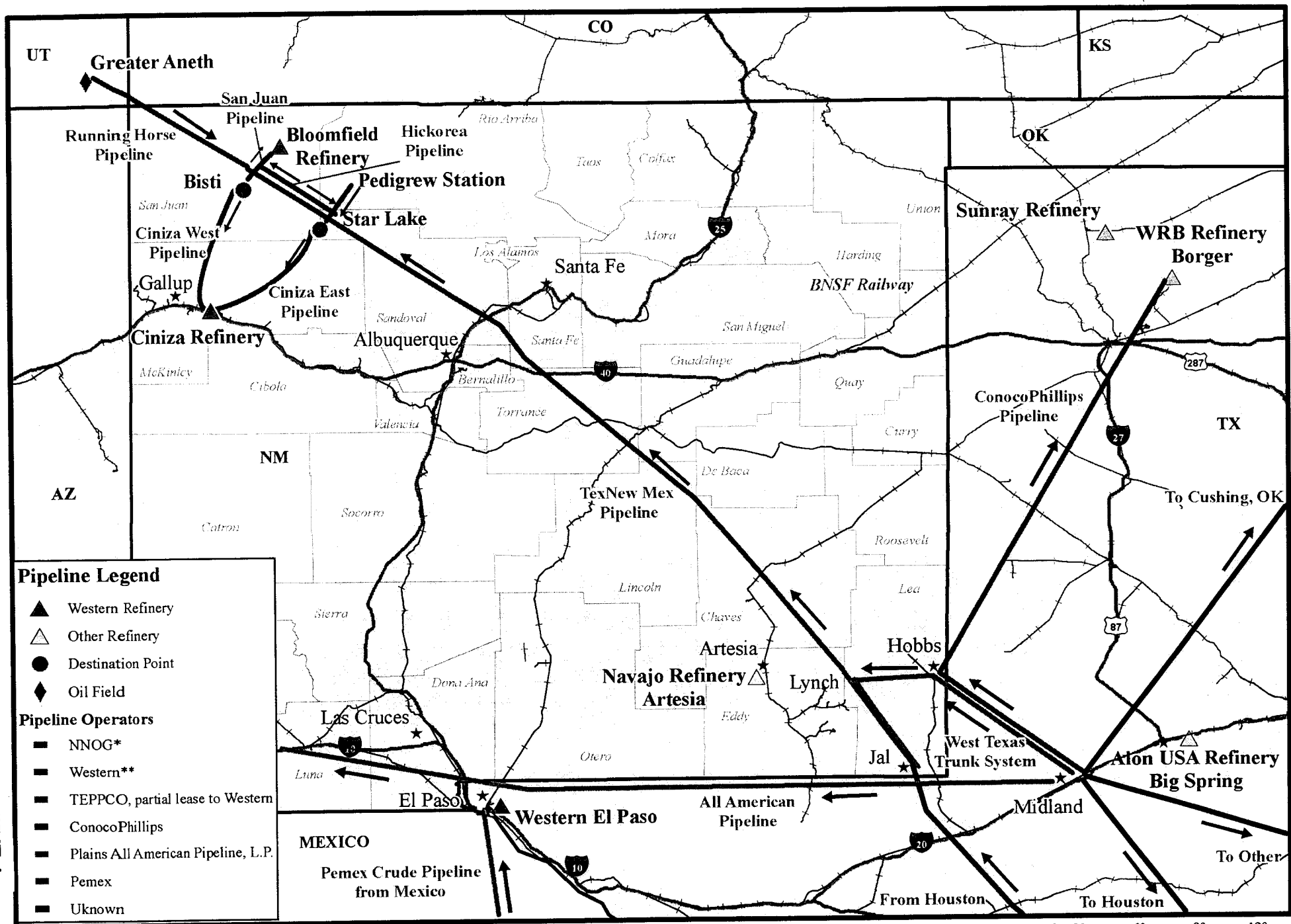


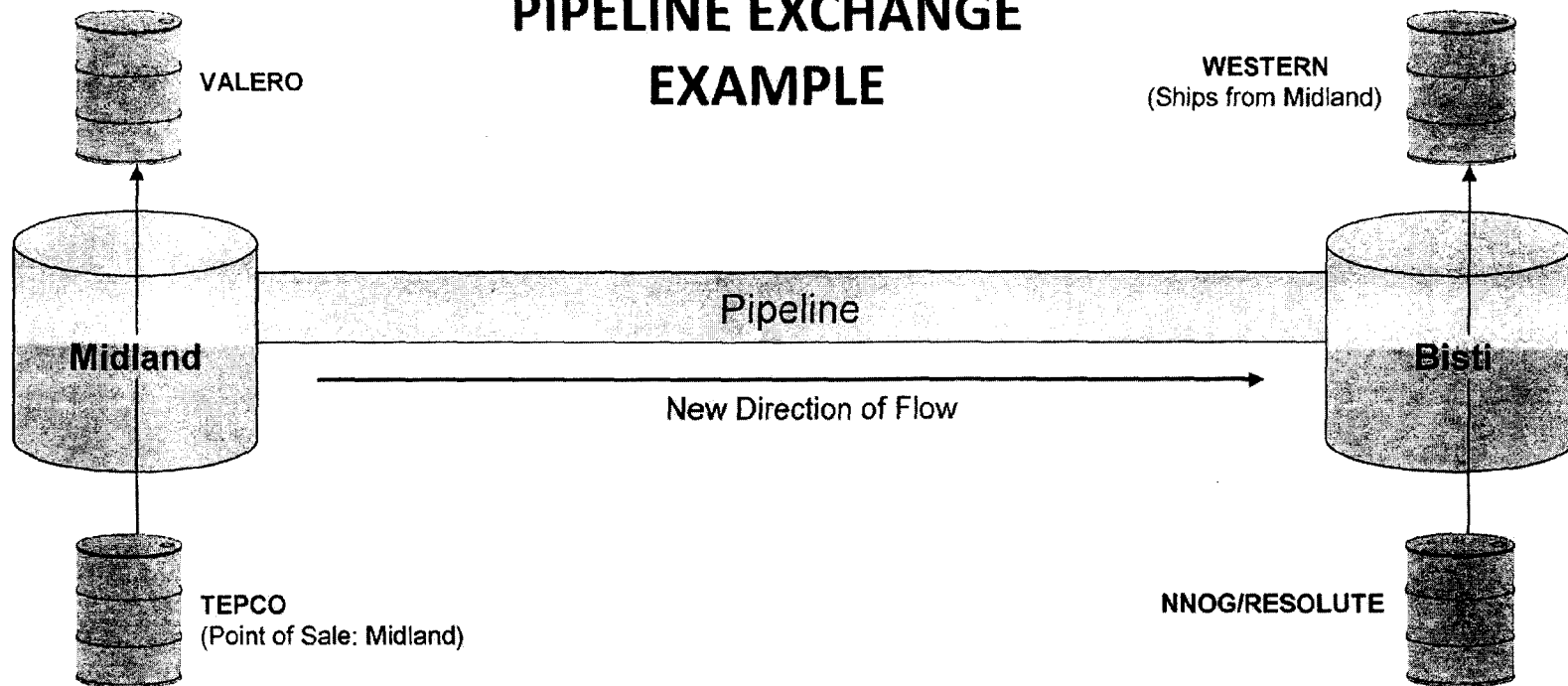
EXHIBIT 1

Source: [www.westernrefining.com](http://www.westernrefining.com), Resolute Natural Resources - Four Corners Area Oil Facilities Map

\*NNOG is Navajo Nation Oil and Gas Co, \*\*Western is Western Refining Pipeline Co

Notes: Pipeline from Lynch to Jal is owned by Western but 100% leased to TEPPCO; Western Refinery is operated by Western Refining Southwest, Inc., a subsidiary of Western Refining, Inc.

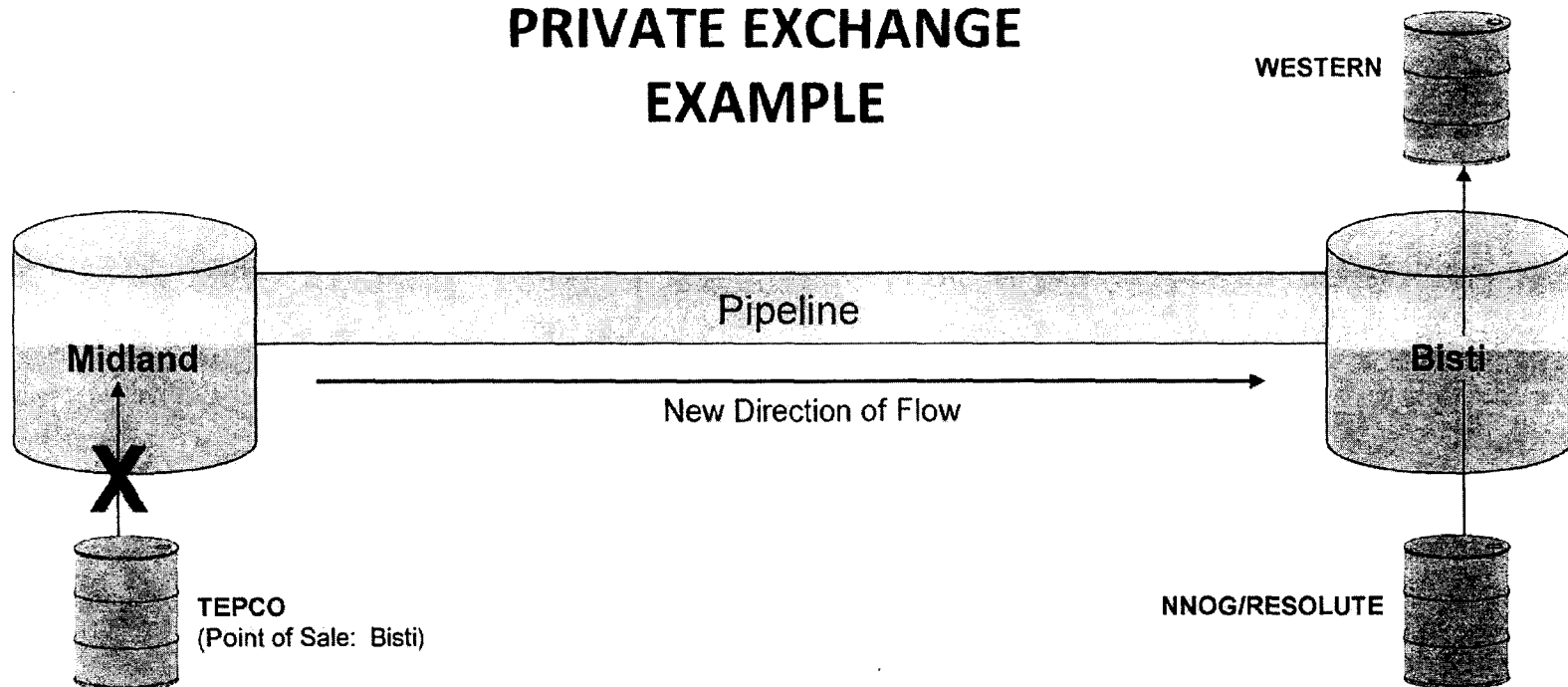
## PIPELINE EXCHANGE EXAMPLE



- TEPCO has contract to sell barrels to Western at Midland.
- NNOG/Resolute, who have barrels in Bisti, would like to sell to Valero in Midland, but cannot deliver the barrels without pipeline assistance because point of physical sale is distant from NNOG/Resolute.
- To accomplish exchange, pipeline takes barrels of TEPCO and delivers them to Valero, and takes barrels of NNOG/Resolute and delivers them to Western.
- NNOG/Resolute are treated as having transported barrels to Valero, and TEPCO is treated as having transported barrels to Western.
- Pipeline collects a fee for both transports, but no barrels were shipped on pipeline.



## PRIVATE EXCHANGE EXAMPLE



- **TEPCO has contract to deliver barrels to Western at Bisti – normally would put barrels in at Midland and would ship those barrels to Bisti.**
- **Instead, NNOG/Resolute enters into contract with TEPCO to deliver NNOG/Resolute's barrels to Western at Bisti on TEPCO's behalf.**
- **Western pays TEPCO and TEPCO pays NNOG/Resolute.**
- **No barrels flow through the pipeline – the pipeline collects no shipping fees.**

# FCS Alternative Markets

Western Refining Company, LP

