Before the
FEDERAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Market Manipulation Rulemaking	)	**No. P082900**
	)	

COMMENTS OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

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COMMENTS OF
THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

The International Swaps and Derivatives Association, Inc. ("ISDA") respectfully submits the following comments in response to the Federal Trade Commission's (the "Commission" or "FTC") Advance Notice of Proposed Rulemaking; Request for Public Comments, with respect to Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007 ("EISA").

I. <u>Interest Of ISDA In The Manipulation ANPR</u>

ISDA is the global trade association representing participants in the privately negotiated derivatives industry. ISDA has over 670 member entities from 47 countries. ISDA's members include most of the world's major institutions who deal in, as well as leading end-users of, privately negotiated derivatives.

ISDA leads efforts to identify and reduce sources of risk for its members. In an effort to reduce legal and documentation risk, ISDA developed the ISDA Master Agreement, the form of master trading agreement that is the recognized standard in the derivatives industry. ISDA also has developed annexes to the ISDA Master Agreement that facilitate the wholesale trading of various products and commodities by parties under the ISDA Master Agreement framework and is currently in the process of developing such documentation for physical crude oil transactions. Through these and related initiatives, ISDA promotes sound risk management and risk reduction practices and advances the understanding and treatment of derivatives from the public policy and regulatory capital perspectives.

Many ISDA members purchase and sell various wholesale, physical, crude oil, gasoline and petroleum distillates ("Petroleum Products") and other energy commodities, and trade derivatives contracts based upon notional quantities of such commodities. ISDA and its

members are committed to supporting open, fair and competitive wholesale energy markets and encouraging transparent and effective enforcement programs to preserve the integrity of these markets.

In keeping with its commitment to the integrity of the markets, ISDA appreciates the time and consideration that the Commission has devoted to this advance notice prior to publication. ISDA also commends the Commission for continuing to focus its enforcement efforts in the petroleum industry on maintaining competitive markets. The Commission concluded in its Katrina Report that the U.S. petroleum industry is highly competitive.[1] It also found no evidence of significant harmful or illegal conduct in the industry.[2] Importantly, the Commission emphasized that regulation that interferes with competitive pricing mechanisms could lead to extensive energy shortages, which ultimately will harm consumers.[3] However, by focusing on maintaining free markets, the Commission will be able to deter manipulative behavior and help to ensure that competitive price signals continue to allocate supply and demand for wholesale, physical Petroleum Products.

II. **<u>Overview Of ISDA's Comments</u>**

Congress has tasked the Commission with the challenging assignment of developing a rule that will prohibit and ultimately prevent manipulation in the wholesale, physical Petroleum Products markets. The Commission has acknowledged that, in proposing an anti-manipulation

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[1] *See* Federal Trade Commission, Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases (Spring 2006), <<http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReport Final.pdf.>> ("Katrina Report") at p. vi ("The evidence collected in this investigation indicated that firms behaved competitively").

[2] *Id.* at pp. vi and ix.

[3] *Id.* at p. 184; *see also* Prepared Statement by the FTC before the House Commerce Committee, "Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets" at p.17 (May 22, 2007) (summarizing the Katrina Report).

rule, it should avoid creating a largely duplicative enforcement regime and at the same time propose a standard that is not inconsistent with those standards already applicable to markets for wholesale, physical Petroleum Products. ISDA believes that the best way to accomplish these goals is for the Commission to tailor its rule to: (1) apply only to manipulative schemes involving wholesale physical Petroleum Products, and (2) provide clear guidance about what constitutes prohibited behavior.

ISDA recommends that the Commission encourage voluntary transaction reporting by creating a safe harbor for market participants who provide price and volume data in compliance with prescribed guidelines. In addition, ISDA responds to the Commission's specific questions regarding whether particular conduct, such as public announcements by refineries and pipelines, and certain supply/withholding decisions should be considered manipulative behavior. Finally, ISDA encourages the Commission to propose a definition of "petroleum distillates" that includes only products produced from crude oil and not products such as non-petroleum based ethanol.

III. The Commission's Statutory Mandate

The EISA authorized the Commission to prosecute and punish manipulation in the wholesale crude oil, gasoline, and petroleum distillates markets and to promulgate a rule pursuant to Section 811.[4]

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[4] We encourage the Commission to clarify that any rule it proposes does not create a private right of action. Courts generally will not imply a private right of action absent clear congressional intent. In Section 813(a), Congress provides that Sections 811 and 812 should be enforced in the same manner, by the same means and with the same jurisdiction as the Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41-58, as amended ("FTC Act"), which does not create a private right of action. *See, e.g., Dreisbach v. Murphy*, 658 F.2d 720 (9th Cir. 1981) ("[p]rivate litigants may not invoke the jurisdiction of the federal district courts by alleging that defendants engaged in business practices proscribed by § 5(a)(1) of the [FTC Act]"); *Holloway v. Bristol-Myers Corp*., 485 F.2d 986, 989 (D.C. Cir. 1973) ("[p]rivate actions to vindicate rights asserted under the [FTC Act] may not be maintained."). There is no indication in the statutory language or the legislative history that Congress intended to provide a private right of action for violations of Sections 811 or 812.

Section 811 of the EISA makes it unlawful for any person:

> 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 [FTC] may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens.[5]

Section 812 of the EISA makes it unlawful for any person intentionally to distort statistical data "that is required by law to be reported" to the federal government and is "related to the wholesale price of crude oil gasoline or petroleum distillates" by knowingly submitting false or misleading information.[6] Sections 813 and 814 of the EISA expressly grant the Commission authority to enforce the prohibition on false reporting, and to assess penalties of up to $1,000,000 for each violation of Sections 811 or 812.[7]

IV. <u>The Commission Should Propose A Rule With A Clearly Defined Scope</u>

The Commission should carefully draft a proposed anti-manipulation rule that will provide the most efficient and effective means of deterring manipulation in the wholesale, physical Petroleum Products markets. To that end, ISDA encourages the Commission to create a regime that will not overlap any more than necessary with the jurisdiction of other agencies. ISDA recommends, therefore, that the Commission propose a rule that applies only to manipulative schemes involving wholesale, physical Petroleum Products transactions. ISDA encourages the Commission to liaise with the CFTC to ensure that both agencies implement their anti-manipulation enforcement programs in a coordinated and efficient manner.

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[5] 42 U.S.C. § 17301. The Commission noted in the ANPR that certain entities, including banks, "are wholly or partially exempt from Commission authority under the [FTC Act]." ANPR at n.3. ISDA encourages the Commission to clarify the categories of persons to which any proposed anti-manipulation rule would apply.

[6] 42 U.S.C. § 17302.

[7] 42 U.S.C. §§ 17303 and 17304.

ISDA's recommended focus is mandated by the plain language of the statute, which extends the Commission's jurisdiction to the purchase or sale of Petroleum Products "at wholesale."[8] Focusing on wholesale, physical Petroleum Product transactions also will enable the Commission to concentrate its oversight in an area where it has extensive experience, while relying on the Commodity Futures Trading Commission ("CFTC") to take the lead in policing the listed and over-the-counter ("OTC") derivatives markets.[9] This approach would promote the most efficient allocation of limited government enforcement resources given that the CFTC (including its predecessor) has been monitoring trading activity and enforcing laws prohibiting manipulation, fraud and abusive trading practices in the listed derivatives markets for over seventy years.

By focusing on wholesale, physical Petroleum Products transactions, the Commission also will reduce the chilling effect that the possibility of duplicative enforcement would have on competition. As discussed in greater detail below, market participants faced with overlapping and potentially inconsistent rules relating to the same market activity are likely to reduce their level of participation in those markets because of the risk that activity permitted under one regime may be penalized under another. Increased regulatory risk also raises barriers to entry by new market participants.

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[8] Any proposed rule must stay within the parameters set by the statutory language. *See FDA v. Brown & Williamson Tobacco Corp*., 529 U.S. 120, 151 (2000) ("the power to regulate in the public interest must always be grounded in a valid grant of authority from Congress. [An agency] must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop.") (Internal quotations omitted).

[9] In fact, Congress specifically created the CFTC as an independent agency with the mandate and expertise to regulate listed and OTC derivatives markets. To that end, Congress granted to the CFTC exclusive jurisdiction over listed derivatives transactions. *See* Section 2 of the Commodity Exchange Act, 7 U.S.C. § 2 (a)(1)(A) (2006) ("The Commission shall have exclusive jurisdiction . . . with respect to accounts, agreements . . ., and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated or derivatives transaction execution facility. . .").

In short, the Commission will be able to monitor and prosecute manipulative behavior most effectively if it focuses on wholesale, physical Petroleum Products transactions. Creating an additional enforcement regime to monitor and/or prosecute trading activity in the OTC and listed derivatives markets for wholesale, physical Petroleum Products likely would hinder enforcement efforts by including agencies and courts in jurisdictional challenges, such as those raised in the *Amaranth Advisors* case, in which Amaranth was charged with violating two different anti-manipulation regimes based on the same conduct.[10] Amaranth unsuccessfully challenged the FERC suit in multiple district courts seeking first to enjoin the FERC from filing a complaint and later to stay the FERC proceeding pending the outcome of the CFTC matter.[11] Jurisdictional disputes created by concurrent manipulation prosecutions divert limited government resources from their primary task of protecting the integrity of the market. And, by increasing regulatory uncertainty, they also potentially discourage the very competitive behavior that complements an active enforcement regime.

V. **The Commission Should Provide Clear Guidance To Help Market Participants Understand What Behavior Is Prohibited So As Not To Chill Competitive Conduct**

The Commission should provide straight-forward guidance about what type of behavior is prohibited because participants in wholesale, physical Petroleum Products markets have to make trading and marketing decisions in real-time without the benefit of hindsight. Without clear guidance, they will be less willing and able to compete vigorously in these markets. In proposing an anti-manipulation rule for the wholesale, physical Petroleum Products markets, the

[10] Amaranth allegedly manipulated the price of natural gas futures contracts to benefit certain related derivatives positions. FERC argued that Amaranth's trading activity affected the price of physical natural gas.

[11] *See, e.g., CFTC v. Amaranth Advisors LLC* et al., No. 1:07-cv-6682 (S.D.N.Y. 2007); *Hunter v. FERC*, No. 1:07-cv-1307 (DC. Cir. 2007) (Through a number of procedural challenges, Amaranth and trader Brian Hunter challenged the FERC's jurisdiction to bring manipulation claims against them for conduct relating to natural gas futures contracts, and also sought a stay of the FERC's action pending resolution of the CFTC proceeding.).

Commission has the benefit of writing on a relatively clean slate. ISDA encourages the Commission to propose a rule that draws on the most analogous aspects of those anti-manipulation standards already applicable to the commodities markets, in particular those existing under the Commodity Exchange Act ("CEA"). In this regard, rather than propose a general anti-fraud rule, the Commission should carefully define the elements of a manipulation violation to require proof of:

- Specific intent to manipulate the price of a wholesale, physical Petroleum Product;
- Through deceptive or fraudulent conduct;
- In connection with entering into a wholesale, physical Petroleum Product transaction;
- That has created a price that is materially different from what would be expected in a competitive market.

This will ensure that the Commission targets actual manipulative, as opposed to competitive, market behavior.

A. Any Rule that the Commission proposes should require proof of specific intent to manipulate prices.

The Commission's proposed anti-manipulation rule should make it an offense for a market participant to knowingly and intentionally engage in manipulative practices involving wholesale, physical Petroleum Products transactions. In enacting Section 811 of the EISA, Congress used the same language (*i.e.*, making it unlawful for any person "to use or employ . . . any manipulative or deceptive device or contrivance") that it has used in other contexts and that courts consistently have interpreted to require scienter (*i.e.*, intent to deceive, manipulate, or defraud). Most notably, in *Ernst & Ernst v. Hochfelder*, the Supreme Court held that the words "to use or employ" and "fraudulent or deceptive" as used in Section 10(b), indicate that Congress

intended to prohibit *only* knowing or intentional misconduct.[12] Indeed, the *Hochfelder* Court stated that the word "manipulative" is virtually a term of art that "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting [price]."[13] The Federal Energy Regulatory Commission ("FERC"), in promulgating its anti-manipulation rule based on similar language, also noted that it was, "not intended to regulate negligent practices or corporate mismanagement," but rather to deter and punish intentionally manipulative conduct in wholesale energy markets.[14] Accordingly, any rule proposed under the same language in Section 811 also should be construed to require proof of scienter.[15]

In determining the appropriate level of intent to require for a violation of the manipulation rule it proposes, ISDA recommends that the Commission adopt the same standard used under the CEA. Both the EISA and the CEA seek to protect the integrity of competitive markets without discouraging competition. The most appropriate way to ensure that the Commission's rule punishes wrongdoers in a wholesale commodity market involving sophisticated commercial parties making trading and marketing decisions in real time, in many

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[12] *Ernst & Ernst*, 425 U.S. 185, 197-99 (1976)

[13] *Id.*

[14] Prohibition of Energy Market Manipulation, 71 Fed. Reg. 4244, 4246 (2006).

[15] Many offenses under the Sherman Act also require proof of specific intent. *See, e.g.*, *Spectrum Sports v. McQuillan*, 506 US 447, 456 (1993) (specific intent to monopolize required); *H.J., Inc. v. International Tel. & Tel. Corp*., 867 F.2d 1531, 1540 (8th Cir. 1989) (plaintiff needed to prove defendants specifically intended to control prices or destroy competition to establish an attempt to monopolize); *Bonjorno v. Kaiser Aluminum & Chemical Corp.*, 752 F.2d 802 (3d Cir. Pa. 1985) ("[t]he plaintiff must present evidence that the defendants deliberately produced the effect, sufficient to provide a reasonable basis for the jury to conclude that the 'squeeze' was not the result of natural market forces such as supply and demand or legitimate competition."); *Papst Motoren GmbH v. Kanematsu-Goshu (U.S.A.) Inc*., 629 F. Supp. 864, 870 (S.D.N.Y. 1986) ("Walker and its progeny emphasize that to sustain [defendant's] antitrust counterclaim, 'deliberate fraud' is required: 'there must be allegations and proof of knowing, willful and intentional acts of misrepresentation to the Patent Office.'") (quoting *Erie Tech. Prods. v. JFD Elec. Components Corp.*, 1978 U.S. Dist. LEXIS 19704 (E.D.N.Y. Feb. 6, 1978)). The Commission's consumer protection precedent (which does not require proof of scienter) is not relevant because it is based on different statutory language and (as discussed above) should not apply to wholesale commodity markets involving transactions between sophisticated principals.

cases without perfect information, is to target specifically those parties whose goal is to manipulate prices through deceptive conduct. By requiring specific intent to prove a violation of the CEA, Congress carefully balanced the benefit of prosecuting persons who manipulate commodity prices against the cost of chilling competition in complex and dynamic markets.[16] ISDA encourages the Commission to do the same here and apply the specific intent standard developed under the CEA's anti-manipulation provisions.

A specific intent standard also is appropriate in light of the very high penalties associated with a violation of Section 811. Indeed, Section 813 provides for penalties of $1 million per day per offense, as compared with $11,000 per day per offense for violating the FTC Act. The Commission should be persuaded that a market participant consciously desired to manipulate prices before imposing such a substantial penalty.

Although a lower standard of intent may be appropriate in retail markets or consumer-protection contexts, it is not appropriate in the wholesale, physical Petroleum Products markets, which are comprised of sophisticated commercial parties that negotiate transactions on an arm's-length basis. ISDA, therefore, encourages the Commission to clarify that mere recklessness is not sufficient to establish the intent element of a manipulation violation.[17] Proposing a recklessness standard as a predicate for imposing substantial civil penalties in this context likely would have a myriad of unintended consequences. For example, traders could very well reduce

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[16] It is settled law under the CEA, that a finding of manipulation requires more than proof of intent to influence prices. It requires specific intent to create an artificial price. *See Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971).

[17] Although the FERC adopted a recklessness standard for proof of manipulative intent, the Commission should rely instead on the CFTC's standard, which is a more appropriate standard for prosecuting manipulation in wholesale, physical Petroleum Products markets. FERC's historical role as a rate-setting agency, and its broad authority to ensure "just and reasonable rates" in regulated energy markets, distinguishes its jurisdiction from that of both the CFTC and the Commission.

their level of participation in these markets for fear that their competitive trading strategies or miscalculations may later be misconstrued by regulators reviewing their conduct with the benefit of hindsight. Other potential entrants may decide that the regulatory risks exceed the potential benefits and opt not to enter the market. Both of these consequences would impact liquidity and depth of the markets generally.

B. The Commission should clarify that a "manipulative or deceptive device or contrivance" requires proof of deceptive or fraudulent conduct.

Commonly understood prohibited conduct is most likely to deter manipulative behavior. To that end, the Commission should propose a focused anti-manipulation rule that requires proof of deceptive or fraudulent conduct to establish a violation.

An anti-manipulation rule prohibiting conduct designed to mislead the market about the supply and demand for a commodity comports with the statutory language (which prohibits any "manipulative or deceptive device or contrivance") and is consistent with CFTC and FERC precedent governing commodity market manipulation.[18] Moreover, traders and compliance personnel understand and are able to structure compliance programs to prevent this type of behavior. In contrast, an anti-manipulation rule that could be applied to prosecute an entity for purchases and sales made in an open and competitive market would not only be difficult to comply with, but also difficult to enforce.

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[18] The CFTC has focused primarily on prosecuting manipulation that involves fraudulent and anticompetitive conduct. *See, e.g., United States v. Valencia*, 2003 U.S. Dist. LEXIS 15264 (Aug. 25, 2003) (alleging false reporting of transaction data to index publishers); *CFTC v. Delay*, 7:05CV5026, 2006 U.S. Dist. LEXIS 85068, at *9-10 (D. Neb. Nov. 17, 2006) (alleging fictitious transactions); *CFTC v. Amaranth Advisors, L.L.C.,* No. 07 CV 6682 (S.D.N.Y. May 21, 2008) (holding that waiting to purchase or sell a large volume of a commodity until the close of trading when the trades will have the greatest price effect because other bids and offers cannot respond to equalize prices could constitute attempted manipulation). *See also* 71 Fed. Reg. 4244 (prohibiting intentionally fraudulent conduct designed to manipulate prices).

ISDA believes that it only would be appropriate for the Commission to address manipulative practices premised upon conduct that does not involve deceptive devices and contrivances to the extent that enforcement resources are dedicated to prosecuting entities that unlawfully exercise market power or engage in other anticompetitive conduct (*i.e.*, entities that take advantage of their ability to create a price that is materially different than what would be expected in a competitive market).[19] The reason for this is two-fold: first, it is inherently difficult to engage in "effective" manipulation in open and competitive markets; second, the Commission has a great depth of experience dealing with anti-competitive behavior.[20]

In determining which behaviors or practices constitute manipulation, the Commission should be guided by its deep understanding of the importance of competitive pricing in markets. For example, in its report to Congress investigating post-Katrina alleged price manipulation and price increases, the Commission demonstrated this insight when it emphasized that "instances in which one or more firms temporarily . . . raise prices relative to costs and reduce output because markets have been disrupted by supply problems arising from natural disasters or by sudden and unanticipated changes in demand . . . should not be illegal because [such conduct] entails each

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[19] There is a close relationship between manipulation and the illegal exercise of market power. *See, e.g., Cargill v. Hardin*, 452 F.2d 1154 (8th Cir. 1971) (finding an unlawful exercise of market power in the form of a manipulative squeeze under the CEA); *General Foods Corp. v. Brannan*, 170 F.2d 220 (7th Cir. 1948) (alleging abuse of market power, *i.e.*, a manipulative corner under the CEA). Indeed, "manipulation and monopoly are similar concepts." 2 Philip M. Johnson & Thomas L. Hazen, *Commodities Regulation*, § 5.06[7], at 5-60, 5-61 (3d ed. 1999); *see also In re Global Minerals & Metals Corp.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,914, 1999 CFTC LEXIS 245, at *29 (Nov. 12, 1999) ("Manipulation law is essentially a facet of antitrust law.").

[20] The Commission's characterization of the Supreme Court's decision in *Socony-Vacuum*, while not inaccurate, suggests that any purchases made for prices "at or under the market" may constitute price fixing. We would like to clarify that this decision applies only in the context of conspiracies to restrain trade. A single market participant is permitted to purchase or sell at prices higher or lower than the market as long as they do not engage in predatory bidding or selling. *See*, *e.g.*, *Weyerhaeuser,* 127 S. Ct. 1069.

individual firm's independent decisions about how to allocate the sales of its products among markets." *See* Katrina Report, p. ii, n. 6.

ISDA agrees with the Commission's analysis in this context and believes that it may be applied effectively in the context of developing an anti-manipulation rule. We believe that any attempt to focus on reducing prices in contravention of competitive pricing mechanisms (*i.e.*, by proposing a very broad anti-manipulation rule) would actually do more harm than good. *See, e.g., Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.,* 127 S. Ct. 1069, 1073 (2007) (in which the Supreme Court explained in the context of a predatory bidding case, that it would not impose liability for purchasing a commodity at higher than necessary prices because that would risk "chilling pro-competitive conduct").

ISDA believes that in proposing a standard for what constitutes manipulative behavior, the Commission should not be guided by the approach adopted by the FERC, which indicated that it would import precedent established under the securities laws in the context of transactions involving purchases and sales of natural gas and electricity.[21] Securities precedent is not illuminating with respect to how to develop a rule to prosecute manipulation in wholesale, physical Petroleum Products markets because there are substantial differences between the market frameworks. The securities laws are designed to promote the raising of capital by enterprises and to protect retail investors who may purchase or sell securities. In furtherance of this objective, the accompanying regulatory regime includes expansive disclosure provisions,

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[21] Unlike Section 811 of the EISA, FERC's legislative mandate required it to consider securities precedent in drafting an anti-manipulation rule. *See* Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), §§ 313 and 1283.

including detailed standards regarding the information that an enterprise must disclose to current holders and potential purchasers and sellers of its securities. The disclosure requirements and various additional regulatory mandates are intended to ensure that potential investors (who, except in special contexts involving sophisticated market participants, have no ability to negotiate terms) have equal access to issuer-specific information when deciding whether to invest in a company.

In contrast, the wholesale, physical Petroleum Products markets are comprised exclusively of sophisticated commercial parties transacting at arm's-length to procure or sell a commodity. Participants in wholesale markets for physical Petroleum Products do not rely on analogous issuer-specific information when deciding whether to transact, and they have no duty to disclose proprietary information.[22] Rather, they are guided by their ability to source or sell their products to sellers or buyers in an open market where terms are negotiated.

For many of the same reasons, the Commission also should not rely on Section 5 of the FTC Act. Applying the broad definition of "deceptive act" applicable under Section 5 (*i.e.*, a material act that is "likely to mislead consumers acting reasonably under the circumstances") would cast too broad a net with respect to wholesale transactions entered into between commercial parties, and would hamper beneficial, profit-seeking competitive behavior.

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[22] In fact, the CFTC published a report in 1984 acknowledging that trading in order to profit from one's own cash or futures market position is legitimate commercial behavior. The report concluded "The ability of any person to capture the value of his or her proprietary information is a traditional prerogative of commercial enterprise. Because the futures markets are derivative, risk-shifting markets, it would defeat the market's basic economic function – the hedging of risk – to question whether trading based on knowledge of one's own position were permissible." CFTC Report, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information* 8 (Sept. 1984).

Given the fundamental differences between the securities and commodities markets, proposing a rule that relies on securities precedent or the Commission's consumer protection precedent would create confusion and uncertainty in the energy markets. Rather, the Commission should focus on preventing deceptive or other misleading conduct specifically intended to disrupt a competitive market.

C. The Commission should construe the "in connection with" element narrowly to focus on manipulative schemes involving wholesale, physical Petroleum Products transactions.

In order to establish a violation under its anti-manipulation rule, the Commission should require proof that an entity engaged in a wholesale, physical Petroleum Products transaction as part of its manipulative scheme. (*See also* Section IV above). The Commission should, thus, clarify that the "in connection with" element is not satisfied simply by engaging in a derivatives transaction that has an effect on wholesale, physical Petroleum Products transactions. That is not to say that the Commission should turn a blind eye to such activity. Rather, if the Commission becomes aware of manipulative activity in the derivatives markets that does not directly involve a wholesale, physical Petroleum Products transaction, it should refer the activity to the CFTC for further investigation and prosecution.

D. Any Rule that the Commission proposes should require proof of an actual effect on the market (*i.e.*, creation of a price that is materially different than what would be expected in a competitive market).

In addition to requiring specific intent and deceptive conduct involving a wholesale, physical Petroleum Products transaction, the Commission should propose an anti-manipulation rule that requires proof of an actual effect on prices. In its ANPR, the Commission suggested that *either* an intent to affect prices (without an actual effect) or an actual effect on prices (without specific intent) could support a manipulation claim under Section 811. Both specific

intent and an actual effect should be elements of a manipulation violation. Requiring a market impact will enable the Commission to focus its resources where they are most needed and most likely to be effective in punishing actual wrongdoing.

Requiring an actual effect on price is consistent with the Commission's approach to claims of unlawful monopolization under the Sherman and FTC Acts which generally require proof of market effect to establish a violation except with respect to certain well-established statutory *per se* violations.[23] In this context, the Supreme Court has emphasized that the focus of the antitrust laws is to protect competitive markets rather than individual market participants.[24] Thus, unless a party's conduct "harm[s] competition, it is beyond the antitrust laws' reach."[25] The wholesale, physical Petroleum Products markets are similarly comprised of sophisticated parties engaged in vigorous competition. Therefore, the Commission should require an actual impact on price here as well.

The Commission requested comments regarding how to determine whether an artificial price has been created. Because all trading activity arguably affects prices, the Commission should require proof that a party's deceptive or fraudulent conduct created a price that is materially different than what otherwise would be expected in a competitive market. The CFTC also requires proof of market effect before imposing liability for actual manipulation. However, ISDA encourages the Commission to take a different approach to determining whether a price is "artificial" (defined by courts interpreting the CEA as a price that does not reflect supply and demand) because the CEA standard has proven to be very difficult to understand and apply in

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[23] *See*, *e.g.*, *Brown Shoe. Co.*, *Inc.*, *v. United States*, 370 U.S. 294, 320 (1962) (noting that "the legislative history illuminated congressional concern with the protection of competition, not competitors").

[24] *See Rambus Inc. v. FTC*, 522 F.3d 456, 464 (D.C. Cir. 2008).

[25] *See id.* at 464.

practice. Rather than try to divine what price reflects supply and demand at a particular point in time, the Commission should analyze price in the context of whether it was generated in a competitive market.

Focusing on whether a price is higher than one's costs is too simplistic and impractical. Pricing of wholesale transactions between sophisticated commercial parties in a competitive market is determined by market fundamentals, such as product demand and availability. The wholesale, physical Petroleum Products markets are not cost-based, government-administered markets. The "cost" of a commodity to a marketer is what it pays for the commodity. Rather than focus on price relative to cost, the Commission should focus on maintaining open and competitive markets and allow free markets to set prices.

VI. The Commission Should Encourage Voluntary Reporting Rather Than Create An Obligation To Report Cost And Volume Data

Neither Section 811 nor Section 812 of the EISA authorizes the Commission to impose new reporting requirements. Section 812 specifically addresses the making of false reports to regulators, but by its own terms, is limited to "information [that] was required by law to be reported."[26] If Congress had intended to give the Commission the power to impose new reporting requirements, it would have done so explicitly in Section 812, and would not have simultaneously limited the Commission's false reporting authority to information already "required by law."[27]

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26 42 U.S.C. § 17302(2).

27 *Cf. Price Discovery in Natural Gas and Electric Markets*, 104 FERC ¶ 61,121 (2003); *order on clarif.*, 105 FERC ¶ 61,282 (2003) ("Policy Statement On Natural Gas and Electric Price Indices").

As the Commission itself acknowledged in its ANPR, compiling accurate cost and volume data requires a tremendous amount of time and effort and is "frequently difficult to construct." Requiring all market participants to report all wholesale transactions, all refinery and pipeline outages, and all import and inventory volumes would be exceptionally burdensome. Rather, the Commission should encourage voluntary reporting of market information by creating a safe harbor for market participants that provide price and volume data in compliance with prescribed guidelines.

VII. The Commission Should Analyze Each Of The Scenarios Posed In The ANPR In Terms Of Whether They Involve Deceptive Or Anticompetitive Conduct Specifically Intended To And Actually Creating A Manipulated Price.

A. Supply and withholding decisions may be motivated by a variety of pro-competitive purposes.

The Commission requested comments regarding the circumstances under which one's decision regarding supplying a market (including decisions whether to reduce, increase or maintain unchanged the amount it supplies) should be considered manipulative or deceptive. Because many of the purchase and sales decisions described by the Commission on pages 25621-25622 of the ANPR could be motivated by a variety of non-manipulative reasons – from benign to affirmatively pro-competitive – the Commission should limit its inquiry to whether the conduct involves intentional deceptive or anticompetitive conduct that results in manipulated prices.

The Supreme Court in *Weyerhaueser* explained that market participants may legitimately withhold supplies or purchase more than they need of a commodity because of errors in their projections regarding inventory or future price trends. Similarly, companies might purchase a

commodity for what appears to be a higher price than necessary or sell a commodity for what appears to be lower price than necessary to manage inventory, ensure access to products, increase its market share, or hedge against price risk. Companies sometimes sell a commodity for much more than its cost because of increased demand in areas of reduced production. These behaviors are, in the Supreme Court's words, often "the essence of competition" as firms compete for scarce resources.

If the law were to invite courts or federal agencies to analyze the reasons for one's purchases or sales absent the showing required by the Supreme Court in *Weyerhaeuser*, the net result would be to make all market participants more wary about using the markets in the ways the Supreme Court specifically delineated as pro-competitive.

B. Public announcements by refineries and pipelines only should be considered manipulative if they are false or misleading.

Public announcements by refineries of scheduled maintenance and downtime, and statements by pipelines that a system may be approaching capacity should not be considered manipulative unless they are intentionally deceptive or fraudulent and create a price that is other than what would be expected in a competitive market. To the extent that the Commission is concerned that announcements might facilitate coordination to reduce supply, the antitrust laws should be sufficient to prosecute such activity. Otherwise, truthful announcements of extended or unplanned maintenance, downtime or other statements about capacity utilization (although not routine in the industry) are not harmful, and if anything, are likely to provide some marginal benefit to the industry in terms of inventory planning.

VIII. The Commission Should Clearly Define What Products Are Included In The Term Petroleum Distillates

ISDA recommends that the Commission specify the wholesale distillate products to which the proposed rule will apply. For example, in its Katrina Report the FTC referred to petroleum distillates as including diesel, home heating oil, and jet fuel.[28] This or a substantially similar definition will help to reduce confusion and avoid jurisdictional challenges to enforcement actions under a final rule.

ISDA encourages the Commission to define narrowly the products to which any proposed rule will apply and to exclude non-petroleum based ethanol products from the definition of petroleum distillates. As discussed in Section IV above, the Commission should focus its rule where it can be most effective and try to create a regime that will not overlap any more than necessary with the jurisdiction of other agencies.

IX. Summary Conclusion

ISDA appreciates the opportunity to provide comments on this important initiative and both supports and encourages the development of dynamic markets undistorted by manipulative trading activity. ISDA therefore recommends that the Commission propose a narrowly-tailored anti-manipulation rule focused on punishing intentionally deceptive or anticompetitive conduct involving a wholesale, physical Petroleum Product transaction that creates a price that is materially different than what would be expected in a competitive market. This standard will

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[28] Katrina Report at p.10.

enable the Commission to most effectively identify and prosecute manipulative conduct while maintaining open and competitive markets that complement an active enforcement program.

Respectfully submitted,

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