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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 offer the following comments in response to the Federal Trade Commission's ("FTC" or "Commission") August 13, 2008 Notice of Proposed Rulemaking ("NOPR") in the above-referenced matter.[1]

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 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]

In our June 23, 2008 comments on the Commission's Advance Notice of Proposed Rulemaking,[3] we encouraged the Commission to build on its well-developed expertise in applying the antitrust

[1] 73 Fed. Reg. 48317 (Aug. 19, 2008) *extension granted* 73 Fed. Reg. 53393 (Sept. 16, 2008).
[2] Colonial Oil Industries, Inc.; George E. Warren Corp.; Neste Oy; Statoil Marketing & Trading (USA), Inc.; Trafigura AG; and Vitol, Inc.
[3] 73 Fed. Reg. 25614 (May 7, 2008).

and consumer protection principles embodied in the Federal Trade Commission Act, and in other federal laws, to regulate in a manner that applies its new authority without impeding the operation of pro-competitive forces in the oil markets. We stressed the importance of fashioning regulations that are not costly to producers, traders and consumers. Likewise, we cautioned that overzealous regulation may drive marginal participants from oil markets, reduce competition and increase consumer energy prices.

We welcome the Commission's decision not to propose specific conduct obligations or other affirmative duties that superimpose government norms for the rules of the marketplace. The Commission was correct to conclude that supply and demand decisions generally are best left to the market,[4] and we appreciate that the Commission has attempted to balance the Congressional directive for regulatory oversight with the goal of allowing economic efficiency. That said, we believe that the proposed rule fails to provide the optimum balance and ultimately is considerably more intrusive of legitimate business behavior than is necessary to achieve the Commission's and Congress's stated goals as set forth in the Energy Independence and Security Act of 2007 ("EISA").[5]

We are particularly concerned that the rule, as currently proposed (i) creates duplicative regulatory regimes and impinges upon the Commodity Futures Trading Commission's ("CFTC") exclusive jurisdiction with respect to the futures and other purely financial markets; (ii) applies the wrong standard in assessing intent to manipulate; (iii) is overzealous in its proposed sanctions with respect to attempted manipulation; and (iv) appears to promote potentially costly private litigation. We also comment on several technical issues raised by the proposal.

1. The Scope of the Rule Should Be Narrowed to Avoid Duplicative Regulation

The proposed rule creates a duplicative and potentially highly burdensome enforcement regime. Most troublesome is the Commission's direct assertion of authority over activities within the exclusive jurisdiction of the CFTC. The rule also is misdirected in its attempt to prosecute any conduct that has or could have a consequential impact on physical petroleum markets.[6]

The Commission's decision to seek to regulate futures and financial markets glosses over the very serious question of whether Congress meant to change the scope of the CFTC's exclusive jurisdiction with respect to these markets, effectively ignoring the comments of its sister agency and greatly complicating the challenges faced by those who may be subject to regulation by both agencies. Moreover, even assuming *arguendo* that the FTC is not limited by the exclusive

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[4] *See* NOPR, at p. 42 ("The Commission agrees with commenters that the market is generally the best determiner of supply and demand decisions.").
[5] Pub. L. No. 110-140; 121 Stat. 1492, *codified in relevant part* at 42 U.S.C. 17301-17305 (2008).
[6] NOPR, at 49 (discussing "in connection with" element).

jurisdiction granted to the CFTC by the Commodity Exchange Act ("CEA"),[7] we submit that such an aggressive assertion of the Commission's jurisdiction is both unnecessary and unfair.

In the NOPR, the Commission responded to concerns raised regarding overlapping jurisdiction in the financial markets by stating, "To the extent, if any, that the proposed Rule's requirements could duplicate requirements already established by other agencies for such markets, it would not impose additional compliance costs."[8] We respectfully disagree.

As the Commission is aware, the CFTC has been active in recent years in policing potentially abusive behavior in the financial and physical oil markets. Numerous oil companies, including many of our law firm's clients, have been drawn into these investigations, often not because there is any suggestion that they may have engaged in misconduct, but rather because they are participants in these markets and may have information that the CFTC could find useful. The lessons learned by our clients in these matters are sobering. Just responding to a CFTC document request is a process that will consume huge resources. This is true whether the market participant ultimately is a target of interest or simply an innocent bystander. Costs associated with document production in a single inquiry typically can be measured in the hundreds of thousands of dollars.[9] And even companies that merely are "roadmap witnesses" routinely face testimonial subpoenas and may become witnesses in administrative, civil and criminal proceedings. Thus, it is without any rational basis to suggest, as was stated in the NOPR, that adding another agency to the mix will not add to compliance costs. Not only will compliance costs grow, but we fear that they will accelerate exponentially, as the FTC competes with the CFTC to pursue what amounts to overlapping and highly competitive enforcement regimes.

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[7] 7 U.S.C. § 2(a)(1)(A) (2008).

[8] NOPR, at p. 31.

[9] The most significant expense for companies responding to agency inquiries often is the cost of physically gathering the data and/or documents necessary to respond to the agency's request. In addition to consuming the time of the companies' employees, in many cases, companies find it necessary to outsource some portion of the task of searching for and compiling the data requested. The costs associated with such services can be astronomical, depending on the technical or practical challenges of producing the relevant documents. In our experience, fees to third-party vendors alone (for a single data response to a single agency) can easily cost over $100,000 and can reach price tags approaching one million dollars. Although less quantifiable, the internal costs associated with agency inquiries can be significant as well. Often, answering agency inquiries requires interviewing traders and other personnel directly engaged in trading or related activities. In some cases, responding can even require the traders themselves to spend significant time gathering documents that may be responsive to the document request and explaining the details of the documents to those preparing the response. Moreover, in addition to the significant costs associated with the physical production of documents, prudent companies also will incur the expense of engaging outside counsel to provide advice regarding compliance with the agency's rules and regulations and, in many cases, to manage the document production and data responses.

Unnecessary costs from duplicative enforcement activities do more than simply hurt the bottom line of large companies. These costs can directly impact the ability of companies to participate in the market. The oil markets have many small players for whom the burden of duplicative oversight can be overwhelming. We are concerned that increased regulatory costs could push small, but nevertheless important competitors out of the market, reducing liquidity and increasing the ability of the remaining large traders to influence or manipulate the markets.

In response to concerns regarding jurisdictional overlap, the Commission has indicated that it intends to continue its "longstanding practice of coordinating its enforcement efforts with agencies with which it shares overlapping jurisdiction."[10] However, the Commission also acknowledged that "different agencies could simultaneously initiate enforcement action with respect to the same activities."[11] To the extent that the cooperation anticipated by the Commission is limited to information sharing, as opposed to forbearance by one agency or the implementation of joint investigations, we are concerned that cooperation with sister agencies does not significantly mitigate the substantial cost that the proposed rule will create for market participants. This is particularly true in light of the Commission's proposal to apply differing standards from those applied by the CFTC, a topic discussed below.

In addition to the unnecessary additional costs that the proposed rule imposes on market participants and energy consumers, the needless exercise of overlapping jurisdiction by multiple agencies is fundamentally inequitable. This is especially true in light of the fact that each agency has the authority to impose penalties up to one million dollars per day, per violation. Fundamental fairness dictates that federal agencies avoid the urge to pile on prosecutions and penalties where a single agency can protect the public interest.

We urge the Commission to rethink its approach to this threshold issue. The cooperative arrangements in place between the FTC and CFTC (or those that may be developed in the future) can be tailored to allow each agency to pursue the compliance matters within its greatest competence – the physical markets in the case of the FTC and the financial markets in the case of the CFTC. Taking this approach would obviate any need for the FTC to adopt an overbroad interpretation of the statutory reference to matters "in connection with" the physical oil markets without sacrificing the public policy objective of making sure that market manipulation, wherever found, be subject to appropriate sanction. At the same time, it would allow the relevant agencies to avoid the unfortunate turf battles such as the current jurisdictional competition between the CFTC and another sister agency, the Federal Energy Regulatory Commission, with respect to natural gas matters.

2. The CFTC Anti-Manipulation Model Is More Appropriate than the SEC Model

We believe that the Commission is mistaken in proposing to adopt the Securities Exchange Commission's ("SEC") 10b-5 anti-fraud model and urge the Commission instead to require

[10] NOPR, at p. 31.
[11] NOPR, at p. 31.

proof of specific intent, drawing upon the significant precedent developed under the CEA.[12] We think the CFTC's tighter intent requirement is particularly apt given its proposed application to commodity markets, where inferences of the sort that could be drawn using the SEC model may end up vilifying innocent conduct. Moreover, to the extent that the Commission declines to cede authority to the CFTC with respect to conduct in the futures and financial markets, it would be inappropriate to impose a different standard than the CFTC, particularly in a market with respect to which the FTC is not the expert regulator.

The Commission's proposal appropriately includes scienter as an element of market manipulation,[13] but the Commission should define the scienter requirement narrowly to require specific intent, rather than the lesser standard of recklessness. While both standards require intentional misconduct, the recklessness standard lessens the regulator's prosecutorial burden by allowing an inference of intent based on the actor's actual or imputed knowledge.[14] In other words, under the recklessness standard, the Commission would not need to provide direct evidence that the defendant specifically intended to manipulate the market; rather, the Commission need only demonstrate that the defendant must have known, or *should* have known, that the conduct would have the effect of manipulating the market. Whatever the appropriateness of this standard in the SEC context (*e.g.,* with respect to misleading statements), drawing inferences of misconduct based on imputed knowledge rather than actual intent is not a sound regulatory exercise when applied to the prevention of market manipulation in the commodity markets, where legitimate and illegitimate conduct alike can impact prices and where buyers and sellers do not owe one another fiduciary duties.[15] Thus, we urge the Commission to stay its hand unless documents and evidence show an unambiguous intent to undermine normal supply and demand factors.

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[12] 7 U.S.C. § 1, *et seq*. (2008). Prosecution of market manipulation under the CEA requires the following elements: (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).

[13] *See* NOPR, at p. 45.

[14] *See Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 343-44 (2003) ("the term 'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud") (internal quotations omitted).

[15] *See In Re The Leslie Fay Companies, Inc.*, 871 F. Supp. 686 (1995) (explaining: "Possibly due to the wide variety of factual situations that may give rise to a securities fraud action, the Second Circuit's treatment of the scienter requirement is far from uniform …'[Rule] 10b-5 proscribes only behavior which is either deliberate or so reckless that an inference of fraudulent intent might be drawn by a reasonable finder of fact.' … We did not, however, hold that mere allegations of recklessness were sufficient to satisfy the scienter requirement.") (internal citations excluded).

The effectiveness of this approach is amply demonstrated in the recent cases brought by the CFTC. For example, in *BP Products North America*, the CFTC discovered extensive evidence of specific intent to manipulate the price of physical propane, which included recorded conversations during which traders discussed the scheme and their intent to "control the market at will."[16] Similarly, in *Energy Transfer Partners, L.P.*, the CFTC produced significant evidence of specific intent to manipulate the price of natural gas, including messages from management suggesting that traders sell as much as they can to push the price down.[17]

As noted, consistency in setting prosecutorial standards is especially important if the Commission concludes that its jurisdiction extends to market manipulation where the conduct at issue occurs solely in the futures and financial markets, but arguably has consequences in the physical market. In such cases, differences in prosecutorial standards will impair the agencies' ability to coordinate prosecution and potentially will require parties to present multiple defenses under different regimes for the same conduct, further causing unnecessary costs. Rather than applying differing standards to the same conduct, the Commission should apply the same standard to the same conduct. To do otherwise undercuts the CFTC's jurisdiction in a direct way and potentially subjects target companies not only to multiple enforcement actions but also to significantly different standards of conduct. If nothing else, such governmental piling on is fundamentally unfair.

3. The Commission Should Require Market Impact

The Commission also should require that market manipulation actually impact the market. This is important to avoid expending agency resources and increasing costs to market participants merely to redress inconsequential conduct. Prosecuting cases that *actually* impact the market will deter both actual and attempted manipulation. Further, prosecuting attempted manipulation, particularly if specific intent is not required, runs the risk that any trading activity that deviates from what regulators would expect based on their view of the market could be deemed manipulative. We are concerned that the increased regulatory exposure created by the risk of prosecution for attempted manipulation could push small players from the market or cause all traders to trade less freely; in either case, the result would be a less liquid market, which ironically would increase the market's vulnerability to manipulation. Although we generally

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[16] *See BP Products North America*, Consent Order for Permanent Injunction and Other Relief, PP12-18, Civil Action No. 06-C-3503 (filed Oct. 25, 2007), *approved by* Order Approving Consent Order for Permanent Injunction and Other Relief, Docket No. 06-cv-03503 (N.D. Ill.) (Oct. 25, 2007), *available at* http://www.cftc.gov/newsroom/enforcementpressreleases/2007/pr5405-07.html.

[17] *See C.F.T.C. v. Energy Transfer Partners, L.P.*, Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties Under the Commodity Exchange Act, (filed July 26, 2007), *settled by* Consent Order of Permanent Injunction, Civil Monetary Penalty and Other Equitable Relief Against Defendants Energy Transfer Partner, [et al.], 3:07-cv-01301 (N.D. Tex.) (Mar. 17, 2008), *available at* http://www.cftc.gov/newsroom/enforcementpressreleases/2008/pr5471-08.html.

support the notion of punishing those who seek to manipulate the market even if they fail, the cost of enforcement in such cases would outweigh the benefit.

4. The Commission Should Clarify That There Is No Private Right of Action

The proposed rule includes language indicating the Commission's view that the new regulatory regime does not preempt state law.[18] While we understand that the Commission is making an effort to conform its regulations to the statute, it also should make clear that neither EISA nor the proposed rule creates any private right of action. Nothing in the language of EISA suggests that Congress intended to create a private right of action, and, without addressing the issue of rights under state laws, we believe that the FTC should be on record to that effect.

5. Certain Clarifications

(a) We ask that the definition of "wholesale" be clarified to indicate how the FTC plans to address sales to large end users. In the NOPR, the Commission defines "wholesale" to include "purchases or sales at the terminal rack level or upstream of the terminal rack level [but not] retail gasoline sales to consumers."[19] This language leaves uncertainty as to the status of retail transactions that involve large end users. For example, would jet fuel sold to an airline be a retail sale if it is sold at the airport terminal but a wholesale sale if sold at the rack? Similarly, would gasoline sold at the rack to a large end user, such as a municipality, be considered a retail sale and excluded from the definition of wholesale? (This question appears to turn on the meaning of "*retail* gasoline.") Finally, we read the definition of wholesale to include all non-gasoline (*e.g.*, home heating oil) sales to customers at the rack, regardless of whether the customer will ultimately use the fuel or resell it.

(b) We understand that crude oil, gasoline and petroleum distillates (including certain fuel oils) are covered by the proposed rule. Does the Commission intend to include *heavy* fuel oils (*e.g.*, No. 5 and No. 6 fuel oils)? The definitions do not specifically reference heavy fuel oils, but the definition of petroleum distillates is open-ended. We would expect that No. 5 and No. 6 fuel oils would not be considered petroleum distillates, but we ask that the Commission confirm that transactions involving these fuel oils are not governed by the rule or clarify its definitions to make clear that they are.

6. Conclusion

While we commend the Commission for its efforts in crafting the NOPR, we urge it to narrow the scope of the proposed rule to avoid duplicative and highly burdensome regulation and evidentiary standards that risk sanctioning legitimate market behavior.

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[18] NOPR, at pp. 52-53.

[19] NOPR, at pp. 35-36 (discussing Proposed 16 C.F.R. § 317.2(e)).

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

Very truly yours,

Peter H. Rodgers
Michael W. Brooks