Before the
FEDERAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Market Manipulation Rulemaking	)	Project No. PO82900
	)	

COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE

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I. EXECUTIVE SUMMARY

The American Petroleum Institute ("API") welcomes this opportunity to submit these comments and to offer an industry-wide perspective on the issues raised by the Commission's Notice of Proposed Rulemaking ("NPRM"). At an earlier stage of this proceeding, API submitted extensive comments on the Commission's Advance Notice of Proposed Rulemaking. The issues presented by the NPRM are of great concern to API and its members, and we appreciate this opportunity to share our views.

1. API supports the Commission's interim conclusion that proposals for a market manipulation rule should be evaluated by weighing the anticipated benefits of the rule against its anticipated costs. Any benefits of a market manipulation rule are likely to be limited, both because the Commission's repeated investigations into petroleum markets have uncovered no evidence of significant harmful or illegal conduct, and because much of the conduct that would be prohibited by a new rule is already addressed by existing regulations. In contrast, a market manipulation rule could impose significant costs by interfering with the efficient functioning of petroleum markets that are vital to the national economy. If the Commission decides to proceed with a rule, cost-benefit

analysis strongly supports the Commission's conclusion that the scope of the rule should be narrowly tailored.

API respectfully submits that the Commission's proposed Rule is not narrowly tailored. By proposing to adopt not only the language of Securities and Exchange Commission ("SEC") Rule 10b-5, but also administrative and judicial interpretations of that Rule, the NPRM disregards important differences between the securities markets subject to Rule 10b-5 and the wholesale petroleum markets that would be subject to the Commission's Rule. The proposed Rule would give rise to legal uncertainty and create an incentive for firms to significantly restrict the information they disclose to market participants and others. The potential costs of the proposed Rule are compounded by the possibility that courts will read Section 811 (or analogous state laws) to create an implied private right of action. Accordingly, the Commission should make clear that any final Rule does not give rise to an implied private right of action.

2. Rule 10b-5 governs the sale of securities to retail investors who rely on regulated fiduciaries such as issuers, brokers, and dealers. Parity of access to information about issuers is considered fundamental to the fair and efficient functioning of securities markets. To protect investors, the securities laws subject regulated parties to broad disclosure requirements and a prohibition on insider trading. Courts and the SEC rely upon the Security Exchange Act's ("SEA") investor-protection rationale as a basis for interpreting Rule 10b-broadly.

This rationale has no application to the wholesale petroleum markets, which involve sophisticated parties dealing at arm's length. In contrast to securities markets, the key unknown is not the physical properties or current value of the product, but rather the future direction of the market. In this type of market, it has long been recognized that efficiency and consumer welfare are advanced by encouraging participants to develop their own estimates of future supply and demand and to trade based on the proprietary information they develop.

The NPRM seeks to address these differences by proposing that only the legal regime that has evolved around Rule 10b-5, and not any other provisions of the securities laws, would apply to wholesale petroleum markets. The difficulty with this approach is that the Rule 10b-5 regulatory regime is deeply intertwined with the disclosure obligations and fiduciary duties imposed by the securities laws. At a minimum, these complex connections will create legal uncertainty, making it difficult for market participants to anticipate which elements of Rule 10b-5 precedent the Commission will apply. To avoid this outcome, the Commission should draw on commodities law precedents, which reflect many decades of relevant regulatory experience.

3. The Commission should adjust the proposed Rule to address four specific concerns.

(a) API supports the Commission's proposal to make scienter a requirement of any rule adopted under Section 811. Any final Rule, however, should require a showing of specific intent to deceive or defraud for the purpose of affecting a covered market, rather than requiring only a showing of recklessness. Recklessness is a more malleable standard than specific intent. A recklessness standard would increase the costs of complying with a market manipulation rule and could deter market participants from disclosing relevant information that helps markets to function more efficiently.

Corporate compliance programs typically seek to establish clear rules for employees without specialized legal training. A recklessness standard could lead firms to adopt compliance programs that severely restrict voluntary disclosures of information in order to minimize the risk of liability for arguably "reckless" statements. Although a recklessness standard may be appropriate in the highly regulated securities context, with its fiduciary duties and strict disclosure requirements, it is not suited to wholesale petroleum markets. In analogous circumstances, the Commodities Futures Trading Commission ("CFTC") applies a specific intent standard. By applying such a standard – which reflects more than 70 years of regulatory experience – the Commission would avoid creating a conflict with the CFTC, as well as the costs of applying a standard that is not appropriate for the markets at issue.

Regardless of whether the Commission adopts a specific intent requirement, it should provide a safe harbor for statements or omissions that are not made in connection with reports to government agencies, third-party reporting services, or to the public through corporate announcements, at least absent evidence that such statements were part of a broader scheme to manipulate the market. The goal of any rule should be to protect the market rather than individual traders, while minimizing harm to the efficient functioning of markets. Consequently, the Commission should provide a safe harbor for information exchanged in private transactions between traders.

(b) API agrees with the Commission's conclusion that any market manipulation rule should impose no general duty to disclose information. By leaving open the possibility of liability for "incomplete" disclosures, however, the proposed rule is likely to chill voluntary disclosures by market participants. Reducing the amount of information in the marketplace could seriously harm the efficiency of wholesale petroleum markets. At a minimum, any final rule should make clear that omissions can create a basis for liability only if they are deceptive or fraudulent at the time they are made.

(c) The NPRM states that the Commission intends to interpret the "in connection with" language of Section 811 to require the fraudulent conduct to coincide with a covered purchase or sale. It is important that this language is not read so broadly as to turn every common law fraud that happens to touch a purchase or sale of a covered product into a Rule violation. The courts have justified a broad reading of the "in connection with" language under Rule 10b-5 on the ground that the securities laws create a regime of full disclosure. Because Section 811 is not intended to create such a regime, a narrower interpretation is warranted in this context. To this end, the Commission should make clear in the final Rule that only statements or acts pertaining to specific wholesale petroleum transactions may give rise to liability under the Rule.

In particular, any final Rule should exclude: (i) "rack" transactions and other terminal-level sales and (ii) upstream statements and conduct, including supply decisions. Given the large number of rack prices in the United States, their limited geographic scope and significance, and the lack of an identified problem that would be remedied by a rule, it does not make sense for the Commission to expend resources on enforcement efforts directed to wholesale rack markets. Extending the rule to rack transactions would increase compliance costs by vastly increasing the number of individuals whose conduct may be subject to scrutiny. Moreover, extending Section 811 to upstream production, operational, and supply decisions would create a substantial risk of disrupting competitive activity in petroleum markets. Any final rule should clarify that upstream conduct that is not connected to particular purchases or sales falls outside the scope of the rule. At a minimum, the Commission should make clear that an objective business justification for a challenged supply decision will provide an affirmative defense to liability.

(d) Finally, any rule promulgated under Section 811 should require a material effect on market prices. Absent such a requirement, the Commission runs a risk of straying beyond market manipulation and into routine commercial disputes that are the province of state anti-fraud and contract law. Section 811 does not authorize the Commission to prohibit attempted manipulation. By omitting any requirement of an effect on the market, the Commission is exceeding its statutory authority by effectively outlawing attempted manipulation. The Commission should therefore require proof that a party's deceptive or fraudulent conduct caused market conditions to deviate materially from the conditions that would have existed but for that conduct.

4. As noted in API's ANPR comments, API believes that the Commission has erred by failing to follow the rulemaking procedures of Section 18 of the FTC Act. The relevant statutory language requires the Commission to follow those procedures. When Congress has intended to authorize the Commission to follow the less demanding procedures of Section 5523 of the Administrative Procedure Act, it has said so expressly. It said no such thing in EISA.

II. API'S INTEREST IN THIS PROCEEDING

The American Petroleum Institute is a national trade association representing the U.S. oil and natural gas industry. API's more than 400 members cover all facets of the industry, including exploration, production, transportation, refining and marketing. API, together with the National Petrochemical and Refiners Association, submitted extensive comments on the ANPR in this proceeding. API's comments on the ANPR are annexed to and incorporated by reference into this submission.[1] As explained in those earlier comments, the issues presented in this rulemaking are of great concern to API and its members. In particular, an unduly expansive reading of Section 811 could harm the efficient functioning of petroleum markets that are vital to the U.S. economy. If that were to occur, a rule intended to protect the U.S. economy and consumers could have the opposite effect.

III. THE PROPOSED RULE SWEEPS TOO BROADLY AND WILL IMPOSE COSTS THAT SIGNIFICANTLY OUTWEIGH ITS BENEFITS.

API agrees with the Commission's statement in the NPRM that, in deciding how to carry out its responsibilities under Section 811, the Commission should weigh the anticipated benefits of any proposed rule against its likely costs.[2] Cost-benefit analysis is appropriate because an overbroad rule could harm consumers by discouraging practices that enhance efficiency and competition.[3] The Commission is experienced with cost-benefit analysis, which it regularly applies in the context of the antitrust "rule of reason,"[4] as well as unfairness analysis pursuant to its consumer protection mission.[5]

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[1] *In the Matter of Market Manipulation Rulemaking, Project No. PO82900, Comments of the American Petroleum Institute and the National Petrochemical Refiners Association*, June 23, 2008 (hereinafter, "ANPR Comments").

[2] NPRM at 25 ("[T]he Commission has paid careful attention to maximizing the proposed Rule's benefits while minimizing its costs from both a legal and an economic perspective.").

[3] *Id.* at 24 ("[T]he Commission intends to prohibit manipulative and deceptive conduct without discouraging pro-competitive or otherwise desirable market practices.").

[4] *See, e.g.*, Department of Justice and Federal Trade Commission, *Guidelines for the Licensing of Intellectual Property* 16 (Apr. 6, 1995) ("The Agencies' general approach . . . under the rule of reason is to inquire whether the restraint is likely to have anticompetitive effects and, if so, whether the restraint is reasonably necessary to achieve

In weighing benefits and costs under Section 811, the initial question for the Commission is whether any market manipulation rule, regardless of its scope, is likely to provide net benefits to society.[6] As we explained in the ANPR Comments, the available evidence indicates that such a rule will have, at best, limited benefits.[7] The FTC's previous investigations into petroleum markets have uncovered no evidence of significant harmful or illegal conduct. Moreover, the conduct that would be governed by a new rule under Section 811 is in large part already addressed by other regulatory schemes. Any limited benefits that are identified must be weighed against potentially significant compliance costs, as well as the possibility that a market manipulation rule will interfere with the efficient functioning of petroleum markets and deter procompetitive, welfare-enhancing behavior.[8] Thus, an analysis of the relevant costs and benefits supports a decision not to promulgate a market manipulation rule at this time.[9] However, if the Commission decides to proceed with a market manipulation rule, cost-

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procompetitive benefits that outweigh these anticompetitive effects.") (citing *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986)), *available at* http://www.usdoj.gov/atr/public/guidelines/0558.pdf.

[5] *See* Federal Trade Commission Act, § 5(n), 15 U.S.C. § 45(n) ("The Commission shall have no authority . . . to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."). *See also The FTC Policy Statement on Unfairness,* appended to *International Harvester Co.*, 104 F.T.C. 949, 1070 (1984).

[6] As we explained in our ANPR Comments, the language of Section 811 clearly assigns to the Commission the responsibility for deciding whether a market manipulation rule is necessary at this time. ANPR Comments at 11-12.

[7] *Id.* at 8-16.

[8] *Id.* at 11-16.

[9] *Id.*

benefit analysis strongly supports the Commission's initial determination that the scope of the rule should be "narrowly tailored to address fraudulent practices."[10]

API respectfully submits that the rule proposed in the NPRM is not narrowly tailored and sweeps too broadly, creating a substantial risk that the rule will impose costs that outweigh its benefits. After investigating wholesale petroleum markets in the wake of Hurricanes Katrina and Rita in 2005 and 2006, the Commission found no problem with manipulation in these markets. Yet it proposes to apply to wholesale petroleum markets not only the language of SEC Rule 10b-5, but also the SEC's interpretations of that rule and associated case law. In proposing this regulatory approach, the Commission overlooks material differences between the securities and petroleum markets described in our ANPR Comments.[11] As explained further below, the blanket application of securities precedents to the proposed Rule is unwarranted. If the Commission were to apply the law of Rule 10b-5, without any modification to make it suitable for the wholesale markets at issue, it would not provide the needed clarity, but instead would create confusion and chill pro-competitive behavior.

The proposed Rule would apply to a broad, imperfectly-defined range of conduct, extending beyond intentionally deceptive or fraudulent statements or acts designed to manipulate a wholesale petroleum market. It would create substantial legal uncertainty for market participants, deterring firms from engaging in legitimate activity and causing them to adopt compliance programs that restrict the amount of information disclosed to other market participants. The result would be to "discourage[e] pro-

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[10] NPRM at 15. In our ANPR Comments, we proposed four elements of a rule that would, in API's view, help to avoid these costs. *Id.* at 17.

[11] *See, e.g.*, ANPR Comments at 18-20.

competitive or otherwise desirable market practices" – precisely the result the Commission wishes to avoid.[12]

The potential costs associated with an overbroad Rule are magnified by the possibility that courts will read Section 811 or analogous state laws as creating a private right of action under any rule adopted by the Commission. Congress did not expressly provide for a private right of action in Section 811, but suggested that the FTC has exclusive enforcement authority. Nor is there any basis for finding an implied private right of action.[13] The Commission should make clear in any final Rule that it does not create a private right of action. Even if the Commission makes such a statement, however, private plaintiffs are likely to try to persuade courts to recognize such a right, and it may take years for the matter to be finally resolved. In the interim, even the remote possibility that the Rule will be interpreted as creating a private right of action will cause firms to be especially risk-averse and to design overly-cautious procedures for complying with the proposed Rule. In many instances, this may mean that company

[12] *See* NPRM at 24 and *supra* note 3. Unlike the typical Section 5 case, in which the primary remedy is injunctive relief, violations of a market manipulation rule would expose market participants to substantial monetary penalties. This significantly increases the risk of chilling desirable practices as companies seek to minimize the risk of liability.

[13] In recent years, the Supreme Court has taken a restrictive approach to implied private rights of action. The Court recently stated that "it is settled that there is an implied cause of action only if the underlying statute can be interpreted to disclose the intent to create one." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 772 (2008) (citations omitted). Far from indicating an intent to allow a private right of action under Section 811, Congress included language in Section 813 indicating that it did *not* intend to allow such actions. Section 813(a) states that "this [market manipulation subtitle] shall be enforced by the FTC in the same manner, by the same means, and with the same jurisdiction as though all applicable terms of the Federal Trade Commission Act were incorporated into and made a part of this subtitle." 42 U.S.C. § 17303. Congress clearly intended FTC enforcement of the subtitle to be exclusive. Had it contemplated additional enforcers, it could have provided for them explicitly or, at a minimum, not specified enforcement by the FTC in such a clear, limiting way.

employees are instructed not to voluntarily disclose information for fear that an inadvertent mistake might result in a lawsuit.

In the following section, we explain why the application of Rule 10b-5 precedent to the proposed Rule would impose costs that are likely to outweigh its benefits. In the remainder of these comments, we offer suggestions on how the Commission could refine the proposed Rule to achieve its goal of "maximizing the proposed Rule's benefits while minimizing its costs from both a legal and an economic perspective."[14]

IV. THE PROPOSED RULE MAKES NO ALLOWANCE FOR THE SIGNIFICANT DIFFERENCES BETWEEN SECURITIES MARKETS AND WHOLESALE PETROLEUM MARKETS.

In the NPRM, the Commission proposes to borrow, without modification, both the text and precedent of SEC Rule 10b-5.[15] As noted in its comments on the ANPR, API agrees that a rule promulgated under Section 811 may appropriately include elements of the SEA Section 10(b) regulatory scheme.[16] Our ANPR comments explain, however, that there are important differences between the securities markets regulated by Rule 10b-5 and the wholesale petroleum markets at issue here. In contrast to the restrictions imposed on other agencies under other laws, the Commission unquestionably has the authority (and the responsibility) to modify the Rule 10b-5 regime as needed to accommodate it to the realities of the wholesale petroleum markets covered by Section

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[14] NPRM at 25.

[15] *See* NPRM at 21 ("The Commission believes that using [Rule 10b-5] as a model for the proposed Rule is beneficial for market participants because it leverages the significant body of legal precedent interpreting that scheme.").

[16] ANPR Comments at 17-19.

811. In Section 811, unlike in Section 315 of the Energy Policy Act of 2005,[17] Congress did not instruct the Commission to interpret "manipulative or deceptive device or contrivance . . . as those terms are used in Section 10(b)" of the SEA. The language of Section 811 thus authorizes the Commission to take a different approach than the Federal Energy Regulatory Commission and to modify the Rule 10b-5 regime in light of its extensive experience with the petroleum industry.

Section 10(b) of the SEA and SEC Rule 10b-5 govern the sale of securities to investors. They impose a legal regime designed, *inter alia*, to protect retail purchasers of securities, who depend upon the honesty and good faith of regulated fiduciaries such as issuers, brokers, and dealers. Parity of access to information about the nature and soundness of issuers is considered fundamental to the fair and efficient functioning of the securities markets. To ensure that ordinary investors are not taken advantage of, and to instill confidence in the broader securities markets, the SEA imposes stringent and detailed obligations on regulated parties, including broad disclosure requirements and a prohibition on insider trading. The SEA's investor-protection rationale is frequently cited as a basis for granting the SEC broad enforcement powers under Section 10(b) and for interpreting Rule 10b-5 to prohibit as market manipulation a wide range of conduct that would be treated as garden-variety fraud (if actionable at all) outside the securities context.

This investor-protection rationale has no application to transactions in the wholesale petroleum markets. These transactions generally take place between sophisticated commercial parties dealing with each other at arm's length. In these

[17] Pub. L. No. 109-58, 119 Stat. 594. 691.

markets, efficiency and consumer welfare are best achieved by encouraging each party involved in the purchase or sale of a petroleum product to negotiate competitively to advance its own interests. The concern about insider trading is also inapplicable to wholesale petroleum markets, where the true nature of what is being purchased is seldom at issue. The key unknown in these transactions is not the physical properties or current value of the product, but the future direction of the market for that type of product. Participants on both sides of wholesale petroleum transactions often invest substantial resources in order to estimate future supply and demand of key inputs and outputs, and they rely on this proprietary information in deciding whether and at what price to trade in these commodities. Indeed, commodities regulators have long encouraged participants in these markets to trade based upon their own proprietary information and have allowed participants broad latitude to pursue profit-maximizing strategies that spur competition and investment and ultimately benefit consumers.[18]

The NPRM seeks to address this mismatch between the Rule 10b-5 regime and wholesale petroleum markets by stating that "the Commission is not invoking the entire body of SEC law in this rulemaking, but rather the anti-fraud provisions of SEC

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[18] In 1984, the CFTC 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." Commodity Futures Trading Commission, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information* 8 (Sept. 1984) (hereinafter "CFTC Study"). *See also* Edward F. Greene & Edward J. Rosen, *U. S. Regulation of International Securities and Derivatives Markets* (8th ed. 2005) at § 10.14[3] n.727 ("The securities markets have long been subject to proscriptions against trading on insider information . . . . The futures markets, however, differ from securities markets in that one of the principal purposes of the futures markets is to promote price discovery through trading, not disclosure").

Rule 10b-5."[19] This is an incomplete and unsatisfactory response to a fundamental problem. The SEC's and courts' interpretation and application of Rule 10b-5 are inextricably linked to the purposes that animate the SEA as a whole.

Rule 10b-5 has been interpreted expansively by the SEC and the courts precisely because that rule is part of a regulatory scheme designed to address problems that in many respects are unique to the securities industry. As the Supreme Court has observed:

> Rule 10b-5 . . . forbids the use, in connection with the purchase or sale of any security of any device, scheme or artifice to defraud or any other act, practice, or course of business that operates . . . as a fraud or deceit. Among Congress' objectives in passing the [Securities Exchange] Act was to insure honest securities markets and thereby promote investor confidence after the market crash of 1929. More generally, Congress sought to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.
>
> Consequently, we have explained that the statute should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes.[20]

Subtitle B of the EISA, by contrast, has very different purposes. Its goal is not to create "a philosophy of full disclosure." Instead, Subtitle B is narrowly targeted at enabling the Commission to combat fraudulent or deceptive conduct that is designed to manipulate wholesale petroleum markets.

Because of these basic differences, the Commission's statement that it would adopt only the anti-fraud provisions of Rule 10b-5, but not the rest of the SEA regulatory framework, does not resolve the concern that a regulatory approach based exclusively on securities law precedents overreaches in the context of wholesale

[19] NPRM at 23.

[20] *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (citations and quotations omitted).

petroleum markets. The Rule 10b-5 regulatory regime is deeply intertwined with the disclosure obligations imposed by Section 10(b) and other provisions of the SEA, the scope of which, in turn, are highly dependent on the fiduciary duties and obligations that exist between various market participants.[21] These complex connections will make it exceedingly difficult for market participants to anticipate which elements of Rule 10b-5 doctrine and precedent the Commission intends to adopt in interpreting and applying the proposed Rule, and which elements of the Rule 10b-5 regime the Commission will not adopt. This complexity and uncertainty will exacerbate the problems of compliance costs and loss of efficiency that derive from the Rule's fundamental overbreadth. To avoid this outcome, the Commission should draw on relevant commodities law precedents in addition to elements of Rule 10b-5. As described in more detail below, the commodities law precedents reflect more than seventy years of regulatory experience that is directly applicable to the wholesale petroleum markets at issue in this rulemaking.

V. SPECIFIC CONCERNS WITH THE PROPOSED RULE

As explained in the remainder of these comments, API urges the Commission to adjust those aspects of the proposed Rule that risk deterring procompetitive conduct or impeding the efficient functioning of petroleum markets. Specifically, any final Rule should make clear that:

- the showing needed to establish scienter is one of specific intent to deceive or defraud for the purpose of affecting a covered market;
- an omission may create a basis for liability only if it renders a representation deceptive or fraudulent at the time the representation is made;

[21] *See, e.g.*, *id.* at 823 (holding, in an SEC enforcement action under Rule 10b-5, that "any distinction between omissions and misrepresentations is illusory in the context of a broker who has a fiduciary duty to her clients").

- deceptive or fraudulent statements or conduct that do not pertain to a specific wholesale petroleum transaction fall outside the scope of the Rule; and
- challenged conduct is actionable only if it has a manipulative effect on the market.

We have appended to these comments suggested revisions to the language of the proposed Rule designed to implement these recommendations.

A. The Proposed Rule Should Require A Showing Of Specific Intent To Deceive Or Defraud In Order To Manipulate A Covered Market.

The Commission's proposal to make scienter a requirement of a Section 811 offense is appropriate. The scienter requirement proposed in the NPRM, however, is not sufficient to achieve the Commission's stated purpose of helping to "ensure that the proposed Rule does not chill competitive behavior."[22] The proposed Rule would impose liability based merely on a showing of recklessness. For the reasons set out in our ANPR Comments, any final Rule promulgated under Section 811 should impose liability based only upon a showing of specific intent to deceive or defraud in order to manipulate a covered market.[23]

Recklessness is inherently a more malleable standard than specific intent. In dynamic, fast-moving markets, such as those at issue here, the dividing line between statements or conduct that are reckless (reflecting an extreme departure from ordinary care) and those that are negligent (departing somewhat from ordinary care) can easily be debated, and different fact-finders may reach different results even on identical facts. Incorporation of a recklessness standard into the proposed Rule therefore would require market participants to guard against the possibility that the Commission (or courts) would

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[22] ANPR Comments at 45.

[23] *See id.* at 27-31.

base liability on conduct that falls far short of intentional wrongdoing.[24] This would substantially increase the cost of compliance with the Rule and might deter market participants from engaging in legitimate activities or lead them to limit the amount of information they disclose for fear that any inaccuracies would create a basis for liability. By effectively reducing the amount of information available to market participants, the Rule will have the unintended effect of impairing market efficiency and distorting normal market activity.

We include below some examples to highlight the potential impact of the proposed Rule.

- A hurricane causes significant damage to oil and gas infrastructure in a part of the United States, severely disrupting supply to local residents. A major distributor of gasoline to the regional market asks one of the refineries damaged by the storm to estimate when it will be in a position to resume supplies. Based on the information available to it at the time, the refinery replies that it will be unable to supply gasoline for the next four weeks. The distributor accordingly enters into a bulk transaction with a more distant supplier for the entire four-week period. The higher cost of transporting this gasoline contributes to a temporary spike in gas prices in the local market. It turns out that the refinery incurred less damage than originally thought, and it resumes operations two weeks after the storm. With more care or effort, might the refinery have provided a better estimate of when it would resume operations? Could the refinery's conduct and its resulting effect be claimed to be market manipulation under the proposed Rule?

- A terminal experiences a malfunction that requires it to be taken offline. An employee tells a prospective wholesale buyer that the terminal is likely to come back online the next day. Had the employee checked his very recently received emails, he would have known that other firm employees working to correct the malfunction estimate that the repairs will take at least two days. The employee's statement leads the prospective purchaser not to seek an alternative supply elsewhere. The next day, when the

[24] *See, e.g.*, *SEC v. Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 495 (S.D.N.Y. 2002) (holding, in the context of a Rule 10b-5 enforcement action, "[t]he question is not whether he was 'duped' into believing Credit Bancorp's misrepresentations, but whether, as Trustee, he should have reasonably known otherwise.").

terminal remains closed, the buyer is forced immediately to purchase supply elsewhere at a higher price. Did the employee's actions constitute a "reckless" failure to check a source of information, or a "reckless" failure to correct the misstatement after the first conversation, such that it could support a market manipulation violation?

- An employee tells a prospective wholesale customer that it cannot supply any product because all available supply is already under contractual obligation to other purchasers. In fact, one of these contractual purchasers has informed the supplier that it intends to breach the contract, a development of which the employee was aware, but which was closely held within the company and the subject of ongoing negotiations and possible legal action. The employee's statements lead the purchaser to seek an alternative source of supply and to pay a higher price elsewhere. Could the employee's intentional failure to disclose the possibility of a contractual breach and resulting increase in available supply support a market manipulation violation?

- A supplier of crude oil enters negotiations to divest one of its oil producing assets to a competitor. Following standard practice, news of the divestiture negotiations is tightly held within the supplying company to avoid a public leak that would be detrimental to the company's competitive position. A trader employed by the company, who knows of the possible future divestiture but has been instructed not to disclose it, is asked by a prospective purchaser about the company's future supply position. The trader discloses the supply position existing at that time and says nothing about the possible future divestiture. When the negotiations succeed and the asset is divested, the firm does not have as much supply available as the purchaser had been led to believe. Could the employee's intentional failure to disclose confidential business plans support a market manipulation violation?

Participants in wholesale petroleum markets constantly face challenges in acquiring and disseminating information, and must decide – sometimes in the face of competing considerations – how much information to provide to other market participants on the current and likely future status of their operations. In general, the dissemination of such information helps to improve market efficiency and lower costs, notwithstanding the occasionally inaccurate or incomplete nature of information provided in good faith. The proposed Rule will require companies to reassess the benefits of disclosing such information against the risk of incurring liability under Section 811 if they do so. Companies typically design compliance programs that require employees without specialized legal training to apply clear and relatively simple rules to myriad, complex factual scenarios. In order to avoid liability based on arguably "reckless" statements, companies may choose to instruct their employees to limit severely their disclosures of information.

For example, in the first hypothetical above, the refinery might instruct its employees not to provide estimates of when operations will resume following a hurricane. In the second hypothetical, the terminal owner might instruct employees to state that the terminal is currently offline, and to decline to provide any additional information to customers as to when it might come back online. In the other hypotheticals, too, the risk of liability under a recklessness standard could persuade the company involved to share less information than would otherwise be the case. Limiting liability under the proposed Rule to statements and acts made with specific intent to deceive or defraud in order to manipulate a covered market would effectively create a safe harbor for disclosures made for non-deceptive or non-fraudulent purposes, making it more likely that market participants will share market-beneficial information with each other (within the bounds of existing law).

The potential costs of a recklessness standard are increased by the tendency of agency staff during investigations (based upon our actual experience with other agencies) and courts during litigation to interpret and apply the recklessness standard under Rule 10b-5 in different ways. As the NPRM observes, the Supreme Court has expressly reserved decision on whether recklessness is sufficient to meet the scienter requirement for a Rule 10b-5 violation.[25] In the absence of a definitive statement by the Supreme Court, "the Courts of Appeals have adopted a number of different formulations as to precisely what constitutes recklessness."[26] Although the NPRM suggests that the Commission would apply the more stringent among these different formulations,[27] a rule that adopts Rule 10b-5 precedents without modification would not prevent different circuits, guided by their respective Rule 10b-5 precedents, from applying different tests to establish scienter for the purposes of Section 811.

On a more fundamental level, adopting a recklessness standard under Section 811 would ignore the important differences between the securities and wholesale petroleum markets. As explained earlier in these comments, Rule 10b-5 is part of an integrated regulatory system that seeks, *inter alia*, to protect unsophisticated investors and redress the inherent knowledge imbalance between an enterprise and those that might want to invest in it, including by imposing fiduciary duties and strict disclosure requirements on issuers and brokers. In this highly regulated context, in which brokers and advisers are subject to explicit and detailed duties concerning the nature of their communications with prospective purchasers of securities, a recklessness standard may be appropriate as a means of deterring fraud arising from willful disregard of those duties.

Here, the regulatory context is quite different. Participants in wholesale petroleum markets are sophisticated commercial parties that do not owe fiduciary duties

[25] NPRM at 47 n.130 (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2507 n.3 (2007)).

[26] *Id.* at 47.

[27] *Id.* at 48 ("The Commission believes that a recklessness standard as articulated by the Seventh and District of Columbia Circuits would be adequate to establish scienter for any future violation.").

to each other, and there is little risk of information asymmetry between the parties as to the true nature of the thing being purchased or sold. Market efficiency is enhanced when these participants compete and negotiate aggressively, pursue profit-maximizing strategies, and are free to trade on the basis of any non-public information they may hold, with or without disclosing that information to counter-parties.[28] In the one-on-one communications described in the above examples, neither party expects the counterparty to look out for its interests. The application of a recklessness standard to these markets is not necessary to protect vulnerable parties. Moreover, a recklessness standard is likely to create confusion over whether traders should disclose information when they are less than 100 percent certain that the information is accurate. This is a particularly difficult standard to apply in the rapidly changing circumstances of an emergency or other situations where supply is tight.

A recklessness standard also would place the Commission's Rule in conflict with the specific intent standard applied by the Commodity Futures Trading Commission under the Commodity Exchange Act ("CEA"). As noted in our ANPR Comments, courts have interpreted the CEA's market manipulation provisions to require proof of specific intent.[29] There are powerful reasons for the Commission to apply the CEA's specific intent standard, rather than the SEA's recklessness standard, in the context of Section 811. First, the CEA standard reflects over seventy years of established market manipulation precedent directly applicable to commodities markets. The Commission should give significant weight to this regulatory and judicial experience. Second¸ adopting a specific intent standard in the implementing rules of Section 811

[28] *See* CFTC Study, *supra* note 18.

[29] ANPR Comments at 29 (footnote omitted).

would ensure that a consistent standard is applied to transactions over which the FTC and CFTC may exercise overlapping jurisdiction.[30] Requiring regulated parties to comply with inconsistent regulatory standards would impose additional compliance costs and should be avoided absent a compelling reason.

Finally, the final Rule should provide that the specific intent required for liability is not simply intent to deceive or defraud, but intent to deceive or defraud in order to manipulate a covered market. The Commission's rationale for promulgating a market manipulation rule, as stated in the NPRM, is to "allow[] the Commission to guard against conduct that undermines the integrity of the petroleum market."[31] The Rule proposed in the NPRM sweeps much more broadly than this. If liability can be grounded on nothing more than a deceptive or fraudulent statement made in connection with a covered transaction, the Rule will apply to conduct that entails no risk of market manipulation and that may already be actionable under state anti-fraud and other laws. This in turn will substantially complicate compliance and increase the regulatory costs associated with the Rule. By requiring intent to deceive or defraud in order to manipulate a covered market, the Rule will target only the sorts of deliberately manipulative conduct about which Congress was concerned when it enacted Section 811.

B. The Commission Should Provide A Safe Harbor For Private Transactions Between Traders.

Regardless of whether the Commission adopts a specific intent requirement, the Commission should, at a minimum, provide a safe harbor for statements or omissions that are not made in connection with "reporting . . . to government agencies,

[30] *Id.*

[31] NPRM at 18.

to third-party reporting services, and to the public through corporate announcements,"[32] at least absent concrete evidence that such statements or omissions were part of a broader scheme to manipulate a market. Most statements made in the course of isolated private commercial dealings or other non-public settings have little or no chance of manipulating a market. Raising the specter of market manipulation liability for statements made in such settings will cause firms to impose restrictions on what their employees say in the context of private commercial dealings, with the potential to severely undermine the efficiency of wholesale petroleum markets in effectively moving supply to where it is urgently needed at the best price.

The goal of a market manipulation rule should be to protect the market, not the sophisticated buyers and sellers that transact in that market. As discussed in detail in Section IV, this is a very different focus than the investor protection rationale for the SEC's regulations. The parties to individual transactions in wholesale petroleum markets are well aware that those with whom they deal are self-interested and do not owe fiduciary duties to look after the best interests of their counterparties. Moreover, private remedies for fraud and breach of contract are entirely adequate to address possible problems that may occur in individual transactions. Any damages are confined to the parties themselves, who have the right incentives to pursue private remedies where appropriate. Public statements, in contrast, may create adverse consequences for numerous participants, with no one party necessarily having an adequate incentive to pursue private remedies. Because the goal should be to protect the market rather than

[32] *Id.* at 39.

individual traders, the Commission should provide a safe harbor for information exchanged in private transactions.

C. Imposing Liability For Omissions Will Chill Welfare-Enhancing Disclosures By Market Participants.

API supports the Commission's interim conclusion that a market manipulation rule under Section 811 should "impose[ ] no general duty upon covered entities to disclose information."[33] We understand the Commission's statement to mean that "pure omissions" (omissions that do not relate to explicit representations) cannot be a basis for liability under the proposed Rule. By leaving open the possibility of liability arising from "incomplete" disclosures, however, the proposed Rule is likely to chill voluntary, welfare-enhancing disclosures by market participants.

The NPRM states:

> Section 317.3(b) prohibits omissions of material fact that are necessary to ensure that a previously made statement is not misleading. Accordingly, there may be a violation of Section 317.3(b) if a covered entity voluntarily provides information – or is compelled to provide information by statute, order, or regulation – but then fails to disclose a material fact, thereby making the information provided misleading.[34]

The NPRM makes clear that this aspect of the proposed Rule replicates the treatment of omissions in Rule 10b-5. Section 317.3(b) itself reproduces word for word the language of subparagraph (b) of Rule 10b-5, and the NPRM invokes securities law precedent in describing both the test for materiality[35] and the relevant time period for determining the materiality of an omission.[36]

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[33] *Id.* at 39.

[34] *Id.* at 39-40 (footnote omitted)..

[35] *Id.* at 38 ("Consistent with securities law, a fact is material if there is a substantial likelihood that a reasonable market participant would consider it in making its decision to

The treatment of partial disclosures under the proposed Rule further illustrates the dangers of uncritically subjecting wholesale petroleum markets to a body of Rule 10b-5 case law that has developed to meet the particular and different challenges of the securities industry. Permitting courts to base liability on failure to disclose facts that would "alter[] the total mix of information available"[37] may make sense in the highly regulated securities industry, in which regulated parties often have access to material non-public information about the issuer that may affect the true value of the security, and therefore are governed by detailed disclosure obligations designed to protect unsophisticated investors. As the Supreme Court has observed, "any distinction between omissions and misrepresentations is illusory in the context of a [securities] broker who has a fiduciary duty to her clients."[38] To apply these same rules to the petroleum industry, and to enforce them based on securities industry precedents, risks unintended consequences that will undermine the Commission's objective of preserving the efficiency of the petroleum markets.

As previously explained, participants in wholesale petroleum markets are encouraged to trade on the basis of proprietary information that shapes their expectations about future supply and demand. The goal of efficiency is advanced when market participants are free to decide whether and how much proprietary information to inject into the marketplace. A rule that creates a risk of liability each time some information is

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transact because the material fact significantly alters the total mix of information available.") (citing *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)).

[36] *Id.* at 40 n.111 ("Based on securities law precedent, the relevant time period for determining materiality is at the time of the statement or omission, and not in hindsight.") (citing *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 165 (2d Cir. 2000)).

[37] *See id.* at 38 and *supra* note 35.

[38] *SEC v. Zandford*, 535 U.S. 813, 823 (2002).

disclosed – unless the firm intends to monitor, for each such disclosure, whether additional disclosures are necessary to eliminate the possibility of a misleading impression – will deter market participants from disclosing information in the first place. By reducing the amount of information in the marketplace, the omissions standard set forth in the NPRM could have a serious and harmful impact on the efficiency of petroleum markets. The risk is particularly acute when market conditions are volatile – for example, in the aftermath of natural disasters or other emergency situations – and firms may be struggling to gain an accurate picture of their own operations and the broader market landscape. Yet, it is precisely at such times that more, not less, information is needed in the marketplace in order to facilitate the adjustments in supply needed to restore equilibrium. The proposed Rule would make firms especially sensitive to the risk that disclosures during such times of crisis might later be misconstrued as manipulative because the firm failed to disclose some other piece of information that was later deemed to be material.

In summary, the Commission should ensure that any final Rule is narrowly crafted to avoid the risk of deterring voluntary disclosures by market participants. At a minimum, the proposed Rule should make clear that omissions can create a basis for liability only if they render a representation deceptive or fraudulent at the time the representation is made. In addition, the Rule's Statement of Basis and Purpose should state clearly that a firm's decision to disclose information does not create any duty to make additional disclosures.

D. **The Commission Should Clarify The "In Connection With" Requirement And Establish Safe Harbors For Conduct That Does Not Directly Involve A Specific Purchase Or Sale Of A Covered Product at Wholesale.**

The NPRM states that the "in connection with" language of Section 811 will require the Commission "to show a nexus between the manipulative conduct and the purchase or sale" of a covered commodity, and that the Commission intends to interpret this language as "requiring fraudulent conduct to coincide with" a covered purchase or sale.[39] The Commission also has given its assurance that it will not interpret this requirement "so broadly as to turn every common law fraud that happens to touch a purchase or sale of a covered or uncovered product into a rule violation."[40] The Commission, however, should go further to clarify the scope of this requirement in order to provide greater certainty to market participants.

The NPRM states that the Commission, in interpreting the "in connection with" element of the proposed Rule, will be "[g]uided by Supreme Court precedent in the securities area," and cites *SEC v. Zandford* in support.[41] In *Zandford*, however, the Supreme Court concluded that a broad reading of "in connection with" in Rule 10b-5 was justified because of the specific remedial purposes of the SEA – namely, to respond to the massive economic crisis of 1929 by "'substitut[ing] a philosophy of full disclosure for the

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[39] NPRM at 48 (emphasis added).

[40] *Id.* Interpreting the "in connection requirement" to require a close nexus between the challenged conduct and the purchase or sale of a covered product at wholesale will not, on its own, prevent the rule from regulating a wide swath of common-law fraud scenarios that Congress clearly did not intend to bring within the scope of FTC enforcement. To ensure that the proposed Rule does not federalize state fraud law, the Commission should apply the Rule only to fraudulent or deceptive statements or conduct that have an effect on the market. *See* Section VII, *supra*.

[41] NPRM at 48 (citing *SEC v. Zandford*, *supra* note 20).

philosophy of *caveat emptor*.'"[42] When Congress enacted Section 811, by contrast, it was not responding to an epidemic of market manipulation in wholesale petroleum markets – indeed, the Commission's own studies of the petroleum industry have found an absence of market manipulation.[43] Congress also did not intend, in enacting Section 811, to supplant existing market-based practices in the petroleum industry with an SEC-style "full disclosure" regime. These differences weigh heavily in favor of a narrower reading of the "in connection with" language of Section 811 and the proposed Rule than has been adopted under Rule 10b-5. To this end, the Commission should make clear in any final Rule that only statements and acts pertaining to specific wholesale petroleum transactions may give rise to liability under Section 811.

Furthermore, even the relatively broad interpretation of "in connection with" endorsed by the Supreme Court in recent cases suggests that the anti-fraud provisions of Rule 10b-5 should not reach conduct unconnected to any purchase or sale of a security. As the Supreme Court has noted, Congress did not intend Rule 10b-5 to cover fraudulent or deceptive statements or conduct that "constitute no more than internal corporate mismanagement."[44] A broad reading of the "in connection with" requirement that reaches internal corporate actions and decisions is even less justified in the wholesale petroleum markets for the reasons already discussed. In particular, and as discussed in

[42]*Zanford*, 535 U.S. at 819 (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)).

[43] *See* ANPR Comments at 8-14.

[44] *Zandford*, 535 U.S. at 821-22 ("'We agree that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances *in the purchase or sale of securities* whether conducted in the organized markets or face to face.'") (quoting *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971)) (emphasis added).

more detail below, any final Rule should not apply to transactions at the rack and at or below the terminal or to upstream statements or conduct, including supply decisions.

1. The Proposed Rule Should Exclude Transactions At The Rack And At Or Below The Terminal.

In our ANPR Comments, we urged the Commission to exclude "rack" transactions, dealer tankwagon sales to dealers, and other terminal-level sales.[45] The NPRM indicates that the Commission is inclined to include such transactions within the scope of the Rule. It defends this position on the ground that the DoE's Energy Information Administration defines "wholesale price" to include rack prices, and by relying on the definition of "wholesale" provided in an online dictionary.[46]

Our reasons for urging the Commission to exclude rack and other below-the-terminal transactions from the scope of the Rule are not definitional, but rather based on public policy.

- The Commission has conducted numerous investigations over the past ten years, none of which have found a problem at the wholesale rack level that would suggest a regulatory remedy is required. Moreover, the Commission already has in place an effective program for monitoring terminal rack prices on an ongoing basis.
- Rack pricing decisions are qualitatively different than those that arise in market-based bulk transactions. They generally are set by the rack supplier and tend to remain in effect for a period of time and apply to a variety of different purchasers. The pricing for sales to individual brand dealers (the dealer tank wagon price) is even further removed from a commodities "market price" for bulk spot transactions.
- The rack price published by a petroleum supplier does not necessarily reflect the price available to all wholesale customers at a particular terminal. Incentive prices or alternate competitive price formulas may also be available. The legal uncertainty created by applying the proposed Rule at the terminal rack level could jeopardize the ability of wholesale

[45] *See* ANPR Comments at 24-25.

[46] *See* NPRM at 36.

suppliers to respond to market conditions and offer incentives or alternative price formulas.

- There are over a thousand wholesale rack price locations in the United States. Wholesale rack prices are limited to a relatively small geographic area. Considering the large number of rack prices in the United States, their limited geographic scope, and the lack of any identified problem that the Rule would remedy, it does not make sense for the Commission to expend resources on enforcement efforts directed to the wholesale rack markets.
- Section 317.3(b) of the proposed rule would have the practical effect of chilling pro-competitive communications between rack sellers and buyers without providing any corresponding benefit to consumers.
- A rule applicable to terminal rack transactions would vastly expand the number of individuals whose conduct may be subject to scrutiny and would impose a correspondingly large compliance burden on the wholesale petroleum industry.

To avoid these problems, API recommends for the Commission's consideration a definition of "wholesale" that would exclude transactions at and below the terminal rack, as follows:

> *Wholesale* means bulk purchases or sales in contract quantities of 20,000 barrels or more, delivered or received via pipeline, marine transport or rail, at or near a location for which a price publication firm publishes a reference price. Wholesale transactions do not include sales at the terminal rack or downstream of the terminal rack or retail gasoline or petroleum distillate sales to consumers.

The Commission should exclude transactions at or below the rack from the coverage of any Rule.

2. The Proposed Rule Should Not Apply To Upstream Statements Or Conduct, Including Supply Decisions.

There are strong arguments for excluding upstream decisions from the scope of the Rule. Section 811 expressly states that it applies only to conduct undertaken "in connection with the *purchase or sale* of crude oil[,] gasoline or petroleum distillates *at wholesale*" (emphasis added). The only reasonable interpretation of this language is that Section 811 does not apply to decisions or conduct that are *not* connected to a specific "purchase or sale . . . at wholesale." Interpreting Section 811 more broadly would exceed the rulemaking authority granted to the FTC by the statute itself.

Extending Section 811 to such production, operational, and supply decisions would also run a substantial risk of disrupting competitive activity in petroleum markets. As noted above, firms in the petroleum industry necessarily undertake a wide range of business decisions that are unconnected to the "purchase or sale . . . at wholesale" transactions that are the focus of Section 811. If Section 811 does not clearly exclude ordinary production, operational, and supply decisions, market participants would likely be compelled to factor into every aspect of their business strategy the risk of challenge under Section 811. In an effort to avoid such risks, companies would generally take a more conservative approach, leaving them less able to respond with agility and creativity to market disruptions and market opportunities.[47] Applying a market manipulation rule to upstream conduct is also likely to have significant adverse consequences for consumers.

Although the NPRM indicates in certain passages that "the proposed Rule . . . *does not* regulate supply decisions or require that market participants provide access to terminals or pipelines,"[48] other passages of the NPRM indicate that the Commission does not intend to exclude all supply decisions from the scope of the Rule.[49]

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[47] ANPR Comments at 25-26.

[48] NPRM at 23 (emphasis added); *see also id.* at 42-43 ("The Commission agrees with commenters that the market is generally the best determiner of supply and demand decisions. The Commission does not, however, foreclose the possibility that facts and circumstances may lead it to find that a decision to withhold supply or access that otherwise meets the requirements of the proposed Rule violates the proposed Rule.").

[49] *See* NPRM at 49-50.

The NPRM does not specify whether the Commission intends to apply the proposed Rule to other types of upstream activities – such as decisions concerning upstream production and operations, refining decisions, facility maintenance and upgrades, and management of inventory levels – that are even further removed from purchases or sales of petroleum products at wholesale than supply decisions.

For the reasons set forth in our earlier comments, the proposed Rule should not seek to regulate upstream conduct that is unconnected to a particular purchase or sale of a covered product at wholesale. The Commission should clarify this point in the final Rule and provide that upstream conduct that is not connected to particular purchases or sales falls outside the scope of the Rule.

If the Commission decides not to provide a *per se* exclusion to supply decisions, the Commission should, at a minimum, make clear in the final Rule that a firm's ability to provide an objective business justification for the challenged supply decision should provide an affirmative defense to liability under the Rule.

E. The Proposed Rule Should Apply Only To Statements Or Conduct That Has A Manipulative Effect On A Covered Market.

In our ANPR Comments, we proposed that any rule promulgated by the Commission pursuant to Section 811 require a material effect on market prices. Applying Section 811 to conduct that does not cause a material deviation in market prices would unduly expand the FTC's regulatory oversight and would likely harm consumer welfare in the long run by chilling competitive market behavior, thereby potentially increasing prices. Section 811 should not be viewed as imposing federal regulatory oversight on conduct that is, and properly should be, the province of anti-fraud and contract law. Allegations of fraud and deception are not uncommon in commercial and contract disputes. Unless the FTC requires an appropriate connection between challenged conduct and a material deviation in *market* prices, it runs the risk of having to police every routine commercial dispute as a potential violation of Section 811.

Such a requirement is also consistent with the statutory framework of Subtitle B. In enacting Section 811, Congress specifically sought to target the actual manipulation of prices in petroleum wholesale markets. Section 811 does not prohibit attempted market manipulation. In this respect, Section 811 differs from Section 9(a)(2) of the CEA, which expressly prohibits an "attempt to manipulate." The fact that Congress chose not to create an "attempt" violation in Section 811 reflects Congress' focus on deceptive or fraudulent conduct that actually causes a material deviation in market prices.[50]

The NPRM reflects some ambiguity as to whether the proposed Rule is intended to apply only to conduct that manipulates wholesale petroleum markets, or whether it would apply even to fraud and deceit that has no actual market effect. While certain passages in the NPRM reject any requirement of market effects,[51] the NPRM also states that the proposed Rule is intended to allow the Commission to police only "fraud and manipulation *that affect wholesale petroleum markets*,"[52] and that the Rule is therefore limited to "intentional acts *that obstruct or impair wholesale petroleum markets*."[53] Similarly, the section of the NPRM on misrepresentations of material fact focuses solely on "the reporting of false or misleading information to government

[50] ANPR Comments at 31-32.

[51] *See* NPRM at 50 ("The Commission does not intend to require proof of effects as an element of a cause of action.").

[52] *Id.* at 37 (emphasis added).

[53] *Id.* at 37-38 (emphasis added).

agencies, to third-party reporting services, and to the public through corporate announcements." This suggests that statements and conduct that are not intended to reach the broader market (such as statements made in the context of private commercial negotiations or other non-public situations) – and therefore do not have any reasonable chance of manipulating the market – would fall outside the scope of the Rule.

The Commission should resolve this ambiguity by requiring proof that a party's deceptive or fraudulent conduct caused market conditions to deviate materially from the conditions that would have existed but for that conduct. This sort of an evaluation is well within the experience of the Commission, which analyzes the market effect of conduct in virtually all its antitrust investigations. A market effects requirement would limit the scope of the Rule to the express language of Section 811 and the corresponding Congressional intent – namely, to combat *market* manipulation. Without a market effects requirement, the Rule would potentially apply to each of the millions of private discussions and transactions that take place every day between market participants in wholesale petroleum and related markets. A Rule with such a broad scope would potentially federalize large blocks of state fraud, contract, and tort law as they apply to wholesale petroleum markets. There is no reason to believe that Congress intended Section 811 to authorize such a broad expansion in the Commission's oversight and enforcement, or that the Commission should want to take on such a role.

The NPRM also contends that requiring a showing of market effects "raises an unnecessary risk of regulatory error."[54] The risk of regulatory error is far greater, however, if the proposed Rule applies to statements and conduct that have no

[54] *Id.* at 51.

effect on wholesale petroleum markets. Given the absence of evidence that market manipulation is a significant problem in wholesale petroleum markets, the risk of regulatory error is far greater with respect to the Rule's over-breadth than under-breadth.

It is noteworthy that the NPRM acknowledges that an effect on market prices is required to apply the Rule to manipulative or deceptive conduct involving transactions in non-petroleum commodities.[55] The experience the Commission will gain in measuring price effects in these non-petroleum cases would undoubtedly be directly applicable to measuring the price effects of conduct that directly involves a covered product. This should substantially minimize any concerns that the Commission may have regarding the risk of under-enforcement.

In determining whether a particular deceptive or fraudulent statement or act had an effect on the market in question, the Commission could, for example, analyze historical price trends for correlations between the prices of different commodities or relationships between prices at different delivery points. It could also review the price of the physical, wholesale petroleum product in question immediately prior to and after the deceptive or fraudulent statement or act, as well as other supply and demand fundamentals (*e.g.*, available inventories, weather and international events). Courts applying the CEA in the context of futures market manipulation generally analyze market effects by looking for abnormal deviations between the prices of futures contracts and

[55] *See, e.g.*, *id.* at 32 ("[T]he proposed Rule would also reach manipulative conduct that extends beyond the defined terms if that conduct directly or indirectly impacts wholesale prices for the covered products."); at 34 ("Manipulative or deceptive conduct involving non-petroleum based commodities that directly or indirectly affect the price of gasoline . . . may be the subject of Commission enforcement under the proposed Rule."); at 48-49 ("[T]he proposed Rule would reach manipulative conduct that extends beyond the defined terms if that conduct directly or indirectly impacts wholesale prices for covered products.").

those of the underlying commodity and reviewing historical spreads between futures contract months.[56]

F. This Rulemaking Proceeding Is Subject To The Rulemaking Procedures Of Section 18 Of The FTC Act.

As noted in our ANPR Comments, we believe that the Commission has erred in applying the rulemaking procedures of Section 553 of Administrative Procedure Act to this proceeding, rather than the procedures set out in Section 18 of the FTC Act. The basis for this conclusion is set out in the attached ANPR Comments.[57] The following comments respond to the additional points in the NPRM.

The NPRM states that the plain language of Subtitle B of EISA does not require the use of Section 18(a)(1)(B) procedures. To the contrary, the plain language of Subtitle B directs the Commission to treat a regulation issued under that subtitle "as . . . a rule issued under section 18(a)(1)(B)." 42 U.S.C. 17303(b). That language requires the Commission to use the procedures which Section 18(b) of the FTC Act makes mandatory "[w]hen prescribing a rule under [Section 18(a)(1)(B)]." 15 U.S.C. § 57a(b). Moreover, when Congress intends for the Commission to follow APA procedures rather than Section 18(a)(1)(B) procedures, it says so expressly.[58] Because there is no language

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[56] *See, e.g.*, *Cargill v. Hardin*, 452 F.2d 1154, 1167-68 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972) (holding that Cargill illegally cornered and thereby created an artificial price for wheat futures).

[57] *See* ANPR Comments at 57-59.

[58] For example, Congress explicitly instructed the FTC to use the APA's Section 553 rulemaking procedures to enact trade regulation rules pursuant to the Telephone Disclosure and Dispute Resolution Act of 1992 regarding pay-per-call (*i.e.*, 900 number) services, as well as in relation to the Telemarketing Sales Rule, the Children's Online Privacy Protection Rule, the Contact Lens Rule, and the rules implementing the CAN-SPAM Act of 2003. *See* 15 U.S.C. §§ 5711, 6102, 6502, 7607, 7711. Congress provided no such express authorization to use Section 553 procedures here.

authorizing the FTC to use APA procedures in Subtitle B, the Commission is required to use Section 18(a)(1)(B) procedures.

The NPRM also states that the use of APA procedures is consistent with a congressional expectation of expedition. But nothing in Subtitle B says that the Commission must act with expedition. Even if some Members of Congress have urged the Commission to act expeditiously, those statements cannot trump the statutory requirement to follow Section 18(a)(1)(B) procedures. The FTC may proceed expeditiously, but it must do so in accordance with Section 18(a)(1)(B) procedures.

APPENDIX

PART 317 – PROHIBITION OF ENERGY MARKET MANIPULATION RULE
Sec.

AUTHORITY: 42 U.S.C. 17301 - 17305; 15 U.S.C. 41 - 58.

§ 317.1 Scope.

This part implements Subtitle B of Title VIII of The Energy Independence and Security
Act of 2007 ("EISA"), Pub. L. 110-140, 121 Stat. 1723 (December 19, 2007), *codified at* 42 U.S.C. 17301-17305. This rule applies to any person over which the Federal Trade Commission has jurisdiction under the Federal Trade Commission Act, 15 U.S.C. 41 *et seq*.

§ 317.2 Definitions.

The following definitions shall apply throughout this rule:

(a) *Crude oil* means the mixture of hydrocarbons that exist: (1) in liquid phase in natural underground reservoirs and which remain liquid at atmospheric pressure after passing through separating facilities, or (2) as shale oil or tar sands requiring further processing for sale as a refinery feedstock.

(aa) *In connection with* means pertaining to one or more specific transactions to purchase or sell crude oil, gasoline, or petroleum distillates at wholesale.

(b) *Gasoline* means (1) finished gasoline, including, but not limited to, conventional,
reformulated, and oxygenated blends, and (2) conventional and reformulated gasoline blendstock for oxygenate blending.

(bbb) *Misleading* means deceptive or fraudulent at the time a statement is made.

(c) *Person* means any individual, group, unincorporated association, limited or general partnership, corporation, or other business entity.

(d) *Petroleum distillates* means (1) jet fuels, including, but not limited to, all commercial and military specification jet fuels, and (2) diesel fuels and fuel oils, including, but not limited to, No. 1, No. 2, and No. 4 diesel fuel, and No. 1, No. 2, and No. 4 fuel oil.

(e) *Wholesale* means bulk purchases or sales in contract quantities of 20,000 barrels or more, delivered or received via pipeline, marine transport or rail at or near a location for which a price publication firm publishes a reference price. Wholesale transactions do not include sales at the terminal rack or downstream of the terminal rack or retail gasoline or petroleum distillate sales to consumers.

§ 317.3 Prohibited practices.

It shall be unlawful for any person, directly or indirectly, in connection with the purchase
or sale of crude oil, gasoline, or petroleum distillates at wholesale,

(a) To use or employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person;

with specific intent to deceive or defraud in order to affect a wholesale petroleum market and having an effect on that market.

§ 317.4 Preemption.

The Federal Trade Commission does not intend, through the promulgation of this Rule,
to preempt the laws of any state or local government, except to the extent that any such law conflicts with this Rule. A law is not in conflict with this Rule if it affords equal or greater protection from the use or employment, directly or indirectly, of any deceptive or manipulative device or contrivance, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale.

§ 317.5 Severability.

The provisions of this Rule are separate and severable from one another. If any provision is stayed or determined to be invalid, it is the Commission's intention that the remaining provisions shall continue in effect.

By direction of the Commission.

ANNEX

Before the
FEDERAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Market Manipulation Rulemaking	)	Project No. PO82900
	)	

COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE AND THE NATIONAL PETROCHEMICAL AND REFINERS ASSOCIATION

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June 23, 2008

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Washington, D.C.

In the Matter of

Market Manipulation Rulemaking) Project No. PO82900

COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE AND THE NATIONAL PETROCHEMICAL AND REFINERS ASSOCIATION

I. EXECUTIVE SUMMARY

The American Petroleum Institute ("API") and the National Petrochemical and Refiners Association ("NPRA") welcome this opportunity to submit these comments and to offer an industry-wide perspective on the issues raised by the Commission's Advance Notice of Proposed Rulemaking ("ANPR"). The issues presented by the ANPR are of great concern to API, NPRA, and their respective members, and we appreciate this opportunity to share our views.

1. Section 811 of Subtitle B of the Energy Independence and Security Act of 2007 ("EISA") states that the Federal Trade Commission ("FTC" or "Commission") "may prescribe" rules concerning the use, "in connection with the purchase or sale of crude oil[,] gasoline or petroleum distillates at wholesale," of "any manipulative or deceptive device or contrivance," if such rules are "necessary or appropriate in the public interest or for the protection of United States citizens." The statutory language leaves to the FTC the decision whether to propose a rule under Section 811. The FTC's experience with the petroleum industry indicates that any such rule is unnecessary. Repeated investigations of the industry have found no evidence of significant harmful or illegal conduct in petroleum wholesale markets. Much of

the conduct discussed in the ANPR is already governed by the antitrust laws, and adoption of rules pursuant to Section 811 would substantially duplicate an existing enforcement regime under the Commodity Exchange Act (CEA). In addition, a new set of rules has the potential to deter actions that are likely to benefit consumers and to impose regulatory burdens that outweigh any likely benefits.

2. If the FTC decides to propose a rule, it should craft the rule narrowly to avoid deterring pro-competitive conduct or impeding the efficient operation of petroleum markets. Consistent with these principles, any rule should require that, before a party can be held liable under Section 811, it must at a minimum be shown to have: (a) knowingly made a deceptive or fraudulent statement or engaged in a deceptive or fraudulent act; (b) in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale; (c) with the specific intent to affect the market price for a physical crude oil, gasoline or petroleum distillates product; and (d) caused such market price to deviate materially from the market price that would have existed but for the deceptive or fraudulent statement or act.

(a) Section 811's reference to "any manipulative or deceptive device or contrivance" is derived from the Energy Policy Act of 2005 ("EPA") and the Securities Exchange Act of 1934 ("SEA"). The Supreme Court has held that this language "connotes intentional or willful conduct designed to deceive or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). Other provisions in Subtitle B, and Section 811's limited legislative history, confirm that Congress intended Section 811 to target deceptive or fraudulent conduct.

Although Section 811 is modeled on provisions of the EPA and SEA, Congress delegated broad authority to the FTC to promulgate rules tailored to the nature of the petroleum markets at issue. In exercising this authority, the FTC should retain its long-standing distinction between pure omissions (which are not considered deceptive under the FTC Act) and omissions that are necessary to correct a misimpression. In addition, the FTC should not impose any disclosure requirements or prohibitions on "insider trading" similar to those imposed on securities market participants by SEC regulations.

(b) Section 811, by its terms, applies only to conduct undertaken "in connection with the purchase or sale of crude oil[,] gasoline or petroleum distillates at wholesale." The provision does not apply to retail sales of petroleum products, and should not be applied to "rack" transactions, Dealer Tankwagon ("DTW") sales to dealers, or to other terminal-level sales, or to supply decisions that are unconnected to wholesale purchase or sale transactions. In addition, Section 811 should apply only to transactions in physical commodities, and not to listed or over-the-counter derivatives contracts, which are regulated exclusively by the CFTC.

(c) The language of Section 811 applies to intentional or knowing misconduct that is designed to deceive or defraud. Other sections of the statute, as well as its legislative history, confirm that Section 811 applies only to statements or acts that are intended to mislead. Absent a specific intent requirement, Section 811 is likely to chill dynamic competitive behavior and deter firms from acting on market indications for fear of inadvertently incurring liability. The CEA's market manipulation provisions have been interpreted to require specific intent. If the FTC proposes a rule, it should adopt the same standard.

(d) Any rule proposed under Section 811 should be limited to deceptive or fraudulent statements or acts that cause market prices to deviate materially from the market price that would have existed but for those statements or acts. Section 811, unlike Section 9(a)(2) of the CEA, does not expressly prohibit attempts to manipulate, and requiring an effect on prices is necessary to distinguish actual from attempted manipulation. Also, unless the FTC requires proof of a connection between challenged conduct and a material deviation in *market* prices, it could find itself drawn into disputes that are properly the province of commercial contract and anti-fraud law.

3. Section 811 should not be interpreted to prohibit conduct undertaken "for the purpose or with the effect" of causing certain market effects, as set forth in the ANPR's proposed definition. The use of the disjunctive "or" would allow liability to be imposed on a party that did not intend to cause such market effects, and thus would risk deterring a wide range of behavior that is competitively neutral or pro-competitive. In addition, Section 811 liability should not attach where the purpose or effect of a party's actions was to "increas[e] the market price relative to costs." This formulation would create a risk of liability for economically rational behavior that serves to ensure that goods are produced, sold, and distributed to regions and consumers that need them most.

4. The FTC should avoid imposing duplicative or inconsistent regulatory requirements. In particular, it should avoid creating new, industry-specific antitrust laws, and instead should focus on intentionally deceptive or fraudulent conduct. In addition, the derivatives markets, and to a considerable extent the physical petroleum wholesale markets, are already regulated by the CFTC. The FTC should avoid unnecessary inconsistencies between any rule it may propose under Section 811 and the standards applied by the CFTC under the CEA.

5. Congress has provided for substantial penalties, including civil penalties of up to $1 million per day per violation of Section 811. The magnitude of these penalties could cause companies to adopt rigid rules that would restrict their ability to engage in efficient and pro-competitive activities. Accordingly, in the event the FTC proposes a rule, it should consider a

range of factors in determining the appropriate penalty for a violation, including the seriousness of the violation and the magnitude of the harm.

6. Section 811 should not be interpreted to regulate supply decisions – for instance, about which products to produce, how much of each product to produce, and where to supply those products. Such decisions are enormously complex and interrelated, and are made much more efficiently by companies responding to market forces than by a government agency. Any attempt to apply Section 811 to supply decisions is likely to chill rapid responses to market indications and thus have the perverse effect of prolonging supply disruptions.

Section 811 also should not be interpreted to require firms to release inventory during price spikes. Again, such a requirement would substitute the judgment of the Commission for that of individual firms making ordinary business decisions, and would likely dampen the ability of the market to reach equilibrium after supply disruptions.

In addition, Section 811 should not be interpreted to prohibit truthful public announcements by refiners of planned reductions in utilization. Such announcements help market participants react rationally to market conditions, and any improper coordination among refiners through such announcements is already illegal under the antitrust laws. Moreover, Section 811 should not be interpreted to require access to unregulated terminals.

While API and NPRA recognize that false reporting of price data to private reporting firms could be problematic, any prohibition on such conduct should be appropriately tailored to ensure that market participants do not forego reporting to such firms altogether.

Section 811 does not grant the FTC authority to require companies to maintain and submit burdensome cost and volume data, and in any event the burdens of such a requirement would far outweigh any likely benefits. Section 811 also should not be read to grant the FTC authority to regulate prices. Moreover, the concept of "artificial price" developed by the CFTC is not appropriate for physical commodities markets. The artificial price standard was developed to police futures contracts in which all terms except price are standardized, while Section 811 applies to physical transactions in which many non-standardized contracts are used.

7. Finally, any proceeding to promulgate a rule under Section 811 is subject to the procedures of Section 18(a)(1)(B) of the FTC Act. Section 811 authorizes the FTC to issue rules applicable to acts that are "manipulative or deceptive," and Section 813 specifies that violations of any rules issued under Section 811 "shall be treated as an unfair or deceptive act or practice prescribed under a rule issued under section 18(a)(1)(B)." When Congress has intended to authorize the FTC to use the less demanding rulemaking procedures of the Administrative Procedure Act, 5 U.S.C. § 553, it has said so expressly. Congress did not do so here.

II. API AND NPRA AND THEIR INTEREST IN THIS PROCEEDING

The American Petroleum Institute and the National Petrochemical and Refiners Association are national trade associations representing the U.S. oil and natural gas industry. API's more than 400 members cover all facets of the industry, including exploration, production, transportation, refining, and marketing. NPRA's more than 450 members own or operate virtually all U.S. petroleum refining capacity and include most of the nation's petrochemical manufacturers, which supply the chemicals necessary to produce products ranging from pharmaceuticals to fertilizers to Kevlar. API and NPRA frequently participate in legislative, administrative, and judicial proceedings that present issues of national concern. API and NPRA are able to offer an industry-wide perspective on the issues raised by the ANPR that may be of assistance to the FTC.

The issues presented by the ANPR are of great concern to API, NPRA, and their respective members. We are particularly concerned that an unduly expansive reading of Section 811 could harm the efficient functioning of petroleum markets that are vital to the U.S. economy. If that were to occur, rules intended to protect U.S. consumers and the economy would have the opposite effect.

III. STATUTORY AND REGULATORY BACKGROUND

Subtitle B of the EISA[1] includes provisions respecting certain manipulative or deceptive conduct and the supply of false information to the federal government. Specifically:

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

- Section 812, entitled "Prohibition on False Information," prohibits "any person" from reporting information that is "required by law to be reported" and is "related to the wholesale price of crude oil, gasoline or petroleum distillates" to a federal department or agency if the person (1) "knew, or reasonably should have known, the information [was] false or misleading" and (2) intended such false or misleading information "to affect data compiled by the department or agency for statistical or analytical purposes with respect to the market for crude oil, gasoline, or petroleum distillates."

- Section 813 provides that Subtitle B (including Sections 811 and 812) shall be enforced by the FTC "in the same manner, by the same means, and with the same jurisdiction" as though "all applicable terms" of the FTC Act were incorporated into and made a part of Subtitle B.

- Section 814 provides for civil penalties of up to $1 million per day per violation, in addition to any other penalty applicable under the FTC Act.

- Section 815 provides that nothing in the subtitle (1) limits the authority of the FTC under the FTC Act or other laws, (2) "shall be construed to modify, impair,

[1] Pub. L. 110-140, 121 Stat. 1723, tit. VIII, subtit. B, to be codified at 42 U.S.C. §§ 17301-05.

or supersede the operation of any of the antitrust laws," and (3) preempts any state law.

The Commission's ANPR requests comment on "whether, and if so in what manner" it should promulgate regulations under Section 811.

IV. OVERVIEW OF THE PETROLEUM INDUSTRY

To establish the context for this proceeding, and to aid the FTC in ensuring that any action it undertakes pursuant to Section 811 is appropriately tailored to the petroleum wholesale markets at issue, it is useful to consider certain fundamental aspects of the petroleum industry.

First, the U.S. petroleum industry is highly competitive, and petroleum wholesale markets are not highly concentrated.[2] A 2006 FTC investigation found that no U.S. refiner holds a substantial capacity share either nationally or regionally.[3] Likewise, a 2004 FTC study found that, "[d]espite increases in concentration at some production levels over [the last two decades], particularly since the mid-1990s, most sectors of the petroleum industry at the national, regional, or state level generally remain unconcentrated or moderately concentrated."[4]

A close examination of specific segments of the petroleum industry confirms that competition is robust. For instance, concentration in the refining segment of the industry

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[2] *See, e.g.*, Timothy J. Muris & Richard G. Parker, *A Dozen Facts You Should Know About Antitrust and the Oil Industry* (June 2007) (hereinafter, *A Dozen Facts*). Except where otherwise noted, industry facts and statistics in this section are taken from this monograph.

[3] *See* Federal Trade Commission, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases* (Spring 2006) at 16 (hereinafter, *Katrina Report*). This study found that, nationally, Valero had the largest share of U.S. crude oil distillation capacity with 13 percent, followed by ConocoPhillips with 12.9 percent and ExxonMobil with 11.4 percent. *Id*.

[4] Bureau of Economics, Federal Trade Commission, *The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement* (August 2004) at 15; *see also id.* at 16 ("In sum, mergers have contributed to the restructuring of the petroleum industry in the past two decades but have had only a limited impact on industry concentration.").

remains well below the levels of many other U.S. industries. Moreover, vertical integration between crude oil production and refining has declined over the past two decades among the major U.S. oil companies.[5] New entry and vertical disaggregation have brought increased competition in many segments of the petroleum industry, including refining.

This high degree of market competition and low levels of industry concentration substantially decrease the risk that any single firm will have the ability to distort market prices.

Second, domestic refining capacity has expanded in recent years. U.S. refiners have invested tens of billions of dollars in recent decades to increase refining capacity, improve output, and meet environmental requirements. As a result, domestic refining capacity is greater than it has ever been. This investment suggests that refiners have a continuing incentive to expand output to extract value from additional capacity, not to engage in manipulative behavior that could decrease output.

While domestic refinery expansion has not kept pace with rising demand over the past twenty years, refiners have made capacity expansion decisions, as the Commission has recognized, based on long-term forecasts about market conditions and the costs of building new refineries as compared to expanding existing refineries, and not as part of an effort to limit capacity and increase prices.[6] Multiple layers of federal and state permitting requirements have

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[5] *See id.* at 20-21 (from 1991 to 1996, asset dispositions were more prevalent than acquisitions among large petroleum companies); *see also Consolidation in the Energy Industry: Raising Prices at the Pump?: Hearing Before the Senate Committee on the Judiciary*, 109th Cong., 2d Sess. (Feb. 1, 2006) (prepared statement of the Federal Trade Commission presented by William E. Kovacic, Commissioner, at 3) ("A number of major integrated firms have restructured to concentrate on one or more segments of the industry, and a number of unintegrated refiners or retailers have entered.").

[6] *See Katrina Report*, *supra* n. 3, at 20 ("No single refiner has a large enough market share to manipulate prices unilaterally through either underinvestment in capacity or reduction of refinery (continued…)

to some extent delayed expansion efforts, with the costs of these delays serving as an economic disincentive to adding refining capacity. Foreign refining capacity and imports also have expanded, providing another source of supply for the domestic market. For instance, annual imports of finished motor gasoline have increased substantially in the last decade. The United States imported an average of 177 million barrels a year of finished motor gasoline in the years 2000-2007, up from average annual imports of 116 million barrels in the 1990s.[7] Even though imports have receded somewhat from their 2005 high, annual imports in 2007 were still higher than for any year from 1990-1999. Similarly, there has been a dramatic expansion in imports of motor gasoline blending components. Imports averaged 163 million barrels per year in 2000-2007, up from an average of 38 million barrels per year from 1990-1999, a more than fourfold increase.[8]

Third, the FTC has concluded that refineries are not withholding capacity from the market, but operate at high utilization rates of available capacity.[9] The FTC investigated this issue in 2006 following suggestions that refiners might manipulate refinery utilization to reduce supply or raise prices. The FTC discovered just the opposite to be true, finding that "the best available evidence suggests that companies have not restricted the level of capacity below

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output, and the investigation revealed no evidence that any unilateral manipulation was occurring.").

[7] *See* Energy Information Administration, *Petroleum Navigator* data, *at* http://tonto.eia.doe.gov/dnav/pet/hist/mgfimus1a.htm.

[8] *See* Energy Information Administration, *Petroleum Navigator* data, *at* http://tonto.eia.doe.gov/dnav/pet/hist/mbcimus1A.htm.

[9] *See* Energy Information Administration, *Annual Energy Review 2006* at Table 5.9, *available at* http://www.eia.doe.gov/aer/pdf/pages/sec5_21.pdf.

competitive levels and that they have used their capacity to the fullest practical extent."[10] Former Chairman Majoras testified to Congress that internal company documents "reflected efforts to minimize unplanned downtime resulting from weather and other unforeseen calamities."[11] Finally, as the FTC found in its 2006 investigation, exports of refined products from the United States to foreign markets are "relatively rare."[12]

Fourth, the evidence demonstrates that better management of inventory levels, as well as business and technological innovations, have enabled market participants to generate efficiencies and cost savings while responding quickly and flexibly to changing market demands.[13]

In summary, the picture of the U.S. oil industry that emerges from the empirical data is one of a well functioning and competitive market.

V. THE FTC SHOULD NOT PROPOSE A RULE PURSUANT TO SECTION 811

Section 811 delegates to the FTC the authority to decide whether to propose a rule, prohibiting only conduct that is "in contravention of such rules and regulations as the Federal Trade Commission *may* prescribe as necessary or appropriate in the public interest or for

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[10] *Katrina Report*, *supra* n. 3, at 4.

[11] *Price Gouging: Hearing Before the Senate Comm. on Commerce, Science and Transportation* (May 23, 2006) (prepared statement of the Federal Trade Commission presented by Deborah Platt Majoras, Chairman, at 9) *at* http://www.ftc.gov/os/testimony/0510243CommissionTestimonyConcerningGasolinePrices05232006Senate.pdf.

[12] *Katrina Report*, *supra* n. 3, at 13 ("Exports [of refined products] from the US are relatively rare. In 2005, the U.S. consumed 9.125 million barrels per day of finished gasoline and exported only 136,000 barrels per day, or about 1.5% of consumption.").

[13] *See, e.g.*, *A Dozen Facts*, *supra* n. 2, at iv-v.

the protection of United States citizens" (emphasis added).[14] For the following reasons, API and NPRA respectfully submit that the public interest will best be served by an FTC decision not to propose a rule.

A. The FTC's Experience With The Petroleum Industry Indicates That New Regulation Is Not Necessary

Despite repeated investigations of the petroleum industry over the past several decades, the FTC has found no evidence of significant harmful or illegal conduct. For instance, the FTC's careful investigation of petroleum industry practices in the aftermath of the shortages and price spikes following Hurricanes Katrina and Rita found no evidence of price manipulation and concluded that firms had behaved competitively.[15] A subsequent investigation in response to rising gas prices in 2006 again found no evidence of price manipulation in the petroleum or gasoline markets, concluding instead that responses by importers and domestic refiners had prevented even higher price increases.[16] Similarly the FTC's investigation of a retail gasoline price spike in the Midwest in 2000 "found no evidence of illegal collusion to reduce output or raise prices. Rather, each industry participant acted unilaterally and followed individual profit-maximizing strategies."[17] These FTC investigations have concluded that the price increases and

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[14] The ANPR likewise recognizes that the FTC has the authority to determine "whether, and if so in what manner, the Commission should promulgate a rule pursuant to Section 811." Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007, 73 Fed. Reg. 25,616 (May 7, 2008) (hereinafter *ANPR*).

[15] *See, e.g.*, *Katrina Report*, *supra* n. 3, at vi ("The evidence collected in this investigation indicated that firms behaved competitively."); at ix ("Evidence gathered during our investigation indicated that the conduct of firms in response to the supply shocks caused by the hurricanes was consistent with competition.").

[16] Federal Trade Commission, *Report on Spring/Summer 2006 Nationwide Gasoline Price Increases* (Aug. 2007) at 25 (hereinafter *Spring/Summer 2006 Report*).

[17] Federal Trade Commission, *Midwest Gasoline Price Investigation* (Mar. 29, 2001) at 2 (hereinafter *Midwest Gasoline Report*).

price spikes under investigation were caused by forces of supply and demand, not anticompetitive or manipulative actions.[18] These findings are consistent with the determinations of other studies.[19]

In light of its enforcement experience and careful study, the FTC has consistently and correctly reached the conclusion that new regulation is not necessary. For instance, in its *Katrina Report* investigation, although the FTC used a definition of "price manipulation" similar to the definition set forth on page 23 of the ANPR,[20] the Commission expressly concluded that certain conduct falling within this definition is not – and in the FTC's view should not be – illegal. Moreover, the Commission in its *Katrina Report* pointedly recommended that Congress not adopt price gouging legislation and concluded that the antitrust laws remain the appropriate standard for determining whether unilateral pricing behavior is unlawful: "[T]he Commission cannot say that federal price gouging legislation would produce a net benefit for consumers.[21] … [E]nforcing the antitrust laws strictly to prohibit business behavior that has anticompetitive

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[18] *Spring/Summer 2006 Report*, *supra* n. 16, at 25 (market factors explained increases in the national average retail price, including crude and ethanol price increases, increased consumer demand such as the seasonal effect of summer driving, refining reductions due to MTBE-to-ethanol transition and hurricanes and other external causes); *Katrina Report, supra* n. 3, at 20; *Midwest Gasoline Report*, *supra* n. 17, at Sec. III(B)(1)-(2). In its report on gasoline price changes, the FTC made clear that worldwide supply, demand and competition for crude oil are the most important factors in determining domestic national gasoline prices. *See* Federal Trade Commission, *Gasoline Price Changes: The Dynamics of Supply, Demand and Competition* (2005), at 13.

[19] *See, e.g.*, Zmarak Shalizi, *Energy and Emissions: Local and Global Effects of the Rise of China and India* (World Bank Policy Research Working Paper 4209, 2007); *A Dozen Facts, supra* n. 2 at viii (finding that one lesson from Hurricanes Katrina and Rita is that the petroleum market functions efficiently with "massive supply disruption[s] limited to temporary price increases").

[20] *Katrina Report*, *supra* n. 3 at ii.

[21] *Id.* at 196.

effects will have a major impact in keeping markets free so that prices are set by competitive forces, not by manipulation or 'gouging.'"[22]

B. Section 811 Regulation Would Duplicate Other Rules

Other laws and regulatory regimes already govern conduct that is discussed in the ANPR as potentially covered by Section 811 regulations. Given the potential for harm from ambiguous, duplicative, or overreaching regulation, the public interest would best be served by deferring to these existing statutory and regulatory regimes.

Enforcement of the CEA by the CFTC already reaches much of the conduct discussed in the ANPR. In addition to prohibiting manipulation of the price of commodity futures contracts, the CEA prohibits the manipulation "of the price of any commodity in interstate commerce."[23] The CFTC has taken an expansive view of its jurisdictional reach[24] and has indicated that it will continue to exercise its authority broadly in petroleum markets, including the physical wholesale markets that would be covered by any rule proposed pursuant to Section 811.[25] It is unnecessary and undesirable to overlay a parallel system of FTC regulation to address the same conduct and markets already subject to oversight by the CFTC.[26]

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[22] *Id*. at 197.

[23] 7 U.S.C. § 6(c), 6(d), and 13(a)(2).

[24] The CFTC regards its authority as reaching the regulation of wholesale physical product markets (markets for the actual commodity), and as not limited to regulation of financial instruments traded on a futures exchange. *See, e.g., CFTC v. BP Prods. N. Am., Inc.*, 2006 WL 2176919, No. 06CV3503 (N.D.Ill., 2006) (charging BP traders with manipulating and cornering the physical propane market to artificially inflate prices); *U.S. v. Reliant Energy Servs., Inc.*, 420 F. Supp.2d 1043 (N.D. Cal. 2006) (holding that the "criminal manipulation provision of § 9(a)(2) [of the CEA, 7 U.S.C. § 13(a)(2),] is not limited to futures contracts"); *In re Marathon Petroleum Co., LLC,* 2007 CFTC LEXIS 57, CFTC Docket No. 07-09 (Aug. 1, 2007) (settlement order for attempted manipulation of the price of spot crude oil on a single day).

[25] Press Release, Commodity Futures Trading Commission, *CFTC Announces Multiple Energy Market Initiatives* (May 29, 2008) (announcing the CFTC's investigation into "practices (continued…)

The Sherman Act prohibits suppliers in the petroleum industry and other industries from engaging in anticompetitive conduct, whether it be collusion among competitors or exclusion that may lead to monopoly.[27] The FTC has indicated that it will continue aggressively to enforce the antitrust laws in petroleum markets,[28] and state attorneys general and private plaintiffs also are prepared to bring suits against petroleum suppliers.[29] Much of the conduct discussed in the ANPR as potentially the subject of Section 811 regulation already is governed by the antitrust laws, and in some cases has been expressly determined to be beneficial and lawful under the antitrust laws. Promulgating Section 811 rules that cover, or could be interpreted to cover, the same conduct would create uncertainty among market participants about

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surrounding the purchase, transportation, storage, and trading of crude oil and related derivative contracts") *at* http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503-08.html [hereinafter *CFTC Press Release*]; *see also* Bart Chilton, Commissioner, CFTC, *Speech before the Futures Industry Association, Law and Compliance Luncheon* (Oct. 16, 2007) at 3 (stating that the CFTC "continue[s] to guard against manipulation" and mentioning BP as a case the agency "vigorously pursued") (hereinafter, *Chilton Speech*).

[26] Any FTC rule that was construed as reaching oil pipelines would, in addition, duplicate FERC regulation, given the jurisdiction that agency already exercises over the oil pipeline industry.

[27] *See, e.g.*, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

[28] *See, e.g.*, *Gasoline Prices, Oil Company Profits, and the American Consumer: Hearing Before the Subcommittee on Oversight and Investigations of the House Comm. on Energy and Commerce*, 110th Cong. 1st. Sess. (May 22, 2007) (prepared statement of the Federal Trade Commission presented by William E. Kovacic, Commissioner at 10) (stating that "the Commission aggressively polices anticompetitive conduct" in the petroleum industry and that when the facts suggest anticompetitive behavior, the Commission will challenge such conduct).

[29] *E.g.*, *Marathon Petroleum Co. LLC v. Stumbo*, 528 F. Supp.2d 639 (E.D. Ky. 2007) (dismissing countersuit in attorney general action alleging price gouging); *Madani v. Shell*, No. C07-04296, 2008 WL 268986 (N.D. Cal. Jan. 30, 2008) (action by branded dealers claiming § 1 price fixing violations by Shell and Texaco relating to the companies' joint venture operations); *Sheridan v. Marathon Petroleum Co., LLC*, 2007 U.S. Dist. LEXIS 74022 (S.D. Ind. 2007) (gasoline retailers alleged that refiner and financial institutions engaged in tying and price fixing in violation of Section 1 of the Sherman Act).

whether conduct that today is clearly allowed by the antitrust laws might tomorrow be challenged by the FTC under its market manipulation authority.[30]

C. A New Regulatory Overlay Could Harm The Public Interest

New rules have the potential to over-deter, discouraging beneficial market activity. The ANPR's examples themselves highlight the risk, as they ask for comments on the potential application and effect of Section 811 regulations on such routine and ordinary business action as seasonal inventory planning, routine maintenance planning and announcements, sales to foreign buyers, and other regular and desirable conduct. Without evidence of significant "manipulative" conduct in the petroleum industry, the costs of additional enforcement and their impact on competitive market activity outweigh any benefit to be gained from the FTC applying Section 811 to conduct that is already addressed by other rules.

VI. IF THE COMMISSION DECIDES TO PROPOSE A RULE, IT SHOULD CRAFT IT NARROWLY

For the reasons stated above, API and NPRA believe the public interest would best be served if the FTC did not propose a rule pursuant to Section 811. If the FTC decides nonetheless to propose a rule, such a rule should adhere closely to the statutory text as illuminated by the legislative history, and therefore should target solely manipulation through deceptive or fraudulent statements or conduct. It is also vital that any such rule be crafted narrowly so as to minimize duplication and inconsistency with other applicable laws and regulatory regimes, and to avoid deterring pro-competitive conduct or impeding the normal,

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[30] It is also important to note that parties would have other avenues under state fraud laws for seeking damages caused by misrepresentation or other deceitful behavior. *See generally*, First Amended Complaint at 99, *In re Enron Corp. Securities Litigation*, 465 F. Supp.2d 687 (S.D. Tex. 2002) (No. H-01-3624) (claiming state law fraud violations relating to false and material misrepresentations made by Enron). Section 811 should not be developed in a manner that would be duplicative of those anti-fraud laws.

efficient operation of petroleum markets. Consistent with these principles, any rule should require that, before a party a can be held liable under Section 811, that party must at a minimum be shown to have:

- Knowingly made a deceptive or fraudulent statement or engaged in a deceptive or fraudulent act;
- In connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale;
- With the specific intent to affect the market price for a physical crude oil, gasoline, or petroleum distillates product; and
- Caused such market price to deviate materially from the market price that would have existed but for the deceptive or fraudulent statement or act.

We explain the rationale for each of these elements in further detail below.

A. Deceptive Or Fraudulent Statement Or Act

1. Congress Intended To Limit Section 811 To Deceptive Or Fraudulent Conduct

The core of Section 811 is a prohibition on the use of any "manipulative or deceptive device or contrivance." As the ANPR recognizes, this formulation derives from the market manipulation provisions in Sections 315 and 1283 of the Energy Policy Act of 2005, and ultimately from Section 10(b) of the Securities Exchange Act of 1934. The implementing regulations for both of those statutes have at their core, as a precondition for liability, that a defendant make or engage in a deceptive or fraudulent statement, act or practice.[31] In view of Congress' conscious decision to model Section 811 on these precedents and to entrust its

[31] Securities Exchange Commission, Rule 10b-5, 17 C.F.R. 240.10b-5; Federal Energy Regulatory Commission, 18 C.F.R. Part 1c: Prohibition of Energy Market Manipulation: Final Rule, 71 Fed. Reg. 4,244 (Jan. 26, 2006) (hereinafter "FERC Order No. 670").

enforcement to the FTC, any rule implementing Section 811 should similarly be limited to manipulation involving deceptive or fraudulent conduct.

The legislative history of Subtitle B shows that Congress intended Section 811 to focus on deceptive and fraudulent conduct. Subtitle B's chief sponsor, Senator Cantwell of Washington, made clear that she expects any FTC rule implementing Section 811 to target deceptive or fraudulent conduct. In a letter of April 8, 2008, to the Federal Trade Commission, she wrote:

> [T]he new authority granted to the FTC is modeled on the antimanipulation authorities utilized by other agencies such as the Securities and Exchange Commission (SEC) and the Federal Energy Regulatory Commission (FERC).
>
> . . . [T]he Supreme Court has "read the words 'manipulative or deceptive' used in conjunction with 'device or contrivance'" to cover only "knowing or intentional conduct." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 197. The word "manipulative," it has said, "connotes intentional or willful conduct designed to deceive or defraud . . . by controlling or artificially affecting . . . price[s] . . ." 425 U.S. at 199. It means "practices . . . that are intended to mislead . . . by artificially affecting market activity." *Santa Fe Industries v. Green*, 430 U.S. 462, 476 (1977).[32]

2. The FTC Should Take Account Of The Specific Nature Of The Petroleum Industry

Although Section 811 was modeled on analogous provisions of the EPA and the SEA, Subtitle B does not require the FTC to follow the SEC and FERC models in every respect.

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[32] Similarly, in a floor statement introducing the language that was ultimately enacted as Section 811, Senator Cantwell said that "[t]hese measures are based on provisions in the recently enacted bipartisan energy bill." 151 Cong. Rec. S10238 (daily ed. Sept. 20, 2005).

Subtitle B's other provisions confirm that Congress's intention in Section 811 was to target deceptive or fraudulent conduct. Section 813 states that a violation of Subtitle B is enforceable "as an unfair or deceptive act or practice." Section 815 asserts that nothing in Subtitle B "shall be construed to modify, impair, or supersede the operation of any of the antitrust laws."

While the EPA explicitly requires FERC to interpret "manipulative or deceptive device or contrivance . . . as those terms are used in section 10(b) of the Securities Exchange Act of 1934,"[33] Section 811 contains no such instruction. The petroleum markets covered by Section 811 differ in a number of important respects from the securities markets governed by SEC Rule 10b-5 and the energy markets regulated by the FERC Manipulation Rule. Congress has delegated to the FTC the task of defining any rule proposed pursuant to Section 811 based on the FTC's vast industry-specific expertise developed over the course of numerous investigations of petroleum markets. In doing so, Congress also granted the FTC the flexibility to deviate from the specific courses chosen by the SEC and FERC as needed to suit the particular characteristics of the petroleum markets.

API and NPRA recognize that the SEC and FERC, in interpreting their respective market manipulation rules, have at times adopted a broader view of fraud and prosecuted conduct that goes beyond both the FTC's and the common law definition of deception or fraud.[34] Nevertheless, Section 811 liability should be appropriately tailored to the specific nature of petroleum wholesale markets and reflect the significant differences between those markets and the securities and commodities markets that these other agencies regulate. The broader concept of manipulation employed by these other agencies, which seeks to curtail informed or strategic trading that does not involve fraud, does not translate well to physical markets for petroleum

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[33] Energy Policy Act of 2005, Pub. L. No. 109-58, 109th Cong. 2d Sess., §§ 315, 1283.

[34] *See, e.g.*, Order to Show Cause and Notice of Proposed Penalties re: Amaranth, 120 F.E.R.C. ¶ 61,085 24 (2007) (defining fraud to include "any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market") (citations omitted). A district court recently denied a motion to dismiss a CFTC manipulation complaint "not premised on allegations of fraud." *U.S. Commodity Futures Trading Comm'n v. Amaranth Advisors, LLC*, No. 07 Civ. 6682 (D.D.) 2008 WL 2123323, * 7 (S.D. N.Y. May 21, 2008).

products, where it may result in significant over-deterrence that inhibits pro-competitive conduct and undermines the efficient operation of the price mechanism.[35]

3. Any Rule Should Not Make "Pure Omissions" Unlawful

Consistent with this, API and NPRA urge that the Commission retain its long-standing distinction between pure omissions on the one hand and omissions of information that are necessary to correct a misimpression on the other.36 The Commission historically has not considered pure omissions to be deceptive. It has, however, found an omission to be actionable deception when the representation made would be misleading in a material respect without the omitted information. This balanced approach contrasts with the more extreme position regarding omissions that may constitute market manipulation adopted by FERC in a recent case.37

4. Any Rule Should Not Create New Disclosure Obligations

Any rule that the Commission proposes pursuant to Section 811 should not create new disclosure obligations similar to those imposed on securities market participants by SEC regulations. Obligations of this kind would be entirely inappropriate given the different commercial context in which petroleum wholesale transactions take place. For example, while securities regulations govern the sale of securities to unsophisticated consumers, transactions in the petroleum markets covered by Section 811 generally involve bilateral contracts between experienced, sophisticated market participants dealing with each other at arm's length. Moreover, in the securities context, the availability of accurate information about issuers of

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[35] Moreover, as discussed in Part IX.F of these comments, the concept of an "artificial price," which the CFTC uses in enforcing its market manipulation authority, does not apply well in physical markets for commodities.

[36] *See re Int'l Harvester*, 104 F.T.C. 949 (1984) (Final Order).

[37] *See Amaranth* Order to Show Cause, *supra* n. 34, at 28 (failure to disclose that market prices are being artificially depressed constitutes a form of market manipulation).

securities is critical to evaluating the securities' market value and to avoiding disparities in market participants' access to such information. For these reasons, the market for securities is heavily regulated and governed by long-standing rules that mandate detailed disclosures by issuers, impose fiduciary relationships on issuers and brokers, and prohibit trading based on "insider" information.

These disclosure obligations, fiduciary relationships, and insider trading prohibitions do not – and should not – apply to the petroleum markets covered by Section 811. Participants in these markets routinely invest substantial resources in order to estimate future supply and demand of key inputs and outputs, and they rely on this confidential proprietary information in deciding whether and at what price to trade in these commodities. Consumers benefit from petroleum market participants making these investments and not sharing forecasts with competitors, which diversifies the effort to develop accurate information and reduces risk. Moreover, sustaining incentives for firms to invest in making these forecasts increases the likelihood that the market as a whole will react efficiently and nimbly to changes in supply and demand.

Significantly, Congress has recently affirmed that the CEA does not impose disclosure requirements akin to those arising in the context of the securities law. Recent amendments to the anti-fraud provision of the CEA in the CFTC Reauthorization Act of 2008 specifically provide that the CEA does not obligate transaction counterparties to disclose to each other "nonpublic information that may be material to the market price . . . of the commodity or transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect."[38] Similarly, the FERC Final Rule indicates that FERC does not interpret its market manipulation provisions as imposing SEC-style disclosure requirements.[39] Any FTC rule should be equally clear that Section 811 does not impose disclosure or related requirements on participants in petroleum markets.

5. The Precautionary Approach To Deceptive Conduct Under The FTC Act Is Inapplicable To Section 811

The differences between petroleum wholesale markets and consumer markets require the FTC to distinguish between deception for the purposes of Section 811 and deceptive practices for purposes of the Commission's consumer protection responsibilities. As discussed above, transactions in petroleum wholesale markets generally take place between experienced and sophisticated parties. A party to a wholesale petroleum transaction that believes it has been misled by its counterparty can pursue common law fraud remedies and generally has the means to do so. The FTC's deception analysis, by contrast, "focuses on risk of consumer harm, and actual injury need not be shown."[40] This precautionary approach makes sense because the FTC Act protects consumers -- who are less well placed to detect and remedy fraud -- and therefore is preventive in nature, with an injunction barring the challenged conduct as the primary remedy. Thus, there is no need, under the Commission's consumer protection responsibilities, to distinguish between actual deception and attempted deception – the Commission seeks to prevent both.

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38 *Food, Conservation, and Energy Act of 2008*, Pub. L. No. 110-234, 110th Cong. 2d Sess., § 13102(b).

39 *See* FERC Order No. 670, *supra* n. 31, at 4251-52 (clarifying that its anti-manipulation rule imposes "no new affirmative duty of disclosure" in the "arm's-length, bilateral negotiations that are typical in wholesale energy markets").

40 *Int'l Harvester*, 104 F.T.C. at 1056.

In contrast, a rule proposal pursuant to Section 811 would be punitive, not preventive, imposing substantial penalties to punish illegal conduct. Also, Section 811 authorizes the Commission only to prohibit actual manipulation, not attempted manipulation. The essential difference between actual and attempted manipulation is whether there in fact is an effect on price. As explained in more detail in Part VI.D of these comments, parties should not be liable under any rule implementing Section 811 unless a deceptive or fraudulent statement or act causes the market price to deviate materially from the price that would have existed but for the deception or fraud.

B. In Connection With Purchase Or Sale At Wholesale

On its face, Section 811 applies only to conduct undertaken "in connection with the purchase or sale of crude oil[,] gasoline or petroleum distillates at wholesale." API and NPRA urge that any rule proposed under Section 811 not reach beyond this statutory language.

1. No Application To Retail Transactions

API and NPRA agree with the statement in the ANPR that "Section 811 does not extend to retail sales of gasoline"[41] – or for that matter to retail sales of any petroleum-based products. Congress expressly limited Section 811 to purchases and sales at wholesale, and nothing in the statutory language or legislative history justifies extending the reach of Section 811 to retail transactions.[42]

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[41] ANPR, *supra* n. 14, at 26; 73 Fed. Reg. at 25620.

[42] In the event the FTC decides to propose a rule, API and NPRA urge it to define the term "petroleum distillates" so as to provide greater clarity as to the scope of covered products for purposes of Section 811. In our view, petroleum distillates should be defined to cover diesel fuel, kerosene, jet fuel, and heating oil, without prejudice to the ability of the Commission and other regulators to prohibit market manipulation affecting other petroleum distillates under other statutory regimes.

2. Exclude Transactions At The Rack And At Or Below The Terminal From The Definition Of "Wholesale"

In the event the Commission proposes a rule, API and NPRA urge the FTC to clarify that the term "wholesale" as used in Section 811 covers only bulk transactions in the spot pipeline, tank or marine market, and does not include so-called "rack" transactions, DTW sales to dealers, or other terminal-level sales.

First, our understanding is that none of the other regulatory agencies have construed their jurisdiction to cover transactions at or below the terminal level. Rather, they confine their enforcement efforts to large, market-based bulk transactions. *Second*, wholesale rack pricing decisions are qualitatively different than those that arise in market-based bulk transactions; they generally are set by the rack supplier and tend to remain in effect for a period of time and apply to a variety of different purchasers. The pricing for sales to individual dealers is even further removed from anything like a commodities "market price." *Third*, the potential for market-manipulation-based harm is considerably less for sales at or below the terminal level, so extending Section 811 to cover these types of transactions would not be a wise use of the Commission's resources. *Fourth*, the Commission already has an effective wholesale price monitoring program.[43]

Typically, traders negotiate prices for bulk transactions based on reference markets such as NYMEX or on prices published by firms such as Platts or Argus. Often, completed deals are reported to these same firms, which collect these data and use them to establish a market assessment for the day. Rack prices, by contrast (which in industry parlance are often referred to as "wholesale rack prices"), are the prices at which a particular petroleum

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[43] *See Katrina Report*, *supra* n. 3, at 2.

supplier is willing to sell a certain product at the terminal load rack in truckload quantities. These prices — and prices for sales to individual branded dealers — are typically based on the supplier's individual view of the market, including its own supply and perceived demand, and such transactions are generally not reported to price publication firms.

Accordingly, API and NPRA urge the FTC to restrict the definition of "wholesale" in Section 811 to bulk spot transactions and to exclude from that definition transactions at the rack, DTW, or otherwise at or below the terminal level.

3. No Application To Supply Decisions Unconnected To Wholesale Transactions

Any rule proposed pursuant to Section 811 also should not apply to supply decisions that are unconnected to wholesale purchases or sales of a covered petroleum product – such as decisions concerning upstream production and operations, refining decisions, facility maintenance and upgrades, the management of inventory levels, whether to supply a market and with which products, and where output should be distributed. Section 811 expressly states that it applies only to conduct undertaken "in connection with the *purchase or sale* of crude oil[,] gasoline or petroleum distillates *at wholesale*" (emphasis added). The only reasonable interpretation of this language is that Section 811 does not apply to decisions or conduct that are *not* connected to a specific "purchase or sale . . . at wholesale." Interpreting Section 811 more broadly would exceed the rulemaking authority granted to the FTC by the statute itself.

Extending Section 811 to such product, operational, and supply decisions would also run a substantial risk of disrupting competitive activity in petroleum markets. As noted above, firms in the petroleum industry necessarily undertake a wide range of business decisions that are unconnected to the "purchase or sale . . . at wholesale" transactions that are the focus of Section 811. If Section 811 does not clearly exclude ordinary production, operational, and supply decisions, market participants would likely be compelled to factor into every aspect of their business strategy the risk of challenge under Section 811. In an effort to avoid such risks, companies would generally take a more conservative approach, leaving them less able to respond with agility and creativity to market disruptions and market opportunities.

Such a result would have significant adverse consequences for consumers. In the short run, the risk of liability could inhibit the responses of market participants to price changes, resulting in distorted prices and an inefficient distribution of resources across geographic markets. In the longer run, the risk of liability could adversely affect investment decisions because firms might be unwilling to invest in additional facilities if routine production, operational, and supply decisions are subject to potential liability. These risks are best avoided by making clear that ordinary production, operational, and supply decisions are outside the scope of any rule implementing Section 811.

Indeed, if the Commission proposes any rule pursuant to Section 811, it should consider expressly exempting from such rule conduct that is essential to the efficient functioning of petroleum wholesale markets. Express exemptions from such rules would avoid harm to consumers and the economy from over-deterring beneficial conduct. Exemptions might cover categories of conduct such as: (i) performing contractual obligations to supply existing customers; (ii) decisions on the amount of product sold to a particular customer at a particular time; (iii) investments in facility maintenance or capacity upgrades; (iv) day-to-day operational decisions, including choice of a mix of products to refine; and (v) establishment and management of product inventory levels.

4. Application Limited To Physical Transactions

In addition, Section 811 should apply only to transactions in the physical commodities themselves and should not be interpreted to cover listed or over-the-counter

("OTC") derivatives contracts. The CFTC currently has exclusive jurisdiction over listed derivatives (*e.g.*, futures) and actively monitors and prosecutes manipulation in the listed derivatives and OTC energy markets.[44] Extending Section 811 to such transactions would create unnecessary regulatory overlap, potentially divergent obligations, and additional compliance costs on industry – costs that ultimately would be borne by consumers. Thus, the FTC should limit its oversight to deceptive or fraudulent conduct that actually involves purchases or sales of physical products – so-called jurisdictional transactions.[45]

C. Scienter

Any rule proposed under Section 811 should impose liability *only* if a party acts with specific intent to affect the market price for a physical crude oil, gasoline, or petroleum distillates product. A specific intent standard is supported by the text of Section 811 and other provisions in Title B, by the legislative history, and by judicial precedent interpreting nearly identical language in other statutes. Moreover, a specific intent standard would minimize the risk of imposing conflicting legal obligations on market participants or chilling pro-competitive conduct.

Section 811 by its terms limits the FTC to enacting a rule that would prohibit a person from using or employing a "manipulative or deceptive device or contrivance." The terms

[44] Under the CEA, energy commodities are treated as "exempt" commodities. *See Commodity Exchange Act* § 1a(14). Although transactions in exempt commodities between commercial parties (referred to as Eligible Contract Participants if they meet specific net worth or asset criteria) are exempt from many provisions of the CEA, they remain subject to the CEA's anti-manipulation provisions. *Id*. § 2(h).

[45] The ANPR also invites comment on whether the "in connection with" language of Section 811 should adopt the position of the FERC Final Rule to mean that "'in committing fraud, the entity must have intended to affect, or have acted recklessly to affect, a jurisdictional transaction.'" ANPR, *supra* n. 14, at 26, 73 Fed. Reg., at 25621 (*quoting* 71 Fed. Reg. 4249) (internal quotations omitted). In our view, issues of intent are more appropriately addressed under the scienter requirement, which we discuss in the following section of these comments.

"manipulative" and "deceptive" are generally understood to denote conduct that is deliberately intended to deceive. As the Supreme Court held, in interpreting identical language in Section 10(b) of the Securities Exchange Act, "[t]he words 'manipulative or deceptive used in conjunction with 'device or contrivance' strongly suggest that § 10b was intended to proscribe knowing or intentional misconduct. . . . It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[46]

The conclusion that Section 811 requires specific intent also finds support in Sections 812 and 814 of Subtitle B. Section 812 makes it unlawful for a person to report false or misleading information to a Federal department or agency, but only if "the person *intended* the false or misleading data to affect data compiled by the department or agency . . ." (emphasis added). Given that Congress requires the FTC to establish a specific intent to manipulate with respect to statements made to Federal agencies – which rely on the good faith and honesty of reporting parties – it is illogical to think that Congress would have simultaneously intended the FTC, pursuant to Section 811, to adopt a more lenient standard of scienter in regulating arm's-length transactions between sophisticated commercial parties. The fact that Section 814 authorizes penalties of $1 million per day reinforces the conclusion that Congress intended Section 811, like Section 812, to apply only to intentionally deceptive or fraudulent statements and conduct.

The legislative history supports this reading of Subtitle B. As noted above, Senator Cantwell, one of the principal sponsors of Section 811, has described Congress's intent

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[46] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197, 199 (1976); *accord Aaron v. SEC*, 446 U.S. 680, 690 (1980).

in adopting Section 811 and its focus on "manipulative or deceptive device[s] or contrivance[s]" as follows:

> [T]he Supreme Court has "read the words 'manipulative or deceptive' used in conjunction with 'device or contrivance'" to cover only "knowing or intentional conduct." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 197. The word "manipulative," it has said, "connotes intentional or willful conduct designed to deceive or defraud . . . by controlling or artificially affecting . . . price[s] . . ." 425 U.S. at 199. It means "practice . . . that are intended to mislead . . . by artificially affecting market activity." *Santa Fe Industries v. Green*, 430 U.S. 462, 476 (1977).[47]

A specific intent requirement for Section 811 would also help minimize regulatory conflicts by ensuring that both physical and derivatives transactions for petroleum products are subject to identical scienter standards. Courts have interpreted the CEA's market manipulation provisions to require proof of specific intent.[48] Thus, adopting a specific intent standard in the implementing rules of Section 811 would ensure that a consistent standard is applied to transactions over which the FTC and the CFTC may exercise overlapping jurisdiction.

Finally, a specific intent standard would appropriately target situations in which parties actively seek to manipulate market prices, while minimizing the risk that parties would be chilled from engaging in lawful competitive commercial behavior that merely affects market prices.

Some federal courts of appeals, interpreting similar language in Section 10(b) of the SEA, have held that liability may be imposed on a showing of "recklessness." However, the

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[47] Letter from Sen. Cantwell to FTC Commissioners (Apr. 8, 2008).

[48] *See, e.g.*, *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971); *In re Ind. Farm Bureau Coop. Ass'n*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, 1982 CFTC LEXIS 25, at *14 (Dec. 17, 1982); *In re Hohenberg Bros. Co.*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, 1977 CFTC LEXIS 123, at *22-23 (Feb. 18, 1977); *Frey v. Commodity Futures Trading Comm'n*, 931 F.2d 1171, 1175 (7th Cir. 1991).

rationale for adopting a recklessness standard under Section 10(b) does not apply here. The value of securities is closely linked to the publicly available information about the issuer; therefore, the securities laws seek to ensure that information is accurate and to limit use of material, non-public information. These interests also underlie the fiduciary duties the SEA imposes on brokers and issuers. Given these disclosure obligations and fiduciary duties, imposing liability for "recklessness" arguably serves the underlying purposes of Section 10(b).

The nature of transactions in physical commodities markets, such as petroleum wholesale markets, does not call for similar disclosure obligations or fiduciary duties.[49] Importing a "recklessness" standard from the highly regulated securities markets into unregulated petroleum wholesale markets would create new market uncertainty. It would also impose a novel "industry standard of care" on participants in a market that is currently marked by vigorous competition.[50]

Furthermore, simple recklessness is not a sufficient basis for liability even under Section 10(b). Rather, most courts have held that this Section reaches only highly unreasonable conduct that is effectively tantamount to an intent to deceive.[51] Likewise, although FERC, in its Final Rule implementing the market manipulation provisions of the Energy Policy Act of 2005, adopted a similar recklessness standard, it emphasized that this standard "is not intended to

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[49] *See* Part VI.A, *supra*.

[50] We recognize that FERC recently adopted a recklessness standard in its Final Rule implementing the market manipulation provisions of the Energy Policy Act of 2005. *See* FERC Order No. 670, *supra* n. 31, 71 Fed. Reg. at 4254. FERC's historical role as a rate-setting agency, and its broad authority to ensure "just and reasonable rates" in regulated energy markets, distinguishes it from the FTC's role should it decide to propose a rule pursuant to Section 811.

[51] *See*, *e.g.*, *Sundstrand Corp. v. Sun Chem. Corp*, 553 F.2d 1033, 1045 (7th Cir. 1977) (en banc) (defining recklessness under the securities laws as "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.").

regulate negligent practices or corporate mismanagement, but rather to deter or punish fraud in wholesale energy markets."[52] Thus, if the Commission, contrary to the recommendation offered here, were to adopt a recklessness standard in its implementing rules for Section 811, it should ensure that the standard it adopts is at least as strict as that adopted by the courts under Section 10(b).

In summary, given that Congress explicitly limited Section 811 to markets comprised exclusively of sophisticated commercial parties dealing with each other at arm's length, anything less than a specific intent standard would chill dynamic competitive behavior and would likely deter firms from acting on accurate market indications for fear of inadvertently incurring liability.

D. Effect On The Market

Any rule proposed pursuant to Section 811 should impose liability only if the deceptive or fraudulent conduct at issue caused the market price of a physical crude oil, gasoline, or petroleum distillates product to deviate materially from the market price that would have existed but for the deceptive or fraudulent statement or act. Applying Section 811 to conduct that does not cause a material deviation in market prices would unduly expand the FTC's regulatory oversight and would likely harm consumer welfare in the long run by chilling competitive market behavior, thereby potentially increasing prices.

Section 811 should not be viewed as imposing federal regulatory oversight on conduct that is, and properly should be, the province of anti-fraud and contract law. Allegations of fraud and deception are not uncommon in commercial and contract disputes. Unless the FTC

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52 FERC Order No. 670, *supra* n. 31 at ¶ 5, 73 Fed. Reg. at 25617.

requires an appropriate connection between challenged conduct and a material deviation in *market* prices, it runs the risk of having to police every routine commercial dispute as a potential violation of Section 811.

Such a requirement is also consistent with the statutory framework of Subtitle B. As discussed in Part VI.A of these comments, in enacting Section 811, Congress specifically sought to target the actual manipulation of prices in petroleum wholesale markets. Section 811 does not prohibit attempted market manipulation. In this respect, Section 811 differs from Section 9(a)(2) of the CEA, which expressly prohibits an "attempt to manipulate." The fact that Congress chose not to create an "attempt" violation in Section 811 reflects Congress' focus on deceptive or fraudulent conduct that actually causes a material deviation in market prices.

VII. CONCERNS WITH THE FTC'S PROPOSED DEFINITION

For the reasons set forth above, we believe the elements set forth herein appropriately reflect the statutory text and legislative history of Section 811 and minimize the risks of imposing conflicting obligations on market participants or impeding the normal, competitive operation of petroleum wholesale markets. The proposed definition set forth in the ANPR, on the other hand, would be inconsistent with the statutory language and would not advance the public interest.[53] We are particularly concerned with two aspects of that definition.

A. "For The Purpose Or With The Effect."

The definition set out in the ANPR would encompass conduct undertaken "for the purpose or with the effect" of causing certain market effects. The use of the disjunctive "or" in

[53] *See* ANPR, *supra* n. 14 at 23, 73 Fed. Reg. at 25620 (requesting comment on whether to define market manipulation as "knowingly using or employing, directly or indirectly, a manipulative or deceptive device or contrivance — in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale — for the purpose or with the effect of increasing the market price thereof relative to costs").

this phrase suggests that liability could be imposed upon a party even if it did not intend to cause such market effects or could not reasonably have anticipated such effects.

As discussed in Part VI of these comments, API and NPRA believe that liability should attach under Section 811 only upon proof of deceptive or fraudulent conduct engaged in with the specific intent to affect the market price for a covered petroleum product and where that conduct causes such market price to deviate materially from the market price that would have existed but for the deception or fraud. Imposing liability based solely on market effects could penalize firms for actions or statement made without any deceptive intent and undercut legitimate efforts to respond to market prices or other market indications.[54] Such a broad, effects-based liability standard runs a serious risk of deterring a wide range of profit-maximizing behavior that is competitively neutral or pro-competitive.

Conversely, imposing liability based solely on intent risks penalizing conduct by entities that have no realistic prospect of manipulating the market, whether through deceptive conduct or otherwise. It would also empower the Commission to impose massive penalties of up to $1 million per day absent any proof of effect on market prices.

B. "Increasing Market Price Relative To Costs"

The definition set out in the ANPR would also impose liability where the purpose or effect of a party's actions was to "increas[e] the [wholesale] market price [of crude oil, gasoline, or petroleum distillates] relative to costs." This aspect of the definition likewise raises

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[54] *See, e.g.*, CFTC Commissioner Sharon Brown-Hruska, *Market Manipulation in Energy Markets*, 23 Futures & Derivatives L. Rpt. 8 (Nov. 2003), at 3 (stating that CFTC requires proof of specific intent to manipulate because "it is not unusual to see prices bend as a result of one market participant's [non-manipulative] trading").

the specter of liability merely for engaging in economically rational commercial behavior of the type one would expect in a competitive marketplace.

Situations may arise in a competitive market where goods become more scarce and prices rise relative to costs despite the fact that the market is functioning properly – *i.e.*, in the absence of market manipulation. The aftermath of Hurricanes Katrina and Rita serve as good examples of this. Each hurricane took considerable refining capacity off line. As a result, certain petroleum products became scarce, prices rose relative to costs, and product was distributed to those regions and consumers that needed them most. The effect of the price rise encouraged more supply of that product to enter the region and to reduce demand, which in turn rendered it less scarce and tended to restore prices to pre-hurricane levels. Thus, the existence of prices rising relative to costs is not evidence of market failure or manipulation. Rather, it can be an essential market indication that gives firms financial incentives to increase production of the good – to the benefit of consumers – and serves to ensure that goods are distributed where they are most needed.

These market dynamics apply with particular force in petroleum wholesale markets because the marginal costs for most firms that purchase and sell petroleum products at wholesale are essentially their anticipated future costs. In other words, the prices these firms charge are based on clearing the market and the costs they anticipate they will incur in replacing the inventory they are currently selling, rather than on the costs they have already incurred in producing or procuring that inventory.[55] Thus, if the anticipated future costs of inputs rise (*e.g.*,

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[55] A definition of market manipulation that required an analysis of price relative to past costs would be unworkable in practice because the industry has no way to record the cost of a specific product or gallon of gasoline already in its inventory. Similarly, for gasoline and distillates sold by a supplier directly from its own refinery production, establishing cost would be difficult if not (continued…)

rising crude oils prices), the current prices of outputs (*e.g.*, refined petroleum products) will rise as well, which in turn will often mean a higher price in relation to the costs actually incurred in producing that product.[56]

In its *Katrina Report*, the FTC defined "price manipulation" in terms similar to those set out in the ANPR – namely, as covering transactions and practices "that tend to increase prices relative to costs and to reduce output."[57] The FTC expressly noted, however, that this definition would capture conduct that was not – and in its view should not be – illegal. As the *Katrina Report* noted,

> Under this definition, 'price manipulation' includes instances in which one or more firms temporarily may each have an incentive and ability to 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. In our view, this type of conduct should not be illegal because it entails each firm's independent decisions about how to allocate sales of its products among markets.[58]

The *Katrina Report* also raised the concern that an overly broad prohibition of price manipulation or price gouging could distort market competition and operate in effect as a price control.[59] These concerns apply with equal force to the prohibition on "increasing . . . market price[s] . . . relative to costs" set out in the ANPR's proposed definition.

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impossible. It is also worth noting that different accounting conventions may also lead to different evaluations of cost.

[56] It is worth noting that replacement costs can be particularly difficult to predict in cases of supply disruptions or other abnormal market volatility.

[57] *See Katrina Report*, *supra* n. 3, at ii.

[58] *Id.*

[59] *Id.* at 183 ("[D]istortions caused by controls on prices would be harmful to consumers' economic well-being . . . [I]f there is a 'right' price for a commodity, it is not necessarily the low price; rather, it is the competitively determined market price.")

As indicated above, however, API and NPRA agree that an effect on market prices should be a necessary element for liability under Section 811. The correct standard for determining the existence of an effect on price is whether challenged conduct causes a material deviation in market prices as compared to the market price that would have existed but for the deceptive or fraudulent conduct.

VIII. OTHER ISSUES

A. "In The Public Interest"

The ANPR invites comment on how the FTC may best ensure that any rule it proposes under Section 811 satisfies the statutory requirement that it be "necessary or appropriate in the public interest or for the protection of United States citizens." Specifically, the ANPR asks whether, in view of this language, a Section 811 rule should conform to traditional antitrust analysis.

As discussed in Part V, there are solid grounds to conclude that adoption of a market manipulation rule for petroleum wholesale markets is neither necessary nor appropriate. Numerous FTC investigations have found that the petroleum industry is highly competitive and have further found no evidence of market manipulation. Proposing a rule pursuant to Section 811 is therefore unnecessary and risks making U.S. petroleum markets less efficient, to the ultimate detriment of U.S. consumers.

If the FTC does implement a rule, it should not overlap with existing antitrust rules. Congress made clear that nothing in Subtitle B should be construed to modify, impair, or supersede existing antitrust laws. It is also vital that any such rule be crafted narrowly so as to avoid deterring pro-competitive conduct or impeding the efficient operation of petroleum markets.

B. Penalties

The ANPR also requests comment on how the penalties provided for in Subtitle B should affect the FTC's implementation of Section 811. In an action under Section 13(b) of the FTC Act, the FTC could seek equitable relief in the form of disgorgement from any person who violates Subtitle B. Likewise, in an action under Section 19 of the FTC Act, the FTC could seek relief against any person who violates a rule promulgated under Section 811 or who violates Section 812 as needed to redress injury to consumers, including the refund of money or return of property and the payment of damages. Section 5(m)(1)(A) of the FTC Act permits the Commission to file a federal court civil action against any person who knowingly violates a rule promulgated under Section 811 or knowingly violates Section 812 to recover civil penalties of up to $11,000 per violation. Finally, Section 814(a) of Subtitle B provides that "any supplier that violates section 811 or 812 shall be punishable by a civil penalty of not more than $1,000,000," while Section 814(c) provides that each day of a continuing violation shall be considered a separate violation.

These sanctions, including the risk of substantial civil penalties, represent a significant deterrent. API and NPRA are concerned that, unless any proposed rule contains the elements and safeguards described above, the magnitude of these sanctions could cause firms to implement rigid, burdensome compliance systems that would substantially restrict their ability to engage in efficient and pro-competitive activities.

While many of the sanctions available through the FTC Act can be imposed on "any person," civil money penalties under Section 814(a) are limited to "any supplier" that violates Section 811 or 812. The limitation of civil money penalties under Section 814(a) to "suppliers" rather than "any person" reflects a clear intent by Congress to limit the application of the higher civil money penalties available under Section 814(a) to situations in which firms supplying wholesale petroleum products to the market engage in deceptive or fraudulent conduct. The focus on suppliers reflects an intent to provide special penalties for firms bringing wholesale petroleum products to market. Therefore, the FTC should construe the penalties provided in Section 814(a) to apply only to violations committed by firms through their sales of covered petroleum products at wholesale and not to actions of firms in connection with their purchases of petroleum products. In order to provide clarity and notice, the FTC should also provide an express definition of the meaning of "suppliers" in connection with Section 814(a). In the event the FTC proposes a rule, API and NPRA propose that "supplier" be defined to mean a person who sells or offers to sell a covered petroleum product at wholesale.

In addition, Section 5(m)(1)(C) of the FTC Act constrains the Commission's ability to obtain penalties against any person. It states: "In determining the amount of such a civil penalty, the court shall take into account the degree of culpability, any history of prior such conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require."[60] These considerations should apply to suppliers under any rule proposed pursuant to Section 811 as well.

As the FTC Act requires, the Commission should consider the firm's "history of prior such conduct," including prior enforcement actions against it under Subtitle B of EISA. Moreover, in assessing the impact of a penalty on a firm's "ability to continue to do business," the Commission should consider the potential collateral consequences of significant penalties on the public, on the market, on the firm, and on firm employees not involved in the violation.

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[60] 15 U.S.C. § 45(m)(1)(C).

The Commission should consider a number of factors when assessing the "degree of culpability" for a violation. Moreover, EISA provides that in assessing penalties, the court must consider "the efforts of the person committing the violation to remedy the harm caused by the violation in a timely manner." Factors relevant to culpability and efforts at timely remediation include:

- the pervasiveness of wrongdoing within the firm, including the complicity in the violation by senior management;
- the firm's timely and voluntary disclosure of the violation and its willingness to cooperate in the investigation of the violation;
- the existence and adequacy of the firm's pre-existing compliance program;
- the firm's remedial actions, including any efforts to implement an effective compliance program or to improve an existing one, to replace responsible management, and to discipline or terminate employees involved in the violation, to pay restitution, and to cooperate with the relevant government agencies; and
- actions taken by the firm to correct any deceptive statements or conduct.

Finally, and perhaps most importantly, among "such other matters as justice may require," the Commission should consider the nature and seriousness of the violation, including the risk of harm to the public and the extent of harm to the public caused by the violation. Moreover, Section 814(c) of EISA explicitly provides that in assessing penalties, the court must take into account the seriousness of the violation. Justice, deterrence, and the language of EISA all require that penalties should be reasonably related to the magnitude of the harm that the violation caused.

API and NPRA propose that, in the event the FTC proposes a rule, that the FTC explain its approach to balancing these factors in assessing what civil money penalty to seek and in weighing bases for enhancing or mitigating the appropriate penalty.[61] Such delineation of the factors considered by the FTC in assessing penalties would have beneficial effects for the implementation of the rule by firms in the petroleum industry.

C. Overlapping Jurisdiction

Duplicative or inconsistent regulatory requirements can impose substantial burdens on industry and deter competitive conduct, thereby undermining market efficiency and harming consumers. If the FTC decides to propose a rule pursuant to Section 811, it should be especially careful to avoid two potential sources of regulatory overlap or inconsistency.

First, the FTC should not construe Section 811 to cover the same conduct as the antitrust laws or to create new, industry-specific antitrust rules. Any new FTC regulations should focus on intentional and deceptive conduct that hinders the operation of markets, not business activities that may harm competition in markets, which is covered by the antitrust laws. The text and legislative history of Section 811 show that Congress intended to target deceptive or fraudulent conduct. In contrast, the antitrust laws cover certain unilateral or collusive use of market power, taking advantage of supply and demand conditions, where there is an anticompetitive effect. There is no indication that Congress intended Section 811 to supplement the antitrust laws; on the contrary, Section 815 makes clear that Subtitle B shall not "be construed to modify, impair, or supersede the operation of any of the antitrust laws."

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[61] As explained in Part VI.C, the FTC should require a finding of specific intent in order to establish a violation of Section 811. However, to the extent the FTC proposes a rule with a different scienter standard, the FTC should also consider the level of intent on the part of the perpetrators of the violation and of senior management in assessing the appropriate level of civil money penalties.

Second, the FTC should avoid unnecessary inconsistencies between any rule it issues pursuant to Section 811 and the standards applied by the CFTC in enforcing the market manipulation provisions of the CEA. As indicated in Parts V.B and VI.B.4, the listed derivatives and OTC energy markets, and to a considerable extent the physical petroleum wholesale markets, are already subject to anti-manipulation enforcement by the CFTC. If the FTC decides to prescribe a rule pursuant to Section 811, it is essential that it do everything possible to reduce the potential for duplicative or inconsistent regulation on the petroleum industry. A rule that incorporated at a minimum the elements set forth in Part VI of these comments would, in our view, be most likely to achieve this.[62]

IX. POTENTIAL PRACTICES

The following section comments on the "potential practices" outlined in the ANPR.

A. Examples Relating To Product Supply Decisions

1. The FTC Cannot Make Supply Decisions More Efficiently than Market Participants

Firms in the petroleum industry, as in other industries, routinely make decisions about which products to produce, how much of each product to produce, and where to supply those products. Such production, supply, and distribution decisions in the petroleum industry are enormously complex. The characteristics of the crude oil obtained by a particular refinery will influence the yield of different refined products. Because U.S. refineries usually operate at a high rate of utilization, they typically are forced to decide which products to produce and where to ship them, rather than "how much" to produce. Particular fuels with special characteristics are

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[62] *See, e.g.*, *Chilton Speech*, *supra* n. 25.

acceptable only in certain markets because of regulatory constraints. Transportation networks may constrain the ability to deliver product to certain locations. Moreover, any supply decision has multiple consequences – some products and/or geographic areas receive more supply, while others receive less. One cannot focus exclusively on one area when assessing supply choices.

Competition among firms responding to market demand is the most efficient mechanism for ensuring that supplies are made available and distributed to those markets where they are in greatest demand. Price changes are an essential part of these dynamics – without a change in price, firms would lack a market indication to increase or decrease supplies to the market. Consequently, a supplier generally is free under the antitrust laws to decide to sell or not to sell as it chooses.[63]

The reactions following supply disruptions highlight the way in which firms react to market indications to shift supply. For example, following Hurricanes Katrina and Rita, available supply from the Gulf Coast decreased substantially as many refineries were disabled by the hurricanes. Following the hurricanes, less product was shipped to the East from Gulf Coast refineries and imports from Europe were increased to compensate. Midwest refineries (as well as operating Gulf Coast refineries) increased production, sometimes operating above long term sustainable rates, delaying maintenance, or shifting to other fuels to achieve greater production.

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[63] *See Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004) ("[A]s a general matter, the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to the parties with whom he will deal.'" (quoting *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1966); Statement of Commissioners Anthony, Swindle & Leary, *In re BP Amoco & Atlantic Richfield Co.*, FTC Docket No. C-3938 (Aug. 29, 2000) (noting that exporting crude oil for purpose of increasing domestic prices was lawful and declining to impose restriction on the practice that would be difficult to enforce and ineffective: "[P]eople will be cruelly disappointed if they are led to believe that the export restriction would have a detectable effect on the situation.").

In some instances, products from Midwest refineries were shipped south to the Gulf Coast rather than the usual, and opposite, pattern. The ability to respond quickly to the disruption and price increases was a crucial factor in helping prices stabilize in the affected areas. Within four weeks of Hurricane Rita, price levels had returned to their pre-hurricane levels.[64]

Any rule proposed pursuant to Section 811 that increased the scrutiny of a firm's unilateral decisions would likely chill this behavior and have the perverse effect of prolonging the effects of supply disruptions. If U.S. petroleum companies had faced liability under anti-manipulation regulations for their supply decisions at the time of Hurricanes Katrina and Rita, the price mechanism would not have operated so efficiently, likely resulting in widespread shortages in some areas that could have been avoided if markets had been allowed to function freely, and in delaying the return of normal market conditions.

As discussed in Parts IV and V of these comments, numerous FTC investigations of the petroleum industry have found no evidence that market participants use supply decisions to manipulate market prices. Given the competitive structure of the industry, this is not surprising. In most cases, any individual firm has a relatively small share of supply to a given market and thus lacks a unilateral incentive to restrict output (since restricting output, without the ability to impose a more-than-offsetting increase in market prices, would result in lower profits for the firm).

A rule permitting the FTC to proscribe product supply decisions as market manipulation would effectively substitute the judgment of a regulatory decision maker for that of market participants. The FTC could not exercise such responsibility effectively without a

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[64] *See Katrina Report*, *supra* n. 3, at viii-ix.

tremendous amount of information that the Commission does not have and cannot reasonably obtain. To make product supply decisions in this context, the Commission must know how much of each type of product should be produced at each location, the precise destination to which each type of product should be sent, and whether it should be sent now or later.

For example, a U.S. petroleum company may adopt an internal strategy to store gasoline components during the winter to augment supplies of gasoline during the summer driving season. Imposing liability for “manipulation” if companies decided to withhold supply in the short term frequently would risk creating shortages and price spikes in the longer term. To accurately second-guess decisions about, for example, how much product should be withheld during the winter, the Commission would need perfect knowledge of present and future supply and demand conditions and the precise distribution of product over time that would maximize consumer welfare. Such calculations are beyond the capacity of any individual or organization. That is why we rely on markets to make such decisions and on the profit motive to encourage individual firms to supply the products that consumers value most.

Far from advancing the interests of consumers, a market manipulation rule exposing normal supply decisions to regulatory risk has the potential to undercut firms’ efficient reactions to market events. Efficient markets optimize consumer welfare by enabling firms to make supply decisions in response to market indications guided only by their respective self-interest. If firms had to weigh the risk of future regulatory challenge and exposure to the significant penalties authorized by Section 811, supply decisions would be distorted, resulting in a sub-optimal production and supply of products over geographical markets and time.

The risk of liability under Section 811 would also undermine the ability of market participants to plan efficiently for the long term, including through the conclusion of term contracts. For example, a market manipulation rule that subjected supply decisions to liability might deter a firm from entering into a term contract that was in its overall economic interest, if it would be obligated under the contract to supply product to a particular buyer at a price that may appear from time to time to fall below current spot prices. The risk of potential liability posed by such a broad rule would interfere with the freedom of market participants to enter into long-term supply arrangements, with significant costs for the industry's efficiency and for economic welfare generally.[65] Even without binding contractual commitments, a firm may decide as a matter of business judgment to continue supplying established customers, or market segments and areas that it regards as having higher long-term commercial potential, despite the existence of shortages elsewhere.

Moreover, the ability to produce and supply products across markets requires investment throughout the product chain from refining, pipeline, and terminals to the ultimate delivery of product to consumers. These are unilateral decisions of a firm that are made in response to the market indicators of supply and demand. Through skill, hard work, and investment, firms may find themselves in a position to use those resources and investments profitably. The government should not punish success under the guise of proscribing manipulation, any more than antitrust monopolization law punishes similar success. For example, consider a supply disruption in which, as a result of past investments, a firm has more product to supply than other firms. That firm should be allowed to make supply decisions regarding the sale and distribution of product to maximize its profits; the desire for profit

[65] The fact that regulators had prohibited long-term contracts for electricity contributed to the meltdown of California's electricity markets. When supplies tightened, utilities could not rely on stable supplies at stable prices that long term contracts would have provided.

motivated the investment in the first place. To second guess such supply decisions would undermine the incentives of market participants to engage in similar, pro-competitive investments.

2. No Affirmative Obligation To Release Inventory During Price Spikes

The ANPR asks whether a firm should be under an affirmative obligation to release inventory following a price spike when the firm knows or should know that the release of the products would be profitable. Again, such a requirement would substitute the judgment of the Commission for that of individual firms making ordinary business decisions, and most likely would make matters worse, not better.

Decisions to build and release inventories are complex. Inventory may be held simply for safety reasons; a certain amount of inventory is necessary, for example, to keep storage tanks from failing under certain conditions. Inventory holdings involve significant storage expenses and substantial working capital expenses. Firms maintain inventories of crude oil and refined product to provide reliable, continuous supply to customers without incurring unnecessary costs. Because refiners and wholesalers have commitments to many, if not most, of their customers, quickly exhausting available inventory is an undesirable option. Indeed, firms often put customers on allocations during supply disruptions to avoid running out of product for any particular customers and thereby harming their relationships with those customers.

During a price spike, the opportunity cost of carrying inventory increases substantially, which provides firms with a significant incentive to sell before the price decreases. In most cases, although prices increase in the short run following a disruption, there is a quick reaction as supplies are diverted from other areas. How long a disruption will last, and how quickly other supplies will become available, however, is often unknown. If inventory is released too early and the disruption persists, the likely result will be significantly higher prices and much greater scarcity later.

Firms inevitably operate on limited information, and decisions that, with the benefit of hindsight, seem unusual or irrational may simply reflect actions based on limited information available at the time of the decision. The risk that regulators might second-guess such real-time decisions would necessarily make firms more cautious in their building of inventory, search for additional supply, or their willingness to enter into long-term contracts or commitments. Moreover, interpreting Section 811 to impose what would amount to an "inventory release requirement" could pose a serious threat to the normal industry practice of accumulating inventory on a seasonal basis to anticipate peaks in demand for particular products.

Deciding whether and how much inventory to release at any point is a complex judgment that regulators are ill-equipped to second guess. A rule giving the FTC such authority would necessarily require the Commission to decide a host of complex ancillary questions such as the size and duration of a price increase triggering an obligation to release inventory, the appropriate cost basis for assessing whether a release of inventory is profitable (in many disruptions, replacement cost may be unknown), and how much inventory and to whom it should be released. Nothing in the text or legislative history of Section 811 suggests that Congress intended to grant the FTC authority to make such determinations.

B. Public Announcements Relating To Refinery Utilization

The ANPR asks whether public announcements by refiners of planned reductions in overall utilization of refinery plants or reductions due to maintenance or other factors should be regarded as manipulative under Section 811.[66] Announcements of this type should not be subject to liability under Section 811 unless they at a minimum satisfy the elements set out in Part VI of these comments – in particular that they are deceptive or fraudulent, are made in connection with the purchase or sale of crude oil, gasoline or petroleum distillates at wholesale, with the specific intent to affect the market price of a physical crude oil, gasoline, or petroleum distillates product, and that they cause such market prices to deviate materially from the market price that would have existed but for the deception or fraud. Truthful announcements of downtime, extended or unplanned maintenance, or other statements about capacity utilization increase the efficiency of the market.

A new rule that permitted non-deceptive, non-fraudulent public announcements of downtime to be condemned as market manipulation would do more harm than good. As an initial matter, while announcements other than those related to maintenance are not routine, no standard industry practice exists for making announcements about reductions in refinery utilization. The provision of truthful, accurate information is often helpful for market participants to react rationally to future conditions — knowledge that a market could be undersupplied is in fact a market indication for more product to flow to that market, and for customers to consider how to adjust. Accurate information allows firms to identify potential product shortfalls, and for customers to plan for alternative spot purchases (if necessary) or enter

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[66] Firms typically are careful about announcing capacity reductions (either short term or long term) because of potential liability under the antitrust laws, and some firms have a practice of not making public announcements at all regarding refinery utilization. As discussed below, however, firms have competing responsibilities with respect to some utilization decisions, and, in any event, their actions may indicate they are taking some portion of their refining capacity down.

into short term contractual commitments to ensure consistent supply. In addition, such announcements may achieve other goals, including notices related to safety and security.

The FTC's apparent concern is that announcements might facilitate coordination among refiners to reduce supply. Such coordination is unlikely; in a market where underlying demand factors have not changed, firms will usually have an incentive to respond to a competitor's diminished output by increasing their own output to optimize the value of their inventories. Historical experience in the industry is supportive. Expected production shortfalls generally do not substantially affect prices because suppliers adjust by building up inventories to satisfy contractual commitments, find alternative sources of supply, and increase imports. Incremental refinery economics provide strong incentives to keep refineries running at close to full capacity in the United States. In the last decade, in conditions of both high and low margins, most refineries have run at very high utilization rates.[67]

Moreover, the antitrust laws already prohibit, in appropriate circumstances, efforts by one firm through public communications to signal another firm and thereby collude to reduce output. The Commission should not extend its new authority under Section 811 to prohibit truthful announcements of refinery downtimes or drops in capacity utilization; the effect of such prohibition would likely be to hinder the normal market adjustment process, resulting in greater, not lesser, dislocations of supply.

C. False Reporting Of Price Data To Private Reporting Entities

The ANPR asks whether false or misleading reports to private reporting agencies in thinly traded markets exist, whether these reports are likely to affect market prices, and

[67] *See Katrina Report*, *supra* n. 3, at 21-22 and 24 (figure 1.1 and tables 1.1 and 1.3).

whether a manipulation rule would be effective and beneficial in policing such practices. We agree that the provision of false or misleading pricing information to private reporting entities could be problematic. Firms rely to varying extents on reporting services to understand industry trends and as a basis for contract pricing. Thus, accurate information from these services is important.

A specific intent requirement is critical if suppliers are not to be deterred by the risk of liability for inadvertently inaccurate or misleading reports. Indices are valuable tools that promote efficiency by disseminating pricing information widely across the petroleum markets. Firms provide data to these indices on a voluntary basis. If the risk of manipulation liability for inadvertently delayed or incomplete reporting were to make some market participants forego reporting altogether, the indices -- and especially those in thinly traded markets -- would be rendered less reliable, thereby decreasing market transparency and detracting from market efficiency.

In practice, the CFTC already polices false reporting and manipulation through false market reports and is increasingly prepared to assert its authority to do so in both the futures and the physical markets for petroleum and other commodities. If the FTC chooses to propose an anti-manipulation rule pursuant to Section 811, it should require proof that a party engaged in a deceptive or fraudulent act specifically intending to create a price for a wholesale petroleum transaction that would not have existed but for the deceptive or fraudulent act.[68]

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[68] *See also Policy Statement on Natural Gas & Electric Price Indices*, 104 F.E.R.C. ¶ 61,121 (2003). This FERC Policy Statement provides a "safe harbor" that presumes accurate and good faith transaction data-reporting by data providers that adopt and follow FERC-established standards for trade data reporting. FERC does not penalize such providers for inadvertent errors in reporting.

D. Denial Of Access To An Unregulated Terminal

The ANPR asks whether denial of access to a non-regulated terminal may be an act of market manipulation subject to Section 811. In view of the many legitimate justifications for such denials of access, API and NPRA urge the FTC to ensure that any rule implementing Section 811 makes clear that it does not apply to such conduct.

Companies that own and operate terminals for storing their own product have made substantial capital investments. To mandate that companies make terminal space available to third parties would effectively punish companies that had the foresight to make these investments and would reward those that did not. Moreover, expanding existing storage to accommodate third parties may require a financial commitment from such parties that they are unable or unwilling to meet. If space in a terminal is already fully utilized, mandating that others be allowed access to the terminal might interfere with customer supply relationships. For example, terminals operated by integrated companies are often tied to refinery production, so mandating that terminal space be allocated to third parties might disrupt refinery production and available product supply in the marketplace. If, on the other hand, space is available in a terminal, the operator will often make this space available to third parties so that the terminal is not underutilized. The operator might, however, have a host of valid reasons for denying access to particular users. For example, a “through-putter” seeking access might lack creditworthiness, or the specifications of the particular petroleum product proposed to be stored might render it unsuitable for commingling.

In addition, the market is capable of responding to any genuine shortage of terminal capacity without burdensome regulation. For many years, there has been a trend for independent logistics companies to own and operate not just pipelines, but terminals. These firms generally exist to serve all qualified market participants by providing storage and infrastructure connectivity for a fee. The growth of these logistics firms, which are not part of the integrated oil companies, underscores the ability of market forces to provide additional terminal capacity as needed.[69]

E. Whether The FTC Has Authority To Require Submission Of Cost And Volume Data

The ANPR invites comment on whether the FTC possesses the authority to promulgate a rule under Section 811 requiring a person to maintain and submit cost and volume data for wholesale transactions at all levels of trade, refinery or pipeline outage data, and import and inventory volumes. The clear answer is no. On its face, Subtitle B of EISA grants the FTC authority only to promulgate a rule barring the use of certain manipulative or deceptive devices or contrivances, and to enforce provisions prohibiting the supply of certain types of false information to a federal department or agency. Subtitle B does not grant the Commission the authority to impose new reporting requirements on the petroleum industry.

Even if Congress had granted the FTC the authority to require submission of such data, it would be extremely burdensome for companies to maintain and submit enough data to be useful to the FTC, if they could do it at all. And as explained above, even with huge amounts of data, it is beyond the capacity of any organization accurately to second-guess product supply decisions.

F. How Should The Commission Determine An "Artificial Price"?

The ANPR asks how the Commission should determine an "artificial" price and in particular whether prices above competitive levels should be considered "artificial prices." As

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[69] Requiring access to unregulated terminals would also be contrary to antitrust principles, which generally recognize that competitors are not required to share resources with rivals. *See, e.g.*, *Verizon Commc'ns, Inc.*, 540 U.S. at 408.

explained above, API and NPRA believe that any rule prescribed by the Commission should be limited to regulating certain forms of deceptive or fraudulent conduct. We agree that an effect on market prices should be a necessary element for liability under Section 811 and that the standard for determining the existence of an effect on price should be whether the challenged conduct causes a material deviation in market prices as compared to the market price that would have existed, but for the deceptive or fraudulent conduct. Section 811 should not be read, however, to grant the FTC broad authority to regulate prices, whether or not those prices are designated "artificial." Moreover, defining prices above the competitive level as artificial is inappropriate.

Although the CFTC uses the concept of "artificial price" in enforcing its market manipulation authority, this standard originally developed to police the manipulation of futures contracts in which all terms except price are standardized. The wholesale petroleum distribution markets governed by Section 811, by contrast, use many non-standardized contracts and therefore are substantially less-well suited to price-based regulation than the commodities futures markets.

The term "artificial price" does not translate well to physical markets for commodities. Indeed, as the FTC's experience with antitrust enforcement shows, determining the "competitive price" in actual markets is very difficult. The FTC also should not focus on the extent to which prices exceed costs. Textbook economics states that the perfectly competitive price equals marginal cost, but most markets are not perfectly competitive, and the marginal cost standard is extremely difficult to apply in practice. In addition, because petroleum products' prices are volatile due to the unique short run inelasticity of demand and relative inelasticity of supply, the "competitive" price is a moving target.[70] Moreover, outside of an economics textbook, even the most competitive market will take some time to reach a new equilibrium in response to changed market conditions. Thus, temporary deviations from the longer-term competitive equilibrium price are both normal and expected.

Deeming prices above long-run competitive levels to be "artificial" and market manipulation would amount to price regulation. Long experience, however, shows that price regulation does not benefit consumers. Indeed, experience in the United States and elsewhere demonstrates that such an approach would harm consumers. In the 1970s, when gasoline supplies were reduced, price controls were used with predictably bad results. Instead of allowing prices to respond to market demand and allocate scarce resources appropriately (including by encouraging expansion and new development), the policies during the 1970s resulted in long lines for gasoline and reduced investments.

G. When Should Liability Turn On Purpose, Intent, Or Knowledge?

As indicated above, API and NPRA believe that specific intent to affect market prices always should be required for liability under Section 811.

X. CASE STUDIES

A. BP Amoco/ARCO

The ANPR poses a series of questions about the conditions in which decisions to supply or not to supply a market might violate Section 811, citing as an example the decision of an oil company to export Alaska North Slope ("ANS") crude oil to the Far East "in order to

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[70] Given short run inelastic demand and relatively inelastic supply, competitive prices should be expected to rise substantially during a market disruption. Thus, price increases following disruptions do not imply that firms are exercising market power, even though prices have increased relative to "normal" costs. That is because the relevant costs – the opportunity cost of the marginal source of supply - also rises substantially.

increase spot prices for ANS crude oil on the West Coast."[71] As explained throughout these comments, API and NPRA believe that subjecting product supply decisions to potential liability under Section 811 risks deterring potentially pro-competitive behavior and causing disequilibrium in the petroleum wholesale markets.

There are numerous reasons why a producer of ANS oil might export product to the Far East rather than supply it to the West Coast. For example, if the producer could obtain a higher price in the Far East for the product then, other things being equal, it would be economically irrational to sell it for use on the West Coast. A regulatory scheme that encouraged such irrationality on a large scale would undermine the operation of the price mechanism as a tool for distributing resources efficiently across regions and over time in accordance with underlying forces of supply and demand. Nor should it make any difference that a producer chooses to supply a foreign market in preference to a domestic one in order to secure a better price. As a net importer of crude oil, the United States benefits from the existence of competitive international markets. Indeed, in the weeks following Hurricanes Katrina and Rita, the ability of higher U.S. prices to attract increased supplies of foreign crude oil and gasoline was critically important in helping the country overcome severe disruptions in domestic supply.

There may also be commercial, pro-competitive reasons why a producer of ANS crude oil would export product to the Far East even though prices were higher for supply to the West Coast. For example, the producer might be contractually bound to do so under a long-term

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[71] The ANPR observes that, during its review of the proposed BP Amoco/Atlantic Richfield merger, the FTC had reason to believe that BP had occasionally engaged in this practice. API notes that the FTC ultimately determined that the practice in question did not constitute an antitrust violation.

supply contract with a customer in the Far East. Alternatively, a supplier may be making an investment for future business with new customers to diversify the outlets for its crude supplies and to establish, within those new markets, a reputation as a reliable supplier. A regulatory framework for the implementation of Section 811 that cast doubt on the freedom of producers to make such supply decisions and to honor supply commitments would also undermine the efficiency and competitiveness of U.S. and international wholesale petroleum distribution markets. Profit maximization is a necessary and desirable feature of competitive markets: Long-term contracts are one means by which participants in the petroleum markets strive to maximize their profits. Regulations that constrained the ability of market participants to make decisions on how to distribute crude supplies would inevitably detract from the efficiency of the market, resulting in higher prices for consumers over the longer term.

Although the ANPR's hypothetical does not suggest a pro-competitive rationale for exporting product to the Far East, it also does not suggest that the producer engaged in deceptive or fraudulent conduct. Absent such conduct, the firm's actions would not be subject to liability under the definition proposed in these comments. Moreover, any attempt to impose liability under these circumstances raises a host of analytic challenges. Doing so would require the FTC to determine how much crude oil the producer should have pumped at any particular point in time, the optimal distribution of crude oil between the West Coast and the Far East, both at a particular moment and over time, and the likely responses of its competitors, in both the short and the long run. The FTC cannot make these judgments effectively, and thus should not seek to decide whether shipping more crude oil to one market than another amounted to the use of a "manipulative or deceptive device or contrivance" in violation of Section 811.

B. Enron

In a second case study, the ANPR asks for comments on the relevance to Section 811 of the manipulation of California's energy markets in 2000 and 2001 by Enron and others. While API and NPRA do not condone the type of illegal conduct surrounding Enron's business that has been widely publicized, API and NPRA believe that the activities described in this case study are not especially relevant to a rulemaking under Section 811. For example, the ANPR describes several important characteristics of the markets for electricity and natural gas that facilitated manipulation by Enron and others, which are not shared by wholesale petroleum distribution markets:

- Electricity cannot be economically stored for more than a few seconds. Crude oil, gasoline and petroleum distillates can all be stored for long periods of time.
- Electricity suppliers can increase profits by withholding capacity during peak demand periods when other rival facilities are already committed to production and cannot respond. In part because of the ease of storage of petroleum products, competitors in the wholesale petroleum distribution markets can respond swiftly to decisions by competitors to withhold supplies.

The one manipulative practice described in the Enron case study that is relevant to the wholesale petroleum distribution markets is the submission of false data to private reporting entities. As described on page 36 of the ANPR, California energy market participants provided false reports of natural gas prices and trade volumes to industry publications. As noted above, API and NPRA believe this appropriately could be covered by Section 811, where at a minimum the elements set forth in Part VI of these comments are satisfied.

XI. A PROCEEDING TO PROMULGATE A RULE PURSUANT TO SECTION 811 IS SUBJECT TO THE RULEMAKING PROCEDURES OF SECTION 18 OF THE FTC ACT

The ANPR asserts (p. 4 n.4), 73 Fed. Reg. at 25615 that the issuance of any rule under Section 811 is subject to the notice and comment procedures of Section 553 of Title 5, U.S.C. (the Administrative Procedures Act), rather than the more demanding procedures of Section 18(a)(1)(B) of the FTC Act.[72] We recommend that the FTC reconsider this issue and conclude that any rules issued under Section 811 are subject to Section 18 rulemaking procedures.

The language of Subtitle B demonstrates that Congress intended the FTC, if it deemed it necessary to promulgate any rule, to do so pursuant to the agency's authority to regulate deceptive acts and practices. Section 811 authorizes the FTC to issue rules applicable to practices that are "manipulative or deceptive." That language tracks the FTC's authority under Section 18 of the FTC Act to "define with specificity acts or practices which are unfair or deceptive acts or practices."[73] Moreover, Section 813 of EISA specifies that violations of any rules promulgated pursuant to Section 811 "shall be treated as an unfair or deceptive act or practice prescribed under a rule issued under section 18(a)(1)(B)." Tellingly, when Congress has intended to allow the FTC to use APA procedures to issue consumer protection rules, it has said so expressly.[74] Congress included no such express authorization for Section 811, thus reinforcing the conclusion that Congress intended the FTC to follow Section 18's rulemaking procedures.

The ANPR contends that APA procedures apply because any rule that the FTC promulgates will be issued under Section 811 of EISA, and not under Section 18 of the FTC Act. But consistent with the language in Sections 811 and 813 of EISA discussed above, any such rule will be issued under *both* Section 811 *and* Section 18, which accordingly triggers the

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[72] 15 U.S.C. § 57a(a)(1)(B).

[73] 15 U.S.C. § 57a(b).

[74] *See, e.g.*, 15 U.S.C. §§ 5711, 6102, 6502, 7607, 7711.

obligation to use Section 18's consumer protection procedures. Moreover, even if the regulations were issued exclusively under Section 811, the obligation under Section 813 to "treat" such regulations "as" consumer protection regulations would require the FTC to use Section 18 procedures.