

BEFORE THE
UNITED STATES
FEDERAL TRADE COMMISSION

Hess Corporation)	
1185 Avenue of the Americas)	Market Manipulation Rulemaking
New York, NY 10036)	
)	Project No. P082900
)	

COMMENTS OF HESS CORPORATION

Hess Corporation (“Hess”) respectfully submits the following comments in response to the Commission’s request for public comment on its Advance Notice of Proposed Rulemaking (“ANPR”).

I. Introduction

Hess is an independent, global energy company, engaged in the exploration and production of crude oil and natural gas, as well as refining and marketing refined petroleum products, natural gas, and electricity. In addition, Hess trades in energy commodity contracts, primarily as a hedge against price swings or sudden changes in supply.¹

Hess is aware of the comments of the American Petroleum Institute (“API”) and the National Petrochemical and Refiners Association (“NPRA”), and Hess generally endorses those comments. Because of Hess’s position in the markets being examined by the Commission, however, Hess believes it would be helpful to offer its own additional comments on the ANPR. In particular, Hess would like to offer its perspective as an independent, integrated petroleum

¹ Hess owns an interest in Hess Energy Trading Company, LLC (“HETCO”), a limited liability company engaged in proprietary trading transactions in energy-related commodities. HETCO is managed separately from Hess. The comments herein are submitted solely on behalf of Hess and do not purport to reflect the views or operations of HETCO.

company on the lack of justification for a prescriptive regulatory approach to the unconcentrated markets at issue here.

II. Background on Hess Corporation

Hess has two principal businesses, Marketing & Refining (“downstream”) and Exploration & Production (“upstream”). Over the last twenty years, there have been significant changes in the structure of the downstream industry, particularly in wholesale distribution and retail marketing of gasoline and petroleum distillates. As a result of these changes, Hess’s Marketing & Refining business operations are significantly different than those of the integrated² major oil companies. Hess’s retail customer-focused downstream business provides Hess with a distinctive insight into some of the issues raised by the Commission in the ANPR. Consequently, while Hess is actively involved in the purchase and sale of crude oil, Hess’s comments will focus on wholesale purchases and sales of gasoline and distillate petroleum products.

Started in Asbury Park, New Jersey with a single fuel oil delivery truck in 1933, Hess has extensive petroleum bulk storage and retail operations on the East Coast to serve our customers. Hess currently supplies a chain of approximately 1,300 Hess® retail motor fuel facilities between New Hampshire and Florida, most of which are owned and operated by the company and contain convenience stores. Hess also operates twenty-one petroleum bulk storage facilities on the East Coast. Hess does not own or operate a crude oil refinery, but does own a 65,000 barrels-per-day (“BPD”) stand-alone catalytic cracking facility in Port Reading, New Jersey (“Port Reading”). Port Reading processes an intermediate feedstock to produce blending components that are used to make finished petroleum products, primarily gasoline and home

² Hess uses the term “integrated” in this comment to mean that it is a market participant in all major aspects of upstream and downstream businesses.

heating oil. A wholly-owned subsidiary of Hess owns a 50% interest in HOVENSA LLC (“HOVENSA”), a 500,000 BPD crude oil refining facility in the United States Virgin Islands which produces gasoline, distillates, residual fuel oils and petroleum coke.

1. Hess’s policy is to price competitively and offer fair and consistent value to our customers. For over 40 years, Hess’s marketing philosophy has been to offer customers a reliable and secure supply of high quality gasoline and fuel oils at prices lower than the major brand competition.

2. As a direct marketer, Hess’s interest is in long-term customer relationships, which is inconsistent with attempts at price manipulation. Although most integrated oil companies have sold their retail marketing facilities and few, if any, sell fuel oils directly to end-use customers, Hess retains its focus on retail customers with a goal to build a direct relationship with those customers and be a preferred supplier of energy to those customers. For example, as recently as this month, ExxonMobil announced its intention to sell 820 company operated stations and 1400+ dealer locations. A long-term customer relationship cannot be sustained if the customer doubts or mistrusts the supplier. Moreover, while it can be difficult to remember, times of shortage and high prices are over time balanced out by periods of excess supply and lower prices. During such times, a loyal customer base is even more important than it is in periods of shortage and high prices. Accordingly, it is not in Hess’s interest to seek to participate in price manipulation, if that were possible, because the impact on Hess’s customer base of that kind of information becoming public would be very negative.

Likewise, other integrated oil companies have divested many mid-stream assets such as bulk storage terminals, in part because they are no longer needed to assure supply of gasoline and diesel fuel to retail networks operated by that company. The most important function for the

Hess terminal network is to assure a source of motor fuel supply for the Hess stations in the market area for that terminal or fuel oil supply for other customers. In markets where Hess does not have a terminal, a supply of product is typically acquired from terminals owned by others by exchange agreements. In effect, Hess trades a barrel of Hess-owned motor fuel in another location for a barrel of a motor fuel from another company in a terminal that market.

3. Hess is a net product purchaser, with no incentive to attempt to bring about artificially high product prices. Another important difference between Hess and most of the larger integrated oil companies is that Hess has limited fuels production capacity and is substantially net short of motor fuels relative to overall demand from our customers. Hess must obtain supply of these products from other sources: (1) term product purchase agreements with other third-party suppliers through arm's-length transactions at market based rates, and; (2) spot market purchases, which are used to balance supply needs. Hess employs a team of highly capable professional traders whose job includes locating needed product supply in the market so as to ensure that customer demand for petroleum products is met. In many Hess market areas, gasoline or a gasoline blendstock is blended with ethanol to produce a finished product. Hess does not manufacture ethanol and must also obtain a supply of ethanol in these markets from third parties. For these reasons as well, Hess has a significant disincentive to seek to bring about artificially high product prices; such activity, even if possible, would cost the company more than it would benefit from it.

III. The Commission Should Not Require Covered Persons to Maintain and Submit Cost Information

Commission Request for Comments:

“Accurate cost and volume data for wholesale transactions at all levels of trade, refinery or pipeline outage data, and import and inventory volumes are frequently difficult to construct or are unavailable. The Commission seeks comment on whether it possesses the authority to promulgate a rule

under Section 811 requiring a covered person to maintain and submit such information to the Commission or any other government entity, and, if so, whether it should do so, and what particular data it should require.”

Hess supports other commenters who have taken the position that Section 811 does not provide the legal authority to require the provision of cost data. However, it is also Hess’s view that: (1) cost data can be very difficult to develop in the context of vertically integrated oil companies, and; (2) such data would be of limited value to the Commission.

A. Difficulty of Defining “Cost”

In many cases, “cost” data for a wholesale transaction can be easy to develop and retain. For example dealers and jobbers would be invoiced either by their supplier for fuel they purchase or from a supplier. Likewise, where a company takes delivery of a cargo of motor fuel purchased from a third party, there will be an invoiced price.

This is not necessarily the case, however, for an integrated oil company which may be distributing gasoline and petroleum distillates through a proprietary wholesale and retail network. From an overall supply perspective, Hess manufactures some of its fuel requirements and acquires the remainder on a term purchase or spot (short term) wholesale basis. In some markets, fuel is acquired by exchange agreements from terminals owned by others. Hess does not “pay” a specific price for that fuel, as would be the case for rack customers. These factors make it difficult to set a “cost” on the overall pool of gasoline or other fuels distributed and sold by Hess. Moreover, Hess views the performance of its retail, supply and distribution operations from an overall longer term value chain performance basis rather than on a station-by-station, day-by-day basis. As a result, Hess does not charge its company operated stations for motor fuel on a load-by-load basis, nor is there any formal bill or charge to a company operated station for a specific delivery of gasoline or other motor fuel. For similar reasons, Hess does not have an internal transfer price for motor fuel or fuel oil produced at Port Reading. Thus, Hess does not

keep or retain “cost” information for these transfers to retail operations or product transfers from Port Reading to other parts of the Hess downstream distribution system.

Second, in an integrated context, the cost of the fuel or raw materials is only one component of cost that Hess incurs in connection with the distribution of petroleum products. At a refinery level, calculating the “cost” to produce a specific gallon of a specific product is simply not a practical exercise, because of the multiplicity of economic inputs into production, the number of variables in refinery processing and the number of products to which those costs are allocated. Likewise, at the wholesale distribution level, cost includes factors such as the capital equipment and land at the terminal, overhead, labor costs and transportation. The difficulty of defining product cost in the integrated context has been recognized in various governmental efforts to regulate the price of motor fuels. Many states have below cost sales laws, which attempt to prohibit the sale of petroleum products below cost, ostensibly to protect competition. For refiners, because of the difficulty in defining product cost, these laws almost inevitably use an arbitrary formula, such a minimum markup or rack prices.³

This does not mean that Hess does not have a “cost” for the overall pool of fuel that Hess sells. It does, of course, have costs for fuels. However, Hess does not finely break down fuel costs on a daily or other short-term basis.

B. Utility of Cost Information

Hess believes that cost information at the wholesale level, even if available and reliable, is of limited value in determining whether “market manipulation” has occurred for purposes of

³ See, e.g., NY Gen. Bus. § 370-b(1) (2007). (“‘Refiner cost’ means a refiner’s posted terminal price plus federal, state, and local taxes and fees applicable to motor fuel; freight charges to its retail outlet; and direct labor costs and reasonable rental value of the retail outlet attributable to the retail sale of motor fuel by the refiner.”)

Section 811 of EISA. This is the principally the case because in a competitive market, product prices are set primarily by competition, not by cost. It is also the case because it may be very difficult in fungible product markets to match specific product transactions to the cost paid for those products.

As noted above, Hess's overall marketing strategy is to offer customers a reliable and secure supply of high quality gasoline and fuel oils at prices lower than the competition. At both the wholesale and retail levels of Hess' Marketing and Refining businesses, prices for fuels are set primarily with reference to competitors' prices in the marketplace. Other factors can affect pricing, such as surges in market prices or the need to balance supply and demand at Hess terminals, either by pricing or by limiting through allocation the amount of fuels that customers can purchase. However, market-based pricing is an essential touchstone both for providing value to customers and for maintaining a secure and reliable supply. Because pricing is competition-based, it is not unusual to see the "spreads" between NYMEX, spot, rack and retail prices for petroleum products change over a limited period of time.⁴ For example, during periods of rising wholesale prices, the difference between wholesale and retail typically shrinks initially. Likewise, events like Hurricane Katrina can have a significant effect on the relative relationships of these prices. Thus, Hess does not believe that comprehensively collecting cost information, even if it were possible to do so, will necessarily help identify instances in which manipulation of markets drove up prices.

Finally, Hess notes that while it is very difficult at best to determine the cost of a fuel when it is produced, it is very likely impossible to link the cost of a gallon of fuel produced or

⁴ See, e.g., Federal Trade Comm'n, Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases (Spring 2006), at Figures 6-7 to 6-9.

purchased by Hess to specific sale or distribution transaction. Hess acquires and commingles a pool of fuel from multiple different sources, stores the fuel in multiple locations and sends it in many cases by pipeline where fuel batches may not be segregated. Thus, cost information may not be helpful in analyzing whether an action or practice resulted in manipulation of product prices.

Although it is not within the scope of the ANPR, Hess notes that legislation in many states acts, in effect, to raise product prices artificially by restricting competition or by making markets less efficient. For example, below-cost sales or minimum markup laws, zone pricing restrictions, retail divorcement of refiners and producers of crude oil and self service gasoline mandates have all adversely affected the prices that consumers pay for petroleum products. See, e.g., June 17, 2004 FTC letter on The Michigan Petroleum Marketing Stabilization Act. Hess appreciates the Commission's long history of advocacy in this area and encourages the Commission to continue this critical informational role. In some cases, however, it has been several years since the Commission last addressed some of these competition restricting laws. We encourage the Commission to take a fresh and comprehensive look at these laws, particularly since advocates for such laws seek to use current high prices and popular sentiment that disfavors oil companies as a smoke screen to enact them.

IV. The Commission Should Not Impose an Affirmative Obligation to Release Inventory

Commission Request for Comments:

“Some have argued that market participants with terminal or other storage inventory should be under an affirmative obligation to release inventory during price spikes when the participant knows, or should know, that the release of the product will be profitable. The Commission seeks comment on when such an obligation should be imposed; what possible intent standard should be used as a test for liability; how one should measure profitability in such a circumstance; and, the costs and benefits to consumers of placing such an obligation on potential market suppliers.”

As noted above, the Hess terminal network supports the Hess® branded stations and the needs of the company's customers. Accordingly, Hess manages product inventories at the terminal level in order to maintain adequate stocks to keep pace with projected sales. Inventories are monitored on a daily basis and replenishment programs are constantly adjusted to take into account changes in demand as well as timing changes on resupply. In many markets, the supply and demand balance for Hess is very tight, so that inventory cannot be practically carried. This means that purchases and deliveries must be very frequent in order to balance supply and demand. As a result of its limited storage and high tank-turns in many markets, Hess has very limited ability to either build or draw inventory in those markets.

While Hess does not typically hold petroleum product stocks,⁵ there may be a need to do so to maintain a stable and reliable supply to its customers and retail marketing network. This can be the case for seasonal demand products like summer gasoline or heating oil. It can also be the case for emergency situations like the 2005 hurricanes, where supplies are tight. In such cases, Hess manages inventory to maintain supply to its customers. Requiring Hess to release product because it is profitable in the short term to do so ignores the long term importance to Hess customers of a stable and reliable source of supply. This is particularly true because Hess

⁵ As a general matter, Hess does not believe that holding product in inventory should be viewed as market manipulation. Numerous appropriate economic factors influence the costs and benefits of holding, including availability and cost of shipping, pipeline transportation, tankage, financing costs and world premiums or discounts to acquire product and to sell product. For example, when the product futures market prices are lower than current market prices (a condition referred to as "backwardation"), there is no incentive to build inventory for future demand, because holding inventory in such circumstances imposes an economic penalty on accumulating product in inventory. Historically, backwardation was not typical, but has been relatively more common in the last several years because of short-term uncertainty of supplies of crude oil and finished products. Regardless, any inventory that is built above normal operating levels or drawn below normal levels is subject to market risk. In other words, the value of the petroleum products stored or needed for supply could change either favorably or unfavorably.

is “net short” of motor fuels, since there is no assurance of an alternate for resupply. Moreover, even if Hess *could* raise motor fuel market prices by withholding supplies (an economic impossibility), Hess would have no economic incentive to do so, because Hess would simply end up paying a higher price for much of the motor fuel it sells, without any additional profit.

V. Trading Plays an Important Role in Efficient Petroleum Products Markets

While the Commission appears to be focused on the physical delivery of petroleum products to wholesale purchasers, the ANPR’s proposed interpretation of “in connection with” the purchase or sale of petroleum products potentially covers trading energy commodity contracts as well.⁶ While ensuring a “level playing field” in a transparent environment is essential, Hess urges the Commission to exercise careful scrutiny here and not impose regulations on trading that would unduly encumber or “chill” these markets.

As an initial matter, the trading market is unconcentrated and very competitive. Each market participant, including Hess, is a “price taker,” unable to dictate market prices through any individual purchase or sale decision. In its own studies of the petroleum industry, the Commission has come to the same conclusion. Recently, for example, the Commission’s Spring 2006 study of the gasoline market in the aftermath of Hurricane Katrina specifically addressed trading in the New York Harbor area related to NYMEX gasoline futures contracts. The study found “no evidence” of a logistical bottleneck that might enable a firm (or a small collusive group) to restrict gasoline movements into New York Harbor terminals or that any firm or

⁶ See Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007, Fed. Reg. 25,620-21 (May 7, 2008).

collusive group “could exploit” any constraints “in a manner that would result in manipulation of gasoline futures prices.”⁷

Hess concurs with the Commission’s conclusions. A decision by the Commission aggressively regulating markets that the Commission has repeatedly found to be functioning competitively would be unjustified. Regulations inevitably impose costs and can lead to unintended anti-consumer consequences. For example, as suggested by API and NPRA, if the Commission were to impose regulations closely regulating the price/cost calculations of market participants, ordinary, benign short-term market fluctuations could give rise to detailed and unnecessary government investigations. The incremental effect could be the stifling of the very trading activity that is necessary to provide market liquidity essential for the competitive functioning of wholesale markets.

Competitive futures and over-the-counter⁸ markets are important to the proper functioning of a system to deliver petroleum, gasoline and other energy products to consumers in an economically efficient fashion. First, the futures and over-the-counter transactions Hess undertakes as a commercial trader help ensure consistent supply of energy products to Hess’s customers by providing hedges against price swings and sudden changes in supply.⁹ Without such hedging, sudden changes in price or supply would have negative effects on Hess’s ability to react swiftly, contributing to greater price shifts at the wholesale and retail levels and creating or exacerbating disruption of product supply. Second, proprietary trades by entities that do not take

⁷ See Federal Trade Comm’n, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases* (Spring 2006), at 55.

⁸ Over-the-counter refers to privately negotiated bilateral physical and derivative transactions that are executed off regulated exchanges, such as the NYMEX.

⁹ As noted above, Hess is net short of motor fuels and must purchase supplies from third party sources.

physical possession of the product can often play an important role in maintaining market liquidity, particularly when conditions have placed the normal functioning of markets under stress. When executed within an effective risk-control environment, trades by these commercial counterparties in the industry efficiently distribute risk, protecting the ability of firms without the cash reserves of the major petroleum companies to remain in the marketplace and provide competition that benefits consumers.

Hess therefore urges the Commission to consider the entire spectrum of possible consequences stemming from the contemplated rulemaking. Further regulation of the presently competitive trading market would impose costs (by adding greater risk and uncertainty) with no discernible countervailing competitive benefits.¹⁰ Importantly, increasing trading costs could have the effect of reducing trading activity by smaller entities, thereby limiting their ability to engage in hedging and potentially producing greater market concentration as an unintended consequence. This would be an anticompetitive result. A crowded market is nearly always more competitive than a thinly-traded one; the Commission should avoid rules that would reduce the number of participants in the energy futures markets.

¹⁰ Much of the regulation related to energy trading that is contemplated by the ANPR is already in place from the Commodity Futures Trading Commission (“CFTC”). As the ANPR notes, the CFTC has exclusive jurisdiction over “transactions involving contracts of sale of a commodity for future delivery. . . .” Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007, Fed. Reg. 25,618 (May 7, 2008) (quoting 7 U.S.C. 2(a)(1)(A)). Illustrating its role and continued vigilance, the CFTC recently announced the creation of an Interagency Task Force (involving the CFTC; the Departments of Treasury, Energy, and Agriculture; and the Securities and Exchange Commission) to “examine investor practices, fundamental supply and demand factors, and study the role of speculators and index traders in the commodity markets,” including the crude oil market. Press Release 5508-08, Commodity Futures Trading Comm’n, CFTC Announces Interagency Task Force to Study Commodity Markets (June 10, 2008), available at <http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5508-08.html>. New regulations by the Commission would create the risk of conflicting and/or overlapping regulations of the same activity by two federal governmental bodies.

VI. Conclusion

Hess appreciates the opportunity to provide the Commission with insight on Hess's unique circumstances and how Hess would be affected by the regulations contemplated by the ANPR.