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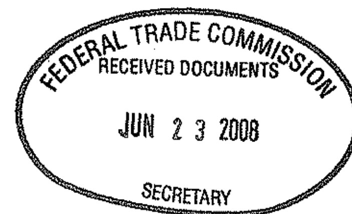

June 23, 2008

Mr. Donald C. Clark
Secretary
U.S. Federal Trade Commission
Room H-135 (Annex G)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Market Manipulation Rulemaking, P082900

Dear Mr. Secretary:

Please find below the comments of Society of Independent Gasoline Marketers of America ("SIGMA") with respect to the Federal Trade Commission's ("FTC's") Advanced Notice of Proposed Rulemaking ("ANPR") regarding market manipulation under section 811 of the Energy Independence and Security Act of 2007 ("EISA").

SIGMA is a national trade association representing approximately 275 independent chain retailers and marketers of motor fuel. SIGMA members represent significant diversity within the industry. While 92% are involved in gasoline retailing, 66% are involved in wholesaling, 36% transport product, 25% have bulk plant operations, and 15% operate terminals. Member retail outlets come in many forms including travel plazas, traditional "gas stations," convenience stores with gas pumps, cardlocks, and unattended public fueling locations. Some members sell gasoline over the Internet, many are involved in fleet cards, and a few are leaders in the mobile refueling movement. Thus, although the Commission correctly notes that any rule under section 811 shall not apply to retail sales of gasoline, SIGMA members have significant interests in the outcome of this proceeding.

EISA

In EISA § 811 Congress declared 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."[1] Pursuant to its rulemaking authority, the Federal Trade Commission (FTC) now proposes the following possible definition of "market manipulation" pursuant to § 811:

> Market manipulation shall mean 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.[2]

SIGMA is very concerned that the underlying statute, the proposed rule, and the issues raised by the Commission in the ANPR could lead to grossly unintended consequences for the petroleum marketplace.

Definition and Scienter

One of the critical issues that the FTC must address is the extent to which violations of any rules or regulations on market manipulation must be made knowingly, or with scienter. This is a major matter for SIGMA members who are involved in petroleum markets on a daily -- if not hourly -- basis. Without defining market manipulation in an appropriate and legally sustainable manner, the FTC jeopardizes the free and fair trade in domestic motor fuels. We set forth below a detailed legal analysis of the scienter requirement.

Securities Law.

The ANPR specifically seeks comment regarding the extent to which jurisprudence under the securities laws should apply to the FTC's new authority to regulate market manipulation. The securities laws are the most directly relevant precedent in analyzing the strict scienter market manipulation standard of EISA § 811. Both the statute and the proposed rule for market manipulation under EISA find their origin in the securities laws. Under § 10(b) of the Securities Exchange Act of 1934 (The "Exchange Act"), for instance, Congress declared that it "shall be unlawful for any person, directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention

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[1] Pub. L. 110-140, 121 Stat. 1723 (Dec. 19, 2007), Title VIII, Subtitle B, *to be codified* at 42 U.S.C. 17301-17305.

[2] *Federal Trade Commission, 16 CFR Part 317: Prohibitions On Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007*, 73 FR 25614, 25620 (May 7, 2008) [hereinafter FTC ANPR].

of such rules and regulations as the Commission may prescribe."[3] The similarity to § 811 of EISA is not elusive.

As the ANPR correctly notes, it has long been held that scienter is required under § 10(b). Importantly, in *Ernst & Ernst v. Hochfelder*, the Supreme Court located this scienter requirement in the statutory language of § 10(b).[4] The Court found that the words "manipulative and deceptive" used in conjunction with "device or contrivance" strongly suggest that section 10(b) was intended to proscribe only "knowing or intentional misconduct" and not negligent conduct.[5] Section 811 of EISA combines the words "manipulative or deceptive" with the words "device or contrivance" in the exact same manner.[6] While the court in *Hochfelder* did note that the term "manipulative" is "virtually" a term of art within the realm of securities laws,[7] the Court clearly based its finding of a scienter requirement on the plain meaning of the words used—the exact same words in § 811.[8]

While any rule promulgated under EISA § 811 must have a strict scienter requirement, the Commission's proposed rule attempts to circumvent this requirement and creates the likelihood of great judicial uncertainty for would-be defendants by adding the language "*or with the effect of* increasing the market price."[9] As the Court in *Hochfelder* aptly noted, courts interpreting a statute always begin with the language of the statute itself.[10] In *Aaron v. Securities and Exchange Commission*, the Court had occasion to analyze and compare the scienter requirements of both § 10(b) of the Exchange Act and § 17(a) of the Securities Act of 1933 based upon the language of the respective sections.[11] Section 17(a) provides that it "shall be unlawful for any person in the offer or sale of any securities . . . directly or indirectly-(1) to employ any device,

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[3] Securities and Exchange Act of 1934, § 10(b).

[4] 425 U.S. 185, 197-98 (1976).

[5] *Id.* at 197.

[6] *See supra* note 1 and accompanying text; Securities and Exchange Act of 1934, § 10(b).

[7] 425 U.S. at 198.

[8] *Id.* at 198 n.20; *see also* Aaron v. S.E.C., 446 U.S. 680, 690 (1980) (noting that the most important consideration in the finding of the *Hochfelder* Court that scienter is required in proving a violation under § 10(b) and Rule 10b-5 is "the plain meaning of the language of § 10(b)").

[9] FTC ANPR at 25620 (emphasis added).

[10] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975)).

[11] *See* Aaron v. S.E.C., 446 U.S. 680 (1980).

scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission 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 (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser."[12]

Much like the lack of direct precedental authority to rely on under § 811 of EISA, the Court in *Aaron* admitted there was little authority to evaluate whether proof of scienter was required by § 17(a).[13] Nevertheless, relying on "controlling principles" the Court concluded that § 17(a)(1) had a clear scienter requirement, while § 17(a)(2) and (3) did not.[14] Even granting that securities laws are to be read flexibly, the Court opined that "if the language of a provision . . . is sufficiently clear in its context and not at odds with the legislative history it is unnecessary" to analyze additional policy considerations.[15] Section 17(a)(1), like § 10(b) of the Exchange Act and § 811 of EISA, uses the language "to employ any device, scheme, or artifice to defraud."[16] Relying partially on the reasoning in *Hochfelder*, the Court held that such language "plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct."[17] Notably, in analyzing the wording of § 17(a)(3), the Court focused on the wording, "which operates or would operate as a fraud or deceit."[18] The Court stated that such language "plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible."[19] Since culpability is not the focus of such language, scienter is not required in proving a § 17(a)(3) cause of action.[20]

As it regards § 811 of EISA, Congress plainly chose language that it has previously used in the context of the securities laws, knowing that the Court implies such usage to connote a strict scienter requirement. Nevertheless, while Congress enacted § 811 with this scienter requirement in mind, the Commission's proposed rule under EISA § 811 includes the language "*or with the effect of* increasing the market price."[21] As the

[12] Securities Act of 1933, § 17(a)(1)—(3).

[13] 446 U.S. 680, 695.

[14] *Id.* at 695-97.

[15] *Id.* at 695.

[16] Securities Act of 1933, § 17(a)(1).

[17] 446 U.S. 680, 696.

[18] Securities Act of 1933, § 17(a)(3).

[19] 446 U.S. 680, 697 (emphasis in original).

[20] *Id.*

[21] FTC ANPR at 25620 (emphasis added).

Aaron Court's effects-based analysis of § 17(a)(3) suggests, this language in the proposed rule is at odds with Congress' intent in using language connoting the requirement of scienter. While any rule promulgated thereunder will be read as a whole, it should avoid the confusing and contradictory language "or with the effect of." Congress clearly meant to proscribe only knowing, intentional acts, and the Commission's proposed language attempts to go beyond this Congressional intent. Therefore, such language does not meet the definition of "necessary and appropriate" as required by § 811 of EISA.[22]

The proposed rule in essence attempts to circumvent Congress' previous decision to discard what would have otherwise been the much more onerous and open-ended price gouging provisions in H.R. 1252.[23] While H.R. 1252 as passed by the House of Representatives would have made it possible for the Commission to bring an action against a party who simply sold gasoline at an unconscionably excessive price, this and related provisions were dropped from the bill before passage of EISA. The fact that recklessness is likely to satisfy the scienter requirement of § 811,[24] combined with language in a rule under § 811 allowing an effects-based intent standard would risk subjecting innumerable parties and actions to liability, making the rule an open ended invitation to litigate any grievance. Over the course of three decades the Court has made a concerted effort to reign in the abusive market manipulation litigation brought under § 10(b) of the Exchange Act;[25] the broadness of any rule promulgated under EISA § 811 cannot possibly escape this judicial evolution.

The question remains, however, whether any rule promulgated under § 811 should be read such that recklessness alone will satisfy the scienter requirement. As it regards the securities laws, while the Supreme Court has not yet had occasion to consider whether recklessness will suffice in satisfying the scienter requirement of 10(b), "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly."[26] That said, "reckless conduct may be defined as a highly unreasonable omission, involving

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[22] *See* Pub. L. 110-140, 121 Stat. 1723 (Dec. 19, 2007), Title VIII, Subtitle B, *to be codified* at 42 U.S.C. 17301-17305 (requiring that rules adopted under EISA be "necessary and appropriate in the public interest").

[23] H.R. 1252, 110th Congress (2007).

[24] *See* discussion *infra* next paragraph.

[25] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (holding that the language of § 10(b) requires private plaintiffs to prove scienter—an intent to deceive, manipulate, or defraud); Aaron v. S.E.C., 446 U.S. 680 (1980) (holding that the scienter requirement of § 10(b) applies to the SEC); Tellabs, Inc., v. Makor Issues & Rights, Ltd., 127 S.Ct. 2499 (2007) (detailing the goal of the Private Securities Litigation Reform Act, which was to reduce frivolous securities litigation by lawyers).

[26] *Tellabs*, 127 S.Ct. at 2507 n.3 (2007).

not merely simple, or even inexcusable negligence, but 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."[27] To extrapolate an example from the Commission's proposed rule—an indirect use of a contrivance that effects the market price of gasoline—would likely not suffice this more permissive definition of scienter.

Based upon the preceding evaluation of the securities laws, wherein the Supreme Court has frequently pursued an analysis of the securities laws based primarily upon the language used therein, and since the Commission's authority rests on identical language to that of § 10(b), there seems little question that the Commission's new authority rests upon that precedent. In evaluating such precedent, the Court has not primarily relied upon regulated versus unregulated behavior as a factor, nor the policy considerations underlying the language used in § 10(b), but rather has relied heavily upon the actual language used in § 10(b) of the Exchange Act—language identical to that used in § 811 of EISA.

Energy Law.

As noted in the ANPR, the Energy Policy Act of 2005 also prohibits the use or employment of "any manipulative or deceptive device or contrivance."[28] in both the electric energy and natural gas industries. When the Federal Energy Regulatory Commission ("FERC") promulgated its rules based upon this statutory language, it also explicitly included a scienter requirement.[29] As detailed in the above analysis, based upon the language of the Energy Policy Act, FERC had no option but to include the strict scienter requirement.

Unlike the FTC's propos ed rule, FERC defined fraud "to include any action, transaction, or conspiracy *for the purpose of* impairing, obstructing, or defeating a well-functioning market."[30] The FTC's proposed rule, which makes liability possible where merely the *effect* of an action is to increase market prices, again does not comport with market manipulation precedent in another area of law. The Energy Policy Act and EISA § 811 are based upon § 10(b) of the Exchange Act, and rules promulgated under such statutory authority simply cannot "regulate negligent practices or . . . mismanagement, but rather [are meant] to deter or punish fraud."[31] By attempting to regulate the effect of

[27] Sanders v. John Nuveen & Co., Inc., 554 F.2d 790, 793 (7th Cir. 1977).

[28] FTC ANPR at 25617.

[29] FTC ANPR at 25617; Federal Energy Regulatory Commission, 18 CFR Part 1c: *Prohibition of Energy Market Manipulation: Final Rule*, 71 FR 4244, 4252 (Jan. 26, 2006) [hereinafter "FERC Prohibition"].

[30] FERC Prohibition at 4253.

[31] FERC Prohibition at 4246.

fraudulent action under § 811, the Commission attempts to undermine a strict scienter requirement contrary to directly related market manipulation precedent and Congressional intent.

Like § 10(b) of the Exchange Act and § 811 of EISA, the FERC prohibition against market manipulation also includes a requirement that the intentionally fraudulent action be made "in connection with" a jurisdictional transaction.[32] Again relying on § 10(b) of the Exchange Act, FERC's final rule declared that "in connection with" means that "the entity must have intended to affect, or have acted recklessly to affect, a jurisdictional transaction."[33] As noted previously, while the Supreme Court has not addressed recklessness under § 10(b), the recklessness standard announced by Courts of Appeal under § 10(b) is exacting, requiring "highly unreasonable behavior."[34] Intending to effect market prices and highly unreasonable behavior effecting market prices does not comport with FTC's proposed rule making the *effect* of increased market prices a standard for liability. Such a rule does not align with FERC precedent regarding the "in connection with" requirement of market manipulation.

FTC Act.

The Commission currently has authority under § 5 of the Federal Trade Commission Act to combat unfairness and deception.[35] However, as the ANPR notes, such authority "is not limited to devices or contrivances, and violations do not require proof of actual fraud or intent to deceive."[36] Section 811 directly and literally limits the Commission's authority to "any manipulative or deceptive device or contrivance" and requires, on its face, proof of actual fraud or intent to deceive.[37] While FTC actions under § 5 of the FTC Act may well have provided the Commission with consumer protection experience, it is difficult to see how such disparate statutory authority could, in the Commission's eyes, "provide [an]...important foundation for conducting this Rulemaking proceeding."[38] The Commission's distinction in footnote 11 between reading "manipulative or deceptive" as a single adjective and the Commission's authority

[32] FTC ANPR at 25618.

[33] FERC Prohibition at 4249.

[34] Sanders v. John Nuveen & Co., Inc., 554 F.2d 790, 793 (7th Cir. 1977).

[35] FTC ANPR at 25616

[36] *Id.*

[37] *See* discussion *supra* regarding securities laws.

[38] FTC ANPR at 25616.

under the FTC Act to combat unfairness and deception is hollow.[39] Instead, the focus in considering whether § 5 of the FTC can inform the market manipulation provisions of § 811 of EISA should be found in the same footnote: they are altogether "separate prohibition[s]."[40]

In *Hochfelder*, the Court considered an argument by the SEC that since the overall purpose of the Exchange Act was to "protect investors against false and deceptive practices that might injure them," that the effect upon those injured is the same whether intentional or not, and therefore, "Congress must have intended to bar all" practices.[41] The Court, recognizing that such a watered-down statutory interpretation could wreak havoc, noted that "the logic of this . . . approach would impose liability for wholly faultless conduct where such conduct results in harm."[42] Clearly, the FTC must keep separate its authority under the FTC Act and its authority under EISA, as it does not want to embrace a previous, failed argument of the SEC.

<u>The Commodity Exchange Act</u>.

Manipulation is also a key component of the Commodity Exchange Act ("CEA"). Specifically, the CEA provides that it is a felony for "[a]ny person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity."[43] As the ANPR notes, courts and the Commodity Futures Trading Commission ("CFTC") have consistently interpreted this provision to require the specific intent to injure through intentionally manipulative actions.[44] Specific intent, unlike the scienter standard discussed above under § 10(b) of the Exchange Act, requires both that the person intend to commit the act and that the person intend to break the law.[45]

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[39] *See* FTC ANPR at 25616, n.11 (declaring that even though FERC and the Supreme Court in context of the Exchange Act treat the words manipulative or deceptive as a single adjective, that the "term "manipulative or deceptive" *arguably* can be read as a single adjective") (emphasis added).

[40] *Id.*

[41] 425 U.S. 185, 197-98.

[42] *Id.* at 197.

[43] 7 U.S.C. § 13(a)(2) (2006).

[44] FTC ANPR at 25620.

[45] *See generally* United States v. Birkenstock, 823 F.2d 1026 (7th Cir. 1987).

The ANPR also notes that in *Merrill Lynch v. Curran*[46] the "Court held that the primary purpose of the 1974 amendments to the CEA was to protect against manipulation of markets and to protect any individual who desires to participate in futures market trading."[47] As it regards this quoted material in the ANPR, the Court in *Merrill Lynch* actually addressed the underlying question of whether a private cause of action should arise under CEA.[48] In the midst of discussing the procedural history of the case before it, the Court, in a footnote, cites the District Court record, which in turn cites Senator Dole as detailing the "primary purpose of the legislation."[49] The Court's footnote material in *Merrill Lynch* quoting the lower court and Senator Dole regarding the intended class of statutory beneficiaries under CEA, amidst the underlying discussion of a private cause of action, adds little substantively to the consideration of a market manipulation standard under § 811, and therefore deserves little weight or consideration.

What does deserve consideration is that the CEA is a specific intent statute more akin to state law criminal statutes than the intentional, willful, scienter requirement of the Exchange Act, FERC final Rule, or EISA. As such, the CEA should not be given much weight in the course of interpreting the market manipulation provisions of EISA; if any weight is given to the CEA, it should not be to given to a loosely worded and potentially misleading conclusion that the Court in *Merrill Lynch* "*held* that the primary purpose of . . .CEA was to…protect any individual who desires to participate in futures market trading."[50]

Some hypotheticals may assist in a practical analysis of this critical legal points in the various laws and regulations discussed above.

For instance, a supplier faces a shortage of motor fuels to provide retailers in Richmond, Virginia, because the region is suffering from a drought, and barges have not been able to make it up the James River. Prices will naturally rise because of the laws of supply and demand. But assume that same supplier has a comfortable inventory in Charlotte, North Carolina. In an effort to satisfy customers in the Richmond area, the supplier engages a pipeline to get product there. As a result, prices may rise in Charlotte, but level off in Richmond. Has the supplier "manipulated" these markets? In the strict sense of the word, the answer is yes. These kinds of decisions, however, are made in the normal course of business all the time, and Congress never intended for them to be outlawed.

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[46] 456 U.S. 353 (1982).

[47] FTC ANPR at 25618 (internal quotations omitted).

[48] 456 U.S. 353, 356.

[49] *Id.* at 372, n.50.

[50] FTC ANPR at 25618 (emphasis added).

Similarly, consider the case of a supplier who has a substantial inventory in his region. He maintains a close grip on his business, but decides to take a month-long vacation abroad, telling his employees not to bother him. While he is away, a natural disaster hits, greatly harming supplies in the region. When he returns, prices have skyrocketed, although they could have remained relatively stable if the supplier had released inventory during the disaster. Clearly, the supplier's failure to release supply has had an "indirect . . . effect" on the market. But taking a vacation should not be cause for federal prosecution.

SIGMA is eager to assist the staff of the Commission in providing information on how our members' markets work in situations like these.

Transparency

SIGMA believes in free markets. But free and fair markets in motor fuels depend on transparency. Indeed, with respect to retail sales, there is probably not a more open and transparent marketplace in the world. Gasoline prices are posted for all to see at every station in America.

The same is not true in wholesale markets. Indeed, there has been much attention in Congress, the CFTC, and the press recently about the historic volatility and high prices in the oil markets. Clearly, there is a strong sense that these conditions result from something other than just the laws of supply and demand.

The wholesale marketplace, however, can benefit from the same brand of transparency that exists at retail. SIGMA feels strongly that transparency regulations should apply to anyone that is effecting trades where United States interests and markets are at stake. The current scope of international trading in U.S. markets is perhaps unprecedented. Any entity with a legal nexis to our markets -- whether their trades occur here domestically or abroad -- should have some accountability to the federal government to ensure that those markets are not being manipulated.

The CFTC has recently proposed or implemented steps to increase transparency in the oil markets. SIGMA applauds these efforts, but they are inextricably linked to the FTC's current rulemaking. We therefore strongly urge the Commission to coordinate its rulemaking in the present proceeding with the CFTC to ensure that regulated parties are governed appropriately.

SIGMA recommends that not all wholesale transactions need be transparent at the time of the purchase or sale. In publicly traded markets, regulated by the CFTC or private exchanges, there should be maximum, readily transparent disclosure. The term "video barrels" has gained some use recently – purchases and sales that only take place on a computer monitor, when a purchaser never anticipates taking actual delivery of a quantity of oil. Any regulation of market manipulation must take account of these transactions.

This stands in contrast to private markets, however, where adequate record-keeping (as opposed to reporting) should be sufficient to ensure that any manipulation does not take place (or that, if it does, the Commission or others can easily investigate it, detect it, and enforce accordingly).

Oversight and Enforcement

Of course, solid regulations concerning market manipulation and transparency will have no practical meaning without adequate compliance oversight and enforcement. In this regard, SIGMA suggests that the FTC look to an SEC-like regime to monitor potential cases of manipulation. Assuming that the Commission and the CFTC have an adequate breadth of requirements for transparency in trading, there is no reason that the FTC cannot identify -- and enforce against -- cases of market manipulation in the same way that the SEC is able to do so in cases of insider trading or similar violations of the securities laws. By virtue of section 811, Congress has effectively charged the FTC with being the "cop on the beat" with respect to manipulation in wholesale petroleum markets. SIGMA has every confidence that the Commission's long history of oversight and enforcement under section 5 of the FTC Act, among other statutory provisions, together with the experiences of the SEC and other agencies, will ensure that the goals of EISA are fulfilled.

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SIGMA greatly appreciates the opportunity to comment on the ANPR. We are anxious to play a productive role in this process, and look forward to working with the Commission to promote abundant motor fuel supplies in the United States.

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