Dissenting Statement of Commissioner William E. Kovacic
Crude Oil Price Manipulation Rule Making, Project No. P082900

Since early 2008, a task force of the staff of the Federal Trade Commission (FTC) has devoted extraordinary care, skill, and effort to the development of a rule to implement Title VIII of The Energy Independence and Security Act of 2007.[1] Their performance on this project – from the early research on the possible content of a rule through the public consultations and drafting of options for the Commission's consideration – is a model of superb public administration. I thank and congratulate them.

I disagree with the choices taken by the Commission today in promulgating a Final Rule. In connection with wholesale transactions involving "crude oil, gasoline, or petroleum distillates," Section 317.3(a) of the Commission's Final Rule makes it illegal to "Knowingly engage in any act, practice, or course of business . . . that operates or would operate as a fraud or deceit" on any person.[2] Section 317.3(b) of the Final Rule makes it illegal for a party "[i]ntentionally" to "fail to state a material fact" where "such omission distorts or is likely to distort market conditions . . . ."[3] Compared to Paragraph 3(a), Paragraph 3(b) imposes a more demanding scienter requirement. To violate Paragraph 3(b), the person must act "intentionally" rather than "knowingly," a state of mind that exists when the person "knew or must have known that his or her conduct was fraudulent or deceptive."[4] Paragraph 3(b) also contains the requirement, missing in Paragraph 3(a), that the behavior "distort market conditions."

I dissent from the Commission's promulgation of the Final Rule. To my mind, a minimally acceptable rule would have departed from the Commission's Final Rule in two major respects. First, it would have incorporated into Paragraph 3(a) the requirements that the conduct be intentional and either actually or likely distorts market conditions. Second, the rule would not have contained a separate command dealing with omissions, thus deleting Paragraph 3(b) of the Commission's Final Rule.[5] As it stands, I cannot say that the Final Rule is in the public interest.[6]

When implemented, the Final Rule will cover a vast number of routine transactions – literally thousands daily – in petroleum products. These transactions are the indispensable means by which gasoline, diesel fuel, and jet fuel move from refineries to end users. Society has an immense stake in avoiding unnecessary disruption to these undertakings. Violations of the Commission's Final Rule are punishable with civil penalties of $1 million per violation, and each day on which the misconduct continues is treated as a separate offense.[7]

By reason of the drafting choices described above, the Commission has taken inadequate precautions to ensure that the aims of the underlying legislation are attained without imposing social costs that swamp the benefits Congress sought to achieve. Because the Final Rule's requirements are unlikely to proscribe only genuinely harmful conduct, there is a serious danger that it will impede routine contracting that is benign or procompetitive and thereby make Americans worse off by damaging the flow of commerce in petroleum products. The Commission's extensive work since the 1960s in reviewing petroleum industry mergers and allegations of anticompetitive conduct ought to have made the agency more attentive to these considerations. The FTC's previous inquiries have determined that price fluctuations for petroleum products result principally from market forces: prices

decline when supply rises or demand falls.[8] This experience does not gainsay the potential harm that consumers *could* suffer from manipulation of market prices. It does suggest, however, that the contributions of a rule against market manipulation for petroleum products to the solution of the nation's larger energy problems are likely to be small. At the same time, the breadth of the substantive commands of the Commission's Final Rule, its applicability to an expansive range of routine contracting, and the severity of the penalties for violations create serious possibilities for deterring suppliers from participating in transactions that pose no threat to consumers. By incorporating the scienter and market distortion elements of Paragraph 3(b) into Paragraph 3(a), the Commission could have minimized these hazards. It unfortunately chose not to do so.

The inclusion in the Final Rule of the omissions provision, Paragraph 3(b), is a second regrettable decision. A proscription on certain acts, practices, or courses of business, alone is sufficiently broad to capture fraudulent omissions. Because the Final Rule is modeled on SEC Rule 10b-5, a separate and distinct omissions prohibition could invite subsequent interpretations that the Final Rule requires affirmative disclosures. Although the Commission explains in the Statement of Basis and Purpose that accompanies the Final Rule that it does not interpret Paragraph 3(b) as requiring an affirmative duty to disclose,[9] it is likely that other adjudicators will be called on to interpret the Final Rule. These adjudicators may not reach the same conclusion as the Commission, especially to the extent that the Final Rule becomes the subject of litigation in state courts under state consumer protection laws.[10]

In light of this substantial liability risk, the omissions component may well force the many firms that engage in legitimate transactions with their competitors on a daily basis to choose between two problematic paths of conduct: one way to avoid a potentially wrongful omission is to disclose more private information to your rival; a second approach is to limit investments in acquiring potentially relevant marketplace information and to reduce the number of encounters that could be examined through the lens of the Commission's Final Rule. Neither alternative is good for consumers. Excessive disclosure of private information among competitors threatens competition and is precisely the type of conduct that the FTC investigates and challenges under the antitrust laws. A competition agency should not be in the business of telling rivals to give each other more information about their business operations. A decision to gather less marketplace information or to engage in fewer transactions promises to translate into higher prices that may not accurately reflect underlying supply and demand conditions.

Last, the Commission's Final Rule has the capacity to deflect needed attention away from root causes of the country's energy problems and to divert effort away from the pursuit of effective solutions. For example, there is a legitimate debate to be had about whether gasoline prices adequately reflect external costs, such as those associated with environmental damage, national security, or traffic congestion. We also might usefully debate the proper mix of increased domestic oil production, nuclear power, or renewable energy sources to enhance energy security. By focusing valuable attention on measures that have little capacity to address these and other fundamental issues, the Commission's Final Rule may serve to relax the urgency that the nation ought to feel to devise approaches that truly come to grips with the larger dimensions of the energy problem.

[1] 42 U.S.C. §§ 17301-17305.

[2] Prohibitions on Market Manipulation, Statement of Basis and Purpose and Final Rule (to be codified at 16 C.F.R. § 317.3(a)).

[3] *Id.* (to be codified at 16 C.F.R. § 317.3(b)).

[4] *Id.* (to be codified at 16 C.F.R. § 317.2(c)).

[5] Such a rule would be similar to the alternative rule proposed in the Revised Notice of Proposed Rule Making, 74 FED. REG. 18304, 18327 (Apr. 22, 2009).

[6] *See* 42 U.S.C. § 17301 (permitting the Commission to adopt a rule to implement the Energy Independence and Security Act if it finds such a rule to be in the "public interest").

[7] 42 U.S.C. § 17304.

[8] *See* FEDERAL TRADE COMMISSION, INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST-KATRINA GAS PRICE INCREASES (2006), *at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf; FEDERAL TRADE COMMISSION, GASOLINE PRICE CHANGES: THE DYNAMIC OF SUPPLY, DEMAND, AND COMPETITION (2005), *at* http://www.ftc.gov/reports/gasprices05/050705gaspricesrpt.pdf.

[9] *See* Statement of Basis and Purpose and Final Rule at 33 n.92 ("Consistent with its position in the NPRM and the RNPRM, the Commission currently does not expect to impose specific conduct or duty requirements such as . . . a duty to disclose, or a duty to update or correct information.").

[10] Some states model their consumer protection laws on the FTC Act, and some allow private causes of action under these laws. Because the Energy Independence and Security Act provides that a violation of the Act "shall be treated as an unfair or deceptive act or practice proscribed under a rule issued under Section 18(a)(1)(B) of the [FTC Act]," 42 U.S.C. § 17303, it is not unreasonable to assume that the Final Rule may provide a cause of action under some state consumer protection laws.