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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION

MARKET MANIPULATION RULEMAKING WORKSHOP
THURSDAY, NOVEMBER 6, 2008

FEDERAL TRADE COMMISSION
600 PENNSYLVANIA AVENUE, N.W.
ROOM H-432
WASHINGTON, D.C.

Reported by: Sally Jo Quade & Debra L. Maheux

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1 P R O C E E D I N G S

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3 MR. WALES: Good morning, everyone, let's go
4 ahead and get started. I'm Dave Wales, I am the
5 acting bureau director in the Bureau of Competition
6 and I want to welcome everyone for coming this
7 morning. We are very excited about today's activities
8 with our Federal Trade Commission Marketing
9 Manipulation Rulemaking Workshop, and so I want to
10 welcome everyone and thank you for coming.

11 This workshop is an important opportunity
12 for the Commission staff and interested parties to
13 gather to discuss the proposed market manipulation
14 rule and the comments received in response to it. The
15 FTC commonly uses public workshops in rulemaking
16 proceedings to deepen its understanding of the issues,
17 and, in fact, it has done so in most of the major
18 rulemakings of the past decade, including the
19 Franchise Rule, the Telemarketing Sales Rule and the
20 CAN-SPAM proceedings.

21 It's somewhat new to us in BC, we don't
22 normally have rulemakings, but we luckily have a lot
23 of people within the Commission who have the
24 experience in doing it.

25 In gathering together to discuss this

1 rulemaking, as raised in the comments, we hope to
2 advance the discussion about the proposed rule and the
3 various alternatives proposed in the comments.

4 What we have found is that people who are
5 stakeholders in these rulemakings are often in the
6 best position to discuss points of contention with one
7 another and draw out important distinctions and
8 challenge underlying factual assumptions. Each of the
9 participants here today comes from some perspective or
10 experience that gives you considerable insight and
11 causes you to have a great deal of information and
12 knowledge about the issues in this rulemaking.

13 The dialogue here today, which will be
14 transcribed and placed in the public record, together
15 with comments received thus far in this proceeding,
16 will inform the Commission's decision on whether to
17 proceed with a rule to prohibit market manipulation in
18 the petroleum industry, and if so, how to craft the
19 rule to achieve maximum benefit to the public while
20 eliminating unnecessary burdens, which of course is
21 very important.

22 We are very grateful for the participation
23 of the interested parties, industry members,
24 associations, consumer advocacy groups, lawyers and
25 scholars who have engaged in this rulemaking

1 proceeding by submitting comments and especially those
2 who have taken the time to be with us here today.
3 Your views and insights will inform the Commission in
4 its decision-making going forward.

5 By way of background, let me first spend a
6 few minutes discussing the process to date. The
7 Energy Independence and Security Act of 2007 was
8 signed into law in December of last year. Section 811
9 of Subtitle B of Title 8 of the Act prohibits market
10 manipulation in connection with the purchase or sale
11 of crude oil, gasoline or petroleum distillates at
12 wholesale in violation of any rule that the FTC may
13 prescribe as necessary or appropriate in the public
14 interest.

15 Section 812 prohibits false or misleading
16 reporting of information required by law to be
17 reported to government agencies. The FTC is
18 exercising its discretionary rulemaking authority
19 under Section 811 of the EISA to promulgate a rule to
20 combat market manipulation in the wholesale petroleum
21 markets.

22 In May 2008, the FTC issued an advanced
23 notice of proposed rulemaking or an ANPR outlining the
24 relevant issues and requesting comment on how it
25 should proceed, and in particular whether a market

1 manipulation rule should be promulgated.

2 The Commission received 155 comments in
3 response to the NPRM, which is quite remarkable. In
4 August 2008, the FTC issued a notice of proposed
5 rulemaking, including the text of the proposed rule
6 modeled after Securities and Exchange Commission Rule
7 10b-5. Comments in response to the NPRM were due on
8 October 17th and to date we have received 35 such
9 comments, all of which are posted on our website.

10 The next step in the process is to discuss
11 the proposed rule in depth in today's workshop
12 together with support, criticism, concerns and
13 suggested alternatives set forth in the comments we
14 have received. I think we have a great group today to
15 accomplish that goal.

16 The topics to be covered in the various
17 panels include whether the FTC should use the SEC's
18 Rule 10b-5 as a model for its market manipulation
19 rule. Second, the proper scienter standard for an FTC
20 rule. Third, the appropriate reach of an FTC rule.
21 Four, types of conduct that would violate any such
22 rule. And lastly, the desirability of including
23 market or price effects as an element of a cause of
24 action for an FTC rule.

25 All of the information in the public record,

1 the comments filed, and the transcript from today's
2 workshop will be considered by the Commission in
3 determining the final outcome of this proceeding.

4 Before we get started, I guess what I wanted
5 to also do is provide special thanks to our entire
6 market manipulation task force, and in particular, the
7 leadership of Patricia Galvan, who has just done a
8 stellar job in putting all this together under a very
9 tight timeline and doing an incredible piece of work.
10 She's a real star within the Bureau of Competition.

11 I also, too, want to thank all of those
12 within the Commission, also in BC, but truly kind of
13 an inter-agency group that I think is a real excellent
14 showing of what the FTC can do with participation from
15 the Bureaus of Competition, Consumer Protection and
16 Economics and the Offices of General Counsel,
17 Congressional Relations, the Secretary, and Public
18 Affairs. So, it's really been kind of a full team
19 effort, I think, that shows in the work product today.

20 So, again, thank you all for participating
21 in this process and expressing gratitude for the
22 information you've provided, the time which you have
23 invested and the continued interest you have shown to
24 this important matter.

25 And with that, I am going to turn it over to

1 Patricia.

2 MS. GALVAN: Thank you. Thank you very
3 much. And I also wanted to extend my own thank you
4 for everybody coming not only to participate in the
5 audience, but also here at the table. We understand
6 the time commitment that this requires, and the amount
7 of preparation work that you had to put into even
8 coming today. So, thank you very much.

9 I am told that I must give a brief overview
10 of security remarks. So, let me just dispense with
11 those first. And this is in case of a fire or an
12 evacuation, but anyone who leaves the building without
13 an FTC badge will be required to go through the
14 magnetometer and x-ray machine prior to re-entry into
15 the conference room.

16 In the event of an emergency, fire or
17 evacuation, the alarms will sound. At that time,
18 please gather your personal belongings, if the
19 situation permits, and leave the building in an
20 orderly fashion. I know you're all paying attention
21 to this.

22 Once outside of the building, orient
23 yourself to the corner of 7th Street and Constitution
24 Avenue, where you will enter the National Gallery of
25 Art, that is our rallying point, everyone will rally

1 by floor. Please stay together. You will need to
2 check in with the conference meeting coordinator.
3 This is not prepared by me.

4 In the event that it is safer to remain
5 inside, shelter in place, you will be advised where
6 you should report to while inside the building.
7 Information and updates will be distributed via the
8 public address system. Please remain with your
9 meeting coordinator.

10 If you spot suspicious activity, please
11 alert the conference meeting coordinator and/or
12 security staff. That is not a way to eliminate a
13 fellow panelist from the room.

14 My name is Patricia Galvan, I am a deputy
15 assistant director at the Bureau of Competition. I
16 want to have everybody at the table introduce
17 themselves, but I do want to go over some ground rules
18 and process points before we get started. As you all
19 know, this proceeding is being transcribed and will be
20 placed on the record, and our reporter is sitting back
21 behind me to my right, she cannot really see you,
22 which requires that you identify yourself when you
23 speak. Especially in the morning until everybody is
24 familiar with each of us. And I assume that's
25 actually probably going to require that you identify

1 yourself all day, just the name of your organization
2 or your name.

3 The procedure for being recognized to speak
4 is that you raise your tent. I will be making note of
5 those tents that are raised, indicating your wish to
6 participate and I will call you either in the order
7 your tent goes up or out of order, depending on what
8 you have said in your comment, perhaps the relevance
9 of something you've said.

10 Just so that you know, at the end of the
11 day, if time permits, we are going to allow
12 participation from the audience in an open mike
13 session. We do request that you sign in at the table,
14 which is in the ante room, so that allows us to
15 determine how much time to make if there is an
16 interest in participation in the audience, and that
17 would be at the end of the day.

18 I do know that several people will have --
19 there are other members from your organization that
20 you may wish to rotate within the seats that you have,
21 we've tried to have them close by in case you want to
22 communicate with them during the workshop or pass
23 notes, please feel free to do that. If you feel that
24 it's important at some point to just rotate, just let
25 me know and we can certainly make the change.

1 I think that's it in terms of process
2 points. One other thing, we do have a lot of topics
3 to cover today, which may require that I cut you off,
4 and I don't mean to be rude when I do that, but it is
5 to move the conversation along. We don't really want
6 to repeat or rehash the comments, but we do recognize
7 a certain amount of stating what you have already
8 stated in the record that may be necessary just to get
9 started.

10 So, I am going to start here to my right,
11 and I ask that you introduce yourself and then we will
12 go around the table.

13 Okay, one more thing, turn your cell phones
14 off. Turn your cell phones off. Please, I mean,
15 there are a lot of people here, every person has three
16 personal devices per person, so please make sure you
17 do that.

18 But in terms of the panelists, when you
19 introduce yourself, please do introduce yourself and
20 your organization, and make a very brief statement
21 about your main concern or the issues that have
22 brought you here today, because there are a number of
23 panelists, we ask that you try to limit yourself to a
24 minute or so. And I will get started with Phill.

25 MR. BROYLES: My name is Phill Broyles, I'm

1 assistant director with the Bureau of Competition with
2 the FTC.

3 MR. VAN SUSTEREN: Yes, my name is David Van
4 Susteren, I'm with Fulbright & Jaworski in Houston,
5 Texas, and the main issue that I appear on today is
6 the lack of a requirement of a showing of price effect
7 in the proposed rule. It's my view, not the firm's or
8 the client's, but it's my view that it should be
9 included in a causation standard.

10 MS. VELIE: My name is Athena Velie, I'm
11 with McDermott, Will & Emery, but I'm appearing on
12 behalf of ISDA, the International Swaps and
13 Derivatives Association today, which is a global trade
14 association representing market participants in a
15 privately negotiated derivatives industry. You may
16 know us from the master trading documentation that
17 ISDA has developed for its members, not only to trade
18 financial instruments, but also physical commodities
19 like petroleum products.

20 We are going to focus in this session today
21 primarily on two points, although we'll, you know,
22 discuss other items as they come up, but first, you
23 know, we would like to encourage the Commission to
24 reconsider its level of reliance on SEC precedent, and
25 secondly, we would ask the Commission to reconsider

1 its use of a recklessness standard.

2 In sum, just because we feel that it's very
3 difficult to apply those standards to these wholesale
4 markets and that it ultimately will chill beneficial
5 trading activity in the markets, and we would like to
6 discuss a few examples when we get a chance. Thank
7 you.

8 MR. PICCONE: I am Jim Piccone, president
9 and general counsel of Resolute Natural Resources
10 Company. We're a relatively small independent
11 exploration and production company. If I may, I would
12 like to introduce the folks who are with me, would
13 that be okay?

14 MS. GALVAN: Certainly.

15 MR. PICCONE: Mr. Perry Shirley sitting over
16 here is a director at Navajo Nation Oil and Gas
17 Company. NNOGC, as we call them, is a federally
18 chartered Navajo Nation corporation that is charged
19 with developing oil and gas resources on the Navajo
20 reservation.

21 Also with me is Gale Miller, with the law
22 firm of Davis, Graham and Stubbs in Denver, he is
23 counsel to Resolute Natural Resources Company. And
24 also Ms. Sheila Hollis, who many of you know, I am
25 sure, is a FERC lawyer. She is also counsel to

1 Resolute Natural Resources in this matter.

2 Resolute's primary business is to work with
3 NNOGC in developing a very old field in southeast
4 Utah. It's called the Aneth field. It's a
5 50-year-old field and it's been in decline for a
6 number of years, but it at one time was a very big
7 field with lots of resources. NNOGC and we have
8 embarked on a program to redevelop that field. That
9 program will take up to a billion dollars in many
10 phases over many years. If we're successful, we will
11 develop some 70 to 80 million barrels of oil that
12 would otherwise be left in the ground.

13 We're here today to encourage the Commission
14 to very clearly include in the rule the concept of
15 manipulation separate from the concept of fraud and
16 deceit. We have a situation that we'll talk about
17 where we think it's rather open, but not deceitful
18 manipulation, and we would like to be sure that the
19 rule covers that.

20 MR. BARNETTE: Hi, I'm Jim Barnette with
21 Steptoe & Johnson here in town here on behalf of the
22 Society of Independent Gasoline Marketers of America,
23 whose members represent an incredibly diverse sector
24 of downstream petroleum sales. We're here in large
25 measure to applaud the Commission for its vast

1 improvements to the ANPR, and look forward to today's
2 discussion.

3 MR. YOUNG: I'm Mark Young, with the law
4 firm of Kirkland & Ellis. I am here today
5 representing the newly named Futures Group. We filed
6 two comment letters, one in response to the advanced
7 notice and one in response to the proposed rule.
8 Comment letters were filed on behalf of the Futures
9 Industry Association, the Managed Funds Association,
10 the National Futures Association, the Intercontinental
11 Exchange, and last but certainly not least the CME
12 Group which will be represented today by De'Ana Dow as
13 well.

14 It is unusual, I think that's an
15 understatement, to get all of these groups to agree on
16 a particular point of view, but in this case, the
17 strong view of our clients is that the Federal Trade
18 Commission should recognize and respect the exclusive
19 jurisdiction of the Commodity Futures Trading
20 Commission as provided in the Commodity Exchange Act,
21 and should -- it should adopt a safe harbor for
22 futures trading activities from the provisions of the
23 Federal Trade Commission's rule, and at the same time
24 coordinate and harmonize the application of the
25 Federal Trade Commission's rule to cash market

1 activities over which the CFTC would have concurrent
2 jurisdiction.

3 MR. DREVNA: Good morning, all, I'm Charlie
4 Drevna, president of NPRA, the National Petrochemical
5 and Refiners Association. We're a national trade
6 association representing nearly 500 members, including
7 companies that own or operate virtually all refining
8 capacity in the United States, as well as most of the
9 domestic petrochemical manufacturers.

10 First of all, grateful for the opportunity
11 to be here. We all have a task to do today, and I
12 think we can work toward a common goal. First of all,
13 I want to also mention that with me today, excuse me,
14 is Susan DeSanti from Sonnenschein, Nath & Rosenthal,
15 and she has been helping us in this effort.

16 But briefly, though, I think as an initial
17 matter, I think we should understand that the reason
18 we're here today, and the reason that we believe that
19 Congress passed this portion of EISA '07 is that
20 political concerns about the potential for market
21 manipulation that will harm consumers, rather than
22 actual evidence of such market manipulation, and
23 that's what motivated this -- I believe that's what
24 motivated this legislation.

25 But that being said, though, as

1 representatives of vast industries, we don't want
2 market manipulation, and we want to make sure that how
3 the FTC and we work together to ensure that that
4 doesn't happen, and to punish those who may try to do
5 it, doesn't end up causing more harm than good. And
6 there's a lot of intricacies in the proposal, and some
7 of the comments that are on the table that I have
8 read, that we could -- if we do this the right way, we
9 can come out with a win-win situation. And that, I
10 think, is why we're all here. I hope that's why we're
11 all here.

12 So, our comments are going to, as you've
13 read before, are going to mirror a lot of the things
14 that we think the path that should be taken and the
15 paths that shouldn't be taken to achieve that goal.
16 So, appreciate the opportunity.

17 MR. MILLS: Hi, my name is Charlie Mills,
18 I'm with the law firm of KNL Gates in Washington, and
19 I am here as a representative of the Committee on
20 Futures and Derivatives Regulation of the New York
21 City Bar. The committee submitted two comments, one
22 in respect of the advanced rulemaking and one in
23 respect of the proposed rule.

24 I guess today I'm thinking I would primarily
25 address securities law questions which our comments

1 went into in some detail and with respect to concepts
2 of recklessness, and scienter and the intent standard.
3 I think the committee's comments are directed toward
4 trying to have a harmonization of securities law with
5 CFTC and FERC law concepts of manipulation in cash
6 markets, which still, I think, is an uncertain playing
7 field in terms of actual precedent for cash markets.

8 I also want to say a disclaimer that any
9 comments that I would make today that are not squarely
10 within the comments made in the committee's
11 submissions would be purely my own and should not be
12 considered to be the committee's. Thank you.

13 MR. HALLOCK: My name is Alan Hallock, and I
14 am general counsel at Flint Hills Resources. Flint
15 Hills Resources is a refiner. We refine about 800,000
16 barrels a day of crude oil. We wholesale all of our
17 products. We don't have any retail stations, and we
18 don't have any crude oil production.

19 Today, I hope to offer the perspective of
20 in-house counsel who will be required to draft
21 compliance policies in response to any rule that the
22 FTC finally adopts. To that end, the policies and the
23 direction that we will need to give our employees will
24 need to be clear and definite. And for that reason, I
25 strongly support the NPRA proposal for a rule, which

1 we believe provides clear and definite instruction to
2 the regulated community. I look forward to
3 participating in today's workshop, thank you.

4 MR. LONG: Good morning, my name is Robert
5 Long, I'm a partner in the law firm of Covington &
6 Burling, and I'm appearing today on behalf of the
7 American Petroleum Institute, and I'm joined by my
8 colleague, Jonathan Gimblett, who is also at Covington
9 & Burling, and by Kristin Noeth, who is a lawyer at
10 API.

11 API has about 400 members, they cover all
12 facets of the industry, including exploration,
13 production, transportation, refining, and marketing,
14 so API's members will be directly affected by the
15 proposed rule, and by just about every aspect of it.
16 So, our comments, if you've been going through them,
17 if for nothing else, you may remember them for their
18 length, as we submitted extensive comments, both on
19 the advanced notice of proposed rulemaking and the
20 notice of proposed rulemaking. And we greatly
21 appreciate the opportunity to participate in today's
22 workshop.

23 API supports the Commission's view that
24 proposals for a market manipulation rule should be
25 evaluated by weighing the anticipated benefits of a

1 rule against the anticipated costs. And API believes
2 that the costs of the rule that is proposed in the
3 NPRM rulemakings are likely to outweigh its benefits.
4 In particular, we do not believe that the rule as
5 proposed accounts for important differences between
6 the securities markets, that are subject to the SEC's
7 Rule 10b-5, and the wholesale petroleum markets that
8 would be subject to the Commission's proposed rule.

9 Because the Rule 10b-5 regulatory regime is
10 deeply intertwined with the disclosure obligations and
11 fiduciary duties of the securities laws, applying that
12 regime to wholesale petroleum markets without
13 appropriate modifications will create uncertainty and
14 interfere with the efficient functioning of markets
15 that are vital to the national economy.

16 To address these concerns, API suggests that
17 the Commission adjust the proposed rule in four
18 respects. First, by requiring a showing of specific
19 intent to deceive or defraud for the purpose of
20 affecting a covered market, and providing a safe
21 harbor for statements and omissions that are not made
22 in connection with reports to government agencies,
23 third party reporting services, or to the public
24 through corporate announcements.

25 Second, by limiting or eliminating liability

1 for incomplete disclosures. Third, by clarifying that
2 the rule is limited to statements or acts pertaining
3 to specific wholesale petroleum transactions and
4 excluding rack transactions and other terminal-level
5 sales, as well as upstream statements and conduct.
6 And fourth, by requiring a showing of a material
7 effect on market prices.

8 The agenda for today provides opportunities
9 to explore each of these points and we look forward to
10 participating in the discussion.

11 MS. HARRINGTON-McBRIDE: John, before you
12 begin, we've been reminded by the folks who are
13 monitoring our webcast that all participants should
14 try to speak into the mike. You can see we're trying
15 to conserve resources, we only have one mike for every
16 two participants.

17 MS. GALVAN: To that end, Jim, if you feel
18 that you need to move your seat over to the end of the
19 table to get closer to the mike, please feel free.

20 MR. PICCONE: Good idea.

21 MR. KINGSTON: Good afternoon, my name is
22 John Kingston, I'm the director of oil at Platts.
23 Every day we produce hundreds and hundreds of
24 assessments of the value of crude oil and products
25 around the world and obviously specifically in the

1 U.S.

2 Our primary concern with the FTC rule is
3 that it be implemented in such a way as to ensure that
4 the free flow of information necessary for proper
5 price discovery is maintained. Platts publishes these
6 assessments. We do so not only to widely available
7 methodologies, but we are also able to do so through
8 the fact that market participants have voluntarily
9 chosen to engage with us.

10 It is vitally important that the Commission
11 ensure that whatever rule it adopts should do so with
12 an eye on making sure that the voluntary engagement
13 continue. Our fear is that if the final rule is
14 written without concern for this information back and
15 forth, voluntary participants may interpret certain
16 passages or a lack of clarity as creating a
17 significant hazard for them to talk to Platts. The
18 end result will diminish this communication and that
19 will help no one.

20 Platts is very appreciative of the
21 Commission's statement that it wants to avoid chilling
22 competitive behavior. In trying to meet this goal, it
23 is vital that the Commission acknowledge the important
24 role that price reporting services provide to market
25 transparency and take steps to ensure that that

1 information keep flowing to them.

2 I also want to second the earlier comment
3 about a safe harbor. We would like to see there be a
4 safe harbor built into this procedure, so such a safe
5 harbor has been adopted by FERC and the national gas
6 and electricity markets and it has served those
7 markets well, and we hope the example set in that case
8 will be looked upon positively by the Commission.

9 And thank you very much.

10 MR. PIRRONG: Good morning, my name is Craig
11 Pirrong, I'm professor of finance and director of
12 energy markets of the Global Energy Management
13 Institute at the University of Houston. I am an
14 academic, but I have studied manipulation for going on
15 20 years now, having written seven articles, academic
16 articles and a book on the subject. In addition, I
17 have been an expert witness in a variety of
18 manipulation cases, including serving as an expert for
19 manipulation related issues in the BP/Amoco/ARCO
20 merger of I guess it was 2001.

21 In my study of manipulation, it's pretty
22 clear that an aspect of manipulation in commodity
23 markets, potentially as distinct from what happens in
24 securities markets, is the concept of market power,
25 and this is something that seems to be completely

1 absent in the proposed rule. Instead, the proposed
2 rule relies upon securities market regulation as its
3 model, and focuses on issues of fraud and deceit.

4 In my view, this is an inappropriate model,
5 and misses sort of the key types of manipulative
6 conduct that are likely to occur in a commodities
7 market like the petroleum market, and so I think that
8 some rather considerable rethinking would be
9 beneficial.

10 MR. COOPER: My name is Mark Cooper, I'm the
11 director of research at the Consumer Federation of
12 America. And we view this rule as interesting. It
13 won't get the headlines, but in many respects, it may
14 actually do consumers as much good as the Do-Not-Call
15 List, as an example of the Federal Trade Commission
16 taking appropriate action to increase and enhance
17 consumer protection. And let me answer the four
18 questions that were raised, others have similarly.

19 We think you definitely should issue a rule.
20 If you insist on a scienter approach, we rather like
21 the idea of recklessness, we think you ought to have a
22 very loose definition of recklessness. There is a
23 great deal of behavior that goes on in these markets
24 that actually harms the public. And in fact, our view
25 of the fact that there is an underlying physical

1 market, a physical market which is highly imperfect,
2 and has imposed a great deal of harm on the public,
3 the existence of that market heightens the incentive
4 and ability to engage in manipulation. So,
5 recognizing that market should move you to provide
6 more consumer protection, not less.

7 We do not believe you should carve out safe
8 harbors, we do not believe you should require a
9 showing of price effects, and we definitely do not
10 believe that claims of jurisdiction and concerns about
11 jurisdictional overlap should dissuade you from
12 issuing an aggressive consumer protection rule.

13 Let us be clear, the existing agencies have
14 failed to protect the public from abuse. That is why
15 Congress enacted a new statute, that is why Congress
16 gave a new agency authority. The intention is to
17 expand consumer protection, not to worry about other
18 agencies and what their jurisdiction is. This is a
19 new jurisdiction, in an area that is desperately in
20 need of more aggressive consumer protection.

21 MS. STUNTZ: Good morning, my name is Linda
22 Stuntz, with the law firm of Stuntz, Davis & Staffier,
23 I'm here on behalf of the Association of Oil Pipe
24 Lines. With me is Steve Kramer, general counsel of
25 the Association of Oil Pipe Lines.

1 The association represents the vast majority
2 of crude oil and petroleum product pipelines in this
3 country, and for brevity's sake, when I refer to oil
4 pipelines, I will include both petroleum product as
5 well as oil pipelines. The reason I'm here is quite
6 simple today, we would ask the Commission to
7 reconsider its view that oil pipelines are, in fact,
8 subject, or should be subject to this rule. Oil
9 pipelines are comprehensively regulated as common
10 carriers under the Interstate Commerce Act by the
11 FERC.

12 The Commission, we believe, has erred in
13 taking the position that only common carriers
14 regulated by the STB, the Surface Transportation
15 Board, are subject to the exemption as provided in the
16 FTC Act. We see no legal basis for that, and believe,
17 in fact, that we should not be subject to this rule.
18 We find further support for this position in the
19 Energy Independence and Security Act of 2007, as
20 paraphrased by Mr. Wales in the introduction of this
21 conference, you will note that he spoke of sales of
22 products in connection with the purchase and sale of
23 petroleum products at wholesale. There is no
24 reference to transportation, as there is, for example,
25 in the FERC market manipulation statute from 2005.

1 Finally, we think, in any event, assuming
2 you didn't agree with us on those, we do not believe
3 it is necessary or appropriate or a prudent use of
4 this agency's resources to regulate petroleum product
5 pipelines, given the comprehensive regulation of their
6 rates, terms and conditions by the FERC, and we look
7 forward to discussing with you why we think that would
8 be counterproductive and not in the interest of the
9 public. Thank you very much.

10 MR. BASSMAN: Good morning. I'm Bob Bassman
11 with the law firm of Bassman, Mitchell & Alfano, I'm
12 here today representing the Petroleum Marketers
13 Association of America and I'm very, very happy to be
14 here and see everybody here this morning.

15 PMAA is a federation of state and regional
16 associations, about 47 of them now, representing about
17 73, 7,400 independent marketers who distribute in the
18 aggregate about 65 percent of America's gasoline and
19 about 95 percent of America's heating oil. These
20 marketers have over the last four years become very,
21 very concerned about manipulation in the marketplace.

22 Those of you who have been doing this for a
23 while will recall that particularly people, for
24 example, like Mr. Kingston, that up until about four
25 years ago, product price movements were small, and

1 relatively infrequent, consisting of a penny or less,
2 generally, on any given day. The markets changed
3 dramatically about four years ago, because of upstream
4 speculation and trading, and PMAA since that time has
5 been pushing very, very hard in the Congress for
6 additional transparency and regulation upstream on
7 those trading activities.

8 PMAA as it said in both of its sets of
9 comments is very, very pleased with the efforts that
10 the Commission staff and the Commission itself has put
11 into this. The doctrine of first do no harm seems to
12 have well been observed. The regulatory proposal on
13 the table here today that we're discussing looks to
14 PMAA to strike about the right balance, and we are
15 very happy to take part in the discussions that are
16 going to be ongoing today. Thank you.

17 MS. DOW: Good morning. My name is De'Ana
18 Dow, I appreciate the opportunity to participate in
19 this process. I'm a managing director with the CME
20 Group, the world's largest derivatives exchange that
21 provides risk management services to customers around
22 the globe. It offers a wide range of product across
23 all major asset classes, including futures and options
24 on interest rates, equities indexes, foreign exchange
25 industry, ag commodities and metals. We are regulated

1 at the highest tier of regulation by the CFTC.

2 Today, we would like to address concerns
3 that we have about the risk associated with applying
4 the new FTC rule to futures markets. That is a recipe
5 for disaster, in our view, because it results in
6 overlapping regulatory regimes by multiple regulators.
7 This type of overlapping regulation can have a
8 chilling effect on the markets, particularly in an
9 environment today where people are promoting and are
10 in favor of and are seeking transparent and regulated
11 market platforms to do business. There are a number
12 of other issues that we would like to identify in
13 terms of the problems that are generated or caused to
14 our markets as a result of being subject to multiple
15 regulators.

16 MS. HARRINGTON-McBRIDE: And I'm Katie
17 Harrington McBride with the FTC.

18 MS. GALVAN: And this is the panel. Thank
19 you very much.

20 To get us started, I'm going to jump right
21 in. The first topic of the day is whether or not the
22 SEC Rule 10b-5 model is the appropriate model. And
23 you will notice that our job here as moderators of
24 this panel is not to do a lot of talking, but to get
25 you to think about what it is that we've proposed and

1 take this dialogue a step further.

2 The first issue I would like to bring to the
3 table is whether or not the fraud concept is the
4 appropriate conceptual approach to market
5 manipulation, and we talked a little bit about in your
6 opening statements various other models, Professor
7 Pirrong talked about market power, the comment from
8 the Navajo participants is about facilitating
9 exploration.

10 So, the question is, is fraud, is targeting
11 fraud, as a means of executing the prohibition against
12 market manipulation, the right approach? And I will
13 call on people if you don't speak up.

14 MR. DREVNA: Patricia, are you referring to
15 fraud under the Rule 10b-5 rule, or just fraud in
16 general?

17 MS. GALVAN: We can go either way.

18 MR. DREVNA: I'm sorry, Charlie Drevna with
19 NPRA, excuse me. Well, first of all, I think for two
20 reasons, the answer would be no, that if -- if you're
21 focusing on the 10b-5 Rule, first is the legal reason.
22 Rule 10b-5 in our -- in everyone's opinion, I believe,
23 applies to situations where one party owes another
24 party fiduciary responsibility. The basic notion that
25 a company's -- the company's insiders did not have the

1 material, and material is nonpublic information that
2 actually belongs to the company's shareholders, I
3 think is the basis for that rule.

4 Secondly, beyond a legal reason, we don't
5 believe there's a practical reason. You know,
6 sophisticated wholesale market participants use skill
7 and investment research, to develop the market
8 information they use in deciding which transactions to
9 undertake. If there was some legal obligation hoisted
10 upon those two parties by a rule, you know, whether
11 the FTC found somebody had omitted something or
12 somebody didn't give up all the information they had,
13 or there was a mistake, I think companies would be
14 reduced to not collecting information.

15 So, I think there's the point I made in my
16 opening statement, that if you're -- there's a fine
17 balance between too much information, not enough
18 information, mandate it. If you're going to -- if the
19 FTC is going to get itself intertwined between a
20 transaction between supposedly two sophisticated
21 market participants, rather than someone who was an
22 innocent shareholder, that we don't believe that that
23 absolutely applies to wholesale petroleum markets. Or
24 any other market for that matter.

25 You know --

1 MS. GALVAN: Let me ask you, Charlie, is
2 your concern just about the application of the SEC
3 precedent, or is it about using fraud as a conceptual
4 model?

5 MR. DREVNA: Well, I mean, as long as fraud,
6 as long as participants are actively engaged in
7 negotiation, each one has their own responsibility to
8 investigate what the market is like. These things are
9 not usually done in a vacuum. It's usually not a
10 one-on-one -- I mean, it's a one-on-one in
11 negotiation, for a contract, but I think it's -- I
12 think it's a little bit naive to believe that this
13 participant is not also negotiating with others out
14 there in gathering other information. There's a
15 plethora of information available out there.

16 So, I'm not so sure how fraud comes into
17 this thing as far as information between two knowing
18 participants in a market. Or supposedly knowing
19 participants in a market. Am I missing something
20 here?

21 MS. GALVAN: Anybody else? Bob? And
22 identify yourself, please.

23 MR. LONG: Patricia, yes, I'm Robert Long
24 for API. I think maybe it's useful to keep the two
25 different questions that I think you posed separate,

1 and the first one you asked, as I understood it, was
2 whether fraud as a concept is an appropriate concept
3 on which to base the rule, and then the second
4 question that I think Mr. Drevna was focusing on was
5 whether the fraud concept of Rule 10b-5 is appropriate
6 without any sort of modification or adjustment.

7 And I think what we would say, and I think
8 this is really consistent with NPRA's comments, too,
9 is that in general, fraud is a useful limiting
10 concept. At the advanced notice of proposed
11 rulemaking stage, when we were thinking about some
12 other models that didn't have that limitation, our
13 view would be you could really get into a situation
14 where the costs of the rule vastly outweighed the
15 benefits, because you would just be creating this sort
16 of specter that all sorts of ordinary market behavior
17 could be challenged as a violation of this rule, and
18 so our view is that fraud is a useful concept, to
19 answer your first general question, to limit the rule,
20 and where you have situations where companies or
21 individuals are making false statements, with the
22 intention to mislead others in the market, and to
23 cause prices to deviate from what they otherwise would
24 be, and when they succeed at that, that is -- and I
25 think you referred to this in your notice of proposed

1 rulemaking, you're getting into an area of conduct
2 there that it's really hard to see the benefits of
3 that kind of conduct.

4 So, I would say that, at least speaking for
5 API, that fraud, as a general concept, is a useful
6 concept on which to base the rule. I think the second
7 point, though, is whether the Rule 10b-5 concept of
8 fraud is appropriate without any sort of adjustments
9 or recognition that these markets are different from
10 securities markets. I think that's what Dr. Drevna
11 was addressing. I think I should stop, because I
12 think that's really a separate question.

13 MS. GALVAN: Well, let me ask, though,
14 because I took your comment, Mr. Drevna, as not just
15 relating to application of securities precedent, I
16 took it as whether or not fraud is the right approach
17 to prohibiting market manipulation in the wholesale
18 market because of the characteristics of the markets.

19 MR. DREVNA: I think fraud is more
20 appropriate for antitrust law and not for market
21 power. I mean, it depends on what your definition
22 of -- I mean, again, I'm confused, for all the reasons
23 I stated, why it doesn't apply, as Mr. Long said, why
24 it shouldn't apply to the securities, I mean, is
25 applicable, but I'm still confused as to what -- if

1 fraud is the intent to mislead the market, then that's
2 market deception. I mean, you saw our comments about
3 that, that there has to be a three-prong kind of
4 approach to that.

5 MS. GALVAN: Let me throw this open,
6 Professor Pirrong?

7 MR. PIRRONG: Yeah, I think that, you know,
8 starting from basics, what we're interested in is
9 reducing price distortions in the marketplace, and
10 price distortions can arise from a variety of
11 different causes, fraud may be one of them. And, so,
12 some things that are maybe fraudulent are
13 manipulative, but all things that are manipulative in
14 the sense that they distort prices can be essentially
15 boiled down to fraud.

16 And that's why I think that the -- you know,
17 the rule is too narrow, and by focusing on fraud, it
18 ignores important kinds of conduct, specifically as
19 related to market power, that can distort prices, and
20 I think that that's a matter of serious concern.

21 With respect to Rule 10b-5 in particular, I
22 mean, securities markets and commodities markets are
23 very different in many ways. Securities markets are
24 all about information, and information is, you know,
25 essentially what securities markets are pricing.

1 Information is certainly important in commodity
2 markets, but at the same time, they're having a role
3 in the allocation of real resources. Who produces
4 what, how much of it, where it's shipped and so on.

5 And I don't think that there's a very sort
6 of comfortable fit between sort of the intellectual
7 model that's appropriate for a securities market and
8 one that's appropriate for a commodities market.

9 If you look at the typical kind of Rule
10 10b-5 case, somebody puts out distorted, fraudulent
11 accounting statements and then later there's a
12 curative disclosure and the stock price responds, it's
13 very hard to find sort of an analog to that sort of
14 thing happening in a securities market -- or in a
15 commodities market like a petroleum market, and it
16 also raises all these issues related to fiduciary duty
17 that are inherent in the securities laws, but which
18 are not really appropriate or really that relevant in
19 a commodities context.

20 I think it's sort of taking something off
21 the shelf and trying to apply it some place else where
22 it's not really appropriate.

23 MS. GALVAN: Okay, Navajo Nation?

24 MR. PICCONE: Jim Piccone for Navajo Nation
25 and Resolute. I totally agree with Professor Pirrong.

1 We should be sitting next to each other, Professor,
2 and what I would like to do is give you a few of the
3 facts of our situation that show that manipulation is
4 occurring outside the concept of fraud. The oil field
5 that I spoke of is in the southeast corner of Utah, a
6 very rural, very isolated area. It's in the Four
7 Corners area of the United States.

8 A company called Western Refining, Inc. owns
9 the only two refineries within hundreds of miles of
10 this oil field. Our field is connected by pipe to
11 those refineries and then, importantly, Western owns
12 the only pipe that takes -- could take -- crude oil
13 out of that area to a competitive market in south
14 Texas.

15 Western, by denying us, all of the producers
16 in the Four Corners, access to that pipeline out of
17 the isolated area, has succeeded, quite openly, and
18 intentionally, without any hint of fraud, in driving
19 down the price of crude oil in the Four Corners
20 enormously over the last 12 months. So, our concern
21 about this rule is that it doesn't go far enough.

22 The Rule 10b-5 model, while we don't have a
23 huge dispute with fraud on its own as a concept,
24 doesn't cover the type of manipulation that we have
25 here, which is open, nonfraudulent manipulation, and

1 that's what we want to see covered by the rule.
2 Congress, I think, in Section 811 wanted to give the
3 Commission new rules, new tools with which to combat
4 and prevent anticompetitive behavior. And as we
5 understand it, the Commission already has authority
6 under Section 5 to combat fraud and deceit, and we
7 think it's really missing the boat here in what
8 Congress intended if it doesn't also cover
9 nonfraudulent types of anticompetitive behavior.

10 MS. GALVAN: Okay. Charlie?

11 MR. MILLS: Yes, Charlie Mills for the New
12 York City Bar Committee.

13 I would take us back legally to the text of
14 the statute, which is a -- are the words out of
15 Section 10b of the Securities Exchange Act, they have
16 been closely interpreted and received lots of
17 attention from the Supreme Court and the other courts,
18 and the other intermediate appellate courts, and it's
19 very clear, I believe, from the precedent, that under
20 that statutory language, fraud is a necessary element
21 of a violation. So, if the Commission were to depart
22 from that, it would not be following securities law
23 precedent.

24 From my point of view, fraud is a good
25 demarcation for any antimanipulation rule, because it

1 provides a basis by which people can govern themselves
2 and know with some understanding of what kind of
3 conduct is going to violate a rule or not.

4 If you don't have a fraud standard, it's
5 going to be very hard in practice as you're sitting
6 there trying to operate your business to know when
7 you're going to be crossing a line. And that's been
8 the problem with market power theory in commodity
9 markets in my personal view for a long time.

10 Persons operating in those markets do not
11 know where you're crossing a line on market power.
12 You learn about it later, after hundreds of thousands
13 of dollars are spent with economists and lawyers
14 looking at everything in great detail and determining,
15 yes, that price was distorted, and it was distorted by
16 a certain amount, or it wasn't distorted, and you will
17 have a battle of the experts. The persons conducting
18 themselves in the marketplace in realtime, in very
19 competitive marketplaces, don't have the benefit of a
20 million dollar bill to tell them when they're crossing
21 the line after the fact.

22 And if you don't have some clear
23 demarcation, you put market participants at enormous
24 risk of possible violations and deterring lawful
25 conduct simply to avoid the possible enforcement

1 investigation, which by itself is a very expensive
2 process to deal with.

3 So, I think fraud is the right standard. My
4 view is if you have an issue with market power, that
5 that's something that you should be dealing with
6 through structural rules of how to frame up the
7 marketplace. And if there are imbalances that the
8 government thinks it should strike the balance of
9 itself between different competitors, then that should
10 be done in a prospective rule that sets a structure,
11 but it doesn't create a liability for manipulation.

12 MS. GALVAN: Athena, did I miss you from
13 earlier?

14 MS. VELIE: That's fine.

15 I agree with that as well, we think fraud is
16 a good standard, as long as it's coupled with specific
17 intent to manipulate a market. As long as it's
18 coupled with that specific intent, we do believe that
19 fraud is the appropriate standard, and just to give an
20 example of why this is confusing, a number of our
21 clients, they're well intentioned, a lot of well
22 intentioned entities out there that want to comply
23 with all the applicable laws, and they need to develop
24 policies and procedures and be able to train their
25 traders as to what kind of transactions are

1 permissible, and without some kind of clear
2 demarcation, I know you're hearing this a lot, it's
3 very difficult for them to do.

4 I'm just going to focus on this, I know
5 we're going to talk about the recklessness standard in
6 a bit, and there are a lot of similar issues. But
7 just for example, with the exception of the duty not
8 to lie, you know, with the exception of that duty,
9 which is understandable, the other duties that arise
10 under this Rule 10b-5 standard, you know, are not
11 applicable to these wholesale markets.

12 So, it's very hard for us to understand what
13 the Commission means. For example, in the third
14 subsection of the rule, the 317.3c, you know, which
15 talks about -- it's a catch -- it's intended to be a
16 catch-all, to prohibit conduct that might operate as a
17 fraud on a market. To us, this seems to get away from
18 fraud.

19 In particular, coupling that with the
20 recklessness standard, because what kind of reckless
21 conduct might be deemed to have operated as a fraud?
22 And that's very difficult for us to draft compliance
23 policies to address, short of telling people just not
24 to engage in certain markets.

25 So, again, we would support the idea of a

1 fraud-based standard with a specific intent
2 requirement.

3 MS. GALVAN: Okay.

4 MR. DREVNA: I would like to clarify that,
5 too --

6 MS. GALVAN: Please go ahead and introduce
7 your organization.

8 MR. DREVNA: Charlie Drevna, NPRA.

9 You know, fraud is the concept, but what I
10 was trying to say is fraud is not to be confused with
11 market power. That's for the Sherman Antitrust Act to
12 worry about. I don't think that's appropriate for
13 these proceedings, in this particular congressional
14 mandate that the FTC has to look at.

15 There's a major difference between a market
16 power which is not inherently market manipulation.
17 And I think the proceedings here today are -- and what
18 the charge of the FTC, under EISA '07, is what
19 potential could be market manipulation in the
20 wholesale market of petroleum and petroleum products,
21 not what is market power. And, yes, fraud is the
22 basic concept, but again, it can't be confused with
23 market power.

24 MS. GALVAN: Mark Young?

25 MR. YOUNG: Mark Young for the Futures

1 Group.

2 I think this discussion sort of illustrates
3 what we all understand, and that is that you could
4 have a considerable challenge in front of you trying
5 to meld these different worlds together. And I think
6 one of the questions you asked earlier was, should we
7 follow securities law precedent or take it into
8 account or just adopt it as wholesale in our rule, I
9 think that was the thrust of one of your earlier
10 questions, and I think you've already answered that
11 question correctly in one area, you've already
12 recognized that the notion of affirmative disclosures
13 in the insider trading context don't apply to the
14 wholesale petroleum market. And I think we agree with
15 that.

16 So, I think you've in a sense already
17 recognized that the wholesale petroleum market and the
18 securities market jurisprudence don't fit perfectly
19 together.

20 The second thing I'd mention is, I don't
21 know about other people, but I get a little lost when
22 we talk about fraud and manipulation being part of the
23 same thing. In some senses, and I think we have to be
24 very specific in how we articulate it.

25 In reading through your releases and in

1 working through some of the questions that you've
2 provided today, I think of three buckets. I think of
3 deception, I think of market manipulation, price
4 manipulation, and I think of false reporting. And is
5 there some level of overlap in those three buckets?
6 There's some level of overlap, because you can have a
7 false reporting case that's designed to move the
8 price, and that would also constitute a market
9 manipulation.

10 But in the Commodity Exchange Act, for
11 example, those three kinds of misconduct are treated
12 separately. And that juris prudence has worked well
13 in the futures market. It is being developed as
14 Mr. Mills, who I'm sure I'll call Charlie before this
15 is over, because I've known him for a long time, but I
16 will try to call him Mr. Mills as often as possible.
17 That's what Mr. Mills alluded to earlier in terms of
18 the juris prudence with respect to the physical
19 markets under that Commodity Exchange Act. It's just
20 developing, it hasn't fully developed.

21 But there are some sign posts out there for
22 how you can apply false reporting and market
23 manipulation standards to the -- under the Commodity
24 Exchange Act -- to the wholesale physical petroleum
25 markets. And thus far, I think at least the CFTC is

1 happy with how those have worked out. I'm not sure
2 the defense bar is always completely happy with how
3 those have worked out.

4 MS. GALVAN: What do you put into the
5 deception bucket? Is it only the outright lie that
6 Athena was talking about?

7 MR. YOUNG: I'm against outright lies.
8 Outright lies are a part of the deception bucket, but
9 Athena also mentioned, and pointed out, the last
10 prong, the collective or the subsection C provision,
11 and I notice that that ends with "would operate as a
12 fraud or deceit upon any person."

13 It doesn't say any market, it doesn't say
14 would operate as a fraud and deceit and therefore
15 cause an artificial market price or market price that
16 does not reflect supply and demand, it says any
17 person. And that suggests more -- a system in which I
18 tell a falsehood to Athena, before we engage in a
19 transaction. I don't think I have -- we don't have a
20 problem with that, I'll put that in the outright lie
21 category, but to move beyond that category and say
22 when I lie to Athena somehow I'm causing a market
23 manipulation because I'm affecting the price, because
24 that's how we think of market manipulation, those
25 concepts seem jarring and don't seem to mesh.

1 MS. GALVAN: Alan?

2 MR. HALLOCK: Thank you, Alan Hallock with
3 Flint Hills Resources.

4 I think it's important to keep a focus,
5 though, on the aim of the fraud, and the aim of the
6 fraud that I believe that the agency has been looking
7 for is fraud upon a market in an attempt to distort
8 the market rather than -- rather than just
9 transactions between individual companies. I believe
10 the FTC has been concerned about distortions or
11 conduct which is -- which is aimed at deceiving not
12 only the individual, but distorting the market, and
13 the person acting such is expecting that they will
14 profit through that distortion of the market.

15 MS. GALVAN: And go ahead.

16 MR. BASSMAN: Bob Bassman from PMAA.

17 What the Commission has endeavored to do
18 here from the very beginning is to strike a balance
19 between the need for markets to work smoothly and
20 quickly. We're talking about a market here for what
21 is in essence the lifeblood of our economy. And on
22 the other hand, to regulate and to prevent fraud and
23 manipulation on the market, or just manipulation on
24 the market. The body of American law on fraud is
25 huge, and it's clear, you have to allow people, as

1 many have said here today, to understand going in what
2 their obligations are.

3 In the SEC Rule 10b-5 sense, which this is
4 not a regulated market in that sense and the fiduciary
5 duty certainly is not appropriate here, but just using
6 fraud as a necessary, is very clear, because none of
7 the people operating in this market operate without
8 the benefit of legal counsel. Any legal counsel
9 understands the concept of fraud, and fraud does
10 belong here.

11 Fraud is very, very important, and fraud is
12 a known commodity here. So, yes, not the -- as we
13 said in our earlier comments, slavishly following Rule
14 10b-5, this is not a regulated industry, that's
15 inappropriate. But I think the Commission has pretty
16 much made that balance. You've got to allow people to
17 trade knowing what they're doing, you've got to allow
18 people to participate in the market, knowing what
19 they're doing, so they're not afraid to when the
20 market just seizes up, and fraud is appropriate.

21 MS. GALVAN: Charlie?

22 MR. MILLS: Charlie Mills for the New York
23 City Bar Committee.

24 To my mind, it's a little bit of a separate
25 question in terms of once you decide fraud is the

1 standard, what frauds are you talking about? Rule
2 10b-5, SEC Rule 10b-5 really is a general antifraud
3 provision. I think it's fair to say, looking at the
4 securities laws, that Congress looked at securities as
5 the lifeblood of capital formation, which is so
6 integral to our society and our capitalistic economic
7 system, and so they've created an entire comprehensive
8 regulatory scheme for those transactions. Fraud being
9 one component, but many other components are there to
10 control those markets.

11 And you could hypothesize fairly that almost
12 any fraud touching on a securities transaction has
13 some impact on securities markets, because every
14 security is its own market. It's not just the New
15 York Stock Exchange, every bond, every stock is its
16 own market.

17 So, any kind of fraud could affect those
18 markets. I think it is worthwhile looking for the
19 Commission here to think about what kinds of frauds
20 really matter for this rule, and manipulation, I
21 think, has been recognized in the securities cases and
22 Supreme Court cases as a specialized species of fraud,
23 and that that's what your rule should address, which
24 goes after activity that is designed to really distort
25 prices through fraudulent behavior, and it's not just

1 any falsehood or fraud that could occur between in
2 this market two counterparties.

3 And I'll just briefly say in that vein, you
4 could have two counterparties negotiating, maybe one
5 defrauds the other. If that's really not something
6 that's impacting these markets from a pricing
7 standpoint, it's not something that the public
8 interest for this statute is really aimed at. And you
9 would take on too big a role to become the policeman
10 or policeperson of all fraud in this marketplace. And
11 that you should tailor the rule to go after price
12 manipulation in particular and how to define that.

13 MS. GALVAN: Okay, and I actually have a --
14 I see that Professor Pirrong's placard is up, but I
15 have a question for you to address as well, which is
16 how deception may play into what your comment, I
17 think, was trying to get at, is the exercise of market
18 power that perhaps is intertwined with the concept of
19 deception?

20 MR. PIRRONG: It can be. Sometimes deceit
21 or fraud might be part of a manipulation strategy that
22 also involves market power, but one can execute a
23 market power manipulation without engaging in any, you
24 know, false statement. So, that's why I don't think
25 that there's necessarily a comfortable fit between the

1 two, that one doesn't imply the other. You can have
2 fraud without manipulation, you can have manipulation
3 without fraud.

4 And, so, that's why I'm a little bit
5 uncomfortable trying to shoehorn the concept of
6 manipulation and make it essentially synonymous with
7 fraud. I think that that's the nub of the concern
8 here. And so it relates to Mr. Mills' point that he
9 says that activity that distorts prices, I agree with
10 that. Then he adds, "through fraudulent activities?"

11 Well, there's a lot of stuff that affects
12 prices that is not necessarily fraudulent. In my
13 view, if the Commission limits itself to just looking
14 at fraudulent activities, there's going to be a lot of
15 regulatory costs, and to be honest with you, I don't
16 think the things that are going to affect prices that
17 much in this market are going to be primarily
18 fraud-driven.

19 So, I think it would be just essentially a
20 wasteful exercise that's going to burden the
21 Commission and market participants without really
22 having any beneficial effect on the overall market.

23 And in terms of the issue of market power
24 and whether it's applicable in this context, I just
25 with respect to what Mr. Mills says, yeah, sure,

1 manipulation cases involving market power do end up
2 involving battle of experts, believe me, I've been
3 there, but to suggest that the concept of fraud as
4 applied in securities markets is crystal clear, and
5 that those don't turn into battles of experts and that
6 there are really no factual disputes over what kind of
7 conduct is or is not fraudulent, I don't think that
8 that's really a fair characterization of what goes on
9 there either.

10 I think if you look at fraud, if you look at
11 market power, those inherently raise complicated
12 issues of fact and interpretation, and, you know, a
13 penny for the pound, if you decide to go on fraud,
14 that's going to create a lot of, you know, potentially
15 fully legal issues as well.

16 MS. HARRINGTON-McBRIDE: Patricia, if I can
17 just jump in one second, something that Mr. Mills said
18 earlier got me thinking that it's maybe inconsistent
19 with what I thought I read in the comments. And that
20 is that fraud would be a good line of demarcation to
21 allow market participants to understand whether their
22 conduct has crossed the line. And I'm not sure that
23 that's reflected in the comments.

24 And yet when you went on in your next
25 comment to say that deceit -- that if you looked at

1 fraud and not in terms of fraud between
2 counterparties, but fraud on the market, I saw a lot
3 of head nodding. Is this the point of distinction
4 that we need to tease out here? It's not necessarily
5 in my understanding that fraud is a murky concept and
6 you can't grasp it, Mr. Bassman says, no, everybody
7 gets what fraud is. The question is are we talking
8 about fraud as between two parties or fraud on the
9 market?

10 Is there any general agreement about that?
11 Because I just saw a lot of head nodding when I
12 thought I was going to see head shaking. So, okay.
13 There's actually nothing for the court reporter, of
14 course, to take away from that, but I saw -- I take it
15 that I can state that proposition, that in fact there
16 is less concern, or Mr. Long?

17 MR. LONG: This is Robert Long for API.

18 I mean, I think that there are a number of
19 points here, they're all very important, and I think
20 the one that Katie is bringing up, we would completely
21 agree with, that there -- I mean, there is such a
22 thing as garden variety fraud, just between two
23 parties to a contract, that's covered by state common
24 law.

25 It's wrong, I mean, I agree, lying is wrong,

1 that shouldn't be allowed, but that's really not
2 something that should be a concern of this Commission,
3 and the concern of a market manipulation rule, in
4 addition to causing you to have to spend time on
5 matters that really are not what you want to focus
6 time on. It would cause a lot of compliance costs if
7 you're putting on an overlay that's not exactly state
8 common law fraud, which would be -- you know, it would
9 raise costs a lot for the industry.

10 So, I think that's one point. Another point
11 that several people are making that I think is a
12 different point, also very important, I mean, there's
13 more than one concept of fraud. It's not a unitary
14 concept that -- I mean, there's the state common law
15 of fraud, there's this Rule 10b-5 concept of fraud,
16 which is not exactly the same thing, and one of the
17 points we're making is we think that -- that concept
18 needs some tweaking or some adjustment to make it
19 really appropriate for this setting, and I think maybe
20 that's a topic for further discussions.

21 But then, the final point which I think
22 maybe was Patricia's very first question, is whether
23 you just sort of burst through the bonds of fraud
24 completely and say, oh, well, this -- you know, this
25 rule would apply to any actions that affect market

1 prices, perhaps.

2 And this was the subject, I think, of some
3 of the discussion and the comments on the advance
4 notice of proposed rulemaking. Our view is that that
5 really would be a bad rule. You know, there are lots
6 of things that are done in markets that are good for
7 competition, that are good for consumers. They may
8 have an effect on prices, but we want that to happen,
9 in response to shortages and so forth. And that fraud
10 is really a limiting concept that helps to focus this
11 rule on the behavior that the Commission wants to get
12 at, and again, going back to this fundamental point of
13 having the benefits of the rule exceed the costs.
14 That's a way to try to focus on benefits and avoid
15 costs. So, those are three separate points. I think
16 they're all very important.

17 MS. GALVAN: Okay, De'Ana?

18 MS. DOW: De'Ana Dow with the CME Group.

19 I agree with a number of the panelists that
20 are attempting to draw the distinction between a
21 fraud, whether it's between two people, or a fraud on
22 the market and a manipulation.

23 Where, you would ask, is the void? I think
24 when you look at the intent of Congress in going into
25 this area, and providing this new authority, you look

1 for where there was a lack of oversight, where in this
2 market is there no one minding the store.

3 So, if you look at the futures markets,
4 again, as Mark Young emphasized, you have a separation
5 of a fraud requirement from a manipulation
6 requirement. I think that model is the model that
7 also needs to transfer into this particular arena,
8 because if you have principal to principal
9 transactions going on, and these transactions are
10 never reported, you know, they never come into a
11 centralized marketplace, they're never reported to the
12 Platts window or whatever, where is your price effect?
13 Where is it that there is a manipulation taking place?

14 What people were concerned about was the
15 high price of oil. Prices were going through the
16 roof. What was causing that? Nobody could tell
17 because nobody could see what was going on in the
18 market. So, if we're talking about false reporting,
19 we're talking about misleading information, and
20 misstatements, there needs to be some sort of
21 disclosure requirement or some sort of regime around
22 that market in order for this type of a concept to
23 actually work.

24 Without that, again, you're talking about
25 just lies between two parties, which is covered under

1 contract or general fraud provisions, and again,
2 you're not reaching the real brunt of the problem of
3 what's causing these prices to go beyond what is
4 deemed to be consistent with market fundamentals.

5 MS. GALVAN: Mark Cooper, do you agree that
6 this concept should be limited to a fraud on the
7 market?

8 MR. COOPER: Actually, we've clearly
9 established that market power and fraud are subsets of
10 manipulation. And in fact, the statute addresses
11 manipulation. So, if we conclude that market power is
12 a category of manipulation that is not properly roped
13 in by a fraud standard, then you ought to write a
14 broader rule, not a narrower rule in my opinion.

15 So, it's quite clear that market power is a
16 form of market manipulation, and the statute addresses
17 manipulation.

18 Second of all, it's interesting to hear the
19 notion that, well, fraud and lies between two parties
20 have no impact on the market. I think we've learned
21 pretty well that the operation of dark and gray
22 markets, the simple fact that some market is beyond
23 regulation does not mean it is not having impact,
24 especially in commodity markets.

25 And, so, the notion that a clearly

1 fraudulent act that might be covered by other laws
2 should not be looked at by this agency because it can
3 have an effect in impairing, obstructing or defeating
4 the operation of the market is incorrect. So, my view
5 is much more expansive.

6 It's quite clear there's a difference of
7 opinion, but if fraud is too narrow to get at
8 manipulation, then the agency hasn't done its job in
9 implementing the intent of the Congress to actually
10 get at manipulation.

11 MS. GALVAN: Athena?

12 MS. VELIE: I think that it's very difficult
13 to talk about fraud just by itself. Because I want to
14 just restate and clarify something that I said before,
15 because it's not just fraud, but as I've said, I think
16 that there needs to be a requirement that you
17 specifically intended to manipulate the market.

18 When we were looking at this 317.3c, the
19 rule says upon any person. To engage in any act, et
20 cetera, that would operate as a fraud upon any
21 persons, as Mark Young pointed out. And then you see
22 in the rulemaking that the Commission restates that as
23 explaining what's meant by that as something that
24 would operate as a fraud upon a market.

25 And again, now you have to lay the

1 additional level, now we're thinking about this in
2 terms of Rule 10b-5, we're thinking about this with a
3 recklessness standard, and when you put those things
4 together, I don't know that we would support the fraud
5 on the market concept if it's reckless conduct that
6 might operate as a fraud upon a market, because I
7 don't understand what that means, and I think there
8 are a lot of people that are very unclear, and that
9 makes people very nervous about what conduct they can
10 engage in.

11 I think that a false reporting example where
12 there was some kind of false reporting specifically
13 intended to manipulate prices, if that's what's meant
14 by a fraud on the market, we absolutely support that.
15 ISDA has an interest as well in there being open and
16 competitive markets not distorted by that kind of
17 fraudulent, intentionally fraudulent behavior.

18 So, again, I think that what's really
19 critical, even in talking about fraud on the market,
20 is that there be an intent, an intent to actually
21 create a manipulated price, to actually manipulate
22 prices.

23 MS. GALVAN: Okay, let me put this out
24 there, then: Is the concept of fraud on the market in
25 the minds of those at the table, can we agree that

1 that's a concept whereby somebody's conduct distorts
2 market price? Or that it encompasses that concept of
3 the distortion of market prices?

4 MR. LONG: This is Robert Long for API.
5 There may be others who know more about this than I
6 do, but I think fraud on the market in securities law
7 has a specialized meaning, it has to do with sort of
8 assumptions that people just assume that all the
9 information is reflected in prices, and so a fraud on
10 anybody counts as a fraud on everybody. The courts
11 have generally been, as I understand it, quite
12 unwilling to extend that concept beyond securities to
13 other sorts of markets.

14 And, so, there may be no problem in using
15 this term as a sort of shorthand to help us with our
16 discussions, but I think I would be cautious about
17 using it in the rule or in the Commission's discussion
18 of the rule, because I think it does have this
19 technical meaning in securities law that would not
20 apply to a physical market.

21 MS. GALVAN: Let me go to Navajo Nation very
22 quickly.

23 MR. PICCONE: Yes, Jim Piccone for the
24 Navajo commenters. I wanted to emphasize and follow
25 on Mark's comments about broadening the rule, and

1 re-emphasize with some of the facts in our particular
2 situation. I mentioned that the Western Refinery's
3 refusal to let us use this pipeline to get to a
4 competitive market and, therefore, to create monopsony
5 power on their part in our market has driven down the
6 price of crude oil in that area, which might seem a
7 good thing for consumers, but it turns out that it's
8 not, neither in the short run nor the long run.

9 In the short run, there's no evidence and no
10 reason to think that Western would pass any of that
11 savings on to the consumers. The evidence that we
12 have is that their prices to wholesale -- to jobbers
13 -- is as high as anybody else's, so they're just
14 meeting the market.

15 But more importantly, in the long run the
16 deprivation of those revenues, which we think properly
17 belong to the producers, reduces the size of the
18 program that we can put together in this field, and
19 will reduce future supplies of crude oil, because we
20 won't have as much capital as we otherwise would have,
21 and that really does harm consumers in the long run.
22 But it's a long-term effect. And we think that this
23 type of manipulation really should be within the
24 concept of what Congress had in mind here.

25 I'm sure Congress is well aware that the FTC

1 already had the ability to regulate simple fraud.
2 And, so, Congress wanted this rule to cover new things
3 that weren't otherwise covered, and that is
4 manipulation that isn't specifically covered by
5 antitrust rules or fraud.

6 MS. GALVAN: Let me ask Mark Cooper, do you
7 believe that the market manipulation, the parameters
8 of the market manipulation rule should cover conduct
9 by a company such as what the Navajo participants is
10 describing?

11 MR. COOPER: Frankly, I believe what the
12 Navajo participants are describing is probably covered
13 by other aspects of antitrust law, but the way the
14 lift under current antitrust practice has become so
15 burdensome that antitrust law has ceased to be
16 effective in giving him relief. I think that's a
17 problem of the ongoing practice.

18 So, I'm very sympathetic to his discovery of
19 a possible new avenue that might give him relief that
20 he deserves under antitrust law, but has been denied
21 as a result of current practice. So, given that a new
22 statute which expanded the scope of your authority, I
23 do think it's entirely appropriate for this Commission
24 to say, we are going to define manipulation broadly,
25 and set out on a new tack.

1 Let me also, I want to address the question
2 that Mr. Long raised. The question of extending
3 beyond -- the notion of extending Rule 10b-5 beyond,
4 and I would like to see the court cases, because
5 there's a very -- two very different situations. In
6 one situation, we might find an agency seeking to take
7 an existing body of law, and moving to a new area.
8 And I can see where the courts might say, no, no, no,
9 you are not intended to go there. But the opposite is
10 happening here.

11 We have a new law here, which it did intend
12 to expand consumer protection. And what this agency
13 has done has said in implementing that law, hey, I've
14 discovered a set of concepts over here I want to use
15 to do what is a legally authorized expansion of
16 consumer protection.

17 So, I'm hesitant to accept all these claims
18 about what the court will let you do. The court has
19 said certain things about what you can do under
20 existing law. Here you have a new law. And frankly,
21 I would not want you to be fearful of exercising this
22 new authority, because I don't think the analogy
23 applies.

24 And that would be true in this case as well.
25 You have now been given a law that says, prevent

1 manipulation, you have a plaintiff here who says, I
2 can't get relief under existing statute, include me in
3 your new category of consumer protection.

4 MR. PICCONE: And we would agree. The key
5 here is that the new law is to be preventative in
6 nature. We may well have an antitrust claim if we
7 proceed with a five-year long, expensive litigation,
8 but at the end of that consumers would have been hurt.
9 The harm would already have been done, quite possibly,
10 and we think Congress wanted there to be a
11 preventative type of rule here that identified the
12 behavior before the harm occurred. And that's why we
13 think this should be covered.

14 MS. GALVAN: Can somebody articulate the --
15 because I think someone had previously stated that
16 it's not necessarily fraud-driven what effects
17 distorts market prices. What kind of conduct is not
18 necessarily price driven that has a distorting effect?
19 If anybody has any comments on that. Professor?

20 MR. PIRRONG: By price driven, you mean
21 fraud driven?

22 MS. GALVAN: Fraud driven, I'm sorry.

23 MR. PIRRONG: That's the whole market power
24 issue. For example, if somebody accumulated on a
25 nonregulated market, off the futures exchange,

1 somebody could accumulate a large position in
2 contracts, derivative contracts, and either through
3 taking delivery on those contracts if it allows it, or
4 alternatively by, for example, making huge purchases
5 in the cash market, can distort prices, drive them
6 from where they would be in a competitive market, in
7 order to enhance the profitability of that derivatives
8 position.

9 So, that would be an example of a kind of
10 conduct which has routinely been described as
11 manipulative since the beginning of these markets back
12 in the 1860s, and where people who are familiar with
13 these markets would understand that as being a type of
14 manipulation, which would not necessarily involve
15 fraud in any way.

16 MS. GALVAN: Dave, we haven't heard from
17 you.

18 MR. VAN SUSTEREN: David Van Susteren,
19 Fulbright.

20 The Commission has a difficult job, made
21 more difficult because of the absolute lack of
22 legislative history on the passage of this section.
23 To my understanding, and my partner, Layne Kruse, with
24 the counsel for the U.S. Senator Maria Cantwell, Joel
25 Merkle put on a seminar in which they described the

1 absolute lack of legislative history. I don't even
2 think there's a conference report on Section 811.

3 So, you are charged with interpreting
4 Section 811, it is clearly modeled after Rule 10b-5,
5 but I'm intrigued by the comments of the CME lawyer
6 who indicated that what is it that the Commission is
7 trying to prevent? Where is the manipulation? Where
8 is the paradigm manipulation that you are trying to
9 target?

10 If it's in the cash and physical markets, it
11 seems to me the FTC has done tremendous investigation
12 of those markets and really not found compelling
13 evidence of fraud or manipulation. And if it's in the
14 financial markets, you have the CFTC issue there, in
15 the overlapping jurisdictions, but, for instance,
16 would trading at the last half an hour of closing, as
17 we saw in the Amaranth case, would the rule that
18 you're proposing here today pick up that kind of
19 conduct?

20 Obviously, just recently, the district court
21 in New York found that the Commodity Exchange Act did
22 not pick that conduct up. And, so, and people could
23 say that that conduct may have led to increased
24 prices.

25 So, it's sort of a where are you trying to

1 focus it? I don't see much benefit in the cash and
2 physical market focus.

3 MS. GALVAN: Mark?

4 MR. YOUNG: It's Mark Young for the Futures
5 Group, and it's never good to be called on in a panel
6 discussion like this when somebody cites a case that
7 you have never heard of before, especially when it's
8 in the area that you are supposed to be talking about.
9 So, maybe, David, if you could tell me a little bit
10 more about what the Southern District of New York held
11 in that case?

12 MR. VAN SUSTEREN: Yeah, it's the Amaranth
13 action in which private plaintiffs brought a hedge
14 fund case against the traders and the Amaranth
15 entities and a motion to dismiss, in early October
16 here or mid-October, was entered. And under the
17 Commodity Exchange Act, the court dismissed many of
18 those claims.

19 MR. YOUNG: Do you know, I'm not sure, I'm
20 not sure whether that case resulted in a dismissal on
21 the basis of the allegation that the substance of the
22 allegations would not constitute manipulation under
23 the Commodity Exchange Act. I know that the CFTC is
24 pursuing an attempted manipulation claim against
25 Amaranth, and I'm reasonably confident that has not

1 been dismissed, otherwise I think the CFTC would have
2 mentioned that to me, and to others. So, let me, in
3 that case, just make the three points I wanted to
4 make, having recovered from my surprise.

5 The first is I think Craig Pirrong made the
6 key point a while ago that I want to underscore,
7 because there has been a lot of discussion that I
8 don't want it to get lost. The focus of your
9 prohibition should be on price distortion. It should
10 be conduct that causes price distortion. It should
11 not vary from that target at all, because that is the
12 concept, that is the essence of preventing price
13 manipulation.

14 The second point I wanted to make is, it's
15 hard for us to respond to some of these comments
16 without doing what Athena did, which I think is
17 absolutely right, and that is bringing in some of your
18 other questions into this discussion, including the
19 question of intent. And specific intent in
20 particular.

21 When I hear specific intent, as an element
22 of manipulation, it's a fraud-like specific intent. I
23 know that doesn't help you that I have just fused the
24 two and mushed them together, but that is what it is.
25 It's I intended to drive the prices down artificially.

1 That's what we're -- that's what we're talking about.
2 And I'm not going to tell anybody that that's what I'm
3 intending to do, because no one would do that.

4 That's the notion of where the specific
5 intent standard and this concept of fraud overlap.
6 And the illustration that I wanted to identify for you
7 folks, of the way the Commodity Exchange Act works,
8 which I think is a broadening of the statute, of the
9 prohibition beyond where you are right now, is this:
10 The Commodity Exchange Act says if you intended to
11 create an artificial price, and you created an
12 artificial price, that's manipulation. And there have
13 been many cases brought under that theory.

14 In the course of litigating those cases, it
15 is often that defendants move for a more definite
16 statement of the allegations against them. And they
17 claim that the manipulation allegation against them is
18 really sounds in fraud, and therefore under, I believe
19 it's Federal Rule of Civil Procedure 9b, a more
20 definite statement is required.

21 So, in the juris prudence of the Commodity
22 Exchange Act, there are fact patterns where courts
23 have looked to see whether a particular manipulation
24 allegation is a specie or akin to fraud, and then the
25 courts require a more definitive statement.

1 That illustrates to me that the breadth of
2 the Commodity Exchange Act prohibition is sufficient
3 to pick up those situations where you do have the kind
4 of fraud that Mr. Mills has been talking about. But
5 even situations in which you don't have an overt
6 disclosure problem, or you don't have a situation
7 where people have not -- or where people are
8 aggressively and overtly trying to deceive you in one
9 way or another.

10 And that's why we've said to you, we think
11 for purposes of this physical market, you should look
12 at the juris prudence as it's developing under the
13 Commodity Exchange Act, and you would find that in
14 some cases, it is broader than even what you
15 have drafted, and than what Congress intended in 811.

16 MS. GALVAN: Let me explore that concept,
17 because when I look at the price manipulation
18 provision of the Commodity Exchange Act, I think
19 intent to manipulate any creation of an artificial
20 price. I don't think is fraud. Is it correct to
21 believe that the price manipulation provision would
22 capture fraudulent behavior and we'll use the term
23 loosely fraud on the market?

24 MR. YOUNG: I'm not --

25 MS. GALVAN: And the question --

1 MR. YOUNG: I'm not sure I know what you
2 mean. Let me go back to what I was trying to say
3 before. There are manipulation cases where the court
4 looks to -- where the court looks to the allegations
5 in the complaint and says, if this particular
6 defendant is alleged to have suggested to other market
7 participants generally that the inventory that the
8 market participant held was less than was true, that
9 is a form of fraud, and you must plead that with
10 particularity. There are cases that hold that.

11 Does that mean that every manipulation under
12 the Commodity Exchange Act is necessarily subject to
13 that heightened pleading standard? I can't tell you
14 that. I don't think the case law has been developed
15 fully on that yet.

16 But there are definitely cases that say that
17 there is an element of fraud in a manipulation
18 allegation, and you, plaintiff, need to allege that
19 allegation with particularity as you would in any
20 other fraud.

21 MS. GALVAN: Charlie?

22 MR. MILLS: Yeah. This is Charlie Mills for
23 the New York City Bar Committee. I'll just hit a
24 couple of points that have been mentioned, starting
25 with the operates as a fraud language in Rule 10b-5.

1 I believe that that's basically dead letter language
2 after Ernst & Ernst versus Hochfelder. That language
3 on its face is recognized by the Supreme Court in SEC
4 versus Aaron, to not require scienter.

5 There are many cases under the Advisors Act
6 where that language appears that are recognized and
7 not require scienter. In Hochfelder, the Court said,
8 no, under Rule 10b-5, you have to have scienter. So,
9 that provision under which the SEC was proceeding, or
10 was the basis for SEC enforcement action and private
11 claims, under that part of Rule 10b-5, has been read
12 differently than the plain language would have it
13 mean. And I think it's a mistake to create a rule for
14 new participants or a new area of law that doesn't --
15 shouldn't -- wouldn't be applied as its plain meaning
16 would have it.

17 So, the operates as a fraud language, I
18 would take out of the rule based on the Hochfelder
19 decision, which says you can't have language in a rule
20 that's broader than the terms of the statutory
21 provision that authorizes it. And Rule 10b of the
22 Exchange Act requires scienter, so language in Rule
23 10b-5 that's broader than that is not effective,
24 unless you apply scienter.

25 On the fraud on the market issue, I just

1 mentioned, that is a specialized terminology in
2 securities law having to do with class action
3 litigation improving reliance, and I don't think it is
4 what we're thinking about here today in terms of using
5 that language broadly.

6 In terms of what is manipulation under the
7 Commodity Exchange Act, I would say there are probably
8 ten different law review articles and economic
9 analyses of that question that are all over the map,
10 and to say what is manipulation under the Commodity
11 Exchange Act is not clear. The CFTC has certain views
12 on it, they're not necessarily the law. If you look
13 at what all economists and lawyers and courts have
14 said, there's a lot of variation in where people come
15 out on that.

16 In the case of U.S. versus Reliant Energy,
17 in California, the court was faced with whether the
18 plain prescription against manipulation under the
19 Commodity Exchange Act is constitutionally vague and
20 unenforceable, and the court there held it was not,
21 but on the facts of the case, basically I believe came
22 to the conclusion that if you don't have fraud as a
23 concept, that the term just to manipulate has no
24 particular meaning that is understandable to the
25 ordinary person, so that they can bring themselves in

1 compliance with that kind of prescription. And the
2 court there didn't have to reach the ultimate
3 decision, because the court found that there were
4 allegations in the indictment involving false rumors
5 in the market and other activity that would clearly
6 fall within a fraud standard and so said, here I don't
7 have to reach the issue. If I had a non-fraud case,
8 whether this would hold up under the constitution.

9 So, I direct your attention to that
10 decision, because it is an important one in
11 understanding this.

12 In the Amaranth case, I believe the recent
13 decision was in the class action litigation, and there
14 I think the court made two different holdings. One
15 was that some allegations of conduct that were not
16 involved with the end of the day trading, those were
17 the ones where I think it was basically a factual
18 finding and effect saying there isn't enough evidence
19 here from which to infer manipulative intent for
20 conduct that wasn't involved with the close of
21 trading.

22 But the trading and the conduct at the
23 close, the court found to reflect a pattern from which
24 someone might be able to infer a manipulative intent
25 or an intent to cause an improper price distortion.

1 And, so, those claims, I think, survived, although
2 there are other matters in that which I think they're
3 going to have to reapplied, but generally, those
4 particular kinds of claims were not found to fail --
5 have ab initio, if you will, from the outset in terms
6 of pleading manipulation.

7 I don't agree with everything in that
8 opinion, personally, but the court did make
9 distinctions between different kinds of conduct in
10 that case and whether it survived a Commodity Exchange
11 Act claim.

12 The other thing I just want to mention very
13 briefly is when you're getting into the cash and
14 physical markets, you're getting into markets that
15 have multiple laws applying to them. And that's
16 different from the futures trading on regulated
17 exchanges where the Commodity Exchange Act is the only
18 law. And you have a narrower application of the
19 Commodity Exchange Act in that context.

20 Once you get into a physical market to say
21 we'll take the developed concepts under futures
22 trading and apply them in a cash market where you do
23 have antitrust laws, you do have state laws applying
24 as well, and once you do that, you're going to have to
25 try to find a way where persons operating in that

1 marketplace cannot come to the conclusion that under
2 the -- at least I believe that from a public policy
3 standpoint, we're okay under the antitrust laws, but
4 we have this vague antimanipulation law, which maybe
5 we're on the wrong side of, maybe we're not, we don't
6 know, and if those two areas of law can't be
7 rationalized, where one stops and what one permits and
8 what the other doesn't, because if the same conduct is
9 lawful under antitrust law, why should it be unlawful
10 under an antimanipulation law promulgated by the
11 Commission?

12 And if there is antitrust jurisdiction and
13 law for the Navajo representative and their concept of
14 anticompetitive behavior, then why should a
15 manipulation law create basically by virtue of its
16 vagueness a claim or a premise that there is something
17 else you have to be complying with that's different
18 from the antitrust laws.

19 MS. GALVAN: Okay, we're going to take two
20 more responses and then we're going to take a break
21 and then we can continue, but let me go to Athena.

22 MS. VELIE: Okay, yeah, I just was -- I
23 would back up a lot of what Mr. Mills had to say, but
24 maybe just to emphasize again, we've talked a lot
25 about what doesn't work and we all recognize the

1 difficulty the Commission has coming up with a rule to
2 capture a broad range of conduct, but yet not chill
3 market behavior.

4 And again, pointing out what Charlie Mills
5 pointed out, there already is the Commodity Exchange
6 Act standard that applies in these same markets, in
7 these wholesale petroleum markets, and we would
8 encourage the Commission to seriously consider that
9 standard, and I believe that at least a core of that
10 standard is fraud.

11 I think there are other types of behavior
12 that are captured under that rule as well, because
13 there are some specifically noted in the statute,
14 cornering and squeezing have always been, again, your
15 core manipulative activity. And those are both market
16 power issues, but they are also specifically noted in
17 the statute. But outside of the cornering and
18 squeezing, I think that fraud is another core
19 manipulative activity, but although this Commodity
20 Exchange Act standard, I believe, is definitely broad
21 enough to get to the type of conduct that we've been
22 talking about, it's not so broad as to capture every
23 activity that has a price effect, because I think
24 every activity has a price effect.

25 So, and that's why it's drafted the way

1 that -- that's why the standard has been developed in
2 the courts the way it has, with specific intent to
3 create an artificial price, and whether the actual
4 creation of an artificial price, that's how you reign
5 in the breadth of that CEA standard.

6 So, given what we understand to be the
7 Commission's goals, and given the fact that this
8 standard is already applicable in these markets, it
9 seems that maybe some more -- you know, we would
10 encourage the Commission to give that more
11 consideration.

12 MS. GALVAN: Okay. I'm going to, one last
13 statement, and then we'll come back to the rest of you
14 after the break.

15 MR. DREVNA: Again, Charlie Drevna with the
16 NPRA.

17 I don't want to sound like I'm piling on
18 here, but I'm compelled to, on this antitrust
19 discussion. You know, antitrust law deals with market
20 power issues. This is not the forum to discuss low
21 level intent to infuse, infuse additional requirements
22 upon your task at hand here. Simply because someone
23 may believe that the antitrust laws aren't
24 particularly working well, according to their
25 estimation, or that it's too expensive or takes too

1 long to deal with.

2 Unfortunately, that wasn't written in EISA
3 '07, and I think if we don't keep our eye on the ball
4 of why we're here today. And I think Mr. Hallock said
5 it earlier and said it very well, let me paraphrase
6 it, it's our hope at the end of this rulemaking that
7 we can tell our employees what's acceptable behavior
8 and what isn't, in these wholesale transactions, that
9 ensures an efficient and robust market. And to try to
10 infuse perhaps other laws that are or are not working
11 or too expensive will tend to retard any efforts to
12 get there.

13 And, so, I just urge the Commission to keep
14 your eye on that ball, why we're here and what the
15 intent is of Congress in a prospective manner to
16 ensure that we have a robust and efficient and open
17 market.

18 MS. GALVAN: Okay. Thank you. We're going
19 to take a ten-minute break and then we will reconvene.

20 (Whereupon, there was a recess in the
21 proceedings.)

22 MS. GALVAN: While we're waiting, I
23 understand that somebody left their driver's license
24 downstairs at the guard desk, I think a Mr. Moore,
25 Arkansas driver's license. If that helps eliminate

1 people checking.

2 I'm going to go ahead and get started, and
3 you had a statement that you would like to make?

4 MR. PICCONE: Jim Piccone with Navajo
5 commenters. I wanted to address this argument that
6 Congress didn't intend for the rule to cover
7 anticompetitive behavior because there were already
8 antitrust laws on the books. If that were Congress's
9 intent, it also didn't want the FTC to do anything
10 about fraud, because there were plenty of fraud laws
11 on the books.

12 Obviously, Congress did want something new
13 to be done, it wanted to give the FTC some new tools.
14 It used the term very clearly in the disjunctive to
15 regulate both manipulative or deceptive devices. Let
16 me read a couple of sentences out of a letter from
17 Senator Lisa Murkowski to the Federal Trade Commission
18 dated October 17, 2008. I believe this is posted, but
19 if not, I suppose it should be, but I'm sure it's part
20 of the record.

21 She writes, she says, "To ask the Commission
22 to address situations involving intentional conduct
23 that distorts the market and inhibits the flow of
24 crude oil to domestic markets, I respectfully request
25 that you use the Commission's new authority to address

1 anticompetitive conduct arising in conjunction with
2 the transportation of crude oil to domestic markets."
3 And there's more.

4 But it's quite clear what at least she
5 thought she was doing when she voted yes on this
6 legislation.

7 MS. GALVAN: Professor Pirrong?

8 MR. PIRRONG: Yes, just basically continuing
9 some of the points made before the break, I mean, I
10 think what this is all revolving around is whether
11 fraud is a necessary or sufficient condition to
12 constitute manipulation. And I think making it
13 necessary is overly narrow, and that making it
14 sufficient, you know, causes some problems as well,
15 because I think that there should be some additional
16 layers on top of that relating to price impact and
17 scienter and things of that nature.

18 Just another couple of points that people
19 have been talking about vagueness. Well, sure, there
20 have been vague rules in the past, and I guess that
21 that's one of the Commission's charges is to come up
22 with something that's sufficiently specific, and is
23 not vague, in order to help the Commission and courts
24 going forward.

25 And, so, I don't necessarily think that the

1 potential failures of regulators or courts in the past
2 should basically be something that precludes the
3 Commission going forward and coming up with something
4 that reduces vagaries going forward.

5 I think Athena made a point that if you look
6 at the CEA antimanipulation standards, yes, fraud is a
7 part of it, but also a corner and a squeeze, which is
8 market power, is part of it as well. So, as the term
9 manipulation has been used in other legal and
10 regulatory contexts, fraud is not a necessary
11 condition.

12 And just one last point relating to what
13 Mr. Drevna talked about, market power and that that's
14 essentially the purview of the antitrust laws. Well,
15 you know, first of all, again, it's clear that the CEA
16 has a market power component to it, so there's not
17 essentially a hard and fast demarcation between market
18 power on the one hand and other regulations on the
19 other, or antitrust laws on the one hand and other
20 regulations on the other, insofar as they pertain to
21 market power. But also, I would also note that there
22 have been antitrust claims made in manipulation
23 actions. So, there have been, for example, the Hunt
24 Silver case had an antitrust violation as part of the
25 complaint and the private action in that matter.

1 So, I just wanted to sort of come up with
2 those clarifying points.

3 MS. GALVAN: All of the topics that we've
4 hit this morning I think are a good groundwork to move
5 into a discussion of the elements of the rule. And I
6 take the point that Athena made earlier, which is it's
7 hard to take this general concept and understand what
8 that means without trying to provide some contours for
9 its application.

10 So, the next topic for discussion is the
11 proposed scienter standard for an FTC market
12 manipulation rule, and I'm going to start with what
13 the Commission had tentatively proposed, which was a
14 recklessness standard, and a lot of the commenters did
15 raise concerns about different treatments among the
16 circuits as to what recklessness meant.

17 So, if we were to move -- if we were to use
18 the Sundstrand standard articulated by the Seventh
19 Circuit on extreme departure from the standards of
20 ordinary care, the court goes on to say, which
21 presents a danger of misleading buyers or sellers that
22 is either known to the defendant or is so obvious that
23 the actor must have been aware of it. I am going to
24 refer to this as the known or must have known
25 standard.

1 What concerns, if any, would any of the
2 panelists have with the recklessness standard
3 enunciated as such?

4 MR. HALLOCK: Alan Hallock for Flint Hills
5 Resources.

6 The recklessness standard is one that gives
7 us great pause in terms of trying to create internal
8 compliance policies. When I think of that
9 recklessness standard, and I look at cases where it
10 may be applied, I have a great deal of fear that the
11 determination of recklessness will be made at a later
12 time when it is obvious what harm has resulted as the
13 result of a misstatement or an omission.

14 In other words, a determination will be made
15 based upon the harm that has occurred that not just
16 that you should have been more careful, but you should
17 have been far more careful. And for us to try to
18 design compliance policies, we are going to have to
19 create clear and definite rules that we can instruct
20 our employees on, and then that we can go back and
21 monitor and audit performance against those standards.

22 When we do that, I think we are going to end
23 up prohibiting an awful lot of conduct which the
24 agency would view as being beneficial to consumers.
25 In other words, I think we are going to have to look

1 at creating rules which limit dissemination of
2 information between customers and suppliers. We're
3 going to have to look at limiting dissemination of
4 information to government agencies where there is
5 not a requirement, simply to avoid the situation that
6 later on it's determined that the information was
7 wrong and because of the effect on the market, you
8 should have been far more careful.

9 MS. GALVAN: So, let me ask you, then, it's
10 not simply that you are concerned that the standard is
11 too relaxed, but also the application of the standard
12 is unclear? I just want to make the distinction. Is
13 it both?

14 MR. HALLOCK: I think it is both, yes.

15 MR. LONG: Robert Long for API.

16 I think, as I understand what you're
17 suggesting, that the Commission is exploring could it
18 within the structure of Rule 10b-5, as it's
19 interpreted by the SEC and applied by the courts,
20 could it move a little bit in the direction of a
21 tougher scienter standard. And I think that's
22 certainly the direction that we think would produce a
23 better rule, but our view is that once you depart from
24 specific intent and pick up this additional concept of
25 recklessness, that you are really inherently thrown

1 into a less certain world, and you are going to have
2 all these costs that Mr. Hallock is describing of
3 companies just deciding, you know, really we can't
4 voluntarily disclose information, even if it's
5 ordinarily going to be correct information and it's
6 going to be helpful ordinarily in helping to inform
7 the market and find the right prices.

8 I mean, a couple of additional quick points
9 I'd make. I think the recklessness standard makes
10 more sense in the Rule 10b-5 context, because there
11 are all these duties to disclose or refrain from
12 trading the frequently fiduciary duties, you know, so
13 that saying, look, you don't even necessarily have to
14 specifically intend to mislead somebody, but since
15 we're in this world, where there's supposed to be
16 equality of information, if you're reckless about not
17 disclosing something, we're going to hold you liable.

18 And one of our themes is here it's really a
19 very different situation, at least as we understand
20 it, we really don't want people to have obligations to
21 disclose everything they know about the market. That
22 is going to harm incentives to go out and figure out
23 what's happening in the market, it's going to
24 interfere with finding the right prices, which is
25 vital for the markets to function and is ultimately

1 good for consumers.

2 MS. GALVAN: Okay, let me, because I want to
3 focus here, we will come to the topic of the conduct
4 and whether there are affirmative obligations, what I
5 want us to focus here on is the knowledge element.
6 What should we expect of the actor? We will talk
7 about whether or not the conduct should be deemed
8 deceptive or fraudulent when we come to the conduct
9 discussion, but what should the burden be on the actor
10 here, not whether or not we're reviewing that after
11 the fact to determine whether or not the conduct was
12 actually deceptive, but what is the gap between
13 specific intent and recklessness in your eyes, Bob?

14 MR. LONG: Well, because once you depart
15 from specific intent, you don't actually have to
16 intend to mislead anybody. You're just very careless.
17 And I think, you know, people can differ about what's
18 very careless. You know, there is this concept that's
19 not just the lowest level of carelessness, but that
20 becomes inherently more difficult to predict, and
21 you're going to necessarily, I think, if you're having
22 to comply with this rule, have to try to figure out
23 how can we have a sufficient zone of safety so that
24 somebody coming back after the fact can't say, you
25 know, looking at this now, I think you were careless.

1 I think you were very careless.

2 MS. GALVAN: And that sounds to me like a
3 concern about how well articulated the standard of
4 recklessness is. John?

5 MR. KINGSTON: I don't want to speak
6 specifically to the recklessness standard, but I think
7 this is an opportunity for us to, again, reiterate our
8 point that you need to be very careful about keeping a
9 free flow of information to pricing services going.
10 It is based on the comments that have been made here,
11 it is not a very big leap for us to imagine that maybe
12 some ragged and not particularly articulate
13 conversations or information flow between somebody on
14 the commercial side and into a pricing service could
15 be deemed after the fact as having been reckless.

16 So, as you're drawing up this standard, I
17 would just like to suggest that you keep the pricing
18 services and their role in it in your mind.

19 MS. GALVAN: Mark?

20 MR. COOPER: Well, I think the so obvious
21 language is language that qualifies. The question of
22 recklessness then does so sufficiently. So,
23 obviously, there is going to be uncertainty here.
24 Elimination of uncertainty is impossible.

25 I think the qualifying language on

1 reckless as so obvious that they should have known
2 is sufficient protection so that there will be a broad
3 zone of activity that people behaving properly will
4 not have fear about engaging in activity.

5 MR. PICCONE: Jim Piccone for the Navajo
6 commenters.

7 We had proposed a little bit different
8 standard, but really amounts to the same thing, and
9 that is foreseeability as the standard. We think
10 something less than scienter should be the standard,
11 because this is supposed to be a preventative rule.
12 It's supposed to give powerful tools to the Commission
13 to prevent harm from being done. Scienter, as we
14 know, is very hard to prove, and usually only after
15 trials and discovery and a lot of arguing about the
16 facts.

17 Foreseeability really amounts to this
18 recklessness standard that the Seventh Circuit has
19 articulated, so obvious the actor must have been aware
20 of it. This is not careless or even very careless,
21 this is way beyond that. And as a general counsel, I
22 would not fear guiding our people with this kind of a
23 standard. I think you can write something that says
24 don't do this, because I've already determined that if
25 you did, it would be foreseeable that we might have an

1 effect on the market in an inappropriate way.

2 It's harder to write a regulation for your
3 people, a policy for your people to not intend
4 something. So, I actually think this helps the
5 general counsel in formulating compliance.

6 MS. GALVAN: Athena?

7 MS. VELIE: Would this be an okay time to
8 just share an example maybe? Because I think that it
9 is actually very difficult, and I'm hoping that I'm
10 going to try to keep this example as simple as
11 possible, but I hope it will maybe illustrate why it's
12 not that simple to tell people just not to engage in a
13 certain behavior when you've got something like a
14 recklessness standard.

15 You know, I want to just highlight an
16 example from the futures markets, because I think it
17 highlights some of the complexity and also dovetails
18 with some of what others at the table are saying about
19 the exclusive jurisdiction of the CFTC and why that's
20 so important in the futures markets, particularly if
21 there's going to be an inconsistent kind of
22 obligation. But I am going to keep this very simple.

23 So, imagine that an oil company that needs
24 oil to fill its supply contract hedges its risk by
25 taking a long futures position. As the contract

1 expiration approaches, the oil company decides it's
2 going to stand for delivery of those contracts, have
3 98 percent of the time they would offset their
4 position before expiration. In this case, they're
5 going to take delivery of this oil. They need oil.

6 Imagine, also, that another trader at this
7 oil company has a physical position that's priced off
8 the futures contract settlement price, and that the
9 futures contract settled higher than it otherwise
10 would have, because oil company stood for delivery on
11 that oil, and didn't offset its position earlier.

12 This is permissible conduct, but under the
13 proposed rule, market participants are worrying that
14 the enforcement staff might second guess these kinds
15 of decisions and allege that the oil company engaged
16 in reckless behavior that raised prices and benefited
17 their physical positions when maybe they could have
18 purchased oil in the wholesale markets instead of
19 standing for delivery under their futures contract.

20 Companies, and I hear this from the
21 financial institutions and many others in the energy
22 sphere, they need the flexibility to make these
23 decisions based on a number of commercial factors, you
24 have fast-paced markets, they're in concurrent
25 markets, they're in multiple markets at the same time,

1 and this is where it becomes very difficult, and they
2 worry, will this be second guessed after the fact?

3 Now, for a compliance example, you know, we
4 could tell them in their compliance programs, never
5 engage in a transaction unless there's a legitimate
6 business purpose. We can tell them that, and they
7 want to comply with that, and they know how to comply,
8 they know how to monitor and deter behavior,
9 prohibited behavior when they've got a kind of a
10 standard. And we tell them if it's really tricky,
11 talk to your legal department first, make sure you've
12 documented the legitimate business purpose, and that
13 can still occur in a very fast-paced environment.

14 But, how would they reduce the regulatory
15 risk with this recklessness standard, except to tell
16 their -- does the company just have to say, well, you
17 can't be trading in related markets? And that might
18 be what would happen.

19 MS. GALVAN: So, to the extent that the
20 court, the Supreme Court has indicated without
21 commenting on whether recklessness is sufficient, that
22 willful or intentional conduct is required under Rule
23 10b-5, we were moving forward with the Rule 10b-5
24 model, the question I have is, could the conduct that
25 Athena is describing meet that requirement that

1 basically recklessness is a form of an intentional
2 conduct? Does anybody believe that even using the
3 Sundstrand known or must have known standard would
4 have allowed the scienter element to be met under the
5 facts that Athena has described?

6 Charlie?

7 MR. MILLS: I'm not anxious to leap into
8 that question, but I would say -- I would defend all
9 day long that that's not reckless and that's not a
10 violation of law under if you use a Rule 10b-5
11 standard or any other standard, but with other
12 circumstances around that, I think CFTC, there could
13 be times when they might say, well, you shouldn't have
14 stood for delivery on that contract. And it's a
15 very -- that's one of the vaguest areas of the law,
16 when can you stand for delivery and when can't you?
17 When does that tip one way or the other?

18 My personal view is you can always stand for
19 delivery, and the CFTC has some statements that would
20 support that, but then they have some other qualifying
21 statements that draw it into question. And when you
22 get to a recklessness standard, you drop it down one
23 more level of uncertainty as to how the law would be
24 applied.

25 I would say this about recklessness under

1 Sundstrand. There is both a subjective and an
2 objective element, as the court delineated it there,
3 and what I believe is the appropriate way to look at
4 that. Is the evidence so strong that you can draw an
5 inference that the person, in fact, had an intent to
6 deceive and defraud? And that you can actually come
7 to a conclusion that we can't say -- we don't have
8 absolute proof that that was what was in their mind,
9 but the evidence is so strong, we can reasonably
10 conclude that it was. And that that's where
11 recklessness is taking you.

12 Some circuit courts grappling with what is
13 the standard have used the term severe recklessness.
14 But that's the kind of gradations that courts and
15 regulators struggle with once you go to a recklessness
16 standard.

17 The only other thing I would mention here is
18 I think in this marketplace, recklessness is more
19 problematic, at least in what I am most knowledgeable
20 about of sorts, would be the trading sphere where
21 traders, for all these companies that are trading with
22 each other and on platforms are trying to figure out
23 every day where the market is, what people are
24 intending to do, what they might do, and they're
25 making calculated guesses and trying to factor that

1 into what impact will that have on price, and should I
2 be long, short, should I get out, should I get in?

3 On top of that is an obligation of most
4 traders to their companies not to disclose proprietary
5 information, because it's very valuable. If you let
6 the market know, yes, I'm going long today, you might
7 be very vulnerable to the rest of the market then
8 taking advantage of you in some way.

9 And, so, there's a very significant interest
10 to hold back information. And in the forays of the
11 marketplace, there has been some academic literature
12 on this, but I describe it to some degree as a poker
13 game.

14 And, so, there is bluffing going on, traders
15 will give a little bit of information, because they
16 want to get a little bit of information from somebody
17 else in the market. And if you say, I'm never going
18 to tell you anything about what I'm thinking, but want
19 you to tell me what you're thinking, what your
20 estimation is of the market, you're not going to get
21 the information. And that's part of trying to gain
22 information and information is power in most of these
23 trading markets.

24 And, so, you're placed into a dilemma as a
25 trader, if someone is trying to get information from

1 you and they artfully ask you questions, and you try
2 to avoid them, or give just a little bit. In
3 hindsight, could somebody say, well, that actually was
4 deceptive, you didn't give them all the information
5 that would have been necessary to accurately reflect
6 what your statement is. And how you apply
7 recklessness in that context is very difficult,
8 because you can tell a trader, never say anything
9 that's false, but it's very hard to apply an
10 application, if somebody else calls you up and says,
11 isn't it true that was your trade that just went off
12 on this platform? And what are you going to say?
13 Let's say it was. You say, no comment.

14 Well, what does that signal? It signals, of
15 course, it was. If you say no, you're telling a lie.
16 Is that actionable? Is that reckless? Or is it good
17 sense because your real obligation is to your employer
18 not to reveal information that might harm the company
19 in the trading world.

20 And that's a moral dilemma that recklessness
21 makes just a little bit harder to get at fairly, or
22 the way the market works.

23 MS. GALVAN: Okay, I see the various
24 placards up, but I want to make sure that we're all
25 talking about the same proposal here, and to the

1 extent that the standard would be that the actor knew
2 or must have known that the conduct was fraudulent or
3 deceptive. I mean, are the concerns still as
4 articulated in the comments? I don't know, De'Ana, if
5 you want to respond to that.

6 MS. DOW: Well, De'Ana Dow with the CME
7 Group.

8 I was not -- that was not what I planned on
9 addressing, but to known or would have known.

10 MS. GALVAN: And let me make that clear,
11 it's known or must have known, which is different than
12 a known or should have known standard, and we can talk
13 about various other standards.

14 MS. DOW: I think in the context of
15 recklessness, I think what you are going to find is
16 there is a body of law that defines what is meant or
17 what is intended by recklessness, whether it's extreme
18 departure from the standards of ordinary care, or in
19 your scenario, known or must have known, I think there
20 is going to be considerable amount of confusion as to
21 what is acceptable behavior.

22 If you don't go with a standard of specific
23 intent, and in fact, an intent to create an artificial
24 price, which to me is what, you know, we should be
25 targeting in the context of going after bad actors.

1 I wanted to address the concern raised by
2 Mr. Piccone about the ability to prove whether or not
3 there was intent. I would argue that in this day and
4 age of technology, modern technology, it's a lot
5 easier, the ability to prove it has gotten easier,
6 with your emails, with your voicemails, with the
7 variety of new technology that's available. There's
8 new evidence that's available to prove intent.

9 If you have someone that's trading against
10 their economic interest, one can see that there's
11 intent. And also, keep in mind that the proof that's
12 required, it's not criminal, it's not the criminal
13 standard. It's not beyond a reasonable doubt, it's a
14 civil standard, which is a mere preponderance of the
15 evidence, that is it's more likely than not, 51
16 percent.

17 And, so, I would suggest that intent maybe
18 is not as difficult today to prove as it may have been
19 in the past. And also, I would like to emphasize that
20 we tend to be talking, I think, at least a few of the
21 commenters that just spoke seemed to be focusing on
22 the futures market, and in that environment, which
23 it's going to be a very different scenario when you're
24 talking about the OTC market, or you're talking about
25 the cash/physical market. All of those present very

1 different types of elements that you would have to
2 address in looking at these standards.

3 So, I think that's important to distinguish.
4 And again, we would emphasize that the futures markets
5 should not, obviously, be a part of this particular
6 rulemaking, and there we do have in the futures market
7 the scienter requirement.

8 MS. GALVAN: Alan?

9 MR. HALLOCK: Alan Hallock with Flint Hills
10 Resources.

11 It seems like a lot of the discussion is
12 focused on use of recklessness as a solution to an
13 evidentiary problem, failing to be able to prove
14 specific intent, and as De'Ana just pointed out, there
15 are other examples in the law where specific intent is
16 proven without the smoking gun email saying I intend
17 to manipulate the market.

18 So, I think the cost of using the
19 recklessness standard as a substitute for
20 circumstantial evidence of specific intent is that you
21 do begin to foreclose or encourage companies to
22 foreclose conduct which is very beneficial to the
23 market, the back and forth discussion between seller
24 and buyer in which both learn more about the market
25 and are able to come to a better price.

1 It is relatively easy to write internal
2 standards that -- and enforce those internal standards
3 that say, do not lie, do not deceive, when we try to
4 write internal standards that say, be very careful and
5 don't be wrong, we move into an entirely different
6 type of conduct.

7 And given the amount of information within
8 even small companies, for a marketer to be having that
9 back and forth conversation with a customer and to be
10 talking about operational conditions and supply
11 conditions and have a 100 percent degree of certainty
12 or even a 95 percent degree of certainty that
13 everything that person is saying is correct, given the
14 information that is within that company, I think that
15 becomes very difficult to do and it causes us to look
16 at whether the conversation is necessary or required
17 by the law.

18 MS. GALVAN: Let me ask, are the concerns
19 about the use of a recklessness standard, even one
20 that's articulated, is it a concern that's driven by
21 reliance on the securities precedent, or is it
22 something that you can separate? If you're not
23 imposing this requirement in the context of fiduciary
24 relationships, but you're saying in the absence of
25 fiduciary relationships, you have a duty not to lie.

1 You have a duty not to act in a manner where you know
2 that somebody is being deceived by it. Is it really a
3 concern that's driven by the application of the
4 securities precedent?

5 MR. HALLOCK: For me, it's not driven by
6 application of the securities precedent, it's driven
7 by a desire to know what the FTC expects. And if the
8 expectation is that the company will not make a
9 mistake in its communications, that ends up having a
10 broad impact on the market, then we can create
11 compliance standards to do that, to meet that
12 expectation, but I think it's going to have an impact
13 upon those conversations.

14 So, that's where the concern comes from.

15 MS. GALVAN: Let me go to Professor Pirrong.

16 MR. PIRRONG: A couple of points, and I
17 think it also partially revolves around, again, what
18 is going to be the scope of the rule? If it's just
19 related to fraud and deceit, or whether other forms of
20 conduct that can distort prices, but which may, for
21 example, involve the exercise of market power, which
22 of those are going to be encompassed by the rule.

23 Relating to Ms. Velie's hypothetical, that
24 is essentially a sort of market power corner sort of
25 story. Given her hypothetical is somewhat incomplete,

1 but I could construct expanded hypotheticals in which
2 that conduct could be sort of a manipulative corner, I
3 could construct other hypotheticals, sort of additions
4 to the hypothetical in which it would not be.

5 But what I can say is that under those sorts
6 of situations, you would be able to utilize a more
7 restrictive standard, essentially a specific intent
8 standard, that would essentially rightfully identify
9 sort of manipulative conduct without the risk of
10 exposing legitimate conduct to regulatory or legal
11 sanction.

12 So, I think in terms of market power, if
13 market power is encompassed by the rule, if market
14 power falls under your definition of manipulation,
15 then a more restrictive standard is appropriate in the
16 sense that it would reduce the compliance burdens that
17 have been raised here, but at the same time, would
18 allow you to get at the kind of conduct that you want
19 to essentially eliminate.

20 When it comes to fraud and deceit, I think
21 there it becomes a little bit more difficult and
22 essentially what you face is a trade-off. To the
23 extent that people are engaging in reckless conduct
24 that distorts prices, well there is a cost associated
25 with that. The cost is the price distortion.

1 The question is, how costly is it for
2 corporations to implement the compliance regime that
3 will reduce that conduct? And I think it's pretty
4 much the sense that I have gotten, not just from what
5 I have heard here today, but from being around the
6 industry for a long time, that those compliance costs
7 are pretty substantial.

8 And, so, I think it really all -- sort of
9 this makes your life more difficult, but to the extent
10 that more kinds of conduct are encompassed by the
11 rule, a one-size-fits-all scienter standard might be
12 problematic.

13 MS. GALVAN: And let me ask, specifically,
14 how much uncertainty would a specific intent standard
15 cure? Because I'm not sure that I am clear on what
16 you're thinking here.

17 MR. DREVNA: Charlie Drevna with NPRA.

18 I think that if you look at trying to -- if
19 you look at our comments, I'm sorry, this thing
20 started by itself.

21 MR. YOUNG: I picked mine up to make it look
22 like it was mine.

23 MR. DREVNA: I'm sorry, it's asking for a
24 command. Sorry about that.

25 In any event, let's look at what is the

1 ultimate goal and how best to get there? And this may
2 amaze you, but to a certain extent, I'll agree with
3 Mark Cooper down at the end of the table there very
4 briefly, that it's impossible, or very impractical to
5 try a write a regulation that is totally void of
6 uncertainty. And as much as we all try to work
7 together to get that, it's tough to do.

8 But to unnecessarily inject an uncertainty
9 into the regulation, I think is definitely the wrong
10 way to go. And if you would stick with the specific
11 intent to inject market material, false or deceptive,
12 and that's an evidentiary thing that I think Charlie
13 is talking about, Charlie Mills is talking about here.
14 That's pretty doable.

15 To add a nebulous, subjective term, even
16 though the courts have -- let me try to give you a
17 definition of what reckless behavior is, but in
18 theory, I mean, in reality, that is a pretty nebulous,
19 ambiguous, uncertain term. And that's something that
20 I believe is unnecessary for your objectives. For our
21 objectives. To make sure that things are done in
22 accordance with proper standards.

23 The other thing you have to think about is,
24 too, professor mentioned the fact that in his -- in
25 which we agree, that in his dealings around the

1 industry and what would happen, yes, it will present
2 an unnecessarily high cost for compliance on industry.
3 But in reality, further than that, it injects more
4 uncertainty into the marketplace.

5 The marketplace could handle an economic
6 uncertainty, what I think the marketplace is unable to
7 handle is regulatory uncertainty. And that leads to
8 paralysis. And that's the last thing, I think, we all
9 want to see. Because I can tell you that I think a
10 lot of refinery people will think twice, three, four,
11 and five times, if they're going to figure -- if they
12 think if I hit that send button, to put that product
13 into the pipeline, or send it to the market, that in
14 two, three, four weeks, or so, that then it will be
15 judged whether they were reckless or not or whether
16 they broke the law.

17 So, I think the more certainty, again, in a
18 very uncertain kind of framework, the more certainty
19 that we can instill -- we can incorporate into your
20 working here, the better off we'll be, and I think by
21 adding a term reckless will only add to more and more
22 and more uncertainty.

23 MS. GALVAN: Navajo Nation?

24 MR. PICCONE: Jim Piccone for Navajo
25 commenters.

1 I actually think that a specific intent
2 standard, in my mind, is far harder to say is certain.
3 It's very subjective. And the whole point of having a
4 recklessness or a foreseeability standard is to have
5 something that you can prove. It is really just a
6 different level of proof of specific intent, if you
7 see what I mean.

8 I think the problem here really is that it's
9 the behavior, the confusion for people being regulated
10 as to what we can or can't do. It's pretty easy to
11 write regulations for -- to your people, to not do
12 things, if you know what you can and can't do. And
13 that's really what needs to be done here.

14 I think that the state of mind here between
15 recklessness and specific intent is really not the
16 point at all. I think there's got to be certainty
17 about what the behavior is.

18 MS. GALVAN: Mark?

19 MR. YOUNG: Mark Young for the Futures
20 Group.

21 I agree with a lot of what's been said, but
22 I want to come back and re-focus it in light of one of
23 the things that the Commission said in the proposing
24 release was, the Commission wanted to avoid
25 contradictions in its rule and the rules that are

1 applicable to the futures markets today. And like
2 Ms. Dow, we're hoping that this will not be applicable
3 to the futures market.

4 So, I'm making this point both to address
5 the issue of contradiction, and as an illustration of
6 now another area of the law treats these same
7 subjects. The question you asked before, would a
8 known or must have known conduct is deceptive
9 standard, would that create legal uncertainty, would
10 that increase compliance costs, would that make the
11 markets less efficient because fewer people will
12 participate in them, I think the answer to that is
13 generally yes.

14 But, if you look at the way the futures law
15 has evolved, it's pretty illustrative. First point:
16 With respect to the fraud standard in the Commodity
17 Exchange Act, that does apply in the fiduciary
18 context, unlike the way we understand your proposed
19 rule would apply. That does use a knew or must have
20 known, a recklessness kind of standard generally.

21 When you get to the question of price
22 manipulation, the standard is specific intent. And
23 the reason for that standard is to protect the market
24 so that it can work and market participants can, as
25 the example that we heard earlier, pursue what's in

1 their best interest. Otherwise, their trading
2 judgments get second guessed and they can't
3 participate in the market fully.

4 But the third category is the false
5 reporting category, and there, the Congress has passed
6 a statute that's existed for decades that says that
7 you cannot deliver a knowingly false report that has
8 an effect on price.

9 Now, there's no standard there of a report
10 that you must have known was false. It has to be a
11 report that you knew was false, I'm not saying you
12 must have known was false. So, there's none of --
13 it's the must have known component that I think
14 creates the problem there and it would create the
15 contradiction if you would apply it in the false
16 reporting context with the law under the Commodity
17 Exchange Act.

18 MS. GALVAN: And then I'm going to let you
19 respond, Charlie, but I also want to ask you, to the
20 extent you had described the evidentiary value of this
21 extreme indifference, extreme recklessness, and that
22 you're inferring intent through that, is that a
23 standard that can be articulated clearly? Is that a
24 standard that's called recklessness when you're using
25 circumstantial evidence to show specific intent?

1 MR. MILLS: I'm not sure I really can answer
2 the question capably, but I'll try. The way I think
3 of it is through circumstantial evidence, someone
4 could prove an intent to deceive and that probably
5 happens, you know, all the time in cases through
6 circumstantial evidence, and they meet the specific
7 intent standard through that means of evidence. And
8 so it's not just an evidentiary issue, but it -- once
9 you say, well -- and my concerns, to some degree,
10 recklessness, if you're instructing a jury on what
11 recklessness is, maybe you can get it pretty darn
12 close to what is very, very close to specific intent,
13 and it's not going to necessarily change the outcome
14 of the case, whether it's reckless or specific intent.

15 But just in terms of participants in the
16 market, when you hear the word reckless, and you don't
17 have the lawyerly Sundstrand, which goes on for
18 several pages, trying to explain what it is,
19 definition, and you're trying to train people who are
20 not lawyers and are not trained to be lawyers,
21 recklessness ends up being a more amorphous concept.

22 And, so, it already puts people who have to
23 live under the rule in a greater amount of uncertainty
24 of where the line is drawn. Because there is
25 ultimately a higher level of subjectivity about

1 whether something is reckless and whether something is
2 specifically intended for a purpose.

3 I don't know if that's helpful, but that's
4 my thinking about it.

5 The other thing I wanted to mention was,
6 does specific intent matter, does it help. If it's
7 specific intent to deceive or defraud, which is what
8 recklessness is and intent is in the securities world,
9 then yes, it makes a difference. When you start
10 talking about a specific intent other than deception
11 or fraud, and it's a specific intent to cause a price
12 distortion, without specific intent, if you're going
13 to go in a market power direction, if you bring in
14 recklessness, to me, for all the comments that have
15 been made, it becomes unworkable.

16 And in Ms. Velie's hypothetical, you're then
17 assuming -- once you get to market power, you're
18 starting to delve into the area of a duty to the
19 marketplace, which is something that doesn't exist in
20 the securities laws. It did for a while, but the
21 Supreme Court in U.S. versus Chiarella said, no, there
22 is no duty to the marketplace, your only duty is if
23 you have a fiduciary duty to disclose something, then
24 you've got to disclose it; otherwise, you don't.

25 If you're sitting there wondering, well, do

1 I take delivery on this contract, or is that going to
2 be held to be manipulative, and therefore a violation
3 of a rule. And the question is then, am I
4 specifically intending to distort the price, but
5 rather am I being reckless about whether there will be
6 a price distortion. Those are two -- that's a pretty
7 huge gap in how to figure out your conduct.

8 You can come to the conclusion, no, I'm
9 taking delivery, because that's what's good for my
10 company, and I have a good purpose for doing that, and
11 I'm not specifically intending, but if the rest of the
12 marketplace says, well, we don't have to prove that,
13 we just have to prove that you should have thought
14 about us, too. You shouldn't have taken delivery,
15 because you knew it was going to impact all these
16 other players in the marketplace, and that is, quote
17 unquote, reckless, then you have an unworkable
18 standard that does tear down the principles and the
19 foundation for the marketplace.

20 MS. GALVAN: Let me ask, what conduct would
21 we be missing if we used a specific intent standard,
22 and if this were to continue to be a rule targeted at
23 fraud and deception? What conduct would we be
24 missing? Bob, I don't know if you want to respond.

25 MR. LONG: Well, I think just following the

1 logic of your rule, there would be situations where
2 people weren't intending to mislead anybody, they
3 weren't intending to make any false statements. They
4 may have put out some information that turned out to
5 be incorrect, you know, and our view is that, again,
6 taking this basic approach of looking at the costs and
7 benefits of a possible rule, in general, having
8 information made available to participants in the
9 marketplace in the absence of people intentionally
10 injecting information that they know to be false, is a
11 good thing. It's something to be encouraged.

12 And, so, yes, you would maybe pick up some
13 places where people would say, okay, we're going to be
14 more careful about this, we'll get it right, or we
15 won't put it out at all. But I think you would lose a
16 lot more, because there's a number of people who would
17 say, look, we've got this rule, it's a million dollars
18 a day in penalties, just stay away from it. Don't
19 talk about this.

20 And, you know, the markets are going to
21 become information starved. I mean, that's strong
22 language, but you're not going to have the optimum
23 amount of correct information in the market. And even
24 with some that turns out to be not quite right, not
25 because of intentional misstatements.

1 MS. GALVAN: Okay. Let me ask this
2 question: When I read the Hochfelder case to say
3 intentional conduct is what's required under Rule
4 10b-5, willful or intentional conduct, and then that
5 the courts have interpreted that to be this extreme
6 form of recklessness, that it would not capture
7 inadvertent mistakes, even under a Rule 10b-5
8 standard. Is that correct?

9 MR. MILLS: I think so.

10 MR. YOUNG: I think that's right.

11 MS. GALVAN: That you would not capture
12 inadvertent mistakes?

13 MR. YOUNG: You would not.

14 MS. GALVAN: So, where I'm having trouble
15 following some of the responses is where the
16 references are to inadvertent mistakes, where there's
17 no willful conduct on the part of the actor, it seems
18 as though those don't meet the recklessness standard.

19 Alan?

20 MR. HALLOCK: Alan Hallock with Flint Hills
21 Resources.

22 I think that gets back to a basic problem
23 with any type of organization. The actor, him or
24 herself, the person speaking, may not have the
25 information necessary to make the statements that they

1 are making. And I think, my fear is that whenever you
2 put statements under a microscope, later on, that you
3 will be able to find the sum total of the information
4 available in that organization and look at that
5 statement and look at that information that was
6 available in the organization and say, you either
7 knew -- you either knew that or you must have known
8 that, given all of this information in the
9 organization.

10 That is my concern.

11 MS. GALVAN: Okay. Mark Cooper?

12 MR. COOPER: Mark Cooper, Consumer
13 Federation.

14 You asked the question, what will you miss
15 if you go to the higher level, and I think the answer
16 is that you may miss manipulations, and manipulations
17 can occur without the linking evidence. I mean, and
18 the example is a good example, and Professor Pirrong's
19 comment sort of reinforces that.

20 The effect of those two acts on the part of
21 the company has to be to distort the price. And, so,
22 it's not only recklessness, but you can't -- you're
23 talking about recklessness in the context of actually
24 distorting or having a possibility of distorting the
25 price.

1 So, in these examples where you have
2 transactions that don't have the effect of distorting
3 the price, or could not reasonably have had the effect
4 of distorting the price, I don't think you have the
5 problem. And, so, what you will miss, if you go to
6 the higher standard, is instances in which people in
7 the company are perhaps not conspiring between them to
8 affect the price, but have the effect of raising the
9 price, if the transactions are large enough in the
10 market.

11 MS. GALVAN: Professor?

12 MR. PIRRONG: I think I can give an example,
13 actually a real world example where something you
14 might miss, and it's going to be sort of points to
15 what the trade-offs are involved in the different
16 standards.

17 Some years ago, in the Eurex market,
18 overseas in Germany, there was a trader that was
19 thought he was trading on the training system for
20 Eurex, and he sold tens of thousands of contracts that
21 caused the price just to plummet. He didn't know that
22 he was actually connected to the live market.

23 So, this is something that definitely had a
24 price impact. Okay? It was completely unintentional.
25 He thought he was essentially playing the financial

1 equivalent of a video game, when, in fact, he was
2 playing for real money that almost drove his bank out
3 of business.

4 So, that was probably reckless. It was
5 probably arguably reckless in terms of the design of
6 the various safeguards in the training system that
7 allowed somebody to connect to the live market from
8 what was supposed to be a training computer. So, that
9 was something that had a price impact, that would
10 probably fall under a recklessness standard, but would
11 not fall under a more specific intent standard,
12 because the party had no intention of actually causing
13 this price distortion.

14 MS. GALVAN: Let me just ask, you can answer
15 this as well, perhaps, does a recklessness standard
16 assume a duty?

17 MR. DREVNA: I'm going to let more legal
18 minds answer that one, but I would like to go back to
19 what Mark Cooper had mentioned. And I think we have
20 to be careful, again, as to, you know, he said this
21 transaction will affect price. It may well. But the
22 price it probably affects is the negotiation between
23 two savvy market oriented people, not the price, or
24 not have an impact on the market.

25 And there, I think, we have to go back to

1 Mark Young's three buckets. What has to happen in
2 order for there to be market manipulation, not trying
3 to do one-upsmanship in a negotiation between two
4 supposedly savvy parties. And I think that's where
5 Mark Cooper's analysis is a little bit of a distortion
6 as to what we're looking at going down that would
7 impact the total market.

8 MR. COOPER: The hypothetical clearly as I
9 understood it was not intended to be not a one-on-one
10 negotiation, but a market transaction. I believe
11 that's the way the hypothetical was set out. So, it's
12 not your example of two parties trying to fool one
13 another at the last round of a poker game. It was a
14 market transaction, and the impact was measured on the
15 market.

16 MS. GALVAN: Okay, let me go to SIGMA.

17 MR. BARNETTE: Okay, great. Thanks very
18 much, Jim Barnette with SIGMA.

19 Let me say as somebody who was heavily
20 involved in the bill last year, Congress didn't do you
21 any favors on this one.

22 I think SIGMA has a huge problem with the
23 recklessness notion primarily just because of the
24 marketplace. This is not a standard sort of Section 5
25 unfair deceptive practice sort of stuff. We're not

1 talking about sales of Coca-Cola. I mean, we're
2 talking about fluctuations and the volatility
3 obviously that we've seen over the last six months is
4 indicative of the issue that we're dealing with.

5 I mean, some of these things depend on OPEC.
6 Some of them depends on wars in foreign lands. What
7 Iran is going to do on nuclear energy. Hurricanes.
8 And on and on. Pipeline breakdowns. So, it's a very
9 dynamic marketplace.

10 Certainly on the retail level, it's the most
11 transparent marketplace probably in the world, and I
12 would leave others to talk about the strict wholesale
13 marketplace, but I think injecting a great deal of
14 uncertainty into what is going to constitute a
15 violation of 811 is really not the way to go.

16 And I would urge the Commission and its
17 staff to take a look at the debates we've been having
18 up on the Hill on price gouging, which I'm sure some
19 of your folks have been following carefully. What we
20 determined, although there still has not been a law
21 enacted on that, what we determined was to try to find
22 a way to define what price gouging is not, as opposed
23 to defining what it is.

24 And, so, whether it's in a preamble to a
25 final rule, or somewhere in the rule itself, I think

1 it would be very helpful to provide examples and to
2 tell the communities that you're going to be
3 regulating what you're not going to be going after.
4 And I would hope that that would not be some ambiguous
5 notion of recklessness that I don't think that the FTC
6 even has the resources at this point to pursue.

7 MS. GALVAN: Can anybody answer the
8 question, does recklessness assume a duty, some
9 relationship of trust or confidence?

10 Bob?

11 MR. LONG: Bob Long for API.

12 I mean, this is something that we addressed
13 in our comments. Our view of the SEC law is that it's
14 all sort of a piece, and we think the recklessness
15 standard really comes out of and makes some sense in
16 the securities context because there are these broadly
17 applicable duties of disclosure.

18 There is this concept that everybody should
19 have equal information in the marketplace. There are
20 lots of fiduciary duties. The Supreme Court has even
21 said that we give Rule 10b-5 a broad interpretation
22 because it is set into this matrix of other rules.

23 So, we understand the suggestion and the
24 notice of proposed rulemaking, and we agree with it,
25 as far as it goes, that to the extent you decide to

1 follow this Rule 10b-5 model, it's essential to try to
2 separate it from duties to disclose, fiduciary duties
3 that don't exist in these markets would be, we think,
4 completely inappropriate in these markets, but we do
5 think that this recklessness standard really
6 ultimately traces back to those duties.

7 And, so, where you've tried to sort of cut
8 the Gordian knot, it doesn't completely work.

9 MS. GALVAN: Mark?

10 MR. YOUNG: This is Mark Young, just
11 quickly.

12 I don't think in a trading market, saying to
13 the traders, the question you have to ask every day
14 is, did your conduct recklessly demonstrate an intent
15 to artificially influence the price? I think that is
16 going to -- if that's the question you're asking, is
17 there a duty of one market participant to all the rest
18 of the market participants to not engage in reckless
19 conduct, I think that's going to chill market
20 activity.

21 If you're asking in the context of a one-off
22 transaction where there's a fiduciary duty, does a
23 recklessness standard make sense? I think
24 historically, in the law, the answer to that is yes,
25 that's when it's been found to apply.

1 MS. GALVAN: Athena?

2 MS. VELIE: Just one other point, too,
3 because again, I think it's that some of the
4 confusion, some of the questions, like you were asking
5 before, is our concern with recklessness driven by the
6 application of the securities precedent, for example.
7 I think that it's really, it's a combination of
8 everything together. It's not just the recklessness,
9 it's that people, or I don't completely understand to
10 what kind of behavior this is going to relate.

11 It's the scope of the rule, potentially
12 being so broad, and part of the problem with not
13 understanding what behavior this applies to is the
14 securities precedent. Because there aren't the same
15 duties. And we are -- this market is comprised of
16 sophisticated market participants, you know, trading
17 at arms length, and there are complicated
18 transactions.

19 But I think the other thing with -- and the
20 fact that there's no market, no requirement for price
21 effect, all of those things together, but also just
22 taking it down to the fact that a lot of this happens
23 in the context of investigations.

24 And, so, obviously not to go into any kind
25 of specifics at all, but I know that what I have seen,

1 in my experience, and it may be in others as well, is
2 that when you get in the context of an investigation,
3 that it's often sort of taken down a notch.

4 So, yes, the government has to prove
5 specific intent to create an artificial price under
6 the commodities precedent, but often there's evidence
7 that looks more like must have known being offered in
8 the course of an investigation. And I think there's
9 also this fear that, then, with a recklessness
10 standard, that the kind of evidence being offered in
11 an investigation where there's a lot of pressure to
12 settle, is that you're going to get evidence of should
13 have known. And that's been our experience under the
14 FERC's rule, is getting some evidence of should have
15 known.

16 And, so, that's part of the concern.

17 MS. GALVAN: That, actually, opens us up to
18 something that perhaps is a source of confusion here
19 at the table. We're not talking about benign conduct
20 that's done recklessly, what we're talking about here
21 is deceptive or fraudulent conduct. And to the extent
22 we are able, perhaps, in a later discussion, to put a
23 proper boundary about what is fraudulent or deceptive
24 conduct. Is fraudulent or deceptive conduct done
25 recklessly still likely to cause concerns about the

1 effect on the marketplace?

2 Athena?

3 MS. VELIE: I don't really want to address
4 it completely, but I do want to just mention that I
5 think there would be less problem if it weren't for
6 that subsection C in the rule, because to me, that
7 still creates a great uncertainty about what's meant
8 by fraud when we're talking about a reckless act that
9 could operate as a fraud. I'm not saying that it
10 would otherwise be perfect, but I think that it would
11 go a ways, you know, it would be definitely helpful to
12 not have that subsection C.

13 MS. GALVAN: Mark?

14 MR. YOUNG: I'm afraid I'm going to answer
15 the same. You have to tell us, I guess we're dealing
16 with tails and dogs, and I'm not sure at this point
17 which is which, which is not a very comfortable
18 position to be in, but I think you have to tell us
19 deceptive conduct that has an effect on price,
20 deceptive conduct that doesn't have an effect on
21 price, deceptive conduct that is arising in the
22 context of a duty, of a legal duty, a fiduciary duty,
23 or just deceptive conduct with respect to the world at
24 large, which is the third of my buckets, the false
25 report bucket, where you knowingly make a false

1 inaccurate report that you know is going to have an
2 effect on price? Yeah, those are all different
3 contexts in which to ask the questions about state of
4 mind and recklessness and what the evidentiary
5 standard is like.

6 I just think Athena's last point about the
7 investigative stage, and I don't want to
8 over-dramatize it and call it the slippery slope, but
9 she's definitely right about that. That point should
10 be underscored, in terms of its ultimate impact on how
11 you conduct compliance, and what kind of guidelines
12 you give to people. That's a very real world
13 observation that you should really take under
14 advisement.

15 MS. GALVAN: Go ahead.

16 MR. DREVNA: Just a quick comment on I think
17 where we are right now. I think all the discussion
18 that's going on has been all good discussion, I think
19 one of the things that some underlying theme that may
20 have surfaced here is that any attempt by the FTC to
21 use securities law or CFTC law to force fit into this
22 regulation is definitely the wrong way to go. It's
23 not that easy of a fit.

24 There may be concepts, there may be pathways
25 or something that are applicable, but -- and again, I

1 think the discussion around the table is that, gee, if
2 you try to slam dunk either the securities or the CFTC
3 law into your regulation, it's going to be fraught
4 with uncertainty and peril for everyone.

5 MS. GALVAN: Any other comments?

6 (No response.)

7 MS. GALVAN: We are at time for lunch,
8 actually, and we will reconvene at 2:00. And if you
9 wouldn't mind being here a few minutes till 2:00 so we
10 can get started promptly at 2:00. Thank you.

11 (Whereupon, at 12:34 p.m., a lunch recess
12 was taken.)

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1 AFTERNOON SESSION

2 (2:00 p.m.)

3 MS. GALVAN: If we could go ahead and take a
4 seat, please. All right. I'm going to have to start
5 imposing sanctions for tardiness, but we'll give the
6 other participants just another minute.

7 I just want to alert everybody at the table
8 to the fact that we do have another person here for
9 the afternoon transcribing the comments, and so we are
10 going to put some additional emphasis on identifying
11 yourself at least for the first part of this
12 afternoon.

13 Also, because the interest in conduct seems
14 to prevail, we're going to move to that topic and deal
15 with the reach section of the discussion today a
16 little bit later in the afternoon.

17 Okay. If we have new participants at the
18 table, if you wouldn't mind identifying yourselves?

19 MR. GIMBLETT: Jonathan Gimblett for API.

20 MS. GALVAN: Then everyone else continues to
21 be the same? Okay.

22 To start off, I'm actually going to ask the
23 question with respect to only subpart B of the
24 proposed rule. Is the concern about scienter standard
25 of recklessness about subpart B of the rule or about

1 the rule in its entirety? I'm referring specifically
2 to those concerns raised by commenters about what
3 constitutes a partial disclosure or a misleading
4 statement. Then perhaps we can come back to this
5 question then in the context of the discussion of
6 conduct.

7 So to start us off here, in terms of the
8 type of prohibited conduct, it might help to identify
9 some conduct that some of you may be concerned would
10 be captured by the rule as proposed that you believe
11 should not be captured. Is there legitimate conduct
12 that you believe would be swept in under the rule as
13 it is currently proposed? Alan?

14 MR. HALLOCK: Thank you. Alan Hallock with
15 Flint Hills Resources. The participants in these
16 markets currently have their actions guided by
17 compliance policies built around antitrust laws. We
18 give our people specific guidance on what they can and
19 can't say to other market participants.

20 Oftentimes your competitor can also be your
21 customer in some situations, and so I am concerned
22 that there can arise situations where there is
23 actually information exchanges being encouraged,
24 whereas the antitrust laws would greatly discourage
25 those sorts of information exchanges, and maybe giving

1 a hypothetical would be helpful.

2 Say that a refiner has had a hydrocracker
3 unit go down, and I'm looking for diesel. I know my
4 competitor across town has a supply of diesel, but
5 before I go to him, I go to the pipeline company that
6 has a terminal in town and check to see if they have
7 diesel.

8 I find out that, no, they don't. Now, I
9 then go to my competitor, and the question is: What
10 information do I need to give to my competitor?
11 Ordinarily we would just talk about price and delivery
12 terms and duration, but with a rule that possibly
13 penalizes omissions or misunderstanding, am I required
14 to tell my competitor my complete competitive
15 circumstances, that I do have this unit down; it's
16 affected me by not being able to produce this amount
17 of diesel fuel?

18 I know that I can't get the diesel fuel from
19 other sources. If I gave them that information, it's
20 going to allow him to have the best information to set
21 a price to me, but it's also going to result in
22 probably higher prices for consumers.

23 MS. GALVAN: In discussing the different sub
24 part of the proposed rule, A B and C, is it fair to
25 say that the issue of statements or the failure to

1 provide information through again a statement falls
2 within subpart B?

3 MR. HALLOCK: I believe subpart B is of
4 particular concern.

5 MS. GALVAN: I don't know, Charlie. Do you
6 have any comments you might want to put in?

7 MR. MILLS: Charlie Mills for the New York
8 City Bar Committee. I would think, yeah,
9 traditionally the omission cases under SEC Rule 10b-5
10 would come under subpart B because it's talking about
11 omissions, that you're omitting a material fact that's
12 necessary to make the rest of what you say accurate
13 and not misleading, and so that's where the courts and
14 the SEC I think tend to focus their position and their
15 cases.

16 Subpart A I could theorize that you could
17 say, Well, you're employing a device to defraud, an
18 artifice to defraud, if you're misleading and you're
19 omitting material facts that are necessary to make
20 what you say accurate, so you could still rationalize
21 it under subpart A, but I think the focal point of
22 cases and so forth would be with respect to subpart B
23 because of the direct reference to omission.

24 You get back in any particular hypothetical
25 in my mind to: If you say something, is there

1 something left out that doesn't make it truthful? One
2 could argue in the hypothetical that Alan just gave
3 that if all you said is, I want to buy diesel, what do
4 you have and what price will you give me, that
5 wouldn't trigger an obligation to disclose anything
6 more because there's nothing about that that's false,
7 and you don't have an affirmative duty to reveal other
8 information to them.

9 In the securities law, securities arena, if
10 you are in a relationship that's a fiduciary one, then
11 you might have to give more information. You would
12 have an affirmative duty at law to provide more
13 information, so that your principal in your fiduciary
14 relationship has all the information they might want
15 to have to make the most informed decision they can,
16 but if you don't have that fiduciary relationship,
17 then you don't have any affirmative duty to tell them
18 anything as long as you aren't, in effect, telling
19 them something that's materially false that they're
20 going to rely on in some way.

21 MS. GALVAN: Is there fraudulent conduct
22 that does not include a statement or an omission?

23 MR. MILLS: Charlie Mills again. I'm
24 hesitant to get into this area as I am mainly a
25 defense lawyer, but the Supreme Court has said

1 recently in the Stoneridge case that conduct can be
2 fraudulent and that you don't have to have an
3 affirmative articulated statement in order to make a
4 case of fraud under 10b-5 if you can make a case that
5 conduct was undertaken to mislead somebody or did
6 mislead someone.

7 That's a fairly new issue under the
8 securities laws, and how that really gets or
9 rationalize -- what are they talking about in terms of
10 conduct being fraudulent is not clear to me. You open
11 up a whole range of issues of, for example, in market
12 manipulation, there's some areas where they will talk
13 about doing something to signal the market, that
14 you're taking some action in the marketplace that's a
15 signal to others, and maybe it's a false signal.

16 So you might say, Well, that's conduct
17 that's deceiving somebody, and I would come back and
18 say, Well, do other participants in the marketplace
19 have a right to take an inference from your conduct,
20 and if they take it, they take it at their own peril
21 because whether you're giving a signal or not, you're
22 not actually making any affirmative statement as to
23 anything in the world.

24 You're just taking action, and maybe they
25 will take the wrong inference from that signal, but

1 you don't have any affirmative duty at law to watch
2 out what signals somebody might draw from your
3 activity, and that if you get into a signaling theory,
4 you end up creating more ability to make a case by
5 somebody's subjective interpretation of your conduct.

6 So once you get into conduct that is fraud,
7 I think it's going to take awhile to try to figure out
8 what the parameters are around that, what other
9 factors have to be there before conduct becomes
10 fraudulent.

11 MS. GALVAN: Okay. Mark Cooper?

12 MR. COOPER: Mark Cooper, Consumer
13 Federation. I think the hypothetical raises a straw
14 man that just doesn't apply here. If you think about
15 the hypothetical, I'm trying to figure out where was
16 the impairment, obstruction or defeating of a market,
17 and so if you call someone up and say, You got some
18 diesel, I need some diesel, there's clearly no
19 obligation to say why I need the diesel.

20 There's not even an obligation to say how
21 much are you willing to pay. You say, What are you
22 selling for, so I mean, I don't see how this
23 creates -- and then the other question is: How did
24 that behavior actually affect the market? If it was
25 just this conversation between these two folks, I just

1 don't think it goes to the issue of manipulation here.

2 So what you're getting is a straw man that
3 is never going to be investigated by this agency, nor
4 should it be, and I don't think the agency
5 contemplates party B filing a complaint. I mean,
6 that's not what this is about, and so on the one hand,
7 I might have ruled out a class of behaviors that will
8 not be looked at by the agency, but I'm perfectly
9 willing to do so because I don't think they go to
10 manipulation.

11 But, I also don't think the agency should be
12 afraid to adopt a rule when people say, But you're not
13 going to let me do those things. Those things is not
14 what this is about in my opinion.

15 MS. GALVAN: Professor?

16 PROFESSOR PIRRONG: Just as an example of
17 conduct that might be fraudulent but doesn't involve a
18 statement would be something like wash trading. Craig
19 Pirrong, University of Houston. So wash trading,
20 trading back and forth, essentially intentionally
21 intended to create a false perception of mark interest
22 or liquidity of something of that nature would be
23 conduct that doesn't involve a statement but could be
24 conveying effectively false information in the
25 marketplace.

1 MS. GALVAN: Mark Young?

2 MR. YOUNG: Mark Young, Futures Group. I
3 think the hypothetical is a good one. I think it
4 raises an important issue, and I think I agree with
5 Mark Cooper. The hypothetical does not raise any
6 question of market manipulation. The hypothetical,
7 however, raises a serious question under the proposed
8 rule, and it's a great hypothetical because it helps
9 to illustrate the problem.

10 Failing to disclose, in light of the conduct
11 that was engaged in by our hypothetical buyer, could
12 it be considered an act, a practice or a course of
13 business? It could. Could it be considered to
14 operate as a fraud of deceit on the other party
15 because you didn't tell them everything? It could.

16 Does it have anything to do with market
17 manipulation? No, it has nothing to do with market
18 manipulation, so I don't think the hypothetical is a
19 straw man, but I think that it illustrates the basic
20 problem that I have with the rule, and that is that
21 the rule extends to what I'll call counter party fraud
22 and attempts to call manipulation counter party fraud,
23 which it just simply isn't.

24 It doesn't have anything to do with price
25 distortion or price manipulation, and that's why I

1 want to stay with my three buckets.

2 MS. GALVAN: If we were to assume, without
3 getting into the conversation of market effects, which
4 we'll discuss later -- if we were to assume that it
5 was made clear that the rule was to reach, as Mark
6 Cooper indicated, conduct that obstructed or defeated
7 a well functioning market, would there continue to be
8 concerns about the rule as drafted if that were made
9 clear? Alan?

10 MR. HALLOCK: Alan Hallock for Flint Hills
11 Resources. I would still have that problem in my
12 hypothetical. If you were to carry it one step
13 further and the refiner, the other refiner who I am
14 buying from has an opportunity to increase his rate,
15 if only he would have known that there was an actual
16 shortage in the market, in that instance, the
17 information that was withheld could have a price
18 effect.

19 I, as a buyer, would be looking to get the
20 best price for that diesel fuel, knowing that the
21 market is going to rise when the full extent of the
22 shortage is known, so I continue to have a problem I
23 think.

24 MS. GALVAN: Perhaps this would be a good
25 time then to focus on what conduct would be considered

1 to interfere with a well functioning market, whether
2 it's fraud based or non fraud based as Professor
3 Pirrong has described it. Mark Young?

4 MR. YOUNG: Mark Young for the Futures
5 Group. Not surprisingly, I think two kinds of conduct
6 would interfere with a well functioning market: False
7 reporting and price manipulation. I don't believe
8 that the counter party fraud, the one off transaction
9 alone interferes with a well functioning market, and I
10 think that's what Mark Cooper was saying, and I agree
11 with him.

12 MS. GALVAN: Professor Pirrong?

13 PROFESSOR PIRRONG: Craig Pirrong,
14 University of Houston. I essentially agree with what
15 Mark Young said, and then the question is: What
16 conduct would constitute price manipulation? Wash
17 sales potentially would be one of those, but again,
18 other conduct that would fall under the rubric of a
19 corner or squeeze or exercise of market power,
20 essentially uneconomic purchases or sales, either
21 through delivery or in the cash market, that have the
22 effect of distorting prices.

23 MS. GALVAN: What, in your mind, constitutes
24 an uneconomic delivery?

25 PROFESSOR PIRRONG: Well, essentially an

1 uneconomic delivery is a delivery that would not have
2 been taken but for the intent to distort the price.
3 I'll give you an example. It's not from the oil
4 markets, but it is from a manipulation case. This was
5 something I'm sure Mark Young is very familiar with,
6 the Ferruzzi squeeze of the soybean markets in 1989.

7 So essentially what Ferruzzi did is they
8 took a large number of deliveries against futures
9 contract, which they claimed they needed for either
10 merchandising, either processing or exporting needs.

11 Well, I'm sure if they had got out and got
12 your sharp pencil and did the calculations, they were
13 essentially paying 30 cents per more bushel to get the
14 soybeans via delivery than they would have paid on the
15 cash market either at the gulf or the export or in the
16 interior of the country for processing.

17 So that was basically, but for their desire
18 to sort of force up the futures price in order to
19 enhance the value of their futures position, they
20 never would have taken those deliveries. It was not
21 something that a competitive price taking merchandiser
22 would have done, and so that's the kind of economic
23 logic and sharp pencil logic that you can apply to
24 distinguish legitimate purchases from those undertaken
25 to distort price account.

1 MS. GALVAN: Mark Cooper?

2 MR. COOPER: And I think there is actually
3 agreement that, and Professor Pirrong's actual
4 argument actually fills it in, so a one off
5 transaction is not likely to fall under this rule, and
6 I use the word likely because we don't have these
7 black and whites lines as much as we would like,
8 right?

9 So could a one off transaction, if it were
10 big enough, if it had other characteristics, get the
11 agency's attention? It could. That is not the
12 intention here, but obviously it is possible for a
13 specific one off transaction to actually have the
14 effect of undermining the operation of a well
15 functioning market.

16 So the test then becomes, and the clear test
17 is whether or not that one off transaction actually
18 has the ability to create the offense. That's why I
19 think pulling the section B out and examining it
20 standing alone misses the point that section B is
21 embedded in the whole rule, right? So section B alone
22 and the definition of conduct alone is not what
23 determines whether the agency will take an action. It
24 is section B embedded in having an impact on the
25 market, et cetera.

1 Even one off transactions, it is possible
2 that they could have the effect of violating the rule,
3 but that is not the intention or the normal operation
4 of the rule. This rule does not intend to regulate
5 those transactions as a matter of course.

6 MR. BOYLE: Dr. Pirrong, I think I
7 understood you to say that uneconomic exercises of
8 market power would be sort of a threshold.

9 PROFESSOR PIRRONG: Yes.

10 MR. BOYLE: But earlier this morning we
11 heard the hypothetical from Ms. Velie about the person
12 delivering -- insisting upon delivery on contracts,
13 and I thought I heard at that point, you said that
14 that could also violate your concept of what market
15 manipulation would be? Am I incorrect?

16 PROFESSOR PIRRONG: No. What I'm saying is
17 that she had a set of facts in the hypothetical, and
18 having answered many questions at depositions, while
19 your hypothetical is incomplete, that was basically
20 taking that tack.

21 I could think of certain additional facts
22 added to her hypothetical, in which the conduct that
23 she describes would be benign and should not be
24 subject to sanction. I can think of other sets of
25 facts, when added to the hypothetical, which would

1 bring the conduct that she describes into something
2 that could be fairly considered as manipulation.

3 So that's why I say what you have to do is
4 get out your sharp pencil and put yourself in the
5 position, if I were let's say a purchaser of a
6 commodity, and well, my objective should be to buy low
7 sell high, if I'm doing something that makes me look
8 like I'm buying high, and there is no other
9 justification for that, that would be the kind of
10 conduct that becomes suspect.

11 MS. GALVAN: From Navajo?

12 MR. PICCONE: Yes, Jim Piccone for Navajo
13 commenters. I just want to remind the staff that our
14 reason for being here and our theme today is that
15 there's other conduct which is manipulative and non
16 fraudulent in the physical market -- having to do with
17 pipelines in our case -- and that we would say denial
18 of access to critical infrastructure such as an oil
19 pipeline for the purpose of manipulating wholesale
20 prices of crude in the area should violate the rule.

21 MS. GALVAN: Okay. Athena?

22 MS. VELIE: I just wanted to address the
23 uneconomic act just very briefly, as I think that
24 actually my hypothetical, assuming all benign -- there
25 was no intent to manipulate. This was an oil company

1 that needed oil, stood for delivery, had no knowledge
2 of the other trader's position, your point about the
3 uneconomic act, Professor Pirrong, raises one of my
4 big concerns, which is that looking in hindsight with
5 a very broad rule with some uncertainties because of
6 the use of securities and the recklessness standard,
7 will that be considered an uneconomic act if again,
8 looking with hindsight, regulators can say: Well, he
9 could have gotten that cheaper in the wholesale
10 market.

11 I think that misses the point because in my
12 hypothetical, that still would not be manipulative
13 behavior. Maybe an oil company could have gotten it
14 more cheaply somewhere else, but again, they're in
15 this fast paced type of environment. They're making
16 split second decisions. They have a large part
17 portfolio. They're working in lots of different
18 markets, so I would really hesitate to use that kind
19 of a standard, and again would really encourage the
20 Commission to either use the CEA standard that's been
21 developed or to rely on fraud with the specific intent
22 to create a price that -- not just to affect a price,
23 but to create a price that actually diverges from
24 supply and demand or what you would otherwise expect
25 to see in a competitive market.

1 MS. GALVAN: Charlie Mills?

2 MR. MILLS: Yes. In terms of uneconomic
3 transactions, I believe that that really introduces a
4 concept that is amorphous and it's fraught with after
5 the fact analyses that can be twisted however you
6 might want.

7 I believe that interfering with a well
8 functioning market, if that's the standard, and I have
9 a problem with that standard because I think it still
10 is too vague and it's -- you have competitors fighting
11 in the marketplace, and it's very easy for one to
12 say -- when they're on the losing end of something in
13 the market to say, You were impairing a well
14 functioning market.

15 And what is a well functioning market in a
16 cash market that isn't in all respects fully
17 developed? It may not always be liquid, and you're
18 operating in a market that may not unnecessarily be
19 well functioning to begin with at various times.

20 My view would be that you have to have some
21 activity that is impairing the functioning of the
22 market in terms of its actual operation: Collusion
23 between competitors to achieve some kind of a price
24 impact; a wash sale; something that undermines the
25 integrity of how the market actually functions rather

1 than saying what you're doing is economic or
2 uneconomic.

3 Because I also think that in any of these
4 markets, which do now to some degree post Commodity
5 Futures Modernization Act allow for speculation, and
6 participants can come into these cash markets, and
7 there is a way in which you can speculate. It's not
8 just for commercial purchases and sales to take
9 delivery and to make delivery.

10 Once you have speculation as a possibility
11 for a trading activity, and speculation is good for
12 markets generally because it creates liquidity, how
13 can you say that -- what's economic about speculation?
14 How does somebody say after the fact, Yeah, I made
15 that trade because I thought the price was going up
16 and I was going to make money on it, that's why I did
17 it? Well, you didn't need to buy that many contracts,
18 did you?

19 That wasn't economic, quote, unquote, and
20 the answer is to me, I'm sorry, I'm speculating, I'm
21 taking a risk in the marketplace, and whether I have a
22 commercial need for it is not the question because I
23 didn't from the outset, and as long as there's a
24 speculative element in the market, which I think is to
25 be encouraged in order to create liquidity and better

1 pricing and have more people participating in the
2 markets, to talk about economic versus economic is
3 really a false road to go down. It just creates more
4 questions than it answers.

5 MS. GALVAN: Jonathan Gimblett.

6 MR. GIMBLETT: Thank you. Jonathan Gimblett
7 for API. My comment really goes to the question of
8 conduct, and I wanted to not to let the discussion of
9 omissions pass without raising a concern that we've
10 outlined in our comments. I can come back to this
11 later if you're expecting to get to it.

12 MS. GALVAN: Let's do that. I want to focus
13 on conduct just for a moment. Professor Pirrong?

14 PROFESSOR PIRRONG: Yes. I just have to
15 respond to several things that have been said here. I
16 mean, first of all, with a response to Athena's point,
17 essentially what I'm arguing is essentially something
18 that is operationalizing the CEA standard.

19 So the CEA standard says you have to have a
20 specific intent to cause an artificial price, so
21 essentially this is basically what kind of conduct
22 would cause an artificial price, how do you prove that
23 the person intentionally engaged in that conduct?

24 If you're talking about a corner or squeeze,
25 the way that that works is you take excessive

1 deliveries or you make excessive purchases in the cash
2 market. How do you determine what excessive is?
3 Inevitably it is going to have to come down to some
4 sort of price comparison, all right?

5 You're going to have to show that, Hey, this
6 does not make any sense when you and the whole world
7 knows that you can buy soybeans in the gulf for seven
8 bucks, you're taking delivery in Chicago for seven
9 bucks, saying that you're going to ship them to the
10 gulf when it's going to cost you 50 cents to ship them
11 there and that's economic conduct? You know, that
12 does not pass any smell test.

13 Second of all, these comments about, Well,
14 oh, you're subjecting these poor traders to some sort
15 of after the fact evaluation. Well, inherently that's
16 the way any legal or regulatory system is going to
17 work, and if you basically preclude any sort of after
18 the fact evaluation, you're essentially keeping these
19 people completely free of any accountability for
20 actions that they can take which demonstrably can have
21 an adverse effect on the market.

22 So I just have to say that I'm orthogonal or
23 completely negatively correlated with a lot of the
24 views that you've taken or expressed.

25 MS. GALVAN: Professor, let me just ask you

1 to make sure I understand the position that you're
2 taking: Are you requiring that there be some
3 financial conduct that's part of the manipulation
4 scheme that you're talking about?

5 PROFESSOR PIRRONG: Well, yeah. Presumably
6 this in some respects relates to intent, but
7 essentially, yeah, sort of the key thing is you're
8 looking at a piece of conduct and sort of you're
9 trying to evaluate whether this conduct is sort of
10 legitimate, commercial activity, the kinds of things
11 that people would do in a competitive market that's a
12 perfectly legitimate profit maximizing activity that
13 does not distort the market.

14 And you're trying to separate that from
15 other sorts of activity, which might be profit
16 maximizing, but does so in a way that essentially
17 distorts market prices, so essentially we want to have
18 a method for evaluating people's conduct in terms of
19 whether it had a deleterious effect on the market and
20 whether it was undertaken with the intent to do so,
21 and I think inevitably, you have to consider
22 alternatives.

23 Well, what else could the person have done?
24 Is there any explanation for what they've done other
25 than their intent to influence the price this way for

1 the purposes of financially benefitting the party
2 taking the action?

3 MS. GALVAN: I perhaps wasn't clear, and
4 when I said financial conduct, I mean in the financial
5 markets as opposed to in the physical markets. Is
6 there conduct that is a fraud that's only occurring in
7 the physical marketplace that doesn't require that
8 there be some financial instruments that are at play?

9 PROFESSOR PIRRONG: Yes. I mean, you can
10 have physically settled physical market contracts that
11 could potentially be utilized for the same purpose.
12 Things get more complicated because we have this whole
13 nexus of interrelated sorts of contracts that are
14 financial and physical, and some are a little bit of
15 both.

16 Yeah, I think that would be especially
17 futile trying to come up with a rule that essentially
18 does not take into account the potential
19 interconnections between these markets.

20 MS. GALVAN: Athena.

21 MS. VELIE: Just to respond to the corner
22 squeeze, that to me is fundamentally different than
23 what I was referring to, and I think Charlie Mills as
24 well. Athena Velie with ISDA.

25 Because the corner or squeeze scenario,

1 there's either control of the underlying commodity or
2 there's some kind of a natural situation where there's
3 a limited underlying quantity of the commodity to
4 deliver on another contract. Now, it can be a
5 futures. It can be a physical market squeeze as well
6 or corner, but there's something in addition to an
7 uneconomic act that -- and I'm sure I think that
8 Professor Pirrong would agree, and I just want to
9 clarify, that also involves proof of market power, so
10 I think what we're talking about is getting beyond
11 that.

12 I would encourage the Commission to not look
13 at uneconomic behavior in retrospect without there
14 being some kind of corner squeeze market power type of
15 issue.

16 PROFESSOR PIRRONG: And just again to
17 clarify, I was not -- this is not again a sufficient
18 condition, so there are various elements of proof in a
19 CEA case, and presumably there would be other elements
20 of proof that would be involved in any action that the
21 FTC would take.

22 I was just focusing on one element of proof,
23 not saying that that would be sufficient to support an
24 allegation.

25 MS. GALVAN: Mark Cooper?

1 MR. COOPER: Mark Cooper, Consumer
2 Federation. I think Professor Pirrong's analysis will
3 enter into every case you bring under this rule no
4 matter how you define it. That is, even if you were
5 to adopt a strict scienter standard, the defendants
6 will bring forth evidence to demonstrate that what
7 they did was merely economic.

8 So even if you have a smoking gun, their
9 first line of defense is going to be, forget the
10 smoking gun, here is why it was economic for me to do
11 that.

12 So I think it's a mistake to believe that
13 ex-post economic analysis somehow or another, whether
14 you have to do it or whether you think you have to do
15 it, should affect the way you write the rule because
16 you will be involved in ex post economic analysis no
17 matter how you write the rule.

18 MS. GALVAN: Go ahead.

19 MR. DREVNA: Charlie Drevna with NPRA, and
20 again I've got to go back to what I said before we
21 broke for lunch. The concepts that the professor is
22 talking about in my mind may work in the futures
23 market, and that's where I think where we're morphing
24 back into that discussion.

25 They're not applicable and do not work in

1 wholesale petroleum markets or for physical
2 commodities. We need to know -- as an industry, we
3 need to know what conduct is prohibited. That's why
4 as NPRA and several others, API and several others
5 around the table, we proposed a clear rule that we
6 know that we could follow in response to the comments.

7 To specifically intend to inject materially
8 false information into a market with specific intent
9 to profit from the effect on that market that
10 reasonably could be expected to result, you know,
11 how -- we don't know how to apply the type of
12 standards that all these past 15 minutes of
13 discussions entailed.

14 What type of conduct impairs or obstructs a
15 wholesale petroleum market? What is market -- what is
16 the market manipulation bucket from the CEA? What
17 conduct does that cover? I think if we can -- I think
18 we're trying to bring in examples and cases that
19 simply don't apply in this situation.

20 I respectfully suggest that we're trying to
21 fit the square peg into the round hole here.

22 MS. GALVAN: Perhaps we need a little
23 clarification what people mean when they refer to cash
24 markets and what wholesale markets -- when we talk
25 about wholesale petroleum markets, what that means to

1 folks.

2 Professor Pirrong, how would you define cash
3 markets?

4 PROFESSOR PIRRONG: Well, essentially a cash
5 market is a phrase that's usually used to refer to
6 essentially any market for the physical commodity, so
7 it could be a wholesale market. It could be anywhere
8 sort of on the marketing chain, but usually it's used
9 to refer to markets, transactions for the physical
10 commodity.

11 It's not really a square peg round hole
12 issue because I can readily think of ways of using
13 those cash market transactions, physical market
14 transactions in order to distort prices in a way that
15 would profit me, maybe on a related financial position
16 as an example.

17 MS. GALVAN: I'm going to ask you, Alan, to
18 think about the answer to this. What I'm trying to
19 understand is how the physical product is traded for
20 the wholesale petroleum markets, what are the
21 different mechanisms by which that occurs.

22 MR. HALLOCK: Alan Hallock for Flint Hills
23 Resources. A good deal of it is sold right across the
24 rack. A transaction between a refiner and a retail
25 customer, a good portion is sold that way. Another

1 portion, at least in our experience, is sold on
2 exchange. Take, for instance, Flint Hills Resources
3 has a refinery in the Twin Cities area. Another
4 refiner does not.

5 We take delivery of -- well, we deliver
6 product to them in the Twin Cities area, and they in
7 turn give us product in the market in which we are not
8 located. There are -- we also will sell on bulk
9 transactions. In other words, we are long on the
10 volume that we either sell via exchange or across the
11 rack. We will sell it to a broker or a reseller who
12 will sell in that market or transport it elsewhere.

13 So those are the markets that we see
14 principally. We do some trading in the futures
15 markets as well, but for us, it's a small portion of
16 what we do.

17 MS. GALVAN: Of the transactions that you
18 engage in, what gets reported in a public manner? And
19 I'm not talking about you specifically as a company,
20 but at what stage do any of the transactions get
21 picked up and are reported in a public way?

22 MR. HALLOCK: Platts is probably in a better
23 position to -- a better position to answer that. We
24 have our own compliance standards on what it is we
25 report.

1 MS. GALVAN: If you wouldn't mind, John.

2 MR. KINGSTON: Yes, thank you. John
3 Kingston from Platts. We are on the market all day
4 long, as we gather information about transactions that
5 are completed, or even if the transaction is not
6 completed, a bid, an offer we'll put out over the
7 course of the day.

8 Our assessment process is based on a
9 philosophy known as market on close, where our price
10 is established on a very firm timeline. It's 3:15 New
11 York time.

12 MS. GALVAN: What price are we talking
13 about?

14 MR. KINGSTON: All of them, and the main --
15 there was some discussion earlier about thinly traded
16 markets, and there could be manipulation, but the fact
17 is that the active benchmarks, Gulf Coast Gasoline,
18 New York Harbor Gasoline, et cetera, those are very
19 active, very mature markets with quite a fair amount
20 of liquidity in open volume.

21 MS. GALVAN: Are these standardized
22 contracts that we're talking about?

23 MR. KINGSTON: Yes. For example, the Gulf
24 Coast Gasoline contract will be based on the Colonial
25 Pipeline specification for gasoline or diesel fuel,

1 whatever.

2 So our process aims at establishing the
3 value of these various products at 3:15 New York time.
4 The bids and the offers that are placed into our
5 market on close process are placed out there by name.
6 If company A is bidding for a certain product, and
7 company B is selling a certain product, that is known.
8 The company A is identified. Company B is identified.

9 We do have a restriction about when
10 companies can announce their intention to be bidding
11 in our market on close process, but if another company
12 sees the bid or offer through our online service, our
13 online system and says, I would like to lift that bid,
14 for example, they're able to, so in essence the
15 potential universe of the participants in our market
16 on close process is infinite.

17 So there's -- sometimes there's a
18 misunderstanding that it's only two or three people
19 who have announced their intention to bid or offer in
20 our end of day process. That's not true. Any company
21 that sees a bid or offer that they like, that meets
22 their needs, can take that out, so again that adds
23 quite a bit of liquidity.

24 We also believe though because we're on the
25 market all day, we do believe that the market on close

1 process allows us to establish a value at 3:15 even in
2 markets where there is no obvious end of day activity
3 in our market on close process.

4 I do want to stress that we have an online
5 service called Platts Global Alert, and all the bids
6 or offers that go in to the window, that go into that
7 process are very visible. Any subscriber can see.

8 MS. GALVAN: But we're talking prices that
9 are being picked up at the bulk level as well as the
10 rack level?

11 MR. KINGSTON: No. Well, no. These would
12 all be -- we're talking different definitions. When I
13 hear wholesale, I tend to think of as rack. When you
14 mentioned cash market I tend to think of as the
15 over-the-counter market between two parties. It could
16 be any two counter parties, one bidding, one selling,
17 discussion that may yield a deal and may not yield a
18 deal.

19 Those discussions go on by telephone. They
20 go on often over Internet instant message services,
21 and that goes on all day. It starts very early in the
22 morning and goes through the day, and that's -- I have
23 never tended to define that as wholesale, but we
24 could -- it's semantics. We could probably debate
25 that for quite some time.

1 MS. GALVAN: Does that make sense? Go
2 ahead.

3 MR. COLUMBUS: My name is Tim Columbus, and
4 I'm sorry to be late to the game today, and if I'm
5 repeating things, I apologize.

6 MS. HARRINGTON: Tim, I'm sorry, can we get
7 you on a mike because we're not picking you up on the
8 web cast?

9 MR. COLUMBUS: That's the first time that
10 anyone has asked for my voice to be amplified, I
11 promise you.

12 MR. DREVNA: You had to do it, didn't you,
13 Katie?

14 MR. COLUMBUS: Charlie will tell you, it's a
15 big mistake. Tim Columbus, and I'm here for Steptoe,
16 from Steptoe for Society of Independent Gasoline
17 Marketers.

18 Let's talk about how prices do get reported
19 because as you'll recall, my client's comments
20 indicated we think you shouldn't be focusing on
21 anything fundamentally south of the bulk market.
22 Platts is an expert on what happens in what I call the
23 bulk market. That's head of the terminal, sometimes
24 in terminal via exchange, whatever.

25 Rack prices are reported by any number of

1 services. It is not necessarily a guarantee that
2 that's -- the fact that a company posts a rack price
3 does not mean that is the only price at which it is
4 selling that day off of a rack. There are different
5 prices terms by suppliers to different customers all
6 the time.

7 I mean, so I urge you not to get confused
8 with rack transactions by individual suppliers as
9 really capable of, quote, manipulating a market. It
10 doesn't work that way. There are too many places to
11 play there for somebody to do that.

12 Once you get above, I'll defer to -- above
13 the rack, I'll defer to people who have more expertise
14 and participate on a daily basis and whose clients
15 participate on a daily basis, but the fact that it is
16 a sale for resale, which English says that's a
17 wholesale sale, I urge you, don't get confused with
18 that in this context.

19 That is not going to move. A particular
20 supplier's individual pricing decision on any day is
21 not going to move an entire rack market in a terminal
22 cluster, probably not even in a common warehouse
23 terminal, so look up to bulk market, and some of this
24 will start to make more sense, and there will be a lot
25 less white noise in the background.

1 MS. GALVAN: Okay. Go ahead.

2 MR. KINGSTON: I will agree that --

3 MS. GALVAN: Identify yourself.

4 MR. KINGSTON: Excuse me?

5 MS. GALVAN: Identify yourself for the
6 record.

7 MR. KINGSTON: I'm sorry, John Kingston of
8 Platts. I would agree that rack prices are a
9 derivative price. I don't mean derivatives in terms
10 of swaps, but derivatives in terms of when they're
11 set, the price setting services within the oil
12 companies will look at what's happening on the NYMEX
13 that day.

14 They'll look at what's going on in the
15 individual cash market to which they're tied, let's
16 see the Gulf Coast or the New York Harbor or Chicago.
17 They will maybe make some small adjustments for
18 conditions in their individual market, but it is very
19 much the tail, and it is not wagging the dog.

20 MS. GALVAN: Go ahead.

21 MR. GIMBLETT: Jonathan Gimblett for API. I
22 just wanted to second those, the last two sets of
23 comments. As we pointed out in our comments, there's
24 various areas to be gained by applying this at the
25 rack level and below, very low probability of

1 manipulation taking place then, and I think this comes
2 back to the compliance points that we made earlier,
3 making clear that rack transactions and below are
4 excluded from the scope of the rule will make it an
5 awful lot easier to comply with the rule.

6 It will take a large set of personnel
7 outside the scope of the rule, and in terms of the
8 cost benefit analysis, what this rule is trying to
9 achieve, that one seems to be a fairly easy win.

10 MS. GALVAN: Does anybody have a different
11 viewpoint in terms of whether or not markets are
12 likely to be affected by activity at the rack level?

13 To the extent we're talking about conduct
14 that operates as a fraud as opposed to omissions,
15 which we'll get to in just a minute, is there conduct
16 that operates as a fraud that doesn't involve a
17 purchase or sale, and we're talking about with respect
18 to supply, operational, production decisions? And I
19 wouldn't say that does but that could. Go ahead.

20 MR. DREVNA: Charlie Drevna with NPRA. I
21 think you're walking down a very, very dangerous
22 slope. If you start questioning production decisions
23 on a daily basis, that for whatever reason we might
24 want to make more diesel, more gasoline, more home
25 heating oil, switching seasons.

1 There may be times when it's just not -- it
2 just doesn't make economic sense to make more of a
3 product. Now, will that impact the market? It
4 probably will. Is that fraud, deception or market
5 manipulation? No, that's good bottom sense economics
6 of the refinery business or any other business.

7 Let me give you an example. In the auto
8 industry, how many times did they mention that they're
9 going to cut back production because they're not
10 selling automobiles? If they would increase
11 production, they would no doubt lower the cost of the
12 product to the consumer. Does that make economic
13 sense? Absolutely not.

14 Why would it make economic sense for a
15 refiner to not make production decisions based upon
16 sound economics and return on investment and
17 profitability? There's no market manipulation
18 involved there. That's how refineries -- that's how
19 business is run in this country or one would hope.

20 MS. GALVAN: Let me ask: With respect to
21 enforcement under the price manipulation standard, as
22 I understand it, with respect to the Commodity
23 Exchange Act, some of the cases that I've seen involve
24 conduct such as say dumping in the physical market to
25 affect a financial position.

1 Is the kind of conduct that we're talking
2 about in terms of the manipulative conduct -- should
3 we go after the dumping in the physical market without
4 more? Is that something that's manipulative? I don't
5 know, Mark Cooper, if you want to take a shot at that.

6 MR. COOPER: Well, that goes with how I was
7 going to respond. Look, decisions in the presence of
8 market power can, in fact, be manipulative. Obviously
9 they're economic in the sense that they will increase
10 the wealth of the person making those decisions, so
11 again I think it's the whole context that has to be
12 examined.

13 I definitely think, as I said at the
14 beginning, that the set of market power issues are in
15 fact manipulation, and if they don't fit under the
16 fraud standard, then you've defined your standard too
17 narrowly to comport with the intent of the Congress,
18 so I definitely think there are those decisions, which
19 can certainly be justified as economic, also can in
20 fact be manipulative.

21 MS. GALVAN: Mark?

22 MR. YOUNG: I'm going to go off on a slight
23 tangent. Mark Young for the Futures Group. Charlie
24 said twice before the break and after the break that
25 you shouldn't use -- we shouldn't export the futures

1 law from the Commodity Exchange Act to the physical
2 market. I think that --

3 MR. DREVNA: Right.

4 MR. YOUNG: I just want to make sure. I
5 think that there's been a little bit of a
6 misunderstanding that I would like to clean up. First
7 of all, we agree that this rule should not apply to
8 the futures market, so we're not suggesting I think
9 how -- in the comments of Professor Pirrong or anyone
10 else, we're not suggesting that the rule should apply
11 to the futures market, and we're going to talk about
12 that later I understand.

13 What we do know is that there are a set of
14 principles that have either been developed or are
15 beginning to be developed under the Commodity Exchange
16 Act that may have application to the physical markets,
17 and what we're talking about and what we've tried to
18 say is, use some of these Commodity Exchange Act
19 concepts as an illustration for how they would apply,
20 how it would apply in the physical market, and one of
21 the things that strikes me that we're sort of missing
22 is: How do you deal with false reporting? How does
23 your proposed rule deal with false reporting?

24 The statute that you're working with treats
25 false reporting to a government agency under a

1 separate provision. Put the false reporting to a
2 government agency aside, my comments are not directed
3 toward that, my comments are directed to a false
4 report to a reporting agency.

5 Is that the conduct -- is that the kind of
6 price influencing misconduct that your rule is
7 designed to try to address? Is that among the kinds
8 of misconduct? That's what we're trying to figure
9 out. I think the answer to that is yes, but I'm not
10 sure, and I know that in the Commodity Exchange Act,
11 in order to establish a violation of the false
12 reporting provision, there's certain things that you
13 need to show, including specific intent and either an
14 effect on a price or a tendency to effect a price.

15 MS. GALVAN: Let me go to John real quick.

16 MR. KINGSTON: I just wanted to point out
17 something about the Platts market on close process and
18 false reporting.

19 Anybody who places a bid or offer in the
20 market on close process, that bid or offer is expected
21 to be firm, and that bid or offer is expected to be
22 able to be acted upon.

23 If we find out after the fact, as has
24 occasionally happened, that one party is balking at
25 actually completing the transaction, we do get

1 involved and normally try to straighten things out,
2 and if we're not able to come to a resolution, then
3 that particular party is no longer able to participate
4 in our process.

5 The point being that just passing on some
6 incorrect information to us through the Platts market
7 on close process is simply not doable. It is a real
8 bid. It is a real offer. It is expected. It's firm,
9 and you are expected to act upon it if somebody wants
10 to take you out.

11 We also have rules on incrementability. If
12 somebody is bidding gasoline at say 3 cents over the
13 Merc in the Gulf Coast, they can't then suddenly bid
14 it at 10 cents over the market with nothing in
15 between.

16 So there are quite a set of rules, quite a
17 set of guidelines in place to ensure what we consider
18 to be a proper assessment process.

19 MS. GALVAN: Okay. De'Ana Dow?

20 MS. DOW: De'Ana Dow with CME Group. I
21 wanted to go back to your question about dumping in
22 the cash market and the effect on the futures market
23 and whether or not that should be actionable I guess
24 under -- whether it's the FTC or CFTC.

25 Obviously there is a tight connection

1 between what goes on in the futures and the physical
2 market. At this stage of the game, under the CEA, the
3 CFTC has the manipulation authority to go after any
4 cash market activity that in some way impacts or
5 affects the futures market. So clearly, a dumping in
6 the cash market to affect a futures price already
7 would be actionable and would come within the CFTC's
8 authority.

9 What I would say though is to the extent
10 that the FTC now has this new authority, this would be
11 an area where it would be important for the agencies
12 to coordinate their efforts because I think what I see
13 in terms of what was anticipated from this new
14 authority was to go after that activity that is not
15 clearly within the authority of a particular agency to
16 go after the regulatory gaps.

17 I think what you described is a clear
18 example of where there is some question as to who
19 would ultimately take the lead given that you now have
20 this additional authority over the wholesale market
21 for oil. Again, the manipulation could begin either
22 in the futures or in the cash market, but either way,
23 the activity is related and both aspects of it need to
24 be addressed.

25 MS. GALVAN: Okay.

1 MR. DREVNA: Just a comment on Mark Young's
2 comments, which we agree with. There's absolutely --
3 let me state this: That in this situation where
4 applicable, plagiarism isn't such a bad thing, but to
5 think that you can again slam dunk a CEA or an SEC
6 kind of mandate or regulation on this market, and I'm
7 not accusing you of doing this, but saying okay, good,
8 we're done, let's go home now, without really looking
9 at the intricacies and the differences between how
10 these things are regulated and how these markets work,
11 that's going to do a disservice to everyone around the
12 table.

13 So what we're saying is, if there's
14 something in the concepts that you can take and hone
15 and make it applicable in a fair and equitable way to
16 this particular rulemaking, fine. Where it fits, it
17 will fit. If it doesn't, it should be discarded.

18 MS. GALVAN: David?

19 MR. VAN SUSTEREN: Yeah, Dave van Susteren
20 from Fulbright. I wanted to follow-up on Mark and
21 Charlie's comments because as I read your notice of
22 proposed rulemaking, I think the FTC reads "in
23 connection with" to allow it to go into the futures
24 market. I don't see it as pulling this rule off of
25 the futures market.

1 So I have heard your comments, Mark, to
2 indicate that you think this rule will not apply to
3 the futures market, but I think they're going to
4 interpret "in connection with" to give them that
5 jurisdictional authority.

6 MS. GALVAN: Let's come to the "in
7 connection with" section shortly. I can anticipate
8 the response that --

9 MR. YOUNG: Let the record show one panelist
10 did not have a stroke.

11 MS. GALVAN: We do need to talk about
12 omissions, and so I'm going to -- I want to make sure
13 I understand the concerns raised by NPRA, which is the
14 applicability of the price manipulation provision
15 that's currently being applied by the CFTC to the
16 wholesale petroleum markets. Is that a fit, and if
17 not, why not?

18 MR. DREVNA: Well, I'm going to have Alan
19 jump in here any minute too, but if you can think
20 about the potential for us having to comply with
21 competing regulation and legislation, there is the
22 potential, if it's not done carefully, that we could
23 be complying with the rule, with your new rule, and
24 being in noncompliance with antitrust kind of
25 implications.

1 That's where this thing could fall apart for
2 us tremendously.

3 MS. GALVAN: Okay. Just to be clear, I'm
4 talking about a price manipulation prohibition as
5 applied under the Commodity Exchange Act, being
6 applied to the wholesale market. Does that work?

7 MR. HALLOCK: If I understand the question
8 correctly, I think one of the key aspects here is that
9 the Commodity Exchange Act and its enforcement are
10 considerably more mature than what we're talking here.

11 In other words, there's an enforcement
12 history, which provides a great deal more certainty
13 for companies like us. When we devise client
14 standards around the Commodity Exchange Act, we are
15 informed by the enforcement history, so we can create
16 very bright lines for our people in house, don't do
17 this, don't do that; if you want to take this action
18 you need to talk with a lawyer before you take it.

19 That's been developed over a number of years
20 of enforcement history, and I think to take that and
21 import it without importing the entire enforcement
22 history will not give participants in this market the
23 type of instruction that they need to give the FTC the
24 immediate benefits of a regulated community, which is
25 all acting in compliance with the law.

1 It's a point I made earlier in the day. Our
2 objective is not to try to litigate the edges of
3 what's acceptable conduct. Our objective, once there
4 is a rule, will be to be in compliance with that rule
5 at all times, and the more specific the instruction
6 can be, the more -- the higher the likelihood is going
7 to be that we can devise the types of rules, internal
8 rules that are needed without cutting off a lot of
9 beneficial activity.

10 MS. GALVAN: Charlie Mills?

11 MR. MILLS: Yes, I just would say briefly
12 here, the Commodity Exchange Act standards that have
13 been enunciated principally by the CFTC and literally
14 probably a handful of courts from 1940s forward are
15 just now being introduced into physical markets, and
16 some of the underlying premises for how those
17 standards might work in a futures context may not bear
18 out in a physical market context.

19 The futures market have all of these other
20 rules around them, and we're talking about exchange
21 trades. The CFTC has a whole rule book of how you can
22 trade and not trade on those exchanges. The exchanges
23 themselves have whole rule books so those standards
24 fit into a much tighter regulatory framework.

25 When you get to the physical markets -- and

1 the other issue is, under the CFTC's standards, one of
2 the hobgoblins is price artificiality. How do you
3 define it? When do you have it? How do you know you
4 have it?

5 There again, I would say the academic
6 literature of economists and lawyers and law
7 professors is all over the map and highly criticized
8 as very uncertain as to what is an artificial price,
9 but at least in the futures context, most of the
10 cases, and maybe all of them when you're talking about
11 futures trading, focus on a spread between the cash
12 price and the futures price at the close of a
13 contract.

14 That's where most of the cases arise is when
15 the contract is going to maturity, and you want
16 convergence of the cash and futures prices. So at
17 least there you have a fairly narrow window from which
18 you can determine the rationality of pricing.

19 When you get to the physical market, you
20 don't necessarily have a comparison that's readily
21 available to say: Well, this price today for cash
22 crude is X, and I should be comparing it against
23 something else, and that's how I know whether it's out
24 of kilter or not.

25 So it's a much more amorphous concept of

1 what is an artificial price, and it makes applying the
2 CEA's standards, to the extent they've been
3 articulated by the CFTC, a more uncertain task when
4 you get to the cash markets.

5 The other thing is that there could be a
6 whole realm of transactions in the cash markets which
7 Congress in the Commodity Futures Modernization Act
8 specifically said the CEA doesn't apply to those, and
9 that's an exemption in Section 2 G, which takes the
10 Commodity Exchange Act completely outside and says
11 nothing in this act shall apply to these transactions,
12 and it lists the characteristics of those
13 transactions.

14 To the extent wholesale crude and other
15 wholesale energy products that are the subject of the
16 rule are going to fall under Section 2 G, you start
17 with the principle that Congress said the CEA shall
18 not apply to this market, to those transactions, and
19 how do you factor that in if you have some
20 transactions that theoretically the CEA could apply
21 to, and others that it doesn't within the same course
22 of conduct that somebody may be trying to claim as a
23 manipulation.

24 So it gets very uncertain, and those are
25 things that have not been really addressed by the

1 courts yet or even the CFTC in any public statement.

2 MS. GALVAN: Okay. Let me do the two quick
3 responses so we can go on to omissions. Go ahead,
4 Mark.

5 MR. YOUNG: Just quickly, I don't really
6 want to make sure -- it's Mark Young for the Futures
7 Group.

8 I just want to make sure that we're not
9 making it harder than it needs to be, and it is very
10 challenging, as I think everyone has said.

11 I think Alan and Charlie are actually saying
12 something very similar, at least to me. What I hear
13 Alan saying is if you have to pick an analogy to the
14 market that you're going to be addressing, the
15 securities analogy doesn't work as well as the futures
16 or Commodity Exchange Act analogy works, if you had
17 two compliance manuals on your shelf today, the one
18 more relevant to the physical market and the question
19 of price manipulation in the physical market would be
20 the Commodity Exchange Act manual, not the Securities
21 and Exchange Commission manual. That's the one thing.

22 The second thing, Charlie is absolutely
23 right, that the application of the Commodity Exchange
24 Act's very broad but basic tests, specific intent, to
25 create an artificial price and the creation of an

1 artificial price, that that is the test of a
2 manipulation under the Commodity Exchange Act.

3 It applies whether it's a futures contract
4 or a cash contract or physical contract, and it has
5 only been recently brought into prominence in the
6 physical market, but what I think that is -- what I
7 heard Congress saying to you folks, what I think that
8 was at issue here, and there is where De'Ana comes in,
9 is where is there -- I'm not even going to stay a gap.
10 Where is there less focus? Where is there less
11 emphasis?

12 Under the Commodity Exchange Act, there is
13 -- thankfully, there is much less emphasis in the
14 physical markets than there are in the futures
15 markets. The primary purpose of the Commodity
16 Exchange Act is to create a regulatory mechanism for
17 the futures market.

18 So assisting the CFTC with respect to
19 policing manipulation in the physical markets is we
20 think -- the Futures Group thinks a very legitimate
21 public policy to be served by the Federal Trade
22 Commission under its new authority, and we would urge
23 you in doing so to look at the kinds of legal
24 standards that are adopted and have been applied under
25 the Commodity Exchange Act.

1 MS. GALVAN: Professor?

2 PROFESSOR PIRRONG: Just a couple of points.
3 Craig Pirrong, university of Houston. The first one
4 is yeah, the exchange rule books are pretty detailed,
5 but when it comes to manipulation, they usually boil
6 down to though shalt not manipulate and don't go much
7 beyond that, so the fact that there's this other rule
8 infrastructure around that I don't think really
9 matters one way or the other.

10 The second thing is that I would have -- as
11 one of the academics who might be all over the map,
12 but I've always been pretty much pointing my compass
13 in the same way is that there's actually a wide
14 variety of different kinds of price information that
15 can be utilized to determine whether a price is
16 artificial, and in fact convergence is typically --
17 not always, but typically one of the at least
18 important ones because if a futures price is
19 manipulated, typically the cash price in the delivery
20 market is going to converge to that artificial price.

21 The comparisons that you make are actually
22 to calendar spread so, for example, is the nearby
23 price that's allegedly manipulated apparently
24 distorted relative to prices for delivery at other
25 times, and is the futures price or the cash price in

1 the delivery market anomalous as compared to prices in
2 other locations or for the prices of comparable
3 commodities.

4 All of those things can be applied to the
5 physical market, and there's actually been a case that
6 arose in a physical energy market, not a petroleum
7 market, but in the propane market, where exactly those
8 sorts of price comparisons were the basis for a
9 Justice Department and a CFTC action going after a
10 large oil producer or a large propane market
11 participant.

12 So actually the sorts of price comparisons
13 that have been used in the futures context are
14 applicable to a wide variety of potential kinds of
15 manipulations, even in physical markets.

16 MS. GALVAN: Okay. Alan, go ahead.

17 MR. HALLOCK: Just very quickly, Alan
18 Hallock with Flint Hills Resources. I want to make it
19 clear that what Flint Hills Resources is advocating is
20 the NPRA rule, and that is a violation would be the
21 specific intent to defraud or deceive a company by the
22 specific intent to profit by that through impacting
23 the market price.

24 MS. GALVAN: Okay. Let's focus on the
25 subpart B of the rule, the untrue statement of the

1 material fact and what concerns that that provision,
2 as currently drafted, raises in some of your minds,
3 and I'm going to suggest to start this discussion that
4 if a change were made to the language of subpart B so
5 that it said "not deceptive" as opposed to "not
6 misleading," if that would address any of the concerns
7 about the applicability of subpart B.

8 It's a small change, and why don't we start
9 off with that. If that subpart were revised to say
10 "not deceptive" as opposed to an untrue statement that
11 was not misleading. API?

12 MR. GIMBLETT: Thank you. Jonathan Gimblett
13 for API. Well, to address the specific question and
14 then make a larger point, I don't think that that
15 would address our concern.

16 One of our concerns is that as worded, this
17 subpart B leaves it unclear whether there's a duty
18 on -- a duty to update statements once made, so, for
19 example, one can envision a refinery making a
20 disclosure about when it expects to come back online
21 if there is a shutdown. Circumstances change
22 rendering that initial disclosure inaccurate. Is it
23 thereby misleading or indeed deceptive? I don't think
24 the change in the words really resolves that issue.

25 This is another example I think where just

1 taking the language of the SEC will tend to be fine
2 and just trying to impose it on the different market
3 raises real risks of affecting the efficiency of the
4 wholesale petroleum markets.

5 Raising questions in the minds of market
6 participants about whether an initial disclosure is
7 going to create the potential for liability if it's
8 not constantly updated as circumstances change will
9 simply encourage those market participants not to make
10 the disclosure in the first place, less information in
11 the marketplace and less efficiency as a result.

12 There are ways I think in which one can word
13 around this, and we've proposed one possibility in our
14 comments.

15 MS. GALVAN: And we have, at the end of the
16 table?

17 MS. STUNTZ: Yes, Linda Stuntz, AOPL. This
18 is one of many areas where the fact that oil pipelines
19 are regulated under the Interstate Commerce Act
20 presents a problem that in our view is unfortunate --
21 if we were to become subject to this rule.

22 Under the Interstate Commerce Act, Section
23 15(13), common carriers like oil pipelines are
24 prohibited from revealing information about shippers
25 that the shippers would consider confidential or

1 proprietary, so, for example, to follow on Alan's
2 example of earlier this afternoon, today, if he came
3 calling at a pipeline and asked for diesel and the
4 pipeline knew there was diesel coming in perhaps, we
5 would not be in a position to disclose that to Alan as
6 a third person.

7 Now, the fact that we didn't -- we told him
8 at the moment maybe he could observe there's no diesel
9 there, but there's some coming in. The fact that we
10 didn't tell him that, does that make that misleading
11 or deceptive? Put aside the fact that it's not really
12 in connection with the sale, but we're going to get to
13 that I know.

14 So we really would be between a rock and a
15 hard place. Do we violate the Interstate Commerce Act
16 and reveal shipper information to him, or do we run a
17 potential risk under here that either is misleading
18 and say, no, we don't have any diesel as of this
19 particular moment?

20 MS. GALVAN: If a statement were to be made
21 that this rule would not -- again, because it's
22 already said in the notice that it does not require
23 affirmative disclosures, but to make clear that it did
24 not require the disclosure of proprietary or
25 commercially sensitive business information, would

1 that alleviate concerns about subpart B? API?

2 MR. GIMBLETT: Jonathan Gimblett. I think
3 it also needs to address explicitly this question of
4 whether there's a duty to update, and I think that can
5 be done fairly easily. We suggested a way of doing it
6 through the definitions.

7 There are presumed other ways as well, and
8 if it's not the intention of the Commission to impose
9 such a duty, we would -- certainly there would seem to
10 be a very big benefit in making that very explicit.

11 MS. GALVAN: I can let you think about it
12 over a short ten-minute break, and we will we
13 reconvene.

14 (Whereupon, a brief recess was taken.)

15 MS. GALVAN: I'm going to make a reminder if
16 anyone in the audience wants to talk at the end of the
17 day, that they please sign up. This is our last
18 session.

19 Here's the game plan for the last session of
20 the day. We are going to reserve the last ten minutes
21 or so, we may even run five minutes over from those
22 from the audience that do want to come up and make a
23 few remarks. I think we have three so far, so those
24 would be remarks for about two or three minutes.

25 I understand we have someone who wants to

1 follow-up on an earlier statement.

2 MR. DREVNA: Yeah. I just want to clarify
3 to make sure for the record -- to make sure that you
4 understand what my comments were when Mark and I were
5 going back and forth about what is applicable and what
6 isn't applicable in the commodities into this
7 rule-making.

8 When I said it was okay to plagiarize, I
9 meant, it's okay to use the analogies and to hone and
10 to craft where applicable, but not to import whole
11 cloth regulatory language that you think would work,
12 which we don't think would work in this situation.
13 Thanks.

14 MS. GALVAN: Any other thoughts in response
15 to my proposal that if it were to be made clear that
16 commercially sensitive information would not be
17 required to be disclosed under the rule, if that would
18 address concerns about subpart B for the application
19 of the rule? Bob Long.

20 MR. LONG: This is Bob Long for API.
21 Patricia, I do think that would help, and one point
22 that I think has come out in a number of the comments
23 and could be addressed in a number of different ways
24 by the Commission is to recognize that in these
25 markets, we really don't expect participants to

1 disclose all the information they know, even if
2 parties on the other side of the transaction, if
3 asked, well, would you regard that as important
4 information in the total mix that would be relevant;
5 they said, well, of course but I don't expect them to
6 tell me because it's not that kind of a market.

7 So we've suggested some particular ways to
8 address that, which we think would be the best, but I
9 think recognizing that perhaps not giving out that
10 sort of information in this kind of market would not
11 really be regarded as fraudulent or deceptive because
12 it's understood that people don't tell those things or
13 it would not be material, not in the sense that it
14 wouldn't be important, but that you wouldn't expect
15 people to tell you that in this kind of market.

16 Those are all different ways to get at
17 really the same point, and if your point is about
18 confidential business information, sensitive
19 information that wouldn't have been disclosed,
20 wouldn't have been expected to be disclosed absent
21 this rule that the Commission is considering, I think
22 it would be a step forward to make clear that that
23 doesn't have to be disclosed.

24 As long as you're not affirmatively
25 misrepresenting or telling falsehoods, you're allowed

1 to retain the information, the business value that
2 you've accumulated.

3 MS. GALVAN: To go back to the point that
4 was made earlier, that some of this obviously is
5 better understood when we consider the current -- when
6 we consider all the elements of a potential cause of
7 action, that suggests that we should move quickly to
8 price effects.

9 In the proposed rule, the FTC choose not to
10 impose a price effects requirement under the rule, and
11 so I think it would be helpful to turn to a discussion
12 of that.

13 MR. BROYLES: Yes. We have heard the
14 comments about applying the commodity standards to our
15 rule and bringing into it the description on the
16 intent to create an artificial price, and I had a
17 question.

18 First of all, in the context of the markets
19 that we're dealing with, in the physical market, how
20 would you define an artificial price, question number
21 1, and once you define it, how would you go about
22 proving it in these markets?

23 MS. GALVAN: Professor Pirrong?

24 PROFESSOR PIRRONG: Yes. Just gratuitous
25 self promotion here, but what I'm going to say,

1 hopefully briefly here, is sort of set out in
2 excruciating detail in an American Law and Economics
3 Review article I did in 2004.

4 When you're talking about artificial price,
5 I think you really have to start off, well, what's
6 your theory about how the artificial price was caused,
7 and so I'm going to focus on an artificial price that
8 was caused by the exercise of market power, a corner
9 or a squeeze.

10 Essentially that sort of conduct has
11 predictable effects on how prices should behave, so a
12 price that's in a corner market or in squeeze market,
13 a market that's subject to market power, will rise
14 relative to the prices of related commodities, so for
15 example, crude oil will rise relative to the price of
16 heating oil and gasoline.

17 The price in the affected market will rise
18 relative to prices in other markets so, for example,
19 if you had a squeeze in Gulf Coast Gasoline, that
20 price would rise relative to the price of gasoline in
21 other markets.

22 Also, there's something in manipulation, a
23 corner or a squeeze calling burying the corpse effect;
24 essentially that when the manipulation ends, there's a
25 precipitous drop in the manipulated price relative to

1 the prices in these other markets.

2 The idea is that, well, if you want -- the
3 story goes that Pete DeRamo (phonetic) was a famous
4 grain trader in Chicago and also the founder of the
5 R.M. Meade Company (phonetic) was once asked, Well, is
6 it easy to corner a market. He says, Well, it's like
7 committing a murder, it's easy to commit a murder, but
8 it's hard to bury the corpse; if you corner the
9 market, you have to buy a lot of the commodity you
10 have to dump that back on the market later. That's
11 called burying the corpse, and that causes prices to
12 decline subsequently.

13 So there's this whole constellation of price
14 effects that you would expect to follow from a
15 manipulation, and then what you can do is, okay, let's
16 see a market that was allegedly manipulated, do we see
17 those price effects, and there's a whole body of
18 empirical methods that have been applied in a large
19 variety of litigation contexts, security markets,
20 antitrust as well as commodity markets that can be
21 employed to test rigorously whether those effects
22 occurred and whether they were highly unlikely to have
23 occurred in a competitive market.

24 MR. BROYLES: Bob?

25 MR. LONG: Robert Long for API. I'll be

1 brief, Phil, because we did address this in our
2 comments at pages 35 and 36 and a few of the
3 footnotes. I do think this can be done. I don't
4 think it's an easy process in many cases, but I did
5 just want to say a word about why API at least thinks
6 it's necessary under the rule.

7 If you promulgate a rule or if the
8 Commission promulgates a rule that really doesn't
9 require any effect on the market, effectively you've
10 created an attempt offense. You would be making it a
11 violation to do something that doesn't actually
12 manipulate the market.

13 Maybe even it would go beyond an attempt
14 offense. Maybe there's not even any dangerous
15 probability of success, that you could have
16 manipulated the market, so we think really in order to
17 be faithful to the language of the statute that really
18 gives the Commission authority to police market
19 manipulation, not attempted market manipulation, and
20 also to get at this problem that we were discussing
21 this morning, that you really don't want to be
22 policing garden variety fraud that doesn't affect the
23 larger market, and it doesn't even have a probability
24 of affecting a larger market.

25 You do need to undertake this exercise,

1 which will require some expertise, but expertise the
2 Commission has to really find an effect on the market.

3 MR. VAN SUSTEREN: Dave Van Susteren,
4 Fulbright. In the Commodity Exchange Act, they do
5 permit an attempted manipulation cause of action, but
6 they have a causation element in the CEA. I don't
7 believe this proposed rule from the FTC has a
8 causation or price effects, and the absence of
9 those -- I think they're two similar concepts.

10 The absence of those two from this rule
11 makes it a sweep too broadly and could pick up anybody
12 really, and so -- and it would risk unwarranted
13 enforcement and so I would suggest that in addition to
14 some of the other comments that had specific intent
15 and severe recklessness, that you incorporate a
16 causation or actual effects.

17 How you define that standard, whether it's
18 as some people have said -- I think Athena's firm has
19 said a direct and material effect on prices or whether
20 it's direct and identifiable effect on price or some
21 other standard, but there should be some standard or
22 it would sweep too broadly.

23 MR. BROYLES: Okay. Tim.

24 MR. COLUMBUS: My name is Tim Columbus. I'm
25 here for SIGMA. Two things: Number 1, somebody who

1 is manipulating a market and not generating a price
2 effect is not really someone you ought to worry about
3 to begin with. The motivation of the people who wrote
4 this statute, at least what they told me their
5 motivation was, was to respond to what they perceived
6 as, it was really rumors, behavior that raised price,
7 that had a tangible price effect.

8 I think it's really important that this rule
9 incorporate a demonstration that it, in fact, did have
10 a material impact on price. Otherwise, you're going
11 to let out on the world, not just through your own
12 enforcement, but I remind you that there are a lot of
13 other people who have a right to enforce under this
14 statute.

15 And for those of you who haven't had the
16 pleasure of having an AG sign a consent decree with
17 one of your clients for price gouging when he
18 stipulates it was the lowest price in the market,
19 turning a rule like this loose for people without
20 having some material anti consumer effect, I just tell
21 you is a bad thing, so I urge you to incorporate.

22 MS. GALVAN: Here's a question I have, which
23 is: Other than the type of conduct that Professor
24 Pirrong has identified like the corner or the squeeze,
25 what kind of conduct is likely to have a price effect

1 that you would all agree is bad conduct, not the
2 ordinary business behavior which is to get the best
3 price for your product?

4 What are we talking about when we're talking
5 about conduct that is going to create an artificial
6 price? Charlie?

7 MR. MILLS: Charlie Mills for the New York
8 City Bar Committee. I mean, the most common one I can
9 think of would be the manipulation by false rumors,
10 where it's not even transactional but putting false
11 information into the marketplace. It could be false
12 reporting or there have been cases certainly in the
13 securities markets and I guess probably in the
14 commodity markets as well of false rumors to try to
15 generate price movements, so that would be an obvious
16 one.

17 I did just want to footnote this, that I
18 think the issue of what is an artificial price is a
19 very difficult determination to make. It has been
20 what has been in my view the foundation for a lot of
21 lengthy litigation that the CFTC has gone through in
22 prior enforcement actions trying to get to what is an
23 artificial price.

24 And Professor Pirrong is correct that many
25 economists will try to approach the issue that way. I

1 believe there is a lot of debate among economists as
2 to what are the legitimate forces of supply and
3 demand, and those cases, you will have experts on both
4 sides that will go on for a long time trying to figure
5 out and have different positions on what is -- whether
6 the price is artificial or not, so it's a very
7 difficult determination.

8 It has been criticized by some in some law
9 review articles as being inherently too vague to be
10 applied as an enforcement tool. There are economists,
11 and Professor Pirrong is certainly one of them, who
12 argue, no, it's clear, and from an economic point of
13 view we can get there.

14 I would just again reemphasize the issue of
15 in real time, if you're going to look at price
16 artificiality, what would you hold the company or the
17 person to know real time whether a price is artificial
18 because everybody is trying to get to the best price,
19 and when you're talking about the crude market, you're
20 talking about a very competitive market, and to
21 presume that what you're doing, that somebody else is
22 agreeing to pay a price and they're doing that at arms
23 length, and that's -- you could assume that's an
24 artificial price as you're in that competitive
25 marketplace is a very difficult conclusion to get to

1 in my mind.

2 To say that it can be demonstrated
3 economically under some economic precepts and models
4 that that price was artificial as defined by
5 economists after months and years of analysis is a
6 different question than what should a company or
7 trader know when they're actually engaging in a
8 transaction at arms length against a very strong
9 competitor to say -- later the government says we
10 think that's artificial, and what's that person
11 supposed to say? Why did the person pay? Why did the
12 other side even enter into the transaction if it's
13 artificial?

14 So that's my few comments, thank you.

15 MR. BROYLES: Ms. Dow.

16 MS. DOW: De'Ana Dow with the CME Group. I
17 think there are a number of different types of
18 activity that would come within that type of violation
19 and would be something you could prosecute.

20 Withholding product from the market for
21 whatever reason, because of the fact that you know or
22 you have some information in your possession that
23 says, this is not the right time to sell, I want to
24 wait and hold off the market.

25 Well, that potentially, depending upon the

1 size of your holding, can have an impact on the market
2 and on the futures market and the cash market as well
3 as the futures market, but the futures market is a
4 very small segment of a very large global market.

5 We estimate as far as the crude oil market
6 that it's -- the cash market is probably seven to ten
7 times larger than the futures market, and what happens
8 out there globally as well as in the U.S. cash market
9 has an impact and has the ability to impact or drive
10 the futures price.

11 Futures market, yes, are a bench mark and
12 are a price discovery market, but everything that's
13 happening globally in the cash market also drives the
14 price in the futures market.

15 So I think that in terms of price affect, I
16 agree with the gentleman from SIGMA. I don't see how
17 it's possible to even manipulate a market without
18 having a price effect. To me, you can't have one
19 without the other, and then along with the price
20 effect, you need to have the intent to affect the
21 price.

22 MR. BROYLES: Mark?

23 MR. YOUNG: Well, the first thing I was
24 going to say -- Mark Young for the Futures Group. The
25 first thing I was going to say is I think we can all

1 agree that we would all be both enlightened and
2 entertained when the day comes when Mr. Mills gets to
3 take Professor Pirrong's deposition on artificial
4 price.

5 MR. MILLS: I'm hoping that day never comes.

6 MR. YOUNG: But I want to underscore what
7 Ms. Dow just said because it is what I wanted to say.
8 We now live in a world where it is easier to show
9 specific intent than it ever was before because of
10 electronic evidence, and very often you have a
11 situation where people say that they may not mean it
12 or they may not think they meant it, but they say, we
13 want to create an artificial price or we want to move
14 the price in one direction or another, let's see if we
15 can do it.

16 And once you have that evidence, then I
17 think the economic inquiry about whether a price is
18 artificial or not as a practical matter becomes easier
19 as a matter of proof.

20 The last point I make is that you don't have
21 a price manipulation standard, and you really don't
22 have anything that addresses what Congress wanted to
23 do unless you are looking at whether the actor
24 intended to create an artificial price.

25 MR. BROYLES: Tim?

1 MR. COLUMBUS: It's Tim Columbus for SIGMA.
2 Patricia asked the question, what kind of stuff would
3 happen. In the absence of collusion, my own view,
4 it's really subverting the quality of information
5 that's available in the market because you can go
6 down, Mr. Kingston will tell you at length, really,
7 the things they go through everyday to try to make
8 sure that nobody gets to play a game off of their
9 reported prices because that price will set other
10 prices via contract all over the country in the
11 physical market; forget the futures market, just in
12 the physical market.

13 You can do -- if you can subvert the quality
14 of the report of what's going on, you can move
15 physical markets all over, so that's what you ought to
16 look at. Are people in fact undertaking a behavior
17 that would result in an inaccurate and, quote,
18 artificial reference price? I'm satisfied for one
19 that the folks at Platts are doing a pretty good job
20 of policing the process.

21 There are other reports on which people base
22 contracts. I haven't spoken to all of them. I don't
23 know if they all go through the hoops that the Platts
24 folks do, but when you say: How could it happen and
25 what do I care about, I really think that's your

1 primary focus?

2 MR. BROYLES: Dave?

3 MR. VAN SUSTEREN: Dave Van Susteren. It
4 occurs to me that the impetus behind this rule in
5 Congress was speculation, and primarily speculation in
6 natural gas markets, that to clue Congress in on what
7 might occur.

8 So in response to the Chair's questions
9 about what are some of those aspects, we talked about
10 one earlier, dumping MOC or dumping the market on
11 close as in the futures market is an area that has
12 caused litigation already.

13 And there hasn't been any investigation yet
14 that I'm aware of in the physical market that has
15 turned a substantial price manipulation finding yet in
16 the oil markets.

17 One other comment to Charlie Mills's
18 statement that false rumors, I think the FTC has some
19 experience in the false rumors case that the DOJ
20 didn't step in nor did the FTC on that aspect of it.

21 MS. GALVAN: Before you answer, Professor
22 Pirrong, let me make sure I understand. Is there any
23 suggestion that we consider the withholding of product
24 to be a form of market manipulation if it is intended
25 to affect a reported price? Is that something that

1 I'm hearing to be a form of market manipulation that
2 we should be going after?

3 I don't know if you want to take a stab at
4 responding, Professor.

5 PROFESSOR PIRRONG: Well, withholding
6 output, that's typically what market power -- someone
7 exercising market power does. They essentially
8 produce less than the competitive quantity with the
9 intent that will cause the price to be higher and that
10 they can make a profit as a result. They'll only be
11 able to do that if they have market power, so that is
12 conceivably something that could fall under the rubric
13 of the rules.

14 I think it's particularly most likely to
15 occur in this sort of trading context, in the context
16 where they have perhaps some other position in another
17 market, a financial market either in a physical market
18 or some OTC instrument.

19 MS. GALVAN: I want to divorce it from
20 whether or not they have another position in another
21 market and limit it to whereby you're just trying to
22 influence a reported price, say a price that's picked
23 up by Platts. If you're taking an action and you need
24 to affect a reported price, like an index price, is
25 that something that you should consider market

1 manipulation?

2 Charlie or Bob? Bob, go ahead.

3 MR. LONG: This is something that we
4 addressed, API addressed extensively in response to
5 the advanced notice of proposed rule-making, and I
6 think it's something the Commission is very familiar
7 with. While you can spin lots of theories, and lots
8 of theories have been spun around this table today, if
9 this rule were to be applied or if the Commission were
10 to say, This can apply to decisions to produce a
11 product, to not produce a product, to sell a product
12 today versus selling it tomorrow versus selling it
13 next week, to send it to one location rather than
14 another location, there really could be potentially
15 very serious negative effects on the functioning of
16 the markets.

17 MS. GALVAN: Bob, I'm going to stop you
18 there because the focus here is when it affects a
19 reported price. If it's intended to affect a reported
20 price, that would suggest it meets the artificial
21 price test that is being suggested if we follow the
22 price manipulation standard under the CEA. I want to
23 make that clear.

24 MR. LONG: Let me be sure. So if the facts
25 were that the only purpose for not selling the product

1 today is to affect a price index, but in a sense it
2 would be a truthful --

3 MS. GALVAN: Yes.

4 MR. LONG: You're not selling it today, but
5 you don't have any other business, and maybe you could
6 show in fact you could get a better price if you sold
7 it today except for the effect that you're expecting
8 through the effect on the index, something like that?

9 MS. GALVAN: And I'm trying to make the
10 distinction, when it impacts a reported price, that
11 that somehow -- because it sounds to me as though it
12 falls under the application of a price manipulation
13 rule, and I want to make sure I understand.

14 MR. LONG: To me, I would say that's a
15 question about sort of what's your definition of
16 fraud, and can you commit fraud through acts as well
17 as through words, and I think mostly we're going to be
18 focused on words, not acts.

19 I mean, I think if you had the exact
20 hypothetical that you're putting out, that there was
21 absolutely no other reason except to mislead people
22 about your intentions to sell, you could argue under
23 this recent decision of the Supreme Court, this is now
24 assuming we're under a securities law model, that that
25 could count as fraud.

1 I mean, I think in real life, there's not
2 going to be that sort of simple case. These are
3 very -- that's part of our comments. These are very
4 complicated situations being used, sort of
5 supercomputers to try to optimize these decisions, and
6 to think you would be -- this would be sort of the
7 singular reason why you would be making one of these
8 basic business decisions is just not realistic.

9 MS. GALVAN: John?

10 MR. KINGSTON: I just wanted to say that
11 if -- John Kingston from Platts. No opinion on the
12 rule, but just here to talk about our processes.
13 You're missing a step in talking about withholding
14 product let's say to affect the published price.

15 The step you're missing is that you can't
16 affect the published price unless you really affect
17 the market, so the published price, the Platts price
18 is only the end result of what actually went on in the
19 market, so I think you're skipping something when you
20 talk about that.

21 MS. GALVAN: Take it in the reverse, dumping
22 product in the market.

23 MR. KINGSTON: Okay. Dumping product in the
24 market, yes, presumably that would affect the Platts
25 price but only because it affected the market price.

1 The two of them are not disconnected from each other.
2 You can't affect the Platts price or any of the price
3 assessments unless you actually affect the market.

4 MS. GALVAN: Charlie Mills?

5 MR. MILLS: Charlie Mills for the New York
6 City Bar Committee. I just wanted to say briefly that
7 the withholding of product from a marketplace is an
8 uncertain situation legally I would say at this point.
9 In U.S. versus Reliant Energy Services, the Court
10 specifically said because one of the theories -- the
11 principal theory of the indictment in that case is
12 that the corporate defendant shut down some power
13 plants in order to reduce supply in a marketplace with
14 the hope that it would cause a price increase that
15 would benefit some derivative contracts or other
16 contracts that they had that were long.

17 The Court there in dealing with the
18 constitutional question of whether the prescription in
19 the CEA against manipulation was unconstitutionally
20 vague said, if it's just withholding product from a
21 market, that Court would have had a hard time
22 concluding that that's manipulation, so that's one
23 Judge's view.

24 The Judge, as I mentioned earlier,
25 eventually upheld the indictment on the basis that

1 there were other allegations in the indictment based
2 on false rumors in the market that made the question
3 of whether manipulation was unreasonably vague or
4 unconstitutionally vague unnecessary to get to.

5 So withholding I think it's -- I would
6 support Robert Long's comments that when you get into
7 trying to look behind decisions not to sell product,
8 there's so many things that can affect that that it's
9 really -- to uses a poor phrase, but you're kind of
10 chasing rabbits at that point with a very uncertain
11 outcome and possibly deleterious effects to the
12 mechanics of the marketplace because somebody sitting
13 there one day deciding, well, should we sell or not
14 and now their lawyer is telling them, I'm going to
15 make this decision for you because if you withhold
16 this amount, maybe it's going to be considered to be
17 manipulative.

18 So now you have to go sell, and I don't
19 think the market is really benefitted by having
20 determinations made in that context, and I say the
21 case law I think is very uncertain as to when
22 withholding would ever be considered to be a
23 manipulation.

24 MS. GALVAN: Let me go back. Professor?

25 PROFESSOR PIRRONG: I'm glad everybody is

1 sitting down because I think I might actually agree
2 with Mr. Mills here, but one thing I think you always
3 have to worry about been you're talking about any
4 regulatory standard is type one errors and type two
5 errors. There's false positives and false negatives,
6 that is the possibility that you will wrongfully find
7 somebody did something wrong when they didn't or you
8 will miss when they did something wrong.

9 I think particularly when you're talking
10 about withholding output, particularly given the kinds
11 of complexities that were mentioned I think by Mr.
12 Long, I think the possibility for those kinds of
13 errors is particularly acute in that context, and so
14 that would be something to be quite concerned about.

15 At the other end of the extreme, and here
16 we'll probably go back to our default position of
17 disagreeing, is that when it comes to things like
18 corners and squeeze, and I would even argue in the
19 Reliant case that those under those circumstances,
20 it's a relatively low likelihood of falsely
21 attributing conduct, saying it's bad when it really
22 isn't.

23 So I think that just looking at withholding
24 is potentially a dangerous area and a dangerous ground
25 to tread.

1 MR. DREVNA: If we could bring it from the
2 ethereal down to some reality and I think for the
3 Commission, before they write their rule, you really
4 have to understand how the petroleum refining market
5 actually works.

6 I mean, for those who don't understand, this
7 is one heck of a very, very, very competitive
8 business, and no one has a corner in the market in any
9 PADD. If refinery A decides to withhold product,
10 believe me, refineries B, C, D and E are going to say,
11 great, we'll crank up our production.

12 There's another thing out there called
13 inventories, and a lot of the prices are based upon
14 what the inventory levels are, and in 21 to 25 days
15 everybody seems to be happy. So even if one
16 refinery -- again, as Tim pointed out, in absent of
17 collusion, and I don't think anyone around here is
18 accusing anyone of collusion here.

19 MR. COLUMBUS: You have a remedy for that.

20 MR. DREVNA: You have a remedy for that, but
21 one refiner is not going to be able to impact the
22 market because I'm going to withhold production for a
23 couple of days because believe me, there will be a lot
24 of other people jumping into that market.

25 Now, in times of weather disasters, Ike,

1 Katrina, Rita, there are blips. There are market
2 disruptions, and there are mechanism that the market
3 uses to adjust to those events. Other people crank
4 out production from other areas. The SPR used, so
5 this is a very elastic, flexible market that, again to
6 echo what Robert Long said, if you tried to get into
7 the day in, day out machinations of a business
8 operation who are trying to maximize their ROI,
9 depending upon any number of external factors, then
10 we're going to see a lot more harm than good that
11 comes out of this rule-making.

12 MR. BROYLES: Athena?

13 MS. VELIE: Athena Velie, ISDA. I was going
14 to point out there are other decisions that support
15 the policy ideas that Charlie Mills was expressing.
16 There is the Delay decision under the Commodity
17 Exchange Act, in which there were actual transactions
18 done. A Federal Court held that these were actual
19 transactions. They were not fictitious transactions,
20 and they were reported to a price indices.

21 The Court said, Well, there's nothing wrong
22 with reporting them to a price indices, so that you
23 affect the price of that as long as they are actually
24 transactions, and I guess I raise this one because I
25 think it would be wise for the Commission to continue

1 to focus on fraud, meaning false statements.

2 And with respect to conduct, I think the
3 analog is fictitious transactions like wash sales
4 because once you get into trying to determine if this
5 is an actual transaction, there's so many when I
6 think -- piggybacking on what Charlie Mills said,
7 there are so many things that go into those decisions,
8 if you've done an actual transaction, I don't think it
9 should be second-guessed as a fraudulent type of
10 conduct.

11 So, I think if you focus on false statements
12 and fictitious transactions, you would be a lot safer,
13 that coupled with a specific intent, but there are a
14 couple cases, and I think that that's why is because
15 it's that kind of policy concern of second guessing
16 these actual cash market wholesale transactions.

17 MR. BROYLES: Mark?

18 MR. YOUNG: Yeah. Mark Young for the
19 Futures Group. I'll be very brief. I think your
20 question was: How would this be treated under the
21 commodities law? I think that was your question
22 awhile back.

23 MS. GALVAN: I would love to hear the
24 answer.

25 MR. YOUNG: And the problem that you're

1 getting in asking that question is some of us may be
2 thinking of ourselves when we hear that question as
3 defense lawyers, and so you're getting that kind of
4 response from us.

5 I think if you ask the same question of the
6 CFTC's enforcement division, I'm reasonably confident
7 you would get a different answer, and they wouldn't
8 see as much complexity as those of us at least on this
9 side of the table see in answering your question.

10 MR. BROYLES: Is there any conduct from
11 which we could infer market effects?

12 PROFESSOR PIRRONG: In my view, conduct is
13 usually not sufficient. Just observing a particular
14 conduct is not sufficient to infer that there is a
15 price effect because there are other conditions in the
16 marketplace. There are variations and conditions in
17 the marketplace where a certain conduct in one set of
18 circumstances could have a price effect, and in
19 another set of circumstance it might not.

20 So, for example, standing on a certain
21 number of deliveries against contracts when supplies
22 are large will have no impact on prices, but when
23 supplies are small might have a very material price
24 impact.

25 So I think that you have to grasp it now.

1 You have to look at evidence of actual price impact as
2 opposed to trying to just say that conduct is
3 sufficient.

4 In this regard, at the risk of committing a
5 logical fallacy of calling on authority, Judge
6 Easterbrook of the Seventh Circuit once wrote that
7 "the undetected manipulation is the unsuccessful
8 manipulation." That is, if there is a manipulation
9 and it works, it's going to have an impact on prices
10 and people are going to notice.

11 So I think that it would be beneficial to
12 market participants to have such a standard in there.
13 I sort of agree with what Mr. Young said is that I
14 am -- particularly for the kinds of egregious conduct
15 that has big impacts on prices, that a lot of these
16 complexities are not going to be as big as they might
17 otherwise appear, and that a price standard or having
18 a price impact standard would reduce the likelihood of
19 wrongly accusing somebody of manipulation, and at the
20 same time allow you to weed out the kinds of actions
21 that you really want to eliminate.

22 MR. BROYLES: Athena?

23 MS. VELIE: I'm sorry.

24 MR. BROYLES: I'm sorry. Bob?

25 MR. LONG: Phil, this is not a direct

1 response to your question, but I think in the notice
2 of proposed rule-making, the Commission deployed
3 essentially the concept of a Per Se Rule saying, Look,
4 if we can identify behavior that has no beneficial
5 effects and only negative effects, then that -- it's
6 really not we're assuming a bad effect on the market.
7 We're just saying because there's no justification for
8 this conduct, we could prohibit it without really
9 looking at bad effects.

10 Now, we made some other objections to that,
11 but I think it's useful just to take a minute to show
12 how these issues really are linked to each other. I
13 think it's the reason why, instead of doing separate
14 panels, that the workshop today is sort of more
15 continuous.

16 If you are focused on fraud, as the notice
17 of proposed rule-making is, if you were to consider
18 the suggestions that a lot of the commenters today are
19 making, that you really require specific intent, true
20 specific intent to make a false statement, and you
21 were to tie it closely to the covered wholesale
22 market, so you're not getting upstream or downstream,
23 then I think you're getting more into this zone.

24 You're really identifying conduct that it's
25 hard to come up with some reason why that might

1 benefit markets or benefit consumers. I think a lot
2 of the debate today is once you start broadening out
3 these various concepts, then you are getting at
4 conduct that is beneficial in some circumstances and
5 then you get into needing a market effect and some
6 other factors.

7 MR. BROYLES: I want to go back briefly to
8 my first question, which is how you would prove price
9 effect, and take it out of the context of Dr.
10 Pirrong's first answer, and if you're looking at sort
11 of other kinds of fraud that leads to effects, I guess
12 the question I would have is: What would you
13 measure -- what would you use as your baseline for
14 measuring whether or not the price was actually
15 distorted?

16 MR. LONG: You looked away from me. Okay.

17 MR. BROYLES: I'll look at you.

18 MR. LONG: I tried to get away from this the
19 first time. We did take a crack at this in our
20 comments on pages 35 and 36 and suggested we could
21 look at historical price trends, correlations between
22 the prices of different commodities or relationships
23 between prices at different delivery points, look at
24 the price of the physical wholesale product
25 immediately prior to and after the deceptive or

1 fraudulent statement that you're looking at, look at
2 other things like inventories, whether international
3 events.

4 I think this is one situation where you
5 could look to the CEA experience and look at sort of
6 deviations that appear to be abnormal and unexplained
7 between the prices of futures contracts and the prices
8 of the underlying commodity and again look at
9 historical spreads.

10 So there are a variety, and I think, maybe
11 you can tell I'm consulting my notes, you know a lot
12 about this. You have really -- and I don't want to
13 try to pretend it's easy because I don't think it is,
14 but I think there are approaches that can be taken.

15 MR. BROYLES: Well, I understand there are a
16 lot of different factors, and I think one of the
17 things that we all know about this market is it's very
18 volatile, and a lot of these factors are changing
19 daily, if not more frequently, and they're changing in
20 different directions, and the question is: How would
21 you disentangle the impact of the market manipulation
22 from these other factors in order to be able to
23 establish that it was the manipulation that caused the
24 effect?

25 PROFESSOR PIRRONG: If I could handle that

1 one. First of all we have to remember that
2 metaphysical certainty is never a possibility here, so
3 we're always going to be in the realm of doing the
4 odds, what are the odds that this price movement was
5 the result of sort of normal circumstances in a
6 competitive market.

7 That's basically right in the sweet spot for
8 conventional, econometric and statistical methods,
9 some of which Mr. Long referred to.

10 If you're talking about kinds of conduct
11 that might not be sort of market power related but
12 more on the fraud side, there's actually something
13 where you might be able to use a whole body of work
14 that's been litigation vetted from securities law.

15 So, for example, if the allegation is that
16 there was a false rumor that had a price impact, we
17 could look for price movements at the time of
18 statement and then price movements at the time of the
19 curative disclosure or sort of the revelation with
20 that price of information was in fact false.

21 In terms of looking at that price effect,
22 you do what people do in 10b-5 cases. You would run
23 an events study where you have various sorts of
24 control variables, and depending on how good your
25 control variables are, you can usually explain a large

1 fraction of price movements in a particular market.

2 If you observe a price movement, let's say
3 at the time of a curative disclosure that's very large
4 relative to those normal price variations, then with a
5 high degree of confidence, you can say that's unlikely
6 to have resulted in chance in a competitive market.
7 It's therefore -- given your burden of proof, sort of
8 what level of burden of proof you have, it sustains an
9 allegation of manipulation or fraud.

10 MS. GALVAN: Let me just see. If we were to
11 propose a test that's not a price effect test that
12 looks to see whether or not the conduct, the offending
13 conduct affects or tends to affect market conditions,
14 and I'm borrowing this language from the false
15 reporting statutory language for the CEA, so affects
16 or tends to affect market conditions as a price to a
17 price effects test, does anyone have any reactions to
18 that?

19 This obviously shifts the burden to showing
20 whether or not there was causation in an actual
21 artificial price, but whether or not the conduct is of
22 the kind that would tend to affect market conditions,
23 again the kind that rises to the level to impede or
24 distort market signals? Tim?

25 MR. COLUMBUS: This is Tim Columbus for

1 SIGMA. I would just urge you, I'm back on this, if
2 there are no price effects, if there are no
3 demonstrable price effects, I urge you to leave this
4 alone, not only because I think you will spend a great
5 deal of time chasing things that will not result in
6 anything productive for you or the consumer, but I
7 also urge you to understand that there is more than
8 one entity, not all of which is as well fixed for
9 adult supervision as you all are and have other
10 motives, who have the opportunity if you decline to
11 enforce this.

12 Price effects are what generated this
13 legislation. Don't take my word for it. Go back and
14 look at the legislative history of this bill, so I
15 urge you not to do that, just it has to have a price
16 effects testing.

17 MS. GALVAN: Professor?

18 PROFESSOR PIRRONG: I would just think if
19 you can't identify a price effect, you're not going to
20 be able to identify something that had sort of a
21 material impact on market conditions. That's
22 inherently more amorphous as a concept and what's more
23 the data that you have available to sort of analyze
24 that is almost always lacking.

25 And so I think that that would be -- I agree

1 with the gentleman from SIGMA, that it would -- that
2 if you don't do prices, then I wouldn't go anywhere at
3 all.

4 MS. GALVAN: Is there any guidance in the
5 case law for the false reporting provision under the
6 CEA as to what kind of conduct would tend to affect
7 market conditions other than what's clearly stated
8 false reporting?

9 MR. YOUNG: This is Mark Young. Maybe I
10 confused you or we confused you in our comment letter,
11 but the statutory formulation under the Commodity
12 Exchange Act does look to an effect on price. It's a
13 false report concerning market conditions that affects
14 the price.

15 So there is a -- I think it was Professor
16 Pirrong who said, If you have a market effect, you
17 have a price effect, and I think that the statutory
18 formulation under the Commodity Exchange Act tends to
19 bear that out.

20 I know of one case involving this particular
21 formulation, and it went off on a jury instruction. I
22 haven't committed the jury instruction to memory. I
23 don't completely recall, but the concept was: Was the
24 false report in that case -- did it have an affect on
25 the price that was reported.

1 MS. GALVAN: Charlie, did you have anything
2 to say from earlier.

3 MR. MILLS: No.

4 MR. VAN SUSTEREN: I think in the Houston
5 false reporting criminal cases -- Dave Van Susteren.
6 In Houston false reporting criminal cases it was
7 challenged for vagueness, that language effects or
8 tends to effect. I think the Fifth Circuit approved
9 that, did not find it vague, but there is currently a
10 case pending before the Fifth Circuit that has
11 attempted manipulation under the CEA that is being
12 considered by them now.

13 The trader was found guilty of attempted --
14 not guilty, it was a civil CFTC action, so there --
15 those cases are out there, but it has been challenged
16 for vagueness.

17 MR. YOUNG: Not for false reporting --
18 that's not the false reporting case. That's an
19 attempt at manipulation case.

20 MR. MILLS: Yes.

21 MR. YOUNG: Attempt at manipulation case,
22 and the question was about the false reporting.

23 MS. GALVAN: Because I do want to get to the
24 reach of the rule, which is really how to construe the
25 "in connection with" language, and I'm going to start

1 that off with revisiting a question I posed earlier,
2 which is: Are there instances where production
3 supplier operational decisions have the effect of
4 distorting the market?

5 You can use whatever intent standard because
6 here we're talking about whether the conduct is
7 fraudulent or deceptive without involving a direct
8 purchase or sale. Perhaps it's made in anticipation
9 of purchases or sales at some elevated price as a
10 result of the conduct, but are there production
11 operational supply decisions that should be reached
12 under this rule because they are the kinds of conduct
13 that would tend to affect the market or have a price
14 effect.

15 Bob?

16 MR. LONG: Bob Long for API. API's answer
17 to that question is definitely no. We think as I said
18 earlier, these kinds of decisions are the very basic
19 business decisions that the companies make. If you
20 were -- we're now talking about I think the "in
21 connection with" standard, and you were to define that
22 very loosely and say, we're going to go way upstream
23 and we're going to go further downstream to the rack
24 transaction, I guess not all the way to the retail
25 station, you all have ruled that out, but as you

1 expand the scope of this thing, and again you get the
2 situation where the lawyers are now saying, Well, I'm
3 not sure you should have this product slate coming out
4 of this refinery today because somebody might say it's
5 going to be manipulative in St. Louis or Houston.

6 That is just could have devastating effects
7 on the market, and I think you all have studied these
8 for many years, and I think understand the kinds of
9 problems, so we actually think that a narrow
10 definition of "in connection with" and in fact the
11 categorical exclusion, just again applying this cost
12 benefit analysis in trying to figure out is the game
13 worth the candle, are the benefits that you could get
14 for society worth the costs that you would impose on
15 society in trying to apply this rule upstream say you
16 know to decisions at the refinery.

17 Or we would also say when you get down to
18 this lower level of the rack where I understand there
19 are more than a thousand of these places across the
20 country, so it's a very hard to manipulate markets in
21 any meaningful way. It's just not worth the cost of
22 having to apply this rule.

23 MS. GALVAN: Let me focus here. If it were
24 to be a specific intent to act fraudulently or
25 deceptively, and it were still to reach operational

1 supply or production decisions because in my mind
2 those kinds of decisions are what drives perceptions
3 of price, if you're perhaps perpetuating false rumors
4 about your inventory position.

5 MR. LONG: If I could follow-up. That would
6 help a lot. That's why we have talked so much
7 about -- because specific intent really is something
8 that is easier to grab hold of and say, Don't tell a
9 lie, and even though it would be invasive in our view
10 to go away from the specific wholesale transactions, I
11 agree with you, Patricia.

12 If this became a specific intent rule
13 without the sort of recklessness piece, that would
14 help. That would lower the costs of the rule. Our
15 proposal is that you do all of the things we've
16 suggested, but they are related as we've talked about.

17 MS. GALVAN: Okay.

18 MR. DREVNA: I don't know how many times
19 you're going to -- I can answer the question that Bob
20 said no, I can say unequivocal no. If the FTC is
21 worried about -- if it wants to get involved in
22 refinery decisions, do I make diesel today, gasoline
23 tomorrow, home heating fuel the next week, if my crude
24 price goes up so high it doesn't make sense for me to
25 make a run on it because I'm going to lose money, will

1 it have an impact on the market? Probably. Is that
2 manipulation? I don't think so.

3 MS. GALVAN: Let's focus on if we had a
4 specific intent to manipulate the market through your
5 conduct.

6 MR. DREVNA: Well, how are you going to get
7 into the minds of the refiner and into a business
8 decision?

9 MS. GALVAN: Okay. Does the specific
10 intent, even if you don't include operational or
11 production decisions alleviate your concerns?

12 MR. DREVNA: Oh, if you don't include -- if
13 we put operational and production decisions, the basic
14 running of a business, a refinery in Al Gore's
15 lockbox, that's great.

16 MS. GALVAN: Let me focus you then because
17 you're still second guessing what a company is doing
18 if you're look at whether or not they have a specific
19 intent to artificially affect a price so I'm not sure
20 I'm following your distinction here.

21 MR. DREVNA: I'm not sure I'm following what
22 Congress asked you to do and look at wholesale
23 transactions between two parties. You're I think -- I
24 may be missing something here, but you're muddying the
25 waters here between an operational decision that I

1 want to keep running or I'm going to cut back a bit
2 because my margins aren't what my shareholders expect
3 me to do here.

4 Or I'm going to have to go to the FTC and
5 say, look, I need special dispensation for from you to
6 cut back on a refinery run here or am I going to be
7 breaking the law here?

8 If there's fraud or specific intent to
9 commit a market manipulation between two parties, I
10 think that's where Congress is -- to manipulate the
11 market, I think that is a fine line. You have to be
12 very, very careful of telling refiners how to run
13 their business, and I can't say that any more plainly
14 than that, Patricia.

15 MS. GALVAN: Charlie?

16 MR. MILLS: Yes, Charlie Mills, New York
17 City Bar Committee. I would just say as legally
18 conceptually, when you're talking about -- you're
19 talking about fraud or deception by conduct, the
20 decision to not produce something or to not sell
21 something I don't think fits in that bucket because
22 you don't have any statement that's going to be
23 misleading in the first place or false in the first
24 place, and you don't have any conduct that's
25 affirmative in any way.

1 So I don't think you can actually get there
2 under a fraud standard. If you have a market power
3 theory of an intent to cause an artificial price,
4 absent a specific intent standard, it would -- I don't
5 know how you could ever apply it with any kind of --
6 except arbitrarily ultimately, but even there, I would
7 question whether the decision not to sell where
8 there's -- there's no activity, and there's no
9 statements to the marketplace, and it's just an
10 internal decision within a company not to sell or to
11 produce some other product alternatively to something
12 else, I don't know how you get to that as a
13 manipulation.

14 MS. GALVAN: Okay. So because I think I
15 understand now where the confusion lies. In covering
16 operational supply or production decisions, let's say
17 if it were accompanied by a false statement, is that
18 the kind of conduct that you think should not be
19 reached under the rule?

20 Now we're talking about where there's
21 falsity, that's an affirmatively false statement, and
22 that is the kind of conduct that necessarily, if
23 you're representing your inventory position, for
24 whatever reason you've chosen to disclose it, that you
25 publicly disclose that and you're misrepresenting

1 where you are.

2 Is that something you're suggesting should
3 not be captured by this rule which in that instance
4 may necessarily affect price? Bob?

5 MR. LONG: It might be worth it, Patricia,
6 just to mention a suggestion that we made in our
7 comments. The one thing that you could consider is
8 having a safe harbor. If the statements or omissions
9 are not made in connection with say corporate
10 announcements, which might come up in this connection
11 of operational decisions or reports to government
12 agencies or to third-party reporting services, this
13 might be something you would want to consider doing in
14 any event.

15 But it would -- basically you could reduce
16 the cost of the rule by putting the regulated entities
17 on notice that what we're really looking at here is
18 when you make a false statement, false public
19 announcement, false statement to a reporting agency,
20 and so you could capture what I think you're getting
21 at in your question, something that looks like bad
22 behavior, but not have these extreme costs.

23 Now that sort of everything is covered,
24 things that don't involve any talkings, don't involve
25 any statements, don't even involve any actions, and

1 just impose potentially debilitating costs.

2 MS. GALVAN: Okay.

3 MR. DREVNA: Agreed. That's what we
4 proposed in our comments, that there's misleading
5 false -- with specific intent, and that that's not
6 so -- I think there is a bright line between that and
7 an operational decision that should not be even looked
8 at.

9 So I agree with what Bob said there at the
10 end.

11 MS. GALVAN: Okay. I'm going to keep moving
12 because we want to get through a couple other issues
13 with respect to "in connection with," and that is
14 we'll get to the futures conduct issue, which is
15 whether or not --

16 MR. YOUNG: I sort of feel like I'm being
17 strung along here.

18 MS. GALVAN: It was to keep you at the
19 table, Mark -- which is whether or not it would be
20 appropriate to reach blending components or products
21 that are input to the gasoline or diesel.

22 MR. DREVNA: The answer would be absolutely
23 yes. If you look at the other favored part of this
24 act of mine here or this act of Congress, EISA 07,
25 they're proposing on a going forward basis a 36

1 billion gallon mandate for blending right now. That
2 would equate to probably around 30, 35 percent of the
3 motor transportation -- of the gasoline pool.

4 So if you could -- if the FTC would consider
5 that, keeping 30 to 35 percent of the pool not
6 applicable to this reg I don't think serves the
7 purpose very well.

8 The other thing you might want to look at
9 too on a going forward basis in this whole concept of
10 biofuels mandate, in that there's a whole new market
11 that's going to be -- is in the process of being
12 implemented and that's the RIN market, the renewable
13 identification, the one that says with this gallon of
14 ethanol or biodiesel, there is this number, and this
15 number is worth money.

16 There's going to be a market for that, and
17 there's -- so I think you have to look at it
18 wholistically, EISA 07, what does the provision that
19 we're talking about today, but to exclude gasoline
20 components or motor fuel components I should say like
21 ethanol and biodiesel I think would not serve the
22 purpose of your regulation.

23 MS. GALVAN: Tim?

24 MR. COLUMBUS: Tim Columbus with SIGMA. I
25 don't know if we ought to reach all of it. Anything

1 that's mandated as a component, and we're really
2 talking about alternative fuels here, that's a really
3 big deal. Even before the mandate, we had states
4 requiring that there be certain components in a
5 finished product that has an enormous impact on the
6 price of a finished product.

7 So yeah, but if this is -- if you're looking
8 at a component which does not have a readily available
9 substitute, then you ought to cover it because if
10 you're trying to cover the product, the price and
11 manipulation of the price of the finished product,
12 you're going to have to deal with mandating
13 components.

14 MS. GALVAN: And let's hold off the futures
15 conduct discussion. Is this about futures?

16 MS. DOW: Not exactly.

17 MS. GALVAN: Okay.

18 MR. COLUMBUS: Or, yes, whichever comes
19 first.

20 MR. YOUNG: Quickly let me try, and I'm not
21 going to say futures other than having just said
22 futures.

23 It's Mark Young. My concern is the
24 component of the component, and we've heard a lot
25 today about how there's no volume of legislative

1 history you can consult and no material evidence of
2 legislative intent and purpose that you could consult,
3 and I therefore sympathize with your quest here to try
4 to fulfill Congressional intent in that situation.

5 But whatever the Congressional intent was, I
6 don't believe that Congress would have ever intended
7 that a component or what I'll call a sub component of
8 a mandatory component, corn, sugar, would have been
9 considered to be a part of this. I want to make --

10 MR. COLUMBUS: That's fine.

11 MR. YOUNG: I don't know whether that's
12 going to upset anyone here, but we never understood
13 that corn and sugar would be considered a part of the
14 gasoline price manipulation issue.

15 MS. DOW: If I could add, this is De'Ana Dow
16 for CME, it has not really been determined at this
17 point whether ethanol is an agricultural commodity or
18 an energy commodity. That is still something that
19 remains to be decided at this stage in the game.

20 MR. COLUMBUS: But I assure you ethanol is a
21 mandated component in the gasoline -- no, I'm looking
22 at Mark on his proposal, and I'm urging you to take
23 yes from me. No, we're not looking for the FTC to
24 regulate sugar and corn. I am looking at them to say
25 if you are going to regulate the manipulation of the

1 motor fuels market, a mandated component is a prime
2 driver of those prices, so....

3 MR. DREVNA: Again just for clarification,
4 never meant to say sugar, corn, anything like that.

5 MS. GALVAN: I didn't take you to say sugar
6 or corn.

7 MR. DREVNA: Right, but as Tim has sort
8 plainly pointed out, if you're going to let
9 potentially 35 percent of the market out of the reg,
10 what's the point?

11 MS. GALVAN: Okay. Near and dear to a few
12 hearts here at the table, let's talk about the reach
13 of the futures market activity and whether or not it
14 would be appropriate, and let me emphasize, the legal
15 arguments have been briefed, and they are in front of
16 the Commission.

17 So let's focus on any policy concerns that
18 you may have or other concerns that you may have with
19 an FTC rule that would reach futures market conduct.

20 MR. YOUNG: Mark Young for the Futures
21 Group. I guess, let me see if I understand the ground
22 rules. I can't talk about the legal issues. I can't
23 talk about the case law. I can't talk about the
24 statute, and I won't.

25 MS. GALVAN: Let me just focus on the

1 exclusivity provision, by all means, please.

2 MR. YOUNG: But I actually was going to
3 divide my answer into two categories. One is could
4 the FTC, as a matter of law, apply this rule to the
5 futures markets? The Futures Group as you know
6 believes the answer to that question is no. Our
7 reasons for that are well documented in our comment
8 letters. I don't want to take up everybody's time
9 here today reprising them.

10 However, I want to assure you that we
11 believe very fervently, very strongly in those. They
12 have been part and parcel of the success of the
13 futures markets for decades, and I think the futures
14 market has been very successful in complying with a
15 single set of standards under the Commodity Exchange
16 Act that governs the activity on the futures market,
17 and I think that's been one of the reasons that the
18 markets have been successful in serving the public
19 interest.

20 That bleeds into the, should you -- if you
21 could, should you apply this rule to the CFTC, and --
22 to the futures market, and at two levels I would say
23 no.

24 Number 1, we've talked here today about the
25 rule should cover those areas where if there's not a

1 gap, there's a weakness, so let's call it that. The
2 futures markets and futures regulation and futures
3 market manipulation is not a weakness.

4 There is a hefty dose of federal prosecutors
5 over at the CFTC and in addition of self regulators
6 that look at futures market manipulation all the time.
7 There is no need therefore to add the FTC to that
8 police force.

9 Second, we have had an extensive debate
10 today about the difficulty in applying the rule that
11 you proposed to futures and cash markets, and I just
12 would summarize that discussion today by saying if
13 it's hard to apply -- if it's harder to apply that
14 rule to the cash markets, it's many times harder to
15 apply that to the futures markets for all the reasons
16 that Craig Pirrong, Charlie Mills and Athena Velie
17 identified as we went through it. I know De'Ana is
18 going to speak after I do.

19 So we would urge you, as a matter of policy,
20 not to complicate regulation of the futures markets
21 and add to additional legal uncertainty in the futures
22 markets, even if you had the power by applying even a
23 manipulation standard to the futures markets, and that
24 doesn't mean that -- to address the weakness.

25 That doesn't mean that we don't think that

1 the FTC should play an important role in acting with
2 the CFTC with respect to the cash and physical
3 markets, to help to prosecute market manipulation,
4 price manipulation when it exists. We just believe
5 that the standards that govern those cases should be
6 the standards that are harmonized with the juris
7 prudence under the Commodity Exchange Act in that
8 area.

9 MS. GALVAN: De'Ana.

10 MS. DOW: Obviously -- De'Ana Dow, CME
11 Group -- I would say ditto to everything that Mark has
12 already said. I would also add that I recall when
13 this legislation was being drafted that I was pointed
14 to the savings clause language of the legislation that
15 basically says that this does not supercede or limit
16 the authority provided -- responsibility to be
17 conferred by or authorized -- any violation or any
18 provision of law.

19 So I was told that this was intended to
20 protect the CFTC's exclusive jurisdiction over
21 futures, and I also would add that again I believe the
22 issue that was being addressed in the context of this
23 legislation was, in fact, activity that was not then
24 being covered by existing laws.

25 And then finally, I would add that we have

1 had, in terms of experience with having multiple
2 regulators, very complicated encounters with the
3 application of the new authority that FERC is
4 operating under, and I will tell you that it is a
5 major strain on the markets as well as on the
6 participants when you're faced with complying with
7 very different standards, when you're responding to
8 very different requests and mandates of sort from
9 different regulators.

10 So I think the practical impact, the
11 application of this type of situation on the markets
12 as well as on the market participants will tend to
13 chill the market and will have a very negative impact
14 on a very important price discovery function that is
15 plagued by these markets.

16 MS. GALVAN: Under what circumstances would
17 it be appropriate to look at futures market activity
18 as part of protecting the wholesale petroleum markets?
19 This goes to the relationship between the two.

20 MR. YOUNG: Well, let me start by saying
21 this first: The futures market exists to discover
22 prices. Those prices are discovered in the futures
23 market, and then they're disseminated, so we
24 understand and Congress understood that everyday,
25 every moment of everyday that the futures markets are

1 opening, they are discovering and disseminating prices
2 to other markets and other businesses in other market
3 participants, non futures market participants.

4 The reason Congress created exclusive
5 jurisdiction was to address that very overlap that
6 you've just described or that effect that you've just
7 described and Congress said, When the activity is --
8 when the conduct exists in the futures market, we want
9 the CFTC to have exclusive jurisdiction.

10 Now, there have been instances where conduct
11 in non futures markets has influenced futures markets,
12 and in those situations, very often the CFTC has
13 worked with other regulatory agencies on prosecutions
14 or investigations.

15 We don't have any problem with that, but our
16 primary concern is that we have a rule that could
17 potentially add another standard for manipulation and
18 another policeman for manipulation to the ones we
19 already have in the futures markets, and so when the
20 activity is solely in the futures markets, and the
21 Amaranth case that De'Ana mentioned is a perfect
22 example, when there's no conduct outside the futures
23 market, we would just urge the Commission to grant a
24 safe harbor from the application of whatever rule you
25 adopt for market participants in the future markets.

1 MS. GALVAN: Let me ask about conduct where
2 there is both activity in the futures and in the
3 physical market as part of, let's say, we'll call it
4 the fraudulent scheme. Doesn't it still cause the
5 same problems that you're concerned about because it
6 still has activity in the futures markets that would
7 be covered under the rule?

8 MR. YOUNG: No.

9 MS. GALVAN: Why not?

10 MR. YOUNG: Because in what I'll call the
11 Amaranth scenario is everyday of every minute of
12 everyday in the futures market, that would allow other
13 agencies, whether it's the SEC, the Federal Trade
14 Commission, the Department of the Treasury, would
15 allow -- that theory would allow other agencies
16 besides the CFTC to focus on exclusively futures
17 related conduct, and that's what we believe exclusive
18 jurisdiction was designed to prevent.

19 What we have said in our comment letters, in
20 both letters is that when you get into the area of
21 physical or cash market activity, whether it's part,
22 whether it's independent of futures market activity or
23 related to futures market activity, we understand that
24 the rule that you ultimately may adopt at the
25 Commission would apply to that activity, and we would

1 urge you to coordinate its application and your
2 enforcement and your investigation with the CFTC.

3 But that would not be something that would
4 be purely a matter of futures trading and therefore
5 not a matter of pure CFTC exclusive jurisdiction.

6 MS. GALVAN: Any other comments on that?

7 MS. DOW: I would agree with that
8 assessment.

9 MS. GALVAN: Now, I think we touched on
10 already whether or not the definition of wholesale
11 should be modified. I don't know if there were any
12 other comments on that, but I think that was one open
13 issue that we didn't really spend that much time on.

14 MR. LONG: We addressed it in our written
15 comments, this is Bob Long for API, and we talked
16 about it briefly. I think that's adequate for our
17 purposes unless you had additional questions.

18 MS. GALVAN: Unless there was anything that
19 anybody wanted to add to something they already said
20 at the table or in their comments, I think we're going
21 to move to the open mike time.

22 MR. LONG: I was just going to make one
23 quick concluding comment, if I could, Patricia, which
24 is going back to where we started, the language that
25 Congress used does come from Section 10b. We all

1 recognize that.

2 There's been a lot of I would say excellent
3 discussion around the table today about the
4 commodities laws and the CFTC approach. What API has
5 proposed and what we think has made sense given the
6 way Congress wrote the statute and given the notice of
7 proposed rule-making that the Commission has issued is
8 to start where you are, start with the Rule 10b-5
9 based rule, but recognize -- I hope we have been able
10 to persuade you through our written comments and
11 discussion today that there are differences between
12 the wholesale petroleum markets and the securities
13 markets and that those differences do justify some
14 adjustments to the pure 10b-5 based rule.

15 And then I think it's appropriate to draw on
16 the experience, I think 70 years or more of experience
17 of regulating commodities markets, futures markets are
18 also not the same as physical markets. I think there
19 was a lot of agreement around the table about that,
20 the application of these futures principles to
21 physical markets is still very much a developing area,
22 and there is a lot of debate.

23 So given that all the prior investigations
24 have not shown big problems in terms of manipulation
25 in these petroleum markets today, given all the

1 concerns about an overbroad rule really causing
2 significant harm to markets and to consumers
3 ultimately, what we think makes sense and is set out
4 in our comments is to make some adjustments like a
5 specific intent requirement, like a showing of market
6 effects, like a tightly focused "in connection with"
7 standard, limiting sort of the requirements of
8 omissions can count as manipulation, and I think that
9 would produce a workable rule.

10 I think you have a difficult job that
11 Congress has given you, but I think that would be a
12 workable solution to the problem that Congress has set
13 in front of you.

14 MS. GALVAN: Okay. Thank you.

15 MS. STUNTZ: Patricia, Linda Stuntz from
16 AOPL. I do not want to restate the legal arguments
17 and would borrow some of the eloquence from Mark. It
18 doesn't mean we don't feel strongly that there is no
19 basis for regulating oil pipelines under this rule
20 when barges or even trucks carrying petroleum products
21 would not be regulated because they're common carriers
22 but they're regulated by a different entity.

23 What I would like to do is just make an
24 important policy point about, putting aside the legal
25 arguments, why we think this would be extremely

1 counterproductive.

2 Within the past six weeks, we are at an
3 historic point in the oil pipeline industry, given
4 what's going on in the petroleum products markets.
5 Within the past six weeks FERC has had before it two
6 different petitions for declaratory order on behalf of
7 major projects to build from the north to the south,
8 which is totally contrary, right?

9 The history of -- the pipeline history has
10 been to go from Texas and Louisiana and those places
11 north to where -- north and east to where we live and
12 consume the products.

13 Now, because of the development of Canadian
14 tar sands and because of the decline down there, we
15 are looking at major projects, \$3 billion in one case,
16 to run from Alberta all the way down to Cushing,
17 Oklahoma. It's totally contrary to what I grew up in
18 this business learning about.

19 Those things -- in order to finance those
20 and build projects of that magnitude, shippers have
21 had to go to the Commission and seek interpretations
22 of the Interstate Commerce Act that would enable them
23 to provide firm transportation because they had a
24 chicken and egg question, I want this pipeline
25 capacity and I will sign up for it but I cannot be

1 prorated because if I'm going to invest the huge
2 amounts of money in tar sands to do this, I have to be
3 able to get this stuff to refineries.

4 So there's a delicate balancing that's
5 occurred. The Commission has made judgments about,
6 yes, a certain percentage of the pipeline can be
7 reserved for anchor shippers. They can get discounted
8 rates in order to encourage the building of this
9 infrastructure. A remaining amount of the pipeline
10 will be left for classic proration, open to all
11 shippers. Why do I go into this?

12 Well, if someone comes along later and says,
13 I want the discounted rate of the anchor shippers, 10
14 years from now, 12 years from now, they'll say, no,
15 this pipeline was built and financed on the basis of
16 judgements made by the Federal Energy Regulatory
17 Commission and interpretation of the Interstate
18 Commerce Act.

19 Well, I don't like that, I'm not getting the
20 same price that this other guy got. It's affecting my
21 ability to sell product. It's affecting the market.
22 I want to be able to go over to the FTC and try to get
23 a different rule because I think there's a market
24 manipulation going on.

25 That kind of potential second guessing I

1 would tell you would make it extremely difficult for
2 these projects to go forward, and I do not think that
3 is in the public interest, so that's a bigger picture,
4 and I just appreciate the chance to relay that to you.

5 One final point, I have restrained myself.
6 I do not believe this, is the appropriate forum to
7 deal with it, with the particular facts of the case
8 before you today. Suffice it to say, the matter has
9 been the subject of two FERC orders this year.

10 It's now pending before the D.C. Circuit. I
11 would be happy to provide citations to your staff if
12 it would be of interest to you, but I would say that
13 the Commission's orders do not necessarily support
14 some of the representations that have been made about
15 the conduct of the pipeline industry, and that's all
16 I'll say thank you.

17 MS. GALVAN: Thank you.

18 MS. HOLLIS: Ms. Galvan, thank you. My name
19 is Sheila Hollis. I'm speaking on behalf of the
20 Navajo Commenters in this proceeding, and thank you to
21 my friend, Ms. Stuntz, for teeing up the issue at the
22 end of a long day.

23 With respect to her position, we beg to
24 disagree with the description of the situation which
25 she has given to you with respect to the jurisdiction

1 of the Federal Energy Regulatory Commission, which
2 under the Interstate Commerce Act is quite different
3 than what the FERC has with respect to the natural gas
4 industry and the electric power industry, including
5 transmission in the electric power area.

6 Under the Interstate Commerce Act, as it has
7 been refined and interpreted, since the FERC became
8 the repository of the Interstate Commerce Act as a
9 result of the creation of the Department of Energy in
10 1977, transferred authority under the Interstate
11 Commerce Act from the Interstate Commerce Commission
12 to the FERC.

13 After that timeframe, the FERC, under the
14 Energy Policy Act of 1992 and interpretations in the
15 Court of Appeals, has been restricted in the approach
16 that it may take with respect to oil pipelines. It
17 has been instructed to use light handed regulation,
18 and in fact it has followed that mandate of the court,
19 and it has been extremely light handed in its
20 regulation of the oil pipeline industry.

21 Just to put it in a clear context, oil
22 pipelines go to the FERC to have their tariffs
23 approved and the practices and rates under those
24 tariffs. The FERC has no control, and as recently
25 just a few weeks ago, the chairman of the FERC

1 testified on this issue before the Congress -- has no
2 control over the licensing, certification,
3 abandonment, reliability of those pipelines, none of
4 that that you might see in the context of either
5 natural gas regulation or electric power regulation.

6 So it is a unique form of regulation that is
7 reflective of the Interstate Commerce Act and the
8 authority, the limited, very limited authority that
9 the FERC has pursuant to the Interstate Commerce Act.

10 If you were to review -- if you were to take
11 a look at the resources of the FERC and how the
12 resources are allocated, you would find that there is
13 a very limited ability to deal with many of the oil
14 pipeline issues that would be dealt with on a natural
15 gas arena and other pipeline context, for example.

16 In the case of the Navajo Commenters, it's a
17 situation where bad things can happen on nice
18 pipelines, and there is a -- it is a situation where
19 there is an exercise of market power, which we believe
20 should be appropriate for the Federal Trade Commission
21 to consider in the context of its development of this
22 rule under the EISA.

23 It is in connection with the sales of crude
24 oil or petroleum products. The FERC, as Ms. Stuntz
25 reflected in her comments, has taken up our issue

1 before the -- our issue has been taken up before the
2 FERC, and the FERC has stated that, in fact, it does
3 not have jurisdiction over the allegations, which we
4 made with respect to anticompetitive control over the
5 crude oil production in the Four Corners region. It
6 explicitly stated that such allegations are beyond the
7 jurisdiction of the FERC.

8 And that is why we are at the FTC today.
9 The FERC cases are pending before the Court of Appeals
10 and making their way through that process, but I was
11 taken by Mark Young's comments that there's too many
12 policemen and by De'Ana's comments that there are too
13 many policemen involved.

14 Here it's a question of: Is there a
15 policeman at all to review the behavior in the
16 marketplace with respect to certain circumstances with
17 oil pipelines, and that is why we're here today.

18 We do believe that the manipulation of oil
19 pipelines in order to either have an effect on price,
20 or, to have an effect on the marketplace is something
21 that is appropriate as is reflected in the ANOPR
22 itself, and as the FTC has reflected in its concerns
23 in bringing this to this table today.

24 I also note that the FERC is very attentive
25 to its jurisdiction. We've had many discussions of

1 the Amaranth case today, and the FERC and the CFTC
2 have jurisdictional issues between them which they're
3 resolving, and here we see that the FERC has said that
4 certain elements of the activities of the oil
5 pipelines are beyond their jurisdiction.

6 And so that is why we're here today, and I
7 am accompanied, another of the Navajo Commenters is
8 from the Navajo tribe to give you a sense of the real
9 world implications that the oil pipeline situation has
10 for price, the impact it has on the producers and the
11 region, and particularly in a region which is remote,
12 where there is a very limited access to competitive
13 markets.

14 So that's why we're here today, and we
15 appreciate the opportunity to present our case so late
16 in the day and to at least to discuss what is a
17 complicated issue, but nonetheless is a terribly
18 important issue.

19 Thank you.

20 MS. GALVAN: Thank you. I want to thank all
21 of the panelists for attending today and sitting
22 throughout the day and we appreciate that.

23 Why don't we take just a few minutes here to
24 allow those that had asked to participate from the
25 audience perhaps come to the end of the table because

1 we don't have a mike standing up, and I believe we had
2 somebody from ARGUS who wanted to make a brief
3 statement. By all means, please have a seat, and we
4 also had someone from Jones Day, Bruce, if you just
5 want to have a seat here, and then, Susan, we'll bring
6 you up as soon as we get those statements.

7 I'm going to ask you, if you wouldn't mind,
8 to be brief, limit yourself to a minute or two.

9 MR. MASSEY: Yes, I will be brief. Dan
10 Massey with Argus Media. We put in a filing to the
11 notice of proposed rule-making, and I'm not going to
12 repeat that.

13 I just wanted to say that I would concur
14 with John Kingston, who was sitting at the table here,
15 that we want to make sure that the free flow of
16 information from the marketplace to the index
17 publisher continues.

18 It does not take much for people to get
19 chilled and to get concerned about that sort of
20 communication, and through that process, John
21 encouraged maybe a safe harbor provision should be
22 written.

23 I wanted to encourage the Commission that if
24 you are going to write a safe harbor provision, you do
25 so very carefully because when the FERC did so in the

1 gas market, it became very prescriptive. The
2 methodology that should be applied for price
3 reporting, the way that reporting of information
4 should be done, and it actually did end up actually
5 slowing the amount of information that could be
6 communicate, so I think that the requirements in that
7 regard should not be onerous.

8 The only second thing I would like to say is
9 that I would encourage the Commission not to prescribe
10 exactly a methodology that should be used. It is true
11 that Platts is a dominant price index reporter here in
12 the United States, but many people don't realize that
13 we are being told that about 80 percent of the crude
14 oil in the United States is actually indexed to prices
15 published by ARGUS.

16 We have a different methodology than Platts
17 does, so the ability for index publishers to, in a
18 competitive market, to come up with different
19 methodologies to serve the industry and to serve
20 regulators is something that I think should continue.

21 MS. GALVAN: Bruce?

22 MR. MCDONALD: Thank you. I'm Bruce
23 McDonald from the Jones Day law firm. I'm not here on
24 behalf of a Jones, Day client but wearing my hat as
25 the chairman of the ABA antitrust sections fuel and

1 energy committee, which filed comments in response to
2 the advanced notice of proposed rule-making.

3 I was a little surprised to hear some of the
4 issues that we covered in our comments raised early
5 today and then at the end of the day relating to the
6 application of the proposed market manipulation rule
7 to conduct that one generally would consider to be
8 already covered by the antitrust laws.

9 And the thrust of the ABA antitrust sections
10 comments was that the market manipulation rule should
11 not cover conduct that already is covered by the
12 federal antitrust laws, and in this context it's
13 primarily the unilateral exercise of market power,
14 which under the antitrust laws sometimes is lawful,
15 sometimes is not lawful, but the recommendation is
16 that it be left to the antitrust laws and not picked
17 up again by any new regulations.

18 It wouldn't be justified under the statute,
19 that EISA says specifically that the regs, the new
20 regs should not modify the antitrust laws. Senator
21 Cantwell made clear in her letter to you that she
22 didn't intend for the legislation to, let me quote:
23 "Catch sellers who take advantage of natural market
24 forces of supply and demand, only those who attempt to
25 affect the market prices by artificial means unrelated

1 to the forces of supply and demand."

2 And then perhaps more to the point, the FTC
3 itself has made clear it doesn't think that industry
4 specific antitrust rules are appropriate, so how does
5 this fit into what has been discussed today?

6 I think it may be only Mr. Cooper who still
7 thinks that unilateral withholding, all by itself,
8 should be prohibited by the market manipulation
9 regulations. It certainly is an accepted principle
10 under the antitrust laws that for a supplier, even a
11 monopolist to withhold supply, is generally not
12 unlawful.

13 And even in the BP/ARCO matter which was
14 discussed in the advance notice, in that matter the
15 Commission determined that BP/ARCO's shipping supply
16 instead of to the West Coast but to the Far East for
17 the purpose of bringing up west coast prices wasn't an
18 antitrust violation, and that prohibiting the practice
19 wouldn't have a long-term beneficial effect.

20 Probably still in dispute at this table is
21 the question of whether denial of access to a facility
22 such as a pipeline ought to be a violation of a market
23 manipulation regulation under the antitrust laws,
24 which do cover the question. Denial access is
25 generally not but on rare occasions, perhaps could be,

1 an antitrust violation.

2 And that general rule is based on the
3 principle that requiring that owners of facility
4 provide access to their competitors is in the long run
5 probably not beneficial to competition and to
6 consumers.

7 This agency and the Justice Department and
8 the courts have spent decades developing antitrust
9 jurisprudence that carefully balances these questions,
10 seeking the long run consumer benefit, and I applaud
11 the Commission for, in its draft rule, moving away
12 from what seemed to be the antitrust questions.

13 And I urge the Commission to stay there, to
14 stay away from the antitrust questions. Obviously
15 you've got plenty of resources to attack it on the
16 antitrust laws if necessary, and I submit that on the
17 record here, the record you've developed in developing
18 this rule, there isn't justification for developing an
19 industry specific antitrust rule but instead focus on
20 deceptive conduct that hinders the operations of
21 markets by misleading market participants.

22 Thanks.

23 MS. GALVAN: Okay. We'll come back to Susan
24 in just a second. Did you want to make any remarks?

25 MS. HOLLIS: This is Perry Shirley from the

1 Navajo Nation, and I'll step away from the table while
2 he's commenting.

3 MR. SHIRLEY: Good afternoon. I appreciate
4 the opportunity to be here today. I will make my
5 comments brief, but just to give you an idea about
6 where the Navajo Nation fits into this discussion here
7 today.

8 I am a board director for the Navajo Nation
9 Oil and Gas Corporation. It is a federally chartered
10 corporation, and it's a wholly owned by the Navajo
11 Nation Indian tribe.

12 As was mentioned earlier by my counterpart
13 here, Mr. Jim Piccone, we are in the Four Corners
14 area, and our reservation is within the boundaries of
15 the states of Arizona, New Mexico and the State of
16 Utah.

17 Through the Navajo Nation Oil and Gas
18 Company, we have acquired, purchased back a majority
19 of the oil and gas producing properties, mostly in the
20 southeastern portion of the State of Utah, and the
21 reason why we're -- this discussion here that you're
22 having, as well as the proposed rule that is at hand,
23 concerns us is that oil production from our leases in
24 the Four Corners areas accounts for 36 percent of the
25 total Indian oil production in the United States.

1 And we are basically involved in the
2 marketing of crude oil from the upstream side of the
3 business, midstream, and then to the end users who are
4 downstream operations, so we do have some idea of the
5 discussion that has been taking place today.

6 And the other important aspect of the point
7 that I want to make is that the revenues that are
8 derived from primarily crude oil, because we're not a
9 big producer of gas, make up approximately 40 percent
10 of the Navajo Nations annual treasury fund monies, and
11 through that, the revenues that we derive from that
12 are used to provide basic needs for Navajo people.

13 And so what that -- when we talk about the
14 various issues at hand today, for instance, market
15 power, as an example, if we look at a price drop of
16 ten dollars just on the basic barrel of oil, we're
17 looking anywhere from a \$19 million decrease in annual
18 revenue to the Navajo Nation, and then an additional
19 \$23 million that would impact our counterpart down in
20 Resolute Natural Resources Company.

21 So when you when you take that into account
22 and you have tools available to you to netback from
23 various markets that can clearly illustrate that we
24 are at the -- I guess at the mercy, if you will, of
25 one company that controls the pipeline, that basically

1 owns both of the refineries that serve our area and
2 that a majority, if not a hundred percent of our
3 production goes to both of those pipelines, you have
4 an issue there.

5 And I sincerely think that through the
6 direction that has been given to the Commission here,
7 that we could -- those issues could be addressed, and
8 we urge the Commission to do so in the promulgation of
9 this rule.

10 MS. GALVAN: Thank you. Our last audience
11 participant?

12 MS. DE SANTI: Thank you, Patricia. I'm
13 Susan De Santi. I'm with the law firm of
14 Sonnenschein, Nath and Rosenthal, and I'm here
15 representing NPRA.

16 First, Patricia and Phil, I wanted to say
17 that I think we very much appreciate your efforts to
18 come back to us and say, Well, what if we change this,
19 what if we change that about the rule, would that be
20 enough to make a difference to address the concerns
21 that you raised in your comments.

22 In the course of a one-day workshop, I'm not
23 sure we've given justice to thinking through all of
24 the ideas that you presented to us.

25 Second, I wanted to endorse Bruce McDonald's

1 comments on antitrust law and its application and its
2 relationship to this rule, and as you will see where
3 I'm going, that's very relevant to how we're thinking
4 about the rule.

5 I just wanted to put a framework around the
6 discussion that we've had today. First we have the
7 securities markets analogy, and in our -- that was the
8 model in your notice of proposed rule-making, and
9 that's what we responded to in our comments and came
10 up with a different proposal for how to address that,
11 but we feel that we've had the chance to thoroughly
12 respond on that issue.

13 Today there's been a lot of discussion of
14 futures markets, and I just want to say that I think
15 that it is very problematic to talk about taking the
16 law and rules in futures markets and transferring them
17 into wholesale petroleum markets.

18 I just want to read you the definition of
19 market manipulation under the -- that the CFTC uses:
20 "That the defendant acted or failed to act with the
21 purpose or conscious object of causing or effecting a
22 price or price trend in the market that did not
23 reflect the legitimate forces of supply and demand."

24 It is very difficult to know what is the
25 conduct that is not going to reflect the legitimate

1 forces of supply and demand, and I would suggest to
2 you that probably the best way to affirmatively
3 identify it is to go towards the fraud and deception
4 model, and I want to be explicit that the NPRA does
5 not support using an CEA model here.

6 And I think in fact, if you look at where
7 the jurisdiction has been and where the enforcement
8 efforts have been, as a practical matter, there's been
9 relatively little antitrust enforcement in futures
10 markets. It's really been the CFTC developing the law
11 around that, and what you will see is that those
12 concepts that have evolved in that -- with respect to
13 futures markets do not have direct parallels in
14 antitrust law, and that takes me to the third type of
15 market we're talking about here, wholesale petroleum
16 markets.

17 Wholesale petroleum markets have in essence
18 been regulated by antitrust law. That's the
19 regulatory scheme that I think you need to think about
20 in terms of where can this rule add to antitrust law
21 to help consumers, and the basic area I would -- well,
22 just as one example there's no concept in antitrust
23 law of an artificial price. It's difficult for an
24 antitrust lawyer I think to even begin to think about
25 what is an artificial price.

1 But we can think about, Okay, where is there
2 a gap, and there is a gap when you get to unilateral
3 conduct that has no efficiency justification. You may
4 take a stab at it under Section 5, and you've just had
5 a workshop about what Section 5 of the Federal Trade
6 Commission Act may cover.

7 You can certainly say, as we did in our
8 comments, that injecting materially false or
9 misleading information into the market with a specific
10 intent, specifically intending to do that with a
11 specific intent to profit from an effect on the market
12 that is reasonably expected from that conduct, that is
13 conduct that we can define, that companies can tell
14 their employees not to do.

15 It clearly doesn't have an efficiency
16 justification, and it clearly is a gap. It's conduct
17 that is not currently covered by the antitrust laws,
18 unless you go back to the S&H Green Stamp case in 1973
19 when the Supreme Court was considering the coverage of
20 Section 5 and it said, Section 5 of the FTC Act is
21 broader than the Sherman Act, okay.

22 Taking that as a basic principle, there has
23 been relatively little case law developed since 1973
24 to say, Okay, what else are we going to capture within
25 that, and I think the Commission's N-Data case and the

1 workshop you just had are the beginning efforts to
2 figure that out.

3 So given that Section 5 has not covered this
4 type of information, this type of conduct before, that
5 is a gap in the regulation of this market that you
6 could use your rule to fill, to prevent market
7 manipulation, and I just want to be very specific
8 about that, that the proposal we have was designed
9 specifically to identify particular conduct that we
10 can tell people not to do with specific intent.

11 So it's not a question that people will come
12 back and say, But you must have known that information
13 was incorrect. Well, no, we didn't know. You either
14 know or you don't know, but must have known is very --
15 there are lots of things that appear to be something
16 you must have known when you're looking at it after
17 the fact.

18 Finally, and in terms of price effects, we
19 came a step back, and in recognition of the fact that
20 you guys justifiably have some concerns about how
21 you're going to sort out and prove that a particular
22 act caused an effect on the market and separate that
23 all out from the noise that's always going on in the
24 market.

25 Recognizing that, in our proposal we took a

1 step back from seeking a requirement of price effect
2 to say, how about a standard that says with specific
3 intent, you have injected materially false or
4 deceptive information in the market, with the specific
5 intent to profit from that conduct through an effect
6 on the price on the market, that you reasonably
7 expected it to occur.

8 So I just wanted to flag those elements of
9 our proposal and how they relate to the discussion
10 today.

11 My final -- my final request is that if you
12 all are seriously considering using CFTC or futures --
13 CEA type of approach to this rule, NPRA would like to
14 file supplemental comments to clarify all the ways in
15 which we think that that would not be an appropriate
16 model and would cause difficulties.

17 So I just -- I just want to say this is --
18 this rule is extremely important. You're really
19 regulating in totally new way in a previously
20 unregulated wholesale petroleum market. It's not like
21 you're going to a place where FERC has already been.
22 FERC was already regulating.

23 And for consumers' sake, it's really
24 important to get this rule right because otherwise
25 consumers are the ones who are going to pay the

1 prices, if wholesale petroleum markets start to work
2 less efficiently and therefore costs rise and those
3 costs get passed on to consumers.

4 Thank you for your patience in listening to
5 me at the end of a very long day.

6 MS. GALVAN: Thank you very much. Thank you
7 everybody for coming.

8 (Whereupon, at 5:18 p.m. the workshop was
9 concluded.)

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CERTIFICATE OF REPORTERS

WORKSHOP TITLE: MARKET MANIPULATION RULEMAKING
WORKSHOP

WORKSHOP DATE: NOVEMBER 6, 2008

We HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the steno notes transcribed by us on the above cause before the FEDERAL TRADE COMMISSION to the best of our knowledge and belief.

DATED: NOVEMBER 10, 2008

SALLY JO QUADE

DEBRA L. MAHEUX