

BEFORE THE FEDERAL TRADE COMMISSION OF THE UNITED STATES

In The Matter Of:)
)
Prohibitions On Market Manipulation And)
False Information In Subtitle B Of The) **RIN 3084 AB12**
Energy Independence And Security Act of 2007)
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COMMENTS OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

The Petroleum Marketers Association of America (PMAA) is a federation of 46 state and regional trade associations representing over 7,000 independent marketers of petroleum products in all 50 states. These marketers distribute approximately 60% of the gasoline and diesel fuel and 95% of the home heating oil consumed in the U.S.

PMAA, its federated associations and their individual marketer members are most concerned that the implementation of the, prohibitions on market manipulation and false information, mandated to the FTC by the Energy Independence and Security Act of 2007, not be carried out in such a manner as to disrupt the efficient distribution of vital petroleum products, particularly in times of market upheavals.

As an initial matter, Commission staff should be complimented on a most thoughtful and rigorous investigation into both the potential benefits and pitfalls in various regulatory approaches to comply with Section 811. The Advance Notice contains a particularly comprehensive review of other regulatory responses to similar congressional mandates, by both the FTC and FERC. Additionally, the many thoughtful questions posed in the Advance Notice shows a sincere and informed effort to create a regulatory scheme that will not hinder the

efficient workings of the petroleum industry. To that end, perhaps the single best piece of advice would be to follow the dictate in the Hippocratic Oath, “first do no harm.”

In its Advance Notice, the FTC poses a series of questions to commenters. These comments attempt to both respond to those questions and suggest means to avoid unnecessary and dangerous regulatory intrusion.

I. Definition of Market Manipulation

PMAA is most aware of the history of laws defining deceptive practices. State and federal statutes and a long line of jurisprudence make this area of the proposal very clear. What is unclear, however, as is pointed out in the Notice, is an appropriate definition of “market manipulation”. In its Notice, the Commission cites Rule 10b-5 cases and the FERC prohibitions on energy market manipulation, Final Rule (18 CFR Part 1c), for the proposition that, “the term manipulative or deceptive arguably can be read as a single adjective.” The Notice goes on to propose the following definition:

Market manipulation shall mean knowingly using or employing, directly or indirectly a manipulative or deceptive device or contrivance -- in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale -- for the purpose or with the effect of increasing the market price thereof relative to costs.

The above definition is not objectionable to PMAA, so long as the Final Rule adopts certain other measures. These are explained below in the form of answers to the questions posed in the Notice.

II. Responses To Questions Raised in the Advance Notice

A. Manipulative or Deceptive Device or Contrivance

Q Should legal precedent established for violations of rules addressing manipulation or deceit in regulated behavior . . . be applied to unregulated behavior, such as the purchase and sale at wholesale of crude oil, gasoline, or petroleum distillates?

A Given the very wide gap between regulated and unregulated behavior, existing precedents should be looked to as informational only and not as having any binding effect upon interpretation of rules promulgated under Section 811. In fact, existing precedents must be distinguished in great part and only referenced with extreme caution.

Q To what extent (or in what particulars) should the jurisprudence under the other laws addressing manipulation apply under the Commission's new authority?

A See above.

Q What should not apply?

A The vast bulk of the jurisprudence concerning regulated industries is not adaptable or of relevance to regulations under Section 811. One reason for this non applicability is the very essence of the difference between most regulated and non-regulated markets. Much of the available jurisprudence relates to public utilities and other entities which are guaranteed a set rate of return. Non-regulated market participants are not guaranteed any such return. The SEC regulations do not share this problem. Reference to Rule 10b-5 jurisprudence is useful, but there are distinctions in the mission here. In crafting the regulations under Section 811, the Commission should also look to the application of its existing authority concerning monopolization, and market power under the FTC, Sherman and Clayton Acts.

Q What are the “potential costs or benefits” of an FERC rule that simply mirrors language of SEC Rule 10b-5 or the language of the FERC Final Rule?

A Section 811 rules must not simply mirror the rules adopted by the SEC and FERC. (See above.) Such rules must provide more specificity to ensure that market participants do not alter their behavior in ways that stultify price-allocation efforts, particularly in times of crisis caused market dislocations.

B. Effect on the Market

Q & A Should new and unique methods of market manipulation and deception be discovered, the Final Rule must allow the Commission significant discretion to pursue those issues. This discretion must, however, be canalized between clearly delineated banks enumerated within the rule itself.

C. Scienter/State of Mind

Q Should scienter/state of mind be a requirement for violation of the Final Rule?

A Absolutely. As is pointed out in the Notice, “the primary focus of the prohibition on manipulation appears to be on practices that are not a reaction to market forces. Instead the focus is on practices that intentionally, willfully or recklessly cause distortion in the market.” This standard could not be met without a scienter requirement.

D. The “Wholesale” Level

Q How should the conduct raised “in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale” be interpreted?

A The Bureau of Competition has acquired much knowledge of the downstream petroleum marketing industry in its work on the major oil company mergers reviewed under the Hart-Scott Rodino requirements over the last 20 years. PMAA believes that FTC staff will

agree, that, short of unlawful collusion, there is virtually no possibility of market manipulation occurring below the terminal rack level. Even at the terminal level, non-collusive manipulation is very difficult to imagine. In any event, this fact aligned with the needs, particularly in emergencies, to allocate product quickly in an unfettered manner, argues for the non-applicability of the 811 regulations to participants or activities that occur below the rack. PMAA believes the 811 regulation should not apply to any participants or activities that occur at that level.

Q Is the FERC rule that “in committing fraud, the entity must have intended to affect, or have acted recklessly to affect, a jurisdictional transaction” appropriate for the 811 rule.

A Yes.

E. Conformance With Antitrust Standards

Q Should the 811 rule conform to traditional antitrust analysis by requiring (1) the use or employment of “any manipulative or deceptive device or contrivance” to satisfy the anticompetitive conduct component of the offenses of monopolization and attempted monopolization prohibited by Section 2 of the Sherman Act and (2) the intent and market power components of those offenses to be satisfied under the standards explained throughout antitrust case law?

A. Yes.

F. Penalties

Q Will penalties up to \$1,000,000 create a chilling effect on legitimate business behavior? And, if so, should this effect be the interpretation of, or required state of mind for a “manipulative deceptive device or contrivance”?

A The very large penalty should only be applied, if at all, to the very largest entities (refiners, trading companies) who participate in the upstream portion of crude and finished product, manufacture and sales. There should be a high monthly dollar sales minimum for its application. There can be no doubt that penalties of this size, if applied to smaller entities, would have a chilling effect on their efforts to meet supply needs in crisis situations.

G. Overlapping Jurisdiction

Q Are there possible effects of overlapping jurisdiction between the 811 rules to be administered by the FTC, and the anti-manipulation authority of the FERC and CFTC, and should there be the agency information sharing on market manipulation regulation law enforcement?

A Yes. A standing inter-agency task force on market manipulation should be set up and charged with this coordination and information sharing tasks.

H. Potential Practices

Q Are refiner announcements of future reductions of refinery utilization manipulative practices? What is the perceived harm from these actions? Do such practices manifest the intent necessary to violate Section 811? And, do business justifications balance the perceived harm?

A Refiner announcements of shutdowns and reduction restrictions could possibly meet the market manipulation test, but, as a general matter, they will not. This is one of the case where the scienter requirement comes into play.

Q What are the costs and benefits of a rule restricting public preannouncements of refinery downtime?

A Such announcements are vital to downstream market participants. Any Commission proposal to regulate them should be one requiring more complete, fully accessible and earlier disclosures.

Q What are the impacts of and what steps should the Commission take to monitor-punish false or misleading physical sales reports furnished to independent purveyors of market inventory and price information?

A PMAA's members rely heavily on pricing and inventory information made available by the government (EIA) and private outlets (e.g., OPIS). Inaccurate or inadequate reporting of this vital data has very real and detrimental effects on the competitive downstream marketplace. The Commission should investigate promulgating rules that assure both the transparency and accuracy of this data.

Q What circumstances, if any, under which a firm's decision regarding supplying a market (including whether to reduce, increase, or maintain unchanged the amount it supplies) should be considered manipulative or deceptive?

A There is little doubt that such decisions have serious impact on the markets they affect. Given our comments on the requirement for scienter and the effect test (see below), we believe that the final rule in this area will rarely impact other than fraudulent behavior. With these safeguards, PMAA would be interested in reviewing any Commission proposal prohibiting or restricting such actions, particularly, during a time a national emergency. What must be clear in any such effort, however, is the normal market rationalization process of rationing-allocating by price. So long as this necessary market tool is preserved and is not punished without fraudulent intent, PMAA can envision some helpful agency action in this area.

Q Should market participants with terminal facilities be under an affirmative obligation to release inventory during price spikes?

A This is an interesting area for speculation but one that must be approached most carefully. PMAA would be very happy to review a specific proposal in this regard. PMAA cautions the Commission to not attempt to regulate this or any other aspect of the 811 rule below the terminal rack.

Q Can denial of access to a non-regulated terminal be an act of market manipulation subject to Section 811?

A Since PMAA's members are the principal customers of finished product at terminal racks, their experience should be useful here. PMAA will endeavor to seek a detailed response to any specific proposal in this area from the marketer members of its federated state associations.

Q Should the Commission regulate or restrict announcements by common carrier pipelines concerning future capacity constraints?

A No. Such announcements are vital to allow downstream players the ability to seek additional and alternative sources of supply when such constraints are looming. Of course, should the scienter requirement be met and enforcement officials find willful and fraudulent behavior in such announcements, they should fall under the 811 rule.

Q Does the Commission possess the authority to promulgate a rule under Section 811 requiring a covered person to maintain and submit accurate cost and volume data for wholesale transactions at all levels of trade, refinery, or pipeline outage data, and import and inventory volumes?

A Yes, it is inherent in the carrying out of the 811 tasks. As pointed out above, this type of data is vital to a smooth working, efficient crude oil-petroleum distribution system. The Commission should require that upstream market participants (above the rack) report this data in such a way that the market is transparent and that the reports accurate and not misleading.

Q How should the Commission determine an “artificial price”?

A Because of the already discussed allocation by price, the Commission should only deem a price to be artificial where the scienter requirement is met.

Q To what extent or in what circumstances should the distinction between forbidden and permitted business behavior be primarily a function of the intent, purpose, or knowledge of the actor?

A Here, too, scienter must be present.

Q If a firm decreases the amount of product sold in a tight market in order to grow its business elsewhere, regardless of whether prices in the tight market will rise, should that be a violation?

A In addition to the above-stated reason for moving the product out of market, scienter must be present.

III. Questions Arising From Two Case Studies

A. The BP, Arco Crude Oil Transshipment

The details of this that have become known indicate that it would meet the market manipulation test. This is in part because scienter was found to be present.

B. Enron

This market manipulation would also fit the 811 standard.

IV. Regulatory Flexibility Act

Q Does Subtitle B of the EISA impose any disparate impact on small businesses?

A So long as the inventory and reporting requirements do not fall upon market participants below the terminal rack, and if the reporting requirements are reasonable, there should be no more than minimum impact on any small business.

V. Conclusion

In conclusion, PMAA applauds the rigorous inquiry by Commission staff in the Advance Notice. PMAA shares the Commission's concern that any regulatory compliance with Section 811 be careful titrated so as not to interfere with market mechanisms so vital to provide necessary petroleum products particularly in times of disaster-induced market chaos.

Respectfully submitted,

Petroleum Marketers Association of America