Before the
FEDERAL TRADE COMMISSION
Washington, D.C.

In the Matter of	)	
	)	Project No. PO82900
Market Manipulation Rulemaking	)	

SUPPLEMENTAL COMMENTS OF THE

NATIONAL PETROCHEMICAL AND REFINERS ASSOCIATION

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National Petrochemical & Refiners Association ("NPRA") respectfully submits these supplemental comments to respond further to the questions asked during the FTC's Market Manipulation workshop on November 6, 2008. We emphasize four points.

First, fraud is the bedrock concept on which the FTC's rule should be based. Second, as a corollary, the FTC should not adopt a rule based primarily on case law under the Commodities Exchange Act ("CEA") regarding market manipulation. Third, the FTC should apply a "specific intent" standard, rather than a standard that would require firms to assess what conduct might "recklessly defraud" a sophisticated participant in wholesale petroleum markets. Fourth, the FTC should avoid the imposition of a novel duty to share information between sophisticated counterparties in ways that could be anticompetitive or inefficient.

The FTC's rule should state clearly what conduct is prohibited, so that NPRA's members can advise and train their personnel to comply fully with the FTC's rule. NPRA members do not wish to test the fringes of how an FTC rule might be interpreted. Rather, NPRA members wish to develop and implement training that will ensure a company's full compliance with the rule without jeopardizing potentially procompetitive activity.[1] Consideration of the points listed above will assist the FTC in promulgating a rule that is clear enough to enable such compliance and will not limit procompetitive activity.

1. Fraud Is the Right Approach to Implement the FTC's Proposed Rule.

FTC staff queried whether NPRA supports fraud as the basis for the FTC's rule.[2] The answer is yes.[3] NPRA agrees that fraudulent conduct[4] has no efficiency justification. Moreover,

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[1] *See* FTC Market Manipulation Workshop Transcript, *available at* *http://www.ftc.gov/bcp/workshops/marketmanipulation/workshoptranscript.shtml* at 168 (hereinafter "Tr.").

[2] Tr. at 30, 34.

the statute that authorizes the FTC to promulgate a market manipulation rule -- the Energy Independence and Security Act of 2007 -- uses the language of Section 10(b) of the Securities Exchange Act (SEA). So, it makes sense for the FTC to look to the language of the anti-fraud provisions of SEC Rule 10b-5 for guidance.[5] Finally, an FTC rule to prohibit affirmatively fraudulent conduct specifically intended to have an effect on a market[6] would provide NPRA members with clear guidance on how to train their staffs to comply with the FTC's rule.

For these reasons, NPRA's comments never suggested the elimination of fraud as the basic concept for an FTC rule. Rather, we proposed specific changes to the language in the SEC Rule 10b-5 model that would improve the ability of the FTC to target affirmative conduct with no associated efficiencies that was intended to affect the market through fraud.[7]

2. <u>A CEA-Based Market Manipulation Standard Would Not Be Appropriate.</u>[8]

At the FTC's workshop, some claimed that the FTC would not cover market manipulation sufficiently if it did not adopt the methodology for challenging market

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3 *See* Comments of the National Petrochemical and Refiners Association, *available at http://www.ftc.gov/os/comments/marketmanipulation2/538416-00034.htm,* at 2 (hereinafter, NPRA Comment).

4 NPRA has noted, however, that the FTC's rule should prohibit affirmative fraudulent conduct, not a failure to act in accordance with a duty that could be inappropriately implied if the FTC imported SEC duties into the FTC rule. NPRA Comment at 7-15.

5 The FTC has stated it sought guidance from the anti-fraud provisions of SEC Rule 10b-5. *See* NOPR, Aug. 19, 2008, 73 Fed. Reg. 48317, 48322.

6 To fulfill EISA's prohibition on "market manipulation," the FTC's rule should prohibit affirmative fraudulent conduct intended to affect the market, not simply ordinary commercial fraud between two market participants. NPRA Comment at 22-24.

7 NPRA Comment at 31.

8 NPRA renews its request for an opportunity to comment further should the FTC decide to amend its proposed rule to move toward a CEA-based model. *See* Tr. at 254. There are many reasons beyond those referenced in this short section why an FTC rule based primarily on CEA case law would not be appropriate for wholesale petroleum markets.

manipulation used by the Commodities Futures Trading Commission (CFTC) pursuant to its authority under the CEA.[9] That is not correct.

Supreme Court precedent makes clear that SEA § 10(b) prohibits "manipulation," if other elements of a violation are met. In deciding that scienter is required for a violation of § 10(b), the Supreme Court noted that "[u]se of the word 'manipulative' [in the statute] is especially significant."[10] The Court explained "[i]t is a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[11]

Moreover, in contrast to the CFTC's market manipulation authority, which has not resulted in clear guidance on the conduct that would qualify as market manipulation,[12] the SEC's authority under Section 10(b) has been construed by some courts to define the basic conduct that underlies market manipulation: *injecting inaccurate information into the market.*[13] As one court explained, "[r]egardless of whether market manipulation is achieved through deceptive trading

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9 *E.g.*, Tr. at 56-57 (Cooper), 100-02 (Pirrong).

10 *Ernst & Ernst v. Hochfelder,* 425 U.S. 1375, 1384 (1976).

11 *Id.*(footnote omitted).

12 Even Professor Pirrong, a proponent of a CFTC-type standard, has acknowledged "[e]vidence abounds that commodity market manipulation law in the United States is extraordinarily confused." Pirrong, Craig, *Commodity Market Manipulation Laws: A (Very) Critical Analysis and a Proposed Alternative*, 51 Wash. & Lee L. Rev. 945 (1994). The elements of "market manipulation," developed through case law, are generally articulated as: "(1) the defendant possessed the ability to influence prices; (2) an artificial price existed; (3) the defendant caused the artificial price; and (4) the defendant specifically intended to cause the artificial price." *In re Soybean Futures Litigation,* 892 F. Supp. 1025, 1045 (N.D. Ill. 1995). These elements provide no guidance on what conduct is prohibited and therefore would be wholly unsuitable as the basis for an FTC rule on market manipulation.

13 *See GFL Advantage Fund v. Colkitt*, 272 F. 3d 189, 205 (3d Cir. 2001)("Requiring a Section 10(b) plaintiff to establish that the alleged manipulator injected 'inaccurate information' into the market or created a false impression of market activity cures this problem [of not providing guidance on which conduct is legitimate and which is not].") .

activities or deceptive statements . . . , it is clear that the essential element of the claim is that *inaccurate* information is being injected into the marketplace."[14]

Accordingly, NPRA proposed that the FTC rule adopt language that would prohibit any person, with specific intent and other elements, from "inject[ing] into the market materially false or deceptive information about important aspects of supply and demand . . . ."[15]

3. <u>The FTC Rule Should Require a Showing of Specific Intent.</u>

One issue discussed at the FTC workshop was whether a showing of specific intent to deceive, manipulate, or defraud should be required to prove a rule violation, or whether the requisite scienter could be shown through "reckless" conduct. NPRA believes the FTC should require a showing of "specific intent" to establish a rule violation. To the extent that the FTC's focus on a "recklessness" standard is fueled by concern about the difficulty of proving "specific intent," that concern should be reduced by case law that holds, "specific intent to defraud may be established by circumstantial evidence,"[16] even in criminal cases. In light of the potential to use circumstantial evidence in proving specific intent, a "recklessness" standard is unnecessary to capture potential market manipulation and would impose additional compliance costs that would not serve the interest of consumers.

Moreover, it is important to note that fraud is prohibited in wholesale markets under various state statutes, but it is not typically analyzed in terms of whether a defendant "recklessly"

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14 *In re Olympia Brewing Co. Securities Litig.*, 613 F. Supp. 1286. 1292 (N.D. Ill. 1985) (emphasis in original).

15 NPRA Comment at 17. Under this standard, a firm that was spreading false rumors about its inventory situation could be liable for "inject[ing] into the market materially false or deceptive information about important aspects of supply and demand," and thus could violate an FTC rule, if other elements of a rule violation were present. *Cf.* Tr. at 214-15.

16 *E.g., United States v. Winkle,* 477 F. 3d 407, 413 (6th Cir. 2007).

defrauded another party. Such a standard might lead to questions about whether a defendant was "careful enough" not to defraud a counterparty. But free market competition has never required a special solicitousness between sophisticated buyers and sellers in a wholesale market, and the FTC's proposed rule surely is not intended to have that result.

4. The FTC's Rule Should Not Create a New Duty to Share Information among Sophisticated Market Participants.

FTC staff queried whether particular changes to the FTC's rule could ameliorate NPRA's concerns with the portion of the proposed rule that could create liability for "omit[ting] to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." The FTC's proposed rule imports an affirmative duty to share information in this particular situation directly from SEC Rule 10b-5. As explained in its earlier Comment, NPRA believes that attempts to comply with this duty in wholesale petroleum markets could either encourage anticompetitive information exchanges or restrict efficient information exchanges, either of which could ultimately raise prices to consumers.[17]

FTC staff queried whether NPRA's concerns would be ameliorated if the duty to share information arose only if necessary to make a statement "not deceptive."[18] We appreciate Staff's effort to address the concerns raised, but do not feel that the change would be helpful. A nuanced distinction between statements that are "misleading" and statements that are "deceptive" is not a useful basis on which to design a compliance system. In either case, compliance programs would have to err on the side of non-disclosure in order to avoid the risk that good-

[17] NPRA Comment at 9-15 (discussing potential for anticompetitive information sharing or companies deciding to withhold market information that otherwise would promote efficient market functioning).

[18] Tr. at 175.

faith efforts to provide accurate information may be vulnerable to after-the-fact allegations if they turn out to have been incomplete at the time made for reasons unrelated to manipulative motives.[19]

FTC staff also queried whether NPRA's concerns would be ameliorated if the duty to share information did not require any disclosure of a firm's proprietary or commercially sensitive information. That change could significantly reduce the likelihood that firms' compliance programs would inadvertently lessen the efficient functioning of wholesale petroleum markets in the ways described in NPRA's Comment.[20] Nonetheless, that change would not eliminate the basic problems caused by transferring a duty to share information that originated to protect relatively unsophisticated investors in securities markets into wholesale markets, in which participants negotiate at arms-length and do not expect to protect each other .

Conclusion

The points raised above are, of course, intertwined with other necessary aspects of the FTC's proposed rule. These include a definition of the prohibited conduct and the intended market effect necessary for a violation. NPRA continues to believe its formulation of a proposed rule would best capture the elements that should be required for a rule violation:

"It shall be unlawful for any person, with specific intent, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale

(a) to inject into the market materially false or deceptive information about important aspects of supply or demand

(b) to profit by virtue of an effect on the market reasonably expected to result from such false or deceptive information."[21]

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19 *See* NPRA Comment at 10-15.

20 *See id.*

21 NPRA Comment at 17-24.