



October 17, 2008

Federal Trade Commission  
Office of the Secretary  
Room H-135  
600 Pennsylvania Avenue, NW  
Washington, DC 20580

Re: Prohibitions on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007, Market Manipulation Rulemaking, P082900

Platts, the energy information division of The McGraw-Hill Companies, Inc., submits these comments for the Federal Trade Commission's (the "Commission") consideration in its Notice of Proposed Rulemaking (NPRM) on implementation of Section 811 of the Energy Independence and Security Act of 2007.

#### I. Statement of Platts' interest

Platts is a global leader in price discovery in the oil, natural gas, electricity, nuclear, coal, petrochemical and metals industries across more than 150 countries from 15 major offices worldwide. Founded in 1888, The McGraw-Hill Companies is a leading publisher, worldwide, in the financial services, education and business information markets through leading brands such as Standard & Poor's, McGraw-Hill Education, BusinessWeek and J.D. Power and Associates.

In particular, certain Platts publications include assessments of prices in the crude oil, gasoline and petroleum distillate markets in the United States that are the subject of this rulemaking. As noted by both the Commission and other commenters in this proceeding, the outcome of this rulemaking could have a direct effect on the price discovery process in which Platts gathers the information on which its assessments are based.

#### II. Overview of Platts' comments

Voluntary engagement in the price formation process by market participants – including producers, consumers and traders – is an important component to the operation of competitive and efficient petroleum markets. If the Commission enacts a final rule on

market manipulation, we urge that it exercise great care to avoid creating disincentives to participation in price discovery and information dissemination.

Effective price discovery in physical energy markets, particularly very complex ones such as oil, depends on the willingness of companies to recognize the collective good of engaging in price formation through the voluntary reporting of trade data, including bids, offers and actual transactions, to publishers of price assessments such as Platts. This information is not just the lifeblood that brings efficiency to market trading; it is also essential to the processes that Platts and other publishers utilize to generate price assessments that are reflective of market value.

In today's environment of volatile prices and intense scrutiny by regulators of market activity, it is clear to Platts that market participants are increasingly weighing the risks of contributing to price formation. We ask that the Commission consider the potential impacts of its rulemaking on price reporting and price formation, and respectfully suggest that the Commission recognize that one effective approach to maintaining robust, voluntary and confident participation in price discovery would be to provide a "safe harbor" assuring market participants that inadvertent errors in price and data reporting will not be pursued as possible instances of market manipulation.

### III. The Commission's proposed rule

Platts will focus its comments principally on those areas where the proposed rule on market manipulation could affect participation and the quality of price discovery in US petroleum markets. As noted in the proposed rule, "false reporting to private data reporting services ... done with the requisite scienter, in connection with the purchase or sale of a covered product at wholesale, would be covered by the proposed Rule. Similarly, trading practices in physical or futures markets would also be covered if the conduct met all the elements of a cause of action" (NPRM at 25). Since "covered products" include the physical petroleum markets for which Platts assesses prices for wholesale transactions, the markets that Platts assesses clearly would be covered by the proposed rule.

As Platts understands the proposed rule, entities would be prohibited from misrepresenting, and in some instances, omitting material information. One type of misrepresentation specifically identified in the proposed rule is "reporting of false or misleading information to government agencies, to third-party reporting services, and to the public through corporate announcements." The reporting of false or misleading information to private data reporting services "may have an impact on market prices and supply decisions" (NPRM at 39).

The proposed rule states that elements of proof would include: a showing of a completed manipulative or deceptive act, such as providing false or misleading information to price reporting services; a showing of scienter, or intent to deceive, manipulate or defraud; and a nexus between the manipulative conduct and the purchase or sale of crude oil, gasoline,

or petroleum distillates at wholesale. A showing of price effect would not be a required element.

#### IV. The proposed rule's possible effects on price discovery

Platts welcomes the Commission's goal to "ensure that the proposed Rule does not chill competitive behavior" (NPRM at 45) and its intent "to prohibit manipulative and deceptive conduct without discouraging pro-competitive or otherwise desirable market practices" (NPRM at 24). Platts agrees that "[m]arkets function best when market participants can presume that the best available information relevant to their decision-making is not distorted" (NPRM at 24). As a global leader in price discovery, Platts would assert that the transparency its indices bring to the market plays an important role in facilitating market efficiencies.

As other commenters have cautioned, Platts urges the Commission to take care to ensure that exercise of any new authority on market manipulation does not unintentionally diminish the quality or amount of market information available to independent price publishers such as Platts. For example, the American Petroleum Institute and the National Petroleum and Refiners Association, filing jointly in June 23 comments, asserted that price indices "are valuable tools that promote efficiency by disseminating pricing information widely across the petroleum markets. Firms provide data to these indices on a voluntary basis. If the risk of manipulation liability for inadvertently delayed or incomplete reporting were to make some market participants forego reporting altogether, the indices – and especially those in thinly traded markets – would be rendered less reliable, thereby decreasing market transparency and detracting from market efficiency" (API at 50).

In addition, Timothy Muris, former chairman of the Commission, commenting jointly with J. Howard Beales III in July 7 comments, warned that "[i]n the ordinary course of business, participants in wholesale oil markets engage in numerous transactions that could be subject to second-guessing arguably as 'manipulation' " and that such second-guessing "would risk serious disruptions of a well-functioning competitive market" (Muris at 8). Observing that "firms that provide information for an index will seek to minimize their costs of doing so," they also posited that "[i]f liability for potential manipulation reduces participation, it may make indices in thinly traded markets less reliable, not more" (Muris at 11).

Platts' assessment processes are capable of generating price assessments reflective of market value regardless of market liquidity, but the transparency and efficiency of price formation are greatest with broad and uninhibited participation. In addition, a robust process in which as many market participants as possible voluntarily engage in price discovery is desirable to increase and reinforce market confidence in published prices. Platts thus cautions the Commission against actions that could discourage participation in price assessment processes.

Platts has firsthand experience with the sort of decline in voluntary participation in the price formation process that can accompany increased regulatory actions. For example, in late 2002, as numerous investigations focused on allegations of false reporting, wash trades and other alleged irregularities in US natural gas price reporting, participation in Platts' natural gas surveys declined significantly. Recognizing that both price publishers and market participants bear responsibility for ensuring a high-quality price formation process, Platts took several steps to restore confidence in its process. These included changes in the sourcing of data submissions from within companies and written assurances from senior executives that data reports are complete and accurate.

Regulators acted as well. One step that the Federal Energy Regulatory Commission took in response to market participants' concerns was to provide a "safe harbor" for their participation in price reporting. FERC in July 2003 adopted a Policy Statement on Natural Gas and Electric Price Indices. The Policy Statement, which remains in place today, provided guidance to both market participants and price index developers on standards for reporting practices. Importantly, FERC recognized the gas industry's concern that action against inadvertent errors could be an obstacle to voluntary participation in price reporting, and it also acknowledged "the need for regulatory certainty" (Policy Statement at 8). As a remedy, FERC included a "safe harbor" affirming that for data providers that can show they follow the Policy Statement guidelines on reporting prices, "the Commission will presume that transaction data submitted to index developers is accurate and timely and submitted in good faith. The Commission does not intend to prosecute and/or penalize parties for inadvertent errors in reporting, nor will it refer such issues to other agencies having jurisdiction" (Policy Statement at 13).

While the Commodity Futures Trading Commission did not formally adopt FERC's Policy Statement, the chairmen of CFTC and FERC issued a joint statement on July 23, 2003, in which they said they "wish to make absolutely clear" that neither agency "has or will bring false-reporting cases against energy market participants where the false report is inadvertent or based solely on human error. ... We look forward to increased reporting of transaction data by energy market participants as this will promote price discovery and the efficient operation of these markets. We will continue to monitor progress in this important endeavor."

FERC has incorporated the safe harbor approach into its policies on market manipulation. As noted in the NPRM, FERC in January 2006 enacted a rule governing manipulation in the US natural gas and electricity markets after it was granted new statutory authority in the Energy Policy Act of 2005. Like the Commission's proposal, the FERC rule is based on the model of the Securities and Exchange Commission's Rule 10b-5. Platts believes the FERC actions have provided useful signals to market participants that have limited the unintended consequences of new rules covering price reporting and market manipulation and, given the similarity of circumstances to this proceeding, believes that similar actions by the Commission would prove useful here.

Of particular interest to entities engaged in price formation facilitated by Platts, the FERC manipulation rule, Order 670, clarified that the new regulations did not supersede its

2003 Policy Statement on price reporting. FERC reiterated that “[w]e continue to encourage market participants to contribute to price formation and to utilize the guidelines of the Policy Statement when reporting pricing information. We also note that if an inadvertent error occurs, it would not involve the scienter needed for application of the Final Rule” (Order 670 at 55).

Platts respectfully submits that it would be easy and straightforward for the FTC to incorporate a safe harbor modeled along the lines of the joint FERC/CFTC statement in July 2003 into its final rule. As FERC and the CFTC have recognized, the safe harbor would assure market participants that the Commission will not bring false-reporting cases against energy market participants “where the false report is inadvertent or based solely on human error.” Based on its experience in natural gas and electricity price reporting, Platts believes this type of safe harbor – which might differ somewhat in specifics from the FERC safe harbor as noted below – would go a long way toward providing market entities the assurance they need that continued participation in price formation processes would not expose them to regulatory risk for inadvertent errors. [Platts distinguishes its suggestion for a safe harbor provision modeled on the FERC/CFTC statement from the requests of some parties in this proceeding who requested a “safe harbor” from potentially overlapping agency jurisdiction (NPRM at 30). Platts takes no position here on issues of regulatory overlap.]

Other participants in this proceeding also have recognized the value of a safe harbor for price reporting in their comments on the Advance Notice of Proposed Rulemaking. API and NPRA cited the FERC Policy Statement in asserting that if the Commission pursues a manipulation rule, “it should require proof that a party engaged in a deceptive or fraudulent act specifically intending to create a price for a wholesale petroleum transaction that would not have existed but for the deceptive or fraudulent act” (API at 50). “A specific intent requirement is critical if suppliers are not to be deterred by the risk of liability for inadvertently inaccurate or misleading reports,” API and NPRA said.

Similarly, the International Swaps and Derivatives Association urged that the Commission “encourage voluntary reporting of market information by creating a safe harbor for market participants that provide price and volume data in compliance with prescribed guidelines” (ISDA at 17).

In summary, an important lesson from the gas industry’s experience earlier this decade is that market confidence is a crucial component in price formation processes, and confidence can be weakened if perceived regulatory risk provides a disincentive to companies’ participation in those processes. Platts believes an important additional component of a final rule is a provision making clear that inadvertent errors in price formation processes will not be construed as attempts to manipulate markets. Platts recognizes that the scienter requirement mitigates concerns about inadvertent mistakes, but asserts that a safe harbor provision would give market participants additional assurance that would aid continued robust participation in price formation processes.

## V. Platts' petroleum market assessment processes

Platts' overarching goal is to promote transparency in energy markets worldwide and to help enable the efficient operation of those markets. This proceeding recognizes the important role played by independent publishers such as Platts in the crude oil, gasoline and petroleum distillate markets. As one of the leading independent publishers for such markets, Platts endeavors to employ methodologies and data-gathering practices designed to yield representative market values that capture normal price relationships across the spectrum of crude oil and oil products.

The keystones to Platts' price assessments in all markets are transparent processes and public methodologies. All Platts price discovery is based on several common principles, including structured and consistent methodologies; thorough data verification processes; transparency toward the market; transparency to company risk control and compliance departments; independence and impartiality; and regular compliance review of Platts' market editors. In all markets, Platts actively seeks broad participation and cultivates detailed information. Platts' assessment methodologies take a market-sensitive approach that recognizes that mechanisms for price discovery differ across markets due to differences in market structure and product characteristics. For example, all Platts US crude oil and refined petroleum product assessments are based on a market-on-close methodology. In other markets, such as US natural gas, however, Platts uses a price survey in which it collects thousands of individual transactions each day.

While the proposed rule appears to contemplate a process in which volume-weighted indices are created from transactions reported to Platts, the market-on-close process used in US petroleum markets does not take that approach. Given the proposed rule's focus on price reporting as one potential area of manipulation and given Platts' status as a leader in price discovery in petroleum markets, a detailed description of Platts' processes in those markets might aid further understanding by the Commission and participants in this rulemaking.

Platts' market-on-close methodology (MOC) is a price discovery process designed to yield a price assessment reflective of market value at the close of the trading day. The MOC process recognizes as a core principle that price is a function of time. Because crude oil and oil products bear natural pricing relationships, the MOC methodology allows for market assessments that capture those relationships at a single point of time and avoids distortions in outright and spread values across the spectrum of crudes and products. The fundamental definition of a Platts spot petroleum assessment is the market value at which a standard repeatable transaction takes place or could take place at arm's length at the designated close of market.

Platts takes into account market information gathered throughout the normal trading day. Platts considers in its assessment process market information including bids, offers and transactions. Bids and offers must be submitted sufficiently ahead of the close of the market to ensure that they are widely visible to the market and can be properly considered by potential counterparties, as well as analyzed by Platts editors for logistical

and performance issues. Last-minute bids/offers that cannot be logistically executed are excluded from the assessment process. The period near the end of the trading day when new bids and offers are no longer accepted into the assessment process is what is commonly termed the “Platts window.”

In Platts’ MOC process, bids and offers are made public and in real time. Companies are named and are expected to perform on any stated position in the MOC process. Bids and offers are expected to be firm and open to the market at large. Platts employs specified, clearly stated standards designed to ensure that reported deals are repeatable and that reported bids and offers move incrementally and logically to avoid price “gapping” at the close of the market, or bidding through an offer or vice versa.

Pursuant to the MOC methodology, companies can submit trading positions to Platts in multiple ways, including telephone and instant messaging. Platts transmits those positions to the subscribers of its electronic service, Platts Global Alert, making the market information available on a real-time basis to anyone – including regulators – with a subscription. At the end of the assessment period, Platts’ market editors analyze the accumulated data in order to derive a time-specific assessment of market value. The Platts MOC methodologies are explained in much greater detail at the company website [www.platts.com](http://www.platts.com) as well as in a background paper, Platts Oil Pricing and Market-on-Close Methodology Explained, which Platts appended to its June 23 comments on the Advance Notice of Proposed Rulemaking in this proceeding.

As noted, Platts’ assessment procedures differ by market. Thus, in the highly commoditized US natural gas spot market, instead of the MOC methodology, Platts uses a methodology that collects and analyzes trade data in daily and monthly markets. For example, for the daily natural gas indices, Platts routinely collects upwards of 4,000 spot transactions per day for next-day delivery. Those prices are submitted electronically to Platts from companies’ mid- or back offices, subject to certification of the reporting process by a senior official of the company. For logistical reasons, US daily gas trading is confined to a few morning hours and ends long before the 2:30 pm ET settlement of gas futures prices on the New York Mercantile Exchange.

In the oil market, however, transactions are far fewer and may take place throughout the workday. One objective of the MOC window for petroleum markets is to align the assessment in time with the daily futures close. Moreover, unlike gas, which typically trades in uniform small packages with few or no unique characteristics other than location, physical oil markets are highly complex, requiring “normalization” techniques to reconcile disparate volumes, quality and logistical characteristics – all of which have an effect on market value.

In its price assessment procedures for all commodities, including petroleum, Platts reserves the right to exclude submitted data when they do not adhere to Platts’ editorial protocols and guidelines. In addition, Platts may exclude a company from reporting data for the MOC window assessments if the submitted data have violated Platts’ editorial protocols and guidelines on more than one occasion or if few counterparties want to trade

with that company due to credit concerns. Importantly, any company that reports a bid or offer to Platts in the MOC assessment process is expected to perform or transact if any other participant in the market expresses a desire to meet the bids or offers published to the market on Platts' real-time PGA system. This performance expectation is critical to the integrity of the process and Platts reserves the right to exclude trade data reported by companies that do not meet this expectation. Again, with the identities of all participants in the assessment process revealed in the MOC window, any interested party can monitor the price formation.

For efficient price formation, Platts strives for broad participation in its MOC window assessment processes. However, the objective of obtaining industry acceptance and full participation can be hindered by concerns within the industry that companies' prices or the basis for particular reported transactions could be "second-guessed" by regulatory authorities. While market participants may have confidence in their reasons for quoting or transacting at certain prices, regulatory risk alone may discourage active participation in the assessment process. Platts believes that such an outcome is counterproductive to efficient and competitive price formation and encourages the Commission to provide guidance to the market participants that will alleviate any disincentives to participation in price formation that may result from the Commission's rulemaking.

In sum, Platts' assessment procedures combine to yield highly efficient prices while protecting against any attempts by market participants to improperly influence the assessment process. Still, a new FTC rule on market manipulation would raise practical questions of how the new oversight role would function in practice. The question of how to ensure that the Commission's new oversight role does not interfere with or decrease the voluntary reporting to independent index publishers such as Platts might be usefully explored in a public workshop.

## VI. Specific questions

Platts will offer comments on certain questions put forth in the proposed rule.

### *Section 317.1 – Scope*

*b. The Commission did not provide for safe harbors or exemptions from the proposed Rule. Should there be safe harbors or exemptions? If so, what should they be? To what should they apply; that is, what types of acts or practices should constitute a safe harbor? Why should that be so? What types of acts or practices should be exempt? Why should that be so?*

As detailed above, Platts believes a safe harbor for price reporting should be incorporated into the final rule to alleviate market participants' concerns that they would be subject to a finding of manipulation for inadvertent errors. While an inadvertent error would not meet the scienter requirement for a manipulation finding, entities still may be inhibited from participating in price formation processes, particularly until the Commission develops a body of law on its interpretation of misrepresentations of material fact and omissions of material information. An affirmative declaration by the Commission that it



would not pursue such instances would provide needed clarity and reassurance to the market.

The FERC safe harbor applies to those companies that comply with the Policy Statement standards for price reporting, which cover areas such as data retention and a code of conduct for employees. Platts recognizes that some of the FERC principles for natural gas and electricity will not be applicable to oil markets because of differences in assessment procedures previously noted. Additionally, the FERC safe harbor is linked to the specifics of the Policy Statement, and thus a safe harbor adopted by the Commission in this proceeding would differ somewhat in details. Still, the basic principle of a safe harbor played an important role in industry's continued participation in Platts' price assessment processes. Platts also would encourage the Commission to provide as much guidance as possible to the industry on its expectations for the price reporting process. Greater specificity should help ensure continued robust participation in that process.

*Section 317.3 – Prohibited Practices*

*f. Has the proposed Rule sufficiently laid out any affirmative duties or other obligations upon entities covered under the proposed Rule? If not, why not?*

The proposed rule opts not to “propose any specific conduct obligations, such as a duty to supply, provide access, or disclose” (NPRM at 41). Platts generally agrees with a non-prescriptive approach for entities' participation in price formation processes. As in the case of the FERC Policy Statement, it may be appropriate to require companies to meet some broad behavioral guidelines (*e.g.*, a corporate code of conduct or record-keeping requirements) in order to qualify for a safe harbor protecting inadvertent errors from prosecution.

In its review of gas price reporting, FERC has taken care not to be overly prescriptive. As stated in a July 6, 2005 order (PL03-3 at 5), the Commission “continue[s] to encourage industry participants to find optimal solutions and approaches to better wholesale price formation.” Platts strongly believes that competitive markets produce the best methods of price discovery. It is committed to work continually and proactively with the petroleum industry, regulators and others to hone, strengthen and explain its processes. Market conditions change over time, and an oversight structure flexible enough to permit adaptation of the price discovery process will best serve all interests.

*h. Section 317.3(b) of the proposed Rule prohibits covered entities from misrepresenting, and in some instances from omitting, material information in wholesale petroleum markets. Is this prohibition adequate to enable the Commission to deter and punish persons who intentionally provide false or misleading information to government agencies, third-party reporting services, or the public through corporate announcements? Why or why not? Does the proposed Rule need to be modified in any way to better address any misrepresentations or omissions, and if so, what should those modifications be?*

Platts believes one area of the proposed rule that would benefit from a sharper focus is the omission of material information. The proposed rule suggests that a finding of manipulation could be made if a “particular statement is false *or incomplete*” (NPRM at 38, emphasis added). Platts submits that whether a statement is “incomplete” is a vague standard that could prove problematic.

*o. Should the Commission consider any affirmative defenses to rule violations? If so, what affirmative defenses should the Commission consider and how can those defenses be justified?*

*p. Is the proposed Rule’s basis for requiring a showing of scienter as an element of proof sound? Should a scienter requirement be part of the text of Section 317.3 of the proposed Rule? Is the Commission’s tentative determination that both intentional and reckless conduct may satisfy the scienter requirement appropriate? Why or why not?*

Platts agrees with the proposed rule’s conclusion that a scienter requirement “would help to ensure that the proposed Rule does not chill competitive behavior” (NPRM at 45). Platts also believes that the Commission should remain open to affirmative defenses against allegations of market manipulations.

As a price publisher, Platts has a keen interest in the integrity of the wholesale commodity markets it covers. To ensure that its price assessments are of the highest quality, Platts takes a number of steps, including publication of its methodologies, and, where necessary, limitation or exclusion from those processes if companies do not comply with Platts’ procedures.

However, different market participants may have access to different levels of market knowledge and may draw differing conclusions from that knowledge. As noted by former FTC Chairman Muris, “[t]he risk that decisions about particular transactions will be judged in hindsight to have been ‘manipulation’ will inevitably encourage participants to make ‘safe’ decisions that are easy to defend on the basis of past practice and established trading patterns. Particularly when disruptions occur due to uncontrollable events such as a hurricane or failure of a vital transportation facility, however, an effective market response will often require creative decisions” (Muris at 9). Platts believes that market participants should not be discouraged from executing competitive market responses in those instances and should be afforded an opportunity to offer explanations related to specific market conditions.

For instance, operational contingencies may arise after a transaction is consummated (*e.g.*, a tanker owner cancels a shipping commitment for a cargo of crude oil). While Platts’ procedures allow for consideration of such circumstances, market participants might fear running afoul of a market manipulation rule and might shy away from participating in Platts’ price assessment processes without reassurance that regulators recognize the potential for exceptional or contingent events that can affect price formation after the fact.

In its own rule on market manipulation, FERC turned aside suggestions that it incorporate specific procedures for handling manipulation complaints into the final rule. For example, it declined a suggestion to explicitly urge parties first to bring potential complaints to its Enforcement Hotline. However, it noted that “[a]ggrieved entities should be free to choose the approach best suited to their circumstances, and if an entity so chooses, the Hotline (or other informal contact with the Commission’s staff) is available for such matters” (Order 670 at 53).

## VII. Conclusion

Platts appreciates the opportunity to comment on this important undertaking and will be pleased to continue to participate as the rulemaking proceeds. Platts embraces the goal of liquid, competitive wholesale petroleum markets and urges the Commission to avoid any actions that could dissuade market entities from participating in price formation processes. Platts believes that its transparent processes and the independence of its price assessment processes have made markets less susceptible to deceptive conduct. However, market participants’ concerns that they may be “second-guessed” under new regulatory authorities could be counterproductive to efficient and competitive price formation, and Platts encourages the Commission to provide sufficient guidance to assuage any such concerns.

Respectfully submitted,

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