



*Market Manipulation in the  
Energy Industry: Do We Need  
Another Government  
Investigation?*

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**September 8, 2011**

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• March 30, 2011



• Jay Rockefeller

Senator Jay Rockefeller (D-WV) Page 1 of 4

*United States Senator*  
**Jay Rockefeller**  
*for West Virginia*

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[Constituent Services](#) **ROCKEFELLER URGES REGULATORS TO INVESTIGATE GAS PRICE SPIKES**

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WASHINGTON, D.C.— Senator Jay Rockefeller sent a letter urging the Federal Trade Commission (FTC) to use its full authority to make sure that American consumers are paying a fair price for gas. Gas prices have spiked recently, hurting families from coast to coast and threatening economic recovery. Since the FTC received new authority in 2007, it now has the necessary tools to protect consumers from artificial gas price hikes caused by fraud or market manipulation.

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Today in the Senate  
Senator Rockefeller's Voting Record

"Even a small gas price increase translates to significant costs for consumers in West Virginia and across America, including higher costs for food and other essentials," Rockefeller said. "When gas prices rise, many people struggle to

We are writing to inquire whether the Federal Trade Commission (FTC) is fully utilizing the regulatory authority granted to it by Congress to ensure American consumers are paying a fair price for gasoline. We urge you to use this authority aggressively to ensure that recent crude oil market price spikes and volatility are not the result of manipulative practices or anticompetitive behavior.

It is critical that the Commission enforce its market manipulation rule with the same proactive aggressiveness that FERC employs, to deter manipulative behavior, prosecute bad actors, and draw a bright line to distinguish legal from prohibited behavior. We request that you provide us a detailed description of the following:



## *History of Market Manipulation*

- ❖ ***Securities and Exchange Commission (SEC)***  
Securities Exchange Act of 1934, § 10 Rule 10b-5 issued 1942.
- ❖ ***Commodity Futures Trading Commission (CFTC)***  
Commodity Exchange Act 1936, 7 U.S.C. § 13(a)(2).
- ❖ ***Federal Energy Regulatory Commission (FERC)***  
Energy Policy Act of 2005, 15 U.S.C. § 717c.1.

## *What is Market Manipulation to the SEC ?*

“It shall be unlawful for any person . . .

(a) to employ any device, scheme, or artifice to defraud;

(b) to make any untrue statement of material fact or to omit 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;

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.”

SEC Rule 10b-5

## *What is Market Manipulation to the CFTC?*

“Manipulation is an intentional exaction of a price determined by forces other than supply and demand.”

*Frey v. CFTC*, 931 F. 2d 1171 (7<sup>th</sup> Cir. 1991); *U.S. v. Reliant*, 420 F. Supp. 2d 1043 (N.D. Cal. 2006).

## *What is Market Manipulation to FERC?*

“(1) To use or employ any device, scheme, or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.”

FERC, Prohibition of Energy market Manipulation: Final Rule, 71 FR 4244, 4253 (Jan. 26, 2006).

*In 2007 Congress gave FTC Authority to Police Petroleum Market Manipulation*

“It is unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of **crude oil gasoline or petroleum distillates at wholesale**, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Federal Trade Commission may prescribe as necessary or appropriate in the public interest or for the protection of U.S. citizens.”

Sec. 811 of Energy Independence and Security Act of 2007, 42 U.S.C. 17301.

## *FTC also Given Authority to Prohibit False Reporting*

- ❖ “It is unlawful for any person to report information related to the wholesale price of crude oil gasoline or petroleum distillates to a federal department or agency if:
  - the person knew, or reasonably should have known, the information to be false or misleading;
  - the information was required by law to be reported;
  - the person intended the false or misleading data to affect data compiled by the department or agency for statistical or analytical purposes with respect to the market for crude oil, gasoline, or petroleum distillates.”

Sec. 812 of Energy Independence and Security Act of 2007, 42 U.S.C. 17301

## *FTC Creates a Fraud-Based Rule*

- ❖ FTC rule not based on antitrust concepts of conspiracy or market power
- ❖ FTC's rule is modeled on the SEC Rule 10b-5, which FERC anti-manipulation rules followed.

74 Fed. Reg. 18,308-09 & 19,319-320  
(April 22, 2009)

*FTC's Final Rule Effective November 4, 2009*  
*16 C.F.R. § 317*

“It is unlawful, to directly or indirectly, in connection with the purchase or sale of covered products at **wholesale**, to:

**Knowingly engage in any act, practice, or course of business** – including the making of any untrue statement of material fact – that operates or would operate as a **fraud or deceit** upon any person; or

**Intentionally fail to state a material fact** that under the circumstances renders a statement made by such person misleading, **provided that such omission distorts or is likely to distort market conditions for any such product.**”

## *What is the Stated Purpose of the FTC Rule?*

- Prevent the same types of fraudulent or deceptive practices that the SEC, the CFTC, and the FERC have pursued
- Prohibit practices that inject false information into transactions
- Protect the integrity of the price discovery process in wholesale petroleum markets

74 Fed. Reg. 40689 (Aug. 12, 2009)

## What Products are Covered ?

<b>Crude Oil</b>	<b>Gasoline</b>	<b>Petroleum Distillates</b>
<p>❖ Hydrocarbons that can be processed into refinery feedstock; hydrocarbons in liquid phase in underground reservoirs that remain liquid at atmospheric pressure after separation; shale oil or tar sands requiring processing into refinery feedstock; liquid crude oil</p>	<p>❖ Finished gasoline (including conventional, reformulated and oxygenated blends); conventional and reformulated gasoline blendstock for oxygenate blending</p>	<p>❖ Jet fuel, diesel fuel; fuel oils (including No. 1, No. 2, and No. 4 diesel fuels and fuel oil), finished fuel products, middle distillate refinery fuel streams including product stream above heavy fuel oils (up to and including lighter products such as on-road diesel, heavy oil and kerosene-based jet fuels)</p>

## *What Transactions are Covered ?*

- ❖ Purchase or sale “**at wholesale**”
  
- ❖ Wholesale includes:
  - All purchases or sales of crude oil or jet fuel;
  
  - All purchases or sales of gasoline or petroleum distillates (other than jet fuel) at the terminal rack or upstream level.

16 C.F.R. § 317.2(f)

## *Does FTC Rule cover “Futures” Market Activities?*

“The Commission declines to adopt a blanket safe harbor for futures market activities,” but the Commission will coordinate with other agencies where it has overlapping or complimentary jurisdiction.

74 Fed. Reg. 40691 (Aug. 12, 2009)

## *What are the Penalties ?*

- ❖ Violations are punishable with civil penalties of up to \$1 million per violation in addition to any penalty under FTC Act.
- ❖ Each day misconduct continues is treated as a separate violation.

42 U.S.C. 17303-04

## *Two Types of Violations; Two Different Intent Standards*

- 1. Affirmative Conduct:** “[K]nowingly engage in any act, practice, or course of business ... that operates or would operate as a fraud or deceit”.  
§317.3(a)
- 2. Omissions:** “**Intentionally**” to “fail to state a material fact” where “such omission distorts or is likely to distort market conditions.” §317.3(b)

## *What is the Definition of “Knowingly” for Conduct Under § 317.3(a)?*

- ❖ “The person knew or must have known that his or her conduct was fraudulent or deceptive.”
- ❖ “Extreme recklessness” is sufficient to show scienter based on SEC Rule 10b-5 precedent.

74 Fed. Reg. 40691 (Aug. 12, 2009)

## *What is the Definition of “Intentionally” for Omissions Under § 3.17(b) ?*

- ❖ “Person must intentionally omit information from a statement with the further intent to make the statement misleading”

74 Fed. Reg. 40698 (August 12, 2009)

*Why Does “Omission” Violation §317(b)  
have a Higher Intent Standard?*

“The Commission has adopted differing scienter standards in order to address commentators’ concerns that the initially-proposed Rule – which used only a single common “knowingly” scienter standard – **would have killed some legitimate conduct**, especially with respect to the prohibition on misleading omissions of material facts from affirmative statements.”

74 Fed. Reg. 40690 (Aug. 12, 2009)

## *Price Effect Not Required to Show Market Distortion*

- ❖ Many commentators supported requiring a price effect to show manipulation.
- ❖ Violations can be shown “whether or not those actions can be shown to result in discernable price effects.”

73 Fed. Reg. 48,329 (August 19, 2008)

see also 74 Fed. Reg. 18,322 n.207 (April 17, 2009)

## *Materiality Requirement*

- ❖ “Guided by securities law precedent, the Commission intends to determine on a case-by-case basis whether a statement (or omission) is material.”

74 Fed. Reg. 40697 (Aug. 12, 2009)

- ❖ A fact is material if a reasonable market participant would consider the fact important in making an investment decision to buy or sell a covered product (p. 9)

FTC Guide to Complying with Petroleum Market Manipulation Regulations

## *How Broadly Will FTC Interpret “In Connection with” a Transaction?*

- ❖ FTC will determine on a case-by-case basis whether supply or operational decisions are “in connection with” wholesale petroleum transactions.
- ❖ FTC “does not intend to apply the final rule to commodities whose predominant use is in non-petroleum products, or to commodities that are inputs for ethanol, such as corn and sugar.” 74 Fed. Reg. 40695 (Aug. 12, 2009)

## *Is there a Private Right of Action?*

- ❖ No mention of private cause of action in statute.
- ❖ 28 States have enacted “Little FTC Acts;” generally, “Little FTC Acts” allow for private right of action based on violations of FTC rules.
- ❖ EPA of 2005 expressly stated new FERC authority for market manipulation created no private right of action; no similar language in EISA of 2007
- ❖ Implied private right of action exists under Rule 10b-5, Securities Exchange Act of 1934 (*Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971))

## *Other Laws Still Apply*

- ❖ “Nothing shall be construed to modify, impair or supersede the operation of any of the antitrust laws.”

42 U.S.C. 17305

- ❖ “The FTC does not intend, through the promulgation of this rule, to preempt the laws of any state or local government, except to the extent that any law conflicts with this rule. A law is not in conflict with this rule if it affords equal or greater protection.”

16 C.F.R. § 317.4

## *What are Examples of Permitted Conduct ?*

- ❖ “Mistakes, unintended conduct, or legitimate conduct undertaken in the ordinary course of business” (p. 3)
- ❖ “Good faith estimates” (p. 3)
- ❖ “Legitimate supply and operational decisions” (p. 3)
- ❖ “Negotiations between two parties when there is no broader dissemination of false or misleading information” (p. 3)
- ❖ “Uncompleted acts such as preparing misleading reports but not transmitting them” (p. 3)

FTC Guide to Complying with Petroleum Market Manipulation Regulations

## *What are Examples of Prohibited Conduct ?*

- ❖ False public announcements of planned pricing or output decisions
- ❖ “Wash” sales intended to disguise the actual liquidity of a market or the price of a particular product  
FTC Press Release (Aug. 6, 2009)
- ❖ Intentionally misreporting or omitting material information to private data reporting company
- ❖ Intentionally omitting material information to mislead government officials during a national emergency

74 Fed. Reg. 40699 (Aug. 12, 2009)

## *. . . More Prohibited Conduct*

- ❖ Fraudulent or deceptive transactions designed to disguise the actual liquidity or price of an asset or market (p. 2)
- ❖ Intentionally omitting material information from a report, such as the operational status of a refinery, terminal, or pipeline that makes the report false or misleading (p. 2)

FTC Guide to Complying with Petroleum Market Manipulation Regulations

## *Will the Rule Impact Routine Transactions?*

“The Commission does not generally intend [to] ... reach **routine bilateral commercial negotiations**, which are unlikely to inject false information into the market process.”

74 Fed. Reg. 40698 (Aug. 12, 2009)

“Fraudulent or deceptive conduct in private contract disputes—such as claims that a contract was entered into under false pretenses or that a party had a pre-existing legal duty to provide information to a counter-party—is more appropriately treated under state law.” (p. 3)

FTC Guide to Complying with Petroleum Market Manipulation Regulations

*When did the FTC say that market information could be withheld?*

- ❖ Intelligence gathered about “market conditions,” even if counter-party would have acted differently if revealed. 74 Fed. Reg. 40698 (Aug. 12, 2009)
- ❖ Estimates of “future inventory levels” to a counter-party during business negotiations. Id. at 40698, n. 147.
- ❖ No requirement to provide “commercially sensitive information,” absent a pre-existing legal obligation. Id. at 40698.

## *How Will FTC Enforce New Rule?*

- ❖ “We are going to use this authority as **aggressively** as possible to stop market manipulation that drives up prices at the pump.” FTC Chairman Leibowitz, Statement on Approving Final Rule; 74 Fed. Reg. 40702 (Aug. 12, 2009).
- ❖ FTC issues Civil Investigative Demands on market manipulation, August 2011. Bloomberg Report.

## *Compliance Issues*

- ❖ A fraud-based rule creates two primary ways to avoid violations:
  - Good faith decisions based on legitimate business concerns; consider how to document good-faith operational decisions that may have an impact on the market
  - Accurate reporting to the government and third-party-index services. Have a policy on reporting to independent data-reporting firms.

## *Today's Presenter*



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