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VIA ELECTRONIC MAIL:

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Attention: Donald S. Clark, Secretary
Federal Trade Commission
Office of the Secretary
Room H-135 (Annex G)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Market Manipulation Rulemaking, P082900

Dear Mr. Clark:

This comment letter is being submitted jointly by Managed Funds Association (“MFA”), Futures Industry Association (“FIA”), New York Mercantile Exchange (“NYMEX”) and CME Group Inc. (“CME”) in response to the Advance Notice of Proposed Rulemaking issued by the Federal Trade Commission (“FTC” or “Commission”) on the implementation of Section 811 of the Energy Independence and Security Act of 2007 (“EISA”). Section 811 makes it 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 United States citizens.”

MFA, FIA, NYMEX and CME have a major interest generally in the deterrence and prevention of price manipulation in commodity markets. Price manipulation has a corrosive effect on the proper functioning of any market. We therefore commend the FTC for moving quickly to begin

to develop rules prohibiting price manipulation in wholesale market transactions in crude oil, gasoline and petroleum distillates.¹

I. Introduction

Crude oil, gasoline and some petroleum distillates² (e.g. heating oil) are the subject of futures trading on the NYMEX floor and through an electronic trading platform operated for NYMEX by CME and therefore are “commodities” under the Commodity Exchange Act (“CEA”) (7 U.S.C. § 1a(4)), the federal statute administered by the Commodity Futures Trading Commission (“CFTC”), which regulates U.S. futures markets and trading. NYMEX and CME

¹ MFA is the voice of the alternative investment industry. MFA members include professionals in hedge funds, funds of funds and managed futures funds. MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$2 trillion invested in absolute return strategies.

FIA is a national trade association. Its regular membership consists of 35 of the Nation’s largest futures brokerage firms, registered with the CFTC as futures commission merchants and its associate membership consists of approximately 150 firms involved in virtually all other segments of the industry. FIA regular members execute customer orders for, and provide the financial guarantees underwriting, approximately 90% of all transactions on U.S. futures markets.

NYMEX is a for-profit corporation organized under the laws of the State of Delaware. It is the chief operating subsidiary of NYMEX Holdings, Inc. As a designated contract market and a registered derivatives clearing organization regulated by the CFTC, NYMEX is the largest exchange in the world for the trading and clearing of futures and options contracts on energy and metals commodities, including crude oil, heating oil and gasoline futures contracts.

CME was formed by the merger of Chicago Mercantile Exchange Holdings Inc. and CBOT Holdings, Inc. in 2007. CME is the parent of Chicago Mercantile Exchange Inc. and Board of Trade of the City of Chicago, Inc., both CFTC regulated, designated contract markets as required under 7 U.S.C. § 7. CME also provides services to other exchanges; of interest here, it provides order routing and execution services to NYMEX. CME serves the global risk management needs of its direct customers and those who rely on the price discovery performed by means of its competitive markets. Under the CFTC’s jurisdiction, CME offers a comprehensive selection of benchmark products in most major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, agricultural commodities, energy, and alternative investment products such as weather and real estate.

² The scope of the term “petroleum distillate” is uncertain. The FTC should consider including a definition of the term in its proposed rules for public comment.

are CFTC-approved self-regulatory organizations, called designated contract markets, which are charged by statute with a responsibility to prevent price manipulation on their exchanges. 7 U.S.C. § 7 (b)(2). Members of MFA and FIA are subject to regulation under the CEA, as market participants, registered intermediaries, or both, and therefore must comply with the many CEA provisions prohibiting different forms of manipulation of futures market prices as well as the price of any related commodity in interstate commerce. See 7 U.S.C. §§ 9, 13(a)(2) and 13(b). Collectively, NYMEX, CME, and members of MFA and FIA touch in one way or another virtually every futures contract traded in the United States. We therefore have a great stake in the proper administration of the CEA and its provisions, especially as they relate to price manipulation.

Congress found that U.S. futures markets serve three vital “national public interest[s]” by providing a means for 1) managing and assuming commodity price risks; 2) discovering commodity prices; and 3) disseminating those prices. 7 U.S.C. § 5(a). The congressionally-approved formula for achieving these public interests is “trading in liquid, fair and financially secure trading facilities.” *Id.* The CEA further specifies that “to foster these public interests, it is ... the purpose of this [Act] to deter and prevent price manipulation....” 7 U.S.C. § 5(b).

The linchpin of the CEA’s statutory structure is its grant of “exclusive jurisdiction” to the CFTC, adopted in 1974 and reaffirmed by Congress as recently as last month: “The Commission shall have exclusive jurisdiction ... with respect to accounts, agreements, ... and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market designated ... pursuant to section 5 ... of this Act.” CEA § 2(a)(1)(A); 7 U.S.C.

§ 2(a)(1)(A). Congress enacted this provision to ensure that CFTC regulations and the CEA would be the sole legal standards applied to U.S. futures trading.

Congress designed CFTC exclusive jurisdiction to serve the public interest by avoiding the application of duplicative, or potentially conflicting, legal and regulatory standards to futures market participants, professionals and exchanges. In this way, CFTC exclusive jurisdiction promotes the very public interests Congress has found futures markets serve: price discovery and risk shifting. 7 U.S.C. § 5(a). Congress understood that price signals generated by futures markets would be used by participants in non-futures transactions and that other regulators of those transactions -- whether the Securities and Exchange Commission, Agriculture or Treasury Departments or the Bureau of Mines -- might otherwise have had a regulatory interest in the transactions that generated those prices. Congress enacted the CEA's exclusive jurisdiction provision to provide legal certainty to futures market participants and futures exchanges that the CFTC, and only the CFTC, had regulatory authority over futures trading in the U.S. In the words of Acting CFTC Chairman Walter Lukken, "Exclusive jurisdiction of futures trading ensures that the futures markets, where many commodities also have a separate cash market regulator, will not face inconsistent and redundant regulation and the uncertainty of differing legal standards."³

We believe the Commission should adopt appropriate rules prohibiting manipulation in the purchase and sale of crude oil, gasoline and petroleum distillates at wholesale under Section

³ Statement of Acting CFTC Chairman Walter Lukken Before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, December 12, 2007.

811 of EISA. But those rules should not implicitly or explicitly extend the Commission's jurisdiction in a manner that overlaps with the CFTC's exclusive jurisdiction over futures trading generally and futures market manipulation specifically. We therefore respectfully request that the Commission propose and adopt a safe harbor provision or other appropriate exception from its rules confirming that nothing in its Section 811 rules would govern or apply, in the words of the CEA, "with respect to accounts, agreements...and transactions involving" futures and options markets and other trading instruments which are subject to CFTC exclusive jurisdiction. 7 U.S.C. § 2(a)(1)(A). The operations of CFTC-regulated designated contract markets (like NYMEX and CME) and registered futures professionals (like the members of MFA and FIA) as well as the actual trading in futures markets should be subject to a single legal standard established under the CEA by the CFTC and the courts. This issue is of paramount importance to the competitive status of U.S. futures markets.

In addition, given our experience with market manipulation prevention and standards, we offer the following suggestions:

- 1) the FTC and the CFTC should work cooperatively without duplication of effort to police price manipulation in those wholesale, non-futures energy transactions over which each agency has anti-manipulation jurisdiction, as the Commission itself has recognized (73 Fed. Reg. at 25618 n.39);

- 2) the absence of a securities law disclosure foundation for wholesale energy transactions argues against adopting an SEC-style anti-manipulation formulation like SEC Rule

10b-5; the CFTC's anti-manipulation jurisprudence for commodities in interstate commerce is more relevant to the FTC's mission; and

3) the FTC's rules implementing Section 811 should include a specific intent to create an artificial price standard to ensure that legitimate commercial conduct is not mislabeled and punished as manipulation.

We will discuss these recommendations in more detail below.

II. The FTC's Proposed Rules Should Not Apply to Futures Market Activity Covered by CFTC Exclusive Jurisdiction.

Section 811 of EISA should not be interpreted to erode CFTC exclusive jurisdiction over futures market activity. The historical context, statutory text, case law and purposes of the exclusive jurisdiction provision compel this conclusion. It is also fully consistent with the provisions of EISA.

A. The Legislative Context Of The 1974 Enactment Of CFTC Exclusive Jurisdiction.

In 1974, Congress overhauled the structure of U.S. futures market regulation under the Commodity Exchange Act. Congress recognized that "the futures markets play a significant role in the economic well being of [the] country"⁴ and "wanted to strengthen futures regulation, create a comprehensive regulatory structure for the esoteric futures trading complex, and avoid

⁴ H.R. Rep. No. 93-975, at 60 (1974).

regulatory gaps.”⁵ To that end, Congress considered whether to replace as the futures market regulator a branch of the Department of Agriculture called the Commodity Exchange Authority with a new independent agency, similar to the FTC or SEC, “to be an expert in futures regulation, which requires highly specialized skills.”⁶

Congress intended that preventing price manipulation would be central to the regulatory mission for the new agency which would be a neutral arbiter of futures prices, not inclined to seek higher or lower prices.⁷ “The proper regulatory function of an agency which regulates futures trading is to assure the market is free of manipulation and other practices which prevent the market from being a true reflection of supply and demand.” (S. Rep. No. 93-1131, at 21 (1974). Congress understood that U.S. futures markets were poised for great growth as innovative new forms of commodity futures trading had either begun or were imminent. This development would give other agencies with regulatory authority over the new underlying commodities reason to assert jurisdiction over the futures markets. S. Rep. No. 93-1131, at 23

⁵ H.R. Rep. No. 93-975, at 1 (1974); S. Rep. No. 93-1131, at 19; 120 Cong. Rec. 34736 (1974) (statement of H. Comm. Chairman Poage) (“It was the intent of the [Conference] Committee to fill all regulatory gaps -- to regulate trading in futures and in options relating to commodities or commodity futures, because such trading is now poorly regulated, if it is regulated at all.”).

⁶ H.R. Rep. No. 93-975, at 71 (1974), see also S. Rep. No. 1131, at 22 (1974 (“persons of demonstrated knowledge in futures trading”).

⁷ H.R. Rep. No. 93-975, at 60 (1974).

(1974). Congress also knew that futures and options trading had already been subjected to the vagaries of state blue sky laws and SEC enforcement actions prior to 1974.⁸

Against this backdrop, Congress adopted the Commodity Futures Trading Commission Act of 1974, which included three major structural reforms. First, Congress created the CFTC as the independent expert futures market regulator. Second, Congress greatly expanded the list of “commodities” that had been subject to the CEA by including all “goods[,],articles,... services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.” 7 U.S.C. § 1a(4). Third, Congress granted the CFTC “exclusive jurisdiction” and mandated that “the [CFTC’s] jurisdiction over futures contract markets...is exclusive...and the [CFTC’s] jurisdiction, where applicable, supersedes state as well as Federal agencies.”⁹ The 1974 Conference Committee further explained that “under the exclusive grant of jurisdiction to the [CFTC], the authority of the Commodity Exchange Act (and regulations issued by the [CFTC]) would preempt the field insofar as futures regulation is concerned.”¹⁰

B. The Text Of The CEA Exclusive Jurisdiction Provision Demonstrates Its Breadth.

The CFTC’s exclusive jurisdiction provision is unambiguous and broad. Section 2(a)(1)(A) of the CEA states:

⁸ (H.R. Rep. No. 93-975, at 48, 120 Cong. Rec. 34737 (1974) (statement of H. Chairman Poage), 120 Cong. Rec. 34997 (1974) (Statement of Sen. Comm. Chairman Talmadge).

⁹ H.R. Rep. No. 93-1383, at 35 (1974) (Conf. Rep.) and S. Rep. No. 93-1131, at 23 (1974) (same).

¹⁰ H.R. Rep. No. 93-1383, at 35 (1974) (Conf. Rep.).

“The [CFTC] shall have exclusive jurisdiction, except to the extent provided in subparagraphs (C) and (D) of this paragraph and subsections (c) through (i) of this section, with respect to accounts, agreements...and transactions involving contracts of sale of a commodity for future delivery traded or executed on a contract market designated or derivatives transaction execution facility registered pursuant to section 7 or 7a of this title or any other board of trade, exchange, or market,... [and]...Except as hereinabove provided, nothing contained in this section shall (I) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any state, or (II) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws.”

This statutory language establishes three things: 1) CFTC jurisdiction “with respect to” “accounts, agreements and transactions” “involving” futures that are traded on “any market” is “exclusive;” 2) any exceptions to CFTC exclusive jurisdiction are set out in the provision itself; and 3) except for those matters committed to CFTC exclusive jurisdiction, the FTC and other federal agencies retain their full powers.

As relevant here, Congress has vested exclusive jurisdiction in the CFTC with respect to accounts, agreements and transactions involving crude oil futures, gasoline futures and petroleum distillate futures. No other federal agency may regulate or police activity or conduct covered by that grant of jurisdiction, including the operations of exchanges, like NYMEX and CME, and of CFTC-registered futures professionals, like the members of MFA and FIA. The breadth of this congressional grant of exclusive authority is demonstrated by the statutory text itself which makes the CFTC’s exclusive jurisdiction applicable to, for example, not just transactions “in” futures, but also transactions “involving” futures, and not just futures trading accounts themselves, but also conduct “with respect to” those accounts. Even the word “transactions” in this statutory provision has considerable elasticity, courts having found that it is

“most naturally read as encompassing...a set of arrangements directly related to the actual sale of commodities futures.” *FTC v. Ken Roberts Co.*, 276 F.3d 583, 590 (D.C. Cir. 2001).

The first “except” clause in Section 2(a)(1)(A) can not be read to give any federal agency, including the FTC, jurisdiction over futures trading that is subject to CFTC regulatory authority. The clause cites three sources of exceptions from CFTC exclusive jurisdiction. The first is subparagraph (C) which originally was enacted as part of the 1982 Shad-Johnson Jurisdictional Accord. The 1982 Accord reassigned to the SEC jurisdiction over some products which became securities outside CFTC jurisdiction. Public Law 97-303, 96 STAT 1409, Secs. 1, 2 (1982); Public Law 97-444, 96 STAT 2294, Sec. 101 (1983). *See* 7 U.S.C. § 2(a)(1)(C). The second is subparagraph (D), enacted as part of the Commodity Futures Modernization Act, Public Law 106-544 (Appendix E) (2000), which created “security futures products” to be jointly regulated by CFTC and SEC, 7 U.S.C. § 2(a)(1)(D). The third set of exceptions applies to the various statutory exclusions and exemptions Congress also enacted in 2000 under 7 U.S.C. § 2(c)-(i). None of these exceptions would apply to futures trading on designated contract markets regulated by the CFTC in crude oil, gasoline or petroleum distillates.

The provisions of the 2008 Farm Bill further underscore that Congress intends the CFTC to exercise exclusive jurisdiction over the trading activity it regulates. In that legislation, Congress empowered the CFTC to determine that certain otherwise CEA-exempt energy transactions offered on what are called “exempt commercial markets,” which trade electronically, are “significant price discovery contracts” if certain criteria are met. HR 6124, 110 Cong. § 13,201(b) (2008). Once instruments are found to be “significant price discovery

contracts,” they become subject to heightened CFTC regulation, including reporting, recordkeeping, position limits and self-policing by the electronic trading facility. *Id.* The Farm Bill also adds “significant price discovery contracts” to the list of instruments subject to exclusive CFTC jurisdiction (H.R. 6124 at § 13203(c)) thereby reconfirming Congress’ continued endorsement of the rationale and need for CFTC exclusive jurisdiction over instruments subject to its regulatory scrutiny.

C. Courts Have Uniformly Found In Favor Of CFTC Exclusive Jurisdiction When Challenged By Other Agencies.

The federal courts have on several occasions interpreted the scope of CFTC exclusive jurisdiction. The two primary cases arose in the context of disputes involving the CFTC and the SEC where the SEC asserted a new product was a security and the CFTC argued the product was subject to CFTC exclusive jurisdiction. The CFTC won each of these cases.

In *Board of Trade of the City of Chicago v. SEC*, 677 F.2d 1137 (7th Cir. 1982), the United States Court of Appeals for the Seventh Circuit set aside an SEC order which would have allowed for securities exchange trading of options on Government National Mortgage Association (GNMA) pass through securities. Although the SEC contended these options on securities were “securities” within the SEC’s jurisdiction under the Securities Exchange Act of 1934, the Seventh Circuit held that the options were instead commodity options, which fell within the exclusive jurisdiction of the CFTC. (GNMA securities were already the subject of a futures contract and therefore were “commodities” under the CEA.) In this decision, the Seventh Circuit addressed the second “except” clause in Section 2(a)(1)(A) of the CEA. It rejected the SEC’s argument that the clause was a claw back of SEC jurisdiction from CFTC exclusive

jurisdiction, finding that the phrase “except as hereinabove provided” referred to only one provision, the affirmative grant of exclusive jurisdiction to the CFTC, and that anything covered by that grant was not subject to the federal securities laws or SEC jurisdiction. 677 F.2d at 1145.

In *Chicago Mercantile Exchange v. SEC*, 883 F.2d 537, 539 (7th Cir. 1989), the Seventh Circuit reaffirmed that CFTC exclusive jurisdiction over futures supersedes the authority of other agencies. In that case, the SEC approved trading in a new product called an Index Participation (IP). Even though the Seventh Circuit accepted the theory that an IP was a security, the court of appeals also found an IP to be a stock index futures contract subject to exclusive CFTC jurisdiction. As the court stated, “if an instrument is *both* a security and a futures contract, then the CFTC” is “the sole regulator...” The grant of exclusive jurisdiction to the CFTC could have “no other possible meaning.” *Id* at 544.

D. The FTC Has Previously Accepted CFTC’s Statutory Exclusive Jurisdiction.

Some years ago, the Commission initiated an investigation against the Ken Roberts Company, which was registered with the CFTC as a commodity trading advisor, relating to instructional materials on futures and securities trading. Roberts resisted the Commission’s investigative demands on the grounds that the CFTC had exclusive jurisdiction over such activities. The FTC explained that Congress designed the CEA’s exclusive jurisdiction provision “to create uniform rules for the operation of the futures market” and rejected Roberts’ request because the FTC’s investigation concerned advertising for “teaching materials,” not actual

trading on the futures markets, and therefore did not implicate CFTC exclusive jurisdiction.¹¹ The Commission also pointed out that it was investigating whether to proceed under its general “unfair or deceptive acts or practices” authority in Section 5 of the FTC Act, a statute of general applicability and therefore undisturbed by CFTC exclusive jurisdiction.¹²

Roberts sought judicial review of the Commission’s decision and the D.C. Circuit agreed with the Commission’s reasoning that CFTC exclusive jurisdiction encompassed actual transactions involving futures trading, not “instruction in commodities trading.” *Roberts*, 276 F.3d at 589. Again the D.C. Circuit acknowledged that the “goal” of the CEA’s exclusive jurisdiction provision “was to bring the futures markets ‘under a uniform set of regulations’ and that ‘only in the context of market regulation does the need for uniformed legal rules apply.’” *Roberts*, at 591, quoting *Am. Agric. Movement, Inc. v. Bd of Trade of the City of Chicago*, 977 F.2d 1147, 1155-57 (7th Cir. 1992).

The Commission’s *Roberts* precedent is perfectly consistent with the Seventh Circuit’s exclusive jurisdiction precedent. The FTC is well within its rights to pursue deceptive practices that do not involve actual transactions on or the operation of the futures markets. But futures market manipulation claims do involve both actual futures transactions and the core price

¹¹ February 25, 2000 FTC Letter to Ken Roberts Company, page 5.

¹² *Id.* Section 811 of EISA is not a statute of general applicability; it would apply only to purchases or sales of gasoline, crude oil and petroleum distillates at wholesale and it would prescribe various practices in connection with those specific transactions.

discovery operations of the futures markets and should be outside the limits of Section 811 due to the CEA's exclusive jurisdiction provision.

As the FTC mentions in its Federal Register notice, the Federal Energy Regulatory Commission ("FERC") and the CFTC are engaged in a dispute over CFTC exclusive jurisdiction in connection with the Amaranth case. Without repeating the arguments we have made in our *amicus curiae* court filings in that case (our brief is attached to this letter), the dispute highlights why we believe the FTC should make explicit that its manipulation rules will not apply to futures trading activities within the CFTC's exclusive jurisdiction. The allegations in Amaranth concern misconduct only in the futures markets and not conduct by the respondents in any FERC jurisdictional transactions. FERC's claim rests on an alleged manipulation of the futures market price. The CFTC's case against Amaranth is based on an attempted manipulation, not an actual manipulation. Determining whether or not a futures market price has been manipulated is a core CFTC function that fits squarely within the zone of the CFTC's exclusive jurisdiction. FERC's attempt to superimpose its judgment over that of the CFTC, however, has led to legal uncertainty in the markets about what legal standard for price manipulation applies to futures markets. At best, FERC's actions are duplicative. At worst, they will result in conflicting agency precedent relating to futures market manipulation. Either way, FERC's actions embody the specific ills Congress enacted CFTC exclusive jurisdiction to prevent. We strongly urge the FTC not to follow FERC's lead.

E. The Text of EISA Supports Respecting CFTC Exclusive Jurisdiction.

Nowhere in the text of EISA did Congress express any intention to override CFTC exclusive jurisdiction. The absence of any effort by Congress to do so is important because EISA expressly preserved the continued application of other statutes where EISA was silent. Section 3 of EISA reads: “Except to the extent expressly provided in this Act or an amendment made by this Act, nothing in this Act or an amendment made by this Act supersedes, limits the authority provided or responsibility conferred by, or authorizes any violation of any provision of law (including a regulation), including any energy or environmental law or regulation.” Under this provision, EISA may not “supersede” or “limit” the CFTC’s exclusive jurisdiction unless “expressly provided” for in EISA. Congress did not expressly provide that the FTC’s new anti-manipulation powers should limit or supersede the CFTC’s exclusive jurisdiction. In fact, Sections 811-815 of EISA do not mention the CEA or CFTC in any way. Thus, the FTC’s recognition of CFTC exclusive jurisdiction would be perfectly consistent with EISA.¹³

The terms of Sections 811 and 814(a) of EISA confirm this result. Section 811 authorizes the FTC to prosecute those who use manipulative devices “in connection with the purchase or sale of crude oil, gasoline or petroleum at wholesale.” As noted by the Commission, “Section 811 ... arguably covers sales and purchases starting at the point at which crude oil, gasoline, or a petroleum distillate is sold by the producer or importer, and ending at the point at

¹³ Misinterpreting EISA to limit or supersede CFTC exclusive jurisdiction also would violate the statutory construction principle that implied repeals of statutory rights are not favored. See *Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 190 (1978).

which it is purchased by a retailer.” 73 Fed. Reg. at 25621. Section 814(a) focuses its primary penalty provision on “suppliers.”

The Commission’s description of Section 811’s focus on wholesale sales and purchases illustrates that Congress did not intend those provisions to apply to futures market transactions by wholesalers. Section 814’s emphasis on suppliers also indicates that Congress did not intend the FTC’s new powers to apply to futures. Futures contracts are trading instruments, not wholesale purchases and sales, and suppliers are surely not the only, or even predominant, participants in futures markets. Far from “expressly provid[ing]” any limitation on CFTC exclusive jurisdiction, this statutory language actually confirms that Congress never intended to disturb the CFTC’s role as the sole federal futures market regulator and enforcement authority, even in futures on crude oil, gasoline and applicable petroleum distillates.¹⁴

Section 811 does not “expressly provide” for the prosecution of activities in futures or derivative markets that have an impact on wholesale prices. Any supplier that engages in a futures price manipulation must therefore be investigated and prosecuted by the CFTC under the uniform futures market price manipulation standard provided in the CEA. In contrast, any supplier that uses a manipulative or deceptive device in relation to a wholesale purchase or sale

¹⁴ The CEA provides for significant penalties for *any* party who manipulates or attempts to manipulate the price of a commodity in interstate commerce. EISA by contrast has a highly bifurcated penalty regime that demonstrates Congress’ regulatory concern was with suppliers. Section 814(a) provides civil penalty authority of up to \$1,000,000, which can be assessed against suppliers for each violation for each day. The FTC’s authority to assess civil penalties against persons that are *not* suppliers (which includes, for example, hedge funds and other speculators that do not participate in the wholesale markets), by contrast, is restricted, under Section 813 of EISA, to \$11,000 per violation.

of crude oil, gasoline or a petroleum distillate could be subject to prosecution by the Commission under Section 811 or the CFTC under the CEA, as we will discuss in the next section.

Last, as we explained earlier, Congress enacted CFTC exclusive jurisdiction to allow U.S. futures markets to serve the public interest. Section 811 permits the FTC to adopt anti-manipulation rules “as necessary or appropriate in the public interest.” FTC rules that purport to overlap with CFTC exclusive jurisdiction would not serve the public interest.

If the Commission disagrees, we would encourage the FTC to advise the public of its position and rationale in the request for public comments accompanying the proposed rules on this subject. This will allow interested parties to consider and submit comments on the FTC’s views before final action is taken.

III. The FTC and CFTC Should Work Together to Prevent and Police Manipulation in Wholesale Crude Oil, Gasoline and Petroleum Distillate Transactions.

The FTC and the CFTC share enforcement jurisdiction over price manipulation in connection with wholesale purchases and sales in crude oil, gasoline and those petroleum distillates which are the subject of futures trading. Section 811 of EISA empowers the FTC to adopt rules prohibiting the use of manipulative or deceptive devices in connection with those wholesale transactions. In addition to futures price manipulation, the CEA makes it a felony for any person to “manipulate the price of any commodity in interstate commerce,” (7 U.S.C. § 13(a)(2)) and authorizes the CFTC itself to bring civil cases against persons who engaged in such manipulations. (7 U.S.C. §§ 9, 13a-1, and 13b). Congress has now amplified those CFTC powers in the Farm Bill of 2008, increasing the CFTC’s fining authority to the greater of \$1

million per price manipulation violation or triple the monetary gain of such violations.¹⁵ To the extent crude oil, gasoline or a particular petroleum distillate is a “commodity,” Congress has now strengthened the CFTC’s enforcement powers in the context of both cases alleging futures price manipulation and related cash commodity price manipulation.

Conduct that constitutes price manipulation of wholesale crude oil, gasoline and petroleum distillate purchase or sale transactions is not, however, subject to CFTC exclusive jurisdiction. Instead, this is an area of concurrent FTC and CFTC jurisdiction. Whether framed as manipulation of purchases or sales of a petroleum commodity “at wholesale” or manipulating “the price of a commodity in interstate commerce,” each agency has authority to investigate and prosecute price manipulations of wholesale transactions to buy or sell crude oil, gasoline or petroleum distillates.

We believe this shared jurisdiction makes considerable sense. The CEA does not focus its comprehensive regulatory structure on wholesale cash market buy and sell transactions, which are not designed to be hedging or price discovery transactions. Congressional concerns about duplicative, conflicting regulation, which underlie the CEA’s exclusive jurisdiction provision, are therefore not implicated by shared concurrent jurisdiction of those wholesale buy and sell transactions. Concurrent jurisdiction also makes sense because it would allow the FTC and CFTC to establish a framework for formal enhanced cooperation in their enforcement efforts. As part of that process, and as relevant to the proposed rules under Section 811, we would

¹⁵ H.R. 6124 § Sec. 13,103(a)(2).

recommend that the FTC delineate its understanding of the scope and contours of the statutory phrases “purchase or sales ... at wholesale.” Such clarification will not only allow buyers and sellers to understand better if they are subject to FTC rules, it will also suggest guidelines that could be helpful to the CFTC and the FTC in working cooperatively and in a complementary manner in exercising their concurrent authority.

The CFTC has been very active in recent years in the enforcement area relating to non-futures energy product transactions.¹⁶ As CFTC Acting Chairman Lukken recently reported to Congress: "During the last five years ... [i]n the energy sector, [CFTC] Enforcement investigated and prosecuted Enron and BP, dozens of other energy companies, and hundreds of other traders and hedge funds."¹⁷ These enforcement actions have no doubt provided the CFTC with valuable experience and insight that could be relevant to both the FTC's development and implementation of its Section 811 rules.

A. Securities Law Principles Should Not be Adopted by the FTC.

We understand that the provisions of Section 811 of EISA were modeled after Section 10(b) of the Securities Exchange Act. We are concerned, however, that a blanket application of federal securities laws adopted under that provision -- specifically SEC Rule 10b-5 -- would lead

¹⁶ "Contrary to the testimony of some commentators, the CFTC has vigilantly pursued and punished manipulative conduct in energy markets during the previous five years. See Report of Commodity Futures Trading Commission on Energy Markets Enforcement Results (March 17, 2008) available at <http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/enfenergyenforcementactions.pdf>

¹⁷ Written testimony of Acting CFTC Chairman Walter Lukken Before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, December 12, 2007.

to uncertainty about compliance and enforcement which would be problematic for wholesale buyers and sellers alike.

SEC Rule 10b-5 was designed to address the interactions of brokers and customers as well as corporate insiders and market participants generally. It imposes on insiders and others an affirmative duty to disclose material facts. And it arises in the general federal securities law context of protecting public investors through a regime of primarily issuer-based disclosure of material information to try to equalize the information to which all investors have ready access. In the absence of that federal securities law context, we do not believe the FTC should make it a manipulative or deceptive device for a wholesale buyer or seller to fail affirmatively to disclose to other buyers or sellers material market information.

Private, bi-lateral wholesale transactions in crude oil, gasoline and petroleum distillate markets arise in a very different legal context and have never been subjected to an affirmative duty to disclose all material information or to abstain from transacting unless all inside, private information is disclosed. Relationships between securities market participants and participants in wholesale petroleum markets are very different and the standards applicable to the former cannot be applied to the latter.¹⁸ The Commission should take those differences into account when it fashions a rule to prohibit misrepresentations by wholesalers as deceptive devices in connection

¹⁸ For example, unlike securities markets, by definition, retail consumers do not engage in wholesale petroleum transactions. The Commission's 1983 policy statement on deception, outlining the principles by which its enforcement authority will be utilized, focuses in significant detail on the areas in which retail consumers may require protection. See <http://www.ftc.gov/bcp/policystmt/ad-decept.htm>.

with buy or sell transactions. The Commission also may want to prohibit wholesalers from making a false statement or a false report that could mislead a counterparty to a wholesale purchase or sale transaction. But the Commission's Section 811 rules should not include any affirmative duty for wholesale buyers or sellers to report or provide material information to a counterparty or others.

B. CFTC Manipulation Standards Should be Adopted By The FTC.

The CEA's anti-manipulation provisions and jurisprudence offer a better alternative than the securities law model. In fact, the CFTC has already flexed its anti-manipulation muscles in recent years in connection with wholesale energy transactions and markets, including its enforcement of the statutory prohibition against making false reports to affect the price of an energy commodity in interstate commerce. Based on this track record, the CEA manipulation standards appear to be more relevant and appropriate for the Commission's consideration as it develops regulations to effectuate Section 811. For these reasons, we would recommend that the FTC embrace the principles of manipulation law developed by the CFTC and courts under the CEA, as cited in the FTC's Federal Register notice.

The CEA has a time-tested standard for market manipulation, the intentional creation of an artificial price. To prove a claim of market manipulation under the CEA, it must be proved that a) a party possessed the capability to create an artificial price; b) an artificial price was created; c) the artificial price was due to actions of the party; and d) the party had the specific

intent to create the artificial price.¹⁹ We urge the FTC to implement this standard through its Section 811 rules.

The development of consistent CEA and EISA manipulation standards for wholesale purchases or sales of crude oil, gasoline and petroleum distillates would promote legal certainty by avoiding conflicting government approaches to price manipulation of the same or similar transactions. These uniform standards would enable buyers and sellers to know what law governed their transactions and how that law would be applied.²⁰ It also could avoid duplicative agency efforts if the FTC and CFTC would develop a formal or informal arrangement to coordinate investigatory activities and even enforcement actions. With each agency's resources now stretched thin, we see no reason why the public interest would be disserved by that kind of team work by the CFTC and FTC in connection with these wholesale transactions in crude oil, gasoline and petroleum distillates. Promoting legal certainty and agency coordination will also improve the competitiveness of U.S. markets.²¹

¹⁹ *Frey v. Commodity Futures Trading Comm'n*, 931 F.2d 1171, 1775 (7th Cir. 1991).

²⁰ The FTC cited one possible definition of market manipulation: "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." 73 Fed. Reg. at 25620. This definition has some common elements with the CEA manipulation standard, but applies only to a long or "higher" manipulated price, not a short or "lower" manipulated price and may be read not to include a scienter standard. It might be appropriate for the Commission to discuss this approach with the CFTC to try to harmonize efforts in this area.

²¹ The United States Treasury Department has increasingly addressed the issue of regulatory cooperation and efficiency in response to the findings of the Committee on Capital Markets Regulation citing an erosion in the competitiveness of US capital markets. See Remarks by Treasury Secretary Henry M. Paulson before the Economic Club of New York, New York, NY (Nov 20, 2006) available at <http://www.ustreas.gov/press/releases/hp174.htm>; Remarks by Under Secretary for Domestic Finance Robert K.

(Continued...)

For these reasons, we recommend that the FTC and the CFTC develop formal coordination mechanisms for investigating and prosecuting anti-manipulation claims in wholesale transactions in crude oil, gasoline and petroleum distillates over which they exercise concurrent jurisdiction. Such measures might include the sharing of market data and analysis, the development of a joint committee to monitor developments in crude oil and refined product markets, and the creation of a process by which the agencies will decide which, if either, agency will prosecute a manipulation claim involving wholesale transactions to buy or sell crude oil, gasoline or petroleum distillates.²²

IV. Specific Intent Should Be An Element Of The FTC's Price Manipulation Prohibition.

In order to prove a claim of market manipulation or attempted manipulation under the CEA, it must be shown that a party had the specific intent to create an artificial price. This requirement, while representing a substantive protection for an accused party, serves an equally vital role in facilitating robust, healthy and legitimate market activity. The CFTC has long

Steel before the American Enterprise Institute. Washington D.C. (Nov. 13, 2007); available at <http://www.ustreas.gov/press/releases/hp677.htm> See also Michael R. Bloomberg and Charles E. Schumer, *Sustaining New York's and the U.S.' Global Financial Services Leadership*, at 80 (Jan. 2007), available at <http://www.nyc.gov> (noting that “an increasingly heavy regulatory burden and a complex, cumbersome regulatory structure with overlaps at the state and national levels is causing an increasing number of businesses to conduct more and more transactions outside the country.”)

²² The Commission and the Department of Justice have developed an efficient model of shared jurisdiction in the context of investigations of merger activities. See <http://www.ftc.gov/opa/2002/04/clearanceoverview.shtm>.

recognized this role stating “we are unable to discern any justification for a weakening of the manipulative intent standard which does not wreak havoc with the market place.”²³

Transactions in product markets have the inherent potential to affect market price. Purchases of a product absorb existing supply at a given price and therefore have a tendency to cause market prices to rise. Similarly, sales of a product fulfill existing demand at a given price and therefore have a tendency to cause market prices to fall. This is particularly true when the quantity transacted is substantial relative to the normal supply-demand dynamics of a particular market. The absence of a specific intent standard as part of an anti-manipulation rule would expose innocent market participants to potential manipulation claims on the basis of lawful market transactions which happened to have a significant effect on market prices. Market participants, self regulatory organizations, courts and even the agencies would have no clear principles by which to distinguish innocent conduct from manipulative conduct. Such a threat would chill legitimate market activity and distort the very market fundamental dynamics that anti-manipulation prohibitions seek to protect.

Wholesale transactions are particularly susceptible to this kind of “false positive.” Unlike futures market trading, wholesale transactions in the cash market may be episodic and

²³ *In re Indiana Farm Bureau Coop.*, CFTC No. 75-14, 1982 WL 30249, at *5 (CFTC 1982). The FTC also emphasized: “Thus, market participants have a right to trade in their own best interests without regard to the positions of others as long as their trading activity does not have as its purpose the creation of ‘artificial’ or ‘distorted’ prices. Indeed, it is this very motivation which gives lifeblood to the forces of supply and demand, [and] [sic] makes the price discovery function of the marketplace viable. Moreover, since the self-interest of every market participant plays a legitimate part in the price setting process, it is not enough to prove simply that the accused intended to influence price.” *Id.*

non-standardized. Two transactions in the same product may occur simultaneously at different prices because the economic terms of each transaction (delivery location, credit terms etc.) give rise to different costs and risks to the counterparties. Further, these unique transactional terms create smaller sub-markets for a product at a given price, making it even more likely that large transactions will have a significant effect on observed prices. Indeed, the inferior liquidity and lack of standardization in wholesale transactions complicate in many circumstances the determination whether a particular market price is artificial.

Wholesale transactions in crude oil, gasoline and petroleum distillates would be hampered if innocent commercial activity could give rise to potential manipulation claims. The absence of such a standard would create a vicious circle. Buyers and sellers would refrain from market activity, draining liquidity and further increasing the possibility that legitimate business activity could cause large movements in prices which might be mistaken as artificial. In order to prevent such a scenario we urge the FTC to adopt the specific intent standard of the CEA as part of any manipulation rule adopted under Section 811.²⁴

²⁴ We also urge the FTC to confirm that no private right of action exists under Section 811 and any implementing rules the FTC adopts. In the absence of a statutory authorization to bring such actions, private party suits should not be allowed. In addition, we suggest that the FTC not rely on its deceptive or unfair trade practice jurisprudence under Section 811. The Commission has noted that “neither knowledge nor intent” is a required element of a violation under Section 5 of the FTC Act (73 Fed. Reg. at 25619 n.56). We therefore believe it would be inappropriate to follow that precedent under Section 811.

V. Conclusion

We appreciate the opportunity to comment on the Commission's preliminary discussion on the implementation of Section 811 of EISA. We look forward to reviewing the Commission's formal proposals in this area and its efforts to strengthen the anti-manipulation safeguards available for wholesale purchase and sale transactions in crude oil, gasoline and petroleum distillates.

Respectfully submitted,



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