January 3, 2011

SUBMITTED ELECTRONICALLY

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Requests for Comments on Proposed Rules Regarding Prohibition on Market Manipulation, RIN Number 3038-AD27

Dear Mr. Stawick:

The American Petroleum Institute ("API") and National Petrochemical and Refiners Association ("NPRA") respectfully submit these comments in response to the notice of proposed rulemaking ("Notice") issued by the Commodity Futures Trading Commission concerning its new anti-manipulation authority in Section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1]

API and NPRA are national trade associations representing the oil and natural gas industry. API's more than 400 members cover all facets of the industry, including exploration, production, transportation, refining, and marketing. NPRA's more than 450 members own or operate virtually all U.S. petroleum refining capacity and include most of the nation's petrochemical manufacturers, which supply the chemicals necessary to produce products ranging from pharmaceuticals to fertilizers to Kevlar. API's and NPRA's members transact in physical and financial, exchange-traded, and over the counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy and refined petrochemical products to wholesale and retail consumers. Associated with the hedging of physical exposures, API and NPRA members enter into swap transactions to offset credit risks and to facilitate physical transactions. Because API and NPRA members rely on the orderly functioning

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[1] Prohibition of Market Manipulation, 75 Fed. Reg. 67,657 (Nov. 3, 2010). These comments refer to "Section 753" of Dodd-Frank, which amends Section 6(c) of the Commodity Exchange Act.

of the markets under the Commission's jurisdiction, we appreciate the opportunity to comment on this Notice.

I. Introduction and Executive Summary

API and NPRA support the Commission's commitment to preventing fraud and manipulation that adversely affects futures and derivatives markets, their participants, and consumers. At the same time, API and NPRA believe that it is vital that any rule avoid harm to petroleum markets and their participants. Wholesale petroleum markets currently function efficiently, effectively moving product to locations where it is needed, with prices reflecting market realities. Decisions regarding purchases and sales must be, and are, made in real time by sophisticated market participants who understand the markets and their counterparties' incentives. A rule that establishes vague, overbroad or inconsistent standards will harm markets and their participants by deterring or hindering legitimate business activity or otherwise imposing undue regulatory, legal and financial burdens on participants, including API's and NPRA's members.

Certain aspects of the Commission's proposed rules are overly broad and vague and, therefore, likely to have the unintended effects of impeding the risk management and price discovery functions of the commodities markets. Specifically, API and NPRA urge the Commission to clarify that:

1. Liability under the Commission's Manipulation by Fraud Rule 180.1 will attach only if conduct has, or is likely to have, a manipulative effect on the market.

2. Deceptive or fraudulent conduct that does not pertain to futures, swaps, or commodity markets underlying futures or swaps, and that lacks a manipulative purpose or effect, falls outside the scope of Proposed Rule 180.1.

3. Liability requires the specific intent to deceive or defraud in order to manipulate a covered market.

4. No liability will attach for omissions, or will attach only in limited circumstances.

5. No liability will attach for good-faith mistakes.

We have appended to these comments suggested revisions to the language of the proposed rule designed to implement these recommendations.

II. The Commission should tailor its market manipulation rules to the distinct purposes of the CEA and the nature of the commodities markets

A. Proposed Rule 180.1 sweeps too broadly and does not advance the Commission's overall regulatory mission

API and NPRA support the Commission's goal of preventing fraud and manipulation that adversely affects futures and derivatives markets, their participants, and consumers. API and NPRA are concerned, however, that Proposed Rule 180.1 sweeps too broadly, creating a substantial risk that the rule will chill beneficial economic activity without providing the benefits intended by the Commission.

First, Proposed Rule 180.1 extends to fraud generally and practices that have nothing to do with market manipulation. Section 753 of Dodd-Frank amended the Commodity Exchange Act ("CEA") to add a new section 6(c)(1) titled "Prohibition Regarding Manipulation and False Reporting Information." As is evident from the title of the provision, Congress intended Section 753 to address fraudulent manipulation of the commodities markets. But rather than addressing the manipulation by fraud targeted by Congress, the Notice states that the Commission "proposes to interpret [new] CEA section 6(c)(1) as a *broad, catch-all provision reaching fraud in all its forms*."[2] This sweeping approach goes far beyond the congressional mandate in Dodd-Frank and will have unintended, counterproductive consequences.

Second, Proposed Rule 180.1 encompasses transactions throughout the physical markets, even those that have no impact on futures and swaps markets that the Commission is charged with protecting. By its express terms, the rule does not apply only to swaps or futures contracts, but instead to "*any* ... contract of sale of any commodity in interstate commerce." The Commission's use of the term "commodity" indicates that the rule would apply to virtually every commercial transaction in the economy, including but not limited to "any" physical sale of petroleum products.[3] Although the statute itself extends the prohibition against manipulation to commodity transactions, a proposed "catch-all" fraud rule untethered to manipulation would extend

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[2] Notice, 75 Fed. Reg. at 67,658 (emphasis added).

[3] *Id.* at 67,662. Proposed Rule 180.1 would even extend to many small, local transactions. The Supreme Court has defined "interstate commerce" broadly to include even local transactions that may affect interstate commerce. *See Gonzales v. Raich*, 545 U.S. 1, 17 (2005) ("Our case law firmly establishes Congress' power to regulate purely local activities that are part of an economic 'class of activities' that have a substantial effect on interstate commerce.") (citing *Perez v. United States*, 402 U.S. 146, 151 (1971)).

Commission authority to transactions that, under well-established principles of federalism, are governed by state contract and tort law, and with respect to certain specific transactions, are also covered by anti-fraud provisions contained in consumer protection laws, state and federal securities laws, and other similar statutes.[4] The proposed rule would be duplicative and potentially inconsistent with these other statutory and common law standards. It would also place an enormous burden on the Commission's resources by obligating the Commission to assume responsibility for policing commercial transactions for products and services far outside the areas of the Commission's traditional jurisdiction and expertise.

Third, the benefits of extending Proposed Rule 180.1 beyond the prohibition on manipulation by fraud intended by Congress are likely to be limited. The Commission already has broad anti-fraud authority over the futures market and that authority has been extended to the swaps market by other provisions of Dodd-Frank. Existing law also prohibits non-fraud based manipulations. The CEA authorizes the Commission to bring enforcement actions for a wide range of manipulative conduct, including, but not limited to: price manipulation and attempted manipulation associated with holding or controlling excessive speculative positions, corners and attempts, and knowingly making false market reports. This is in addition to a general prohibition on fraud and prohibitions on wash sales and certain pre-arranged trades, bucketing orders, accommodation trades, and fictitious sales.[5] Moreover, Section 741 of Dodd-Frank provides the Commission with enhanced authority to police fraud, attempted fraud, and material omissions by any person in connection with the execution of any futures contract, swap, or commodity option.[6]

Considering the wide range of tools and sanctions the Commission already has at its disposal under the CEA, the Commission should adopt a rule that is complementary and not duplicative of the Commission's existing authority.[7] The "broad, 'catch-all'"

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[4] *See* Federal Trade Commission, *Prohibitions on Market Manipulation (Final Rule)*, 74 Fed. Reg. 40,686, 40,696 (Aug. 12, 2009); Federal Energy Regulatory Commission, *Prohibition on Energy Market Manipulation*, 114 FERC ¶ 61,047 (2006).

[5] *See generally* 7 U.S.C. §§ 6a-6c, 9(a)(2). The dissemination of false information is considered market manipulation subject to the anti-manipulation and false reporting provisions of the CEA. *See, e.g.*, *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971).

[6] *See* 7 U.S.C. § 6b(e).

[7] Under the existing regulatory scheme, the Commission has successfully brought numerous actions against companies and individuals for defrauding clients or for making misleading statements regarding market information—the very same conduct governed by Proposed Rule 180.1. *See, e.g.*, *CFTC v. Atha et al.*, Comm. Fut. L. Rep. (CCH) ¶ 30,731 (Nov. 7, 2007); *CFTC v. Bradley Martin*, Comm. Fut. L. Rep.
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provision proposed by the Commission will create unnecessary regulatory redundancy and market confusion.

B. Proposed Rule 180.1 makes no express allowance for the differences between securities and commodities markets

The Commission proposes that "subsection (c)(1) be given a broad, remedial reading" consistent with the securities law.[8] By proposing to adopt the language of Securities and Exchange Commission ("SEC") Rule 10b-5 and an undetermined portion of the SEC's interpretations of that rule, the Commission goes beyond what Congress intended by reading words into the statute that simply do not exist. In Section 753 of Dodd-Frank, unlike in Section 315 of the Energy Policy Act of 2005, Congress did not direct the Commission to interpret "manipulative or deceptive device or contrivance … *as those terms are used in Section 10(b)*" of the Security Exchange Act ("Exchange Act").[9] The language of Section 753 thus empowers the Commission to interpret the phrase manipulative or deceptive device or contrivance as needed to fit the realities of the commodities markets.

Despite the flexibility accorded by the statute, Proposed Rule 180.1 fails to clarify the material differences between the securities markets and the commodities markets. Section 10(b) of the Exchange Act and SEC Rule 10b-5 govern the sale of securities to retail investors who rely on regulated fiduciaries such as issuers, brokers, and dealers. Collectively, they impose a legal regime designed to protect retail purchasers of securities, who depend upon the honesty and good faith of regulated fiduciaries. To ensure that ordinary investors are not taken advantage of, and to instill confidence in the broader securities markets, the Exchange Act imposes stringent and detailed obligations on regulated parties, including "a 'philosophy of full disclosure.'"[10] The Rule

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(CCH) ¶ 30,542 (Jun. 25, 2007); *CFTC v. American Elec. Power Co.*, Comm. Fut. L. Rep. (CCH) ¶ 30,014 (Jan. 26, 2005); *CFTC v. Enron Corp & Shively*, Comm. Fut. L. Rep. (CCH) ¶ 29,714 (Mar. 10, 2004). For example, after the Western Energy Crisis of 2000-2001, the Commission brought claims against *El Paso Merchant Energy, L.P.* and *Dynegy Marketing and Trade* for submitting false information to natural gas price index publishers, including false price and volume information for actual and fictitious trades. In both cases, the Commission was able to police fraudulent market behavior successfully without an expanded anti-fraud rule. *See, e.g.*, *El Paso Merch. Energy, L.P.*, No. 03-09, 2003 WL 21468567 (CFTC Mar. 26, 2003); *Dynegy Mktg. & Trade*, No. 03-03, 2002 WL 31835506 (CFTC Dec. 18, 2002).

[8] Notice, 75 Fed. Reg. at 67,659. *See also id.* at 67,658.

[9] Pub. L. No. 109-58, 119 Stat. 594, 691 (Aug. 8, 2005) (emphasis added).

[10] *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)). *See also SEC v. Zandford*, 535 U.S. 813, 823 (2002) (holding, in an SEC enforcement action under Rule 10b-5, that "any distinction between omissions and

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10b-5 regulatory regime is deeply intertwined with those disclosure obligations imposed by Section 10(b).

Unlike the Exchange Act, where disclosure of material information is paramount, the goal of the CEA is to ensure "a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities."[11] As the Commission-chaired Interagency Task Force on Commodity Markets noted in its 2008 *Interim Report on Crude Oil*, the "futures markets are ideal for aggregating a multiplicity of opinions about the expected price of a commodity at different points in time," because "[i]t is often easier for a common view on an expected price to emerge at a futures exchange than among dispersed producers and consumers of a physical (cash) commodity."[12] Those attributes make "futures markets an important source of price information,"[13] a goal that is advanced when participants are given broad latitude to pursue profit-maximizing strategies. If an overly broad or vague rule deters market participants from trading based upon their own proprietary information, commodity prices will not accurately reflect the fundamental factors of supply and demand, leading to a lack of confidence in markets as venues for price discovery.

The Commission is well aware of the differences between the commodities and securities markets. In 1984, after careful study, the Commission concluded that insider trading in the commodities markets should not be regulated because sellers of futures contracts do not have a fiduciary duty to purchasers. Rather, "the futures markets are derivative, risk-shifting markets," and "it would defeat the market's basic economic function – the hedging of risk – to question whether trading based on knowledge of one's own position were permissible."[14] Indeed, trading on proprietary information

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misrepresentations is illusory in the context of a broker who has a fiduciary duty to her clients"). *See also* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 29 (3d ed. 1989) (describing the "recurrent theme" of federal securities regulation as "disclosure, again disclosure, and still more disclosure").

[11] 7 U.S.C. § 5(a).

[12] Interagency Task Force on Commodity Markets, *Interim Report on Crude Oil* 17 (July 2008), *at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil070.pdf.

[13] *Id.*

[14] Commodity Futures Trading Commission, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information* 8 (Sept. 1984) (hereinafter "CFTC Study"). *See also* Edward F. Greene et al., *U. S. Regulation of International Securities and Derivatives Markets* § 10.14[3] at 10-177 n.727, 10-183 (9th ed. 2009) ("The securities markets exist for capital formation purposes and investors are at a unique informational disadvantage to issuers and corporate
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"allows more accurate commodity prices to be reflected even in the absence of direct disclosure of the nonpublic information."[15] The proposed rule must reflect these critical differences between the securities markets and commodities markets.

C. The Commission should adopt specific modifications to Proposed Rule 180.1 instead of "adapting" SEC precedent over time

The Commission seeks to address the mismatch between the Rule 10b-5 regime and commodities markets by stating that SEC Rule 10b-5 will be "modifi[ed] to reflect the [Commission's] distinct regulatory mission and responsibilities."[16] While the Commission is correct to acknowledge the important differences between the commodities markets and securities markets, the problems presented by Proposed Rule 180.1 cannot be resolved through a case-by-case approach by the Commission's enforcement staff.

<u>First</u>, simply adopting SEC's Rule 10b-5 without explanation or context provides little assistance to market participants working to assure that they are in compliance with the Commission's expectations. As the Commission itself explained, a general rule incorporating wholesale the Rule 10b-5 language will make it impossible for market participants to anticipate which elements of Rule 10b-5 doctrine and precedent the Commission intends to apply and which elements it will not:

> The cases decided under Section 10(b) and Rule 10b-5 illustrate some of the problems with using general fraud prohibitions to combat insider trading in the securities markets. A broad provision such as Rule 10b-5 provides little guidance concerning the specific conduct that it is meant to prohibit. Thus, such a provision invites litigation and, to a large extent, leaves it up to the judiciary to determine what types of insider trading are prohibited.[17]

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insiders. … The futures markets, on the other hand, are generally regarded as risk-shifting markets in which price discovery is paramount and market participants generally have equality of access to market information. Indeed, hedging activity, the *raison d'etre* of the futures markets, is itself a form of insider trading in that the hedger takes a position in the futures market in order to hedge a price risk incident to an undisclosed past or future cash market transaction.").

[15] CFTC Study at 44.

[16] Notice, 75 Fed. Reg. at 67,658.

[17] *See* CFTC Study at app. I A at 6.

Like many companies in the energy industry, API and NPRA members make regulatory compliance a top priority. As written, Proposed Rule 180.1 would apply to a broad, imperfectly-defined range of conduct, extending beyond intentionally deceptive or fraudulent statements or acts designed to manipulate a physical or futures market. To mitigate the risk that any type of commercial transaction may be the subject of an enforcement proceeding, market participants will likely restrict market activity and will have to adopt compliance programs addressing an enormous range of transactions. In a dynamic or volatile market, the ability to respond quickly to supply, demand or price changes is critical for the market to perform its function of efficiently allocating goods and services. A broad rule that creates a risk of exposure with respect to virtually every transaction engaged in by a company, and therefore requires a company to add substantial layers of compliance review, will hinder nimble responses and impede the efficient, fair functioning of the commodities markets.

Second, regardless of the Commission's exercise of discretion, Proposed Rule 180.1 would significantly broaden market participants' exposure to private lawsuits, which are not within the Commission's control. Even if the Commission made an internal judgment to apply the rule more narrowly than its language might permit, a court could construe the rule more broadly—particularly if it took note of Commission rejection of requests to revise the rule to narrow its scope. As in private securities litigation, considerations of litigation burden, expense and risk would place significant pressure on defendants, even in meritless cases.[18]

Finally, the potentially significant compliance costs and legal uncertainty must also be weighed against the limited benefits of the proposed rule. To the extent the breadth of Proposed Rule 180.1 would result in duplication of state and federal enforcement authority, it is both unnecessary and will inevitably create risks of inconsistent standards, thereby further exacerbating market participants' regulatory and compliance risk and burden. At a time when the Commission faces (and likely will continue to face) significant resource constraints, it makes little sense to expand the scope of the Commission's enforcement authority dramatically to cover a plethora of routine cash market transactions in all areas of the economy. To avoid these risks, API and NPRA strongly encourage the Commission to adopt the specific modifications discussed below.

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[18] *See Bondi v. Capital & Fin. Asset Mgmt. S.A.*, 535 F.3d 87, 97 (2d Cir. 2008) ("This Court, as well as Congress—through its adoption of the Private Securities Litigation Reform Act of 1995 ("PSLRA")—has taken note of the pressures upon corporate defendants to settle securities fraud 'strike suits' when those settlements are driven, not by the merits of plaintiffs' claims, but by defendants' fears of potentially astronomical attorneys' fees arising from lengthy discovery.").

III. Specific concerns with Proposed Rule 180.1

A. The proposed rule should apply only to statements or conduct that have a manipulative effect

API and NPRA agree with the Commission's statement that Proposed Rule 180.1 "differs from that of sections 9(a)(2) and 6(c)(3)" in that it prohibits only deceptive or fraudulent statements or acts.[19] We understand the Commission to mean that liability under Proposed Rule 180.1 will not attach to ordinary market trading activity absent conduct that deceives or defrauds market participants. This understanding assigns separate purposes to Proposed Rules 180.1 and 180.2. While the Commission has limited Proposed Rule 180.1 to fraudulent conduct, API and NPRA believe that the Commission should further clarify that its anti-fraud rule applies only to fraudulent manipulation.

Any final rule issued by the Commission should impose liability only if the deceptive or fraudulent conduct at issue had a manipulative effect on the futures or swaps markets, or commodity markets underlying futures or swaps markets. Holding market participants liable for conduct that does not cause a material effect in the market would unduly expand the Commission's regulatory and enforcement oversight. Section 753 should not be viewed as imposing federal regulatory and enforcement oversight on conduct that is, and properly should be, the province of state anti-fraud and contract law. Unless the Commission requires an appropriate connection between challenged conduct and market distortion, it runs the risk of having to police every routine commercial dispute as a potential violation of Section 753.

The Notice reflects some ambiguity as to whether Proposed Rule 180.1 is intended to apply only to conduct that manipulates or is likely to manipulate the commodities markets, or whether it would apply even to fraud and deceit that has no actual market effect. While certain passages in the Notice appear to reject a market effect requirement,[20] the Notice also states that Proposed Rule 180.1 is aimed at conduct that "impair[s], obstruct[s], or defeat[s] the integrity of the markets subject to the jurisdiction of the Commission."[21] The latter statement suggests that conduct that is not intended to effect or distort the broader market (such as statements made in the context of private commercial negotiations or other non-public situations)—and that does not

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[19] Notice, 75 Fed. Reg. at 67,659.

[20] *Id.* at 67,660 (rejecting "loss causation" as an element to establish a violation of Section 753 and the Commission's implementing rule).

[21] *Id.* at 67,659.

have any reasonable chance of manipulating the market—would fall outside the scope of the rule.

The Commission should resolve any ambiguity by requiring, in its final rule, proof that a party's deceptive or fraudulent conduct caused market conditions to deviate materially from the conditions that would have existed but for that conduct. Without such a requirement, the final rule would potentially apply to each of the millions of private discussions and transactions that take place every day between market participants in commodities markets. As a result, the rule could potentially federalize large blocks of state fraud, contract, and tort law as they apply to commodities markets. There is no reason to believe that Congress intended Section 753 to authorize such a broad expansion in the Commission's oversight and enforcement.

At a minimum, the Commission should follow the FTC's lead by clarifying that "a statement made intentionally misleading by reason of the intentional omission of a material fact would violate the Rule only if its dissemination 'distorts or tends to distort market conditions' respecting any covered product.'"[22] There are strong reasons for the Commission to apply the FTC's market effect requirement for material omissions. First, the FTC arrived at its rule after a lengthy and thorough rulemaking process and with extensive industry and consumer input. The Commission should give significant weight to this regulatory experience. Second, adopting a market effect requirement for material omissions in Proposed Rule 180.1 would ensure that a consistent standard is applied to transactions over which the FTC and Commission may exercise overlapping jurisdiction. Requiring regulated parties to comply with inconsistent regulatory standards would impose additional compliance costs and should be avoided absent a compelling reason. Given the heightened risks associated with liability for "incomplete" disclosures, the Commission should give market participants certainty that statements containing material omissions will not be challenged if they do not adversely threaten the reliability of data in the market.

Finally, if the Commission chooses to promulgate a catch-all anti-fraud rule without regard to whether the conduct had a manipulative purpose or effect, (a proposal that API and NPRA respectfully submit would exceed the Commission's authority) the Commission should clarify that the enhanced sanctions in Section 753 apply only to cases of manipulation or attempted manipulation, not to every alleged violation of the rule. Section 753 provides for a civil penalty of $1 million for each violation "in any case of manipulation or attempted manipulation" under Section 6(c) or Section 9(a)(2) of the CEA. The prospect of substantial civil penalties, including $1 million per violation sanctions and treble damages represents a significant compliance risk. API and NPRA

[22] 74 Fed. Reg. at 40,699.

are concerned that, unless the rule clarifies that the enhanced manipulation sanctions apply only to manipulative conduct as the plain language of the statute provides, the magnitude of these potential sanctions could cause firms to implement rigid, burdensome compliance systems for contract negotiations and routine interactions with customers that would substantially restrict their ability to engage in efficient activities.

B. The Commission should limit the "in connection with" requirement to futures, swaps, and commodity markets underlying futures or swaps

The Notice states that the "in connection with" language of Section 753 will "be satisfied whenever misstatements or other relevant conduct are made in a manner reasonably calculated to influence market participants."[23] The Commission has not provided market participants with any assurance that the "reasonably calculated" language will not be interpreted so broadly as to include every common law fraud that happens to touch a transaction on a Commission-jurisdictional market. In order to provide much needed certainty to market participants, API and NPRA believe that the Commission should clarify that only statements and acts pertaining to transactions in futures, swaps, or commodity markets underlying futures or swaps may give rise to liability under Proposed Rule 180.1.

The Notice states that the Commission, in interpreting the "in connection with" element of the proposed Rule, will be "[g]uided by securities law precedent," and cites *SEC v. Zandford* in support.[24] In *Zandford*, however, the Supreme Court concluded that a broad reading of "in connection with" in Rule 10b-5 was justified because of the specific remedial purposes of the Exchange Act—namely, to respond to the massive economic crisis of 1929 by "'substitut[ing] a philosophy of full disclosure for the philosophy of *caveat emptor*.'"[25] While Section 753 is part of the larger Dodd-Frank regime emphasizing transparency and market reliability, nothing in the legislative history of Section 753 indicates a Congressional intent to effect such a radical expansion of the Commission's authority to usurp the traditional role of state enforcement authorities. These differences weigh heavily in favor of a narrower reading of the "in connection with" language of Section 753 and Proposed Rule 180.1 than has been adopted under Rule 10b-5.

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[23] Notice, 75 Fed. Reg. at 67,659-660.

[24] *Id.* (citing *Zandford*, 535 U.S. at 822).

[25] *Zandford*, 535 U.S. at 819 (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)).

API and NPRA members engage in a host of business activities that are substantially removed from the commodities markets—e.g., decisions concerning upstream production and operations, refining decisions, facility maintenance and upgrades, management of inventory levels, and retail transactions. If Proposed Rule 180.1 does not clearly exclude ordinary production, operational, and supply decisions, market participants would likely be compelled to factor into every aspect of their business strategy the risk of challenge under Section 753. In an effort to avoid such risks, companies would generally take a more conservative approach, reducing market liquidity to the ultimate detriment of consumers.

C. The proposed rule should require a showing of specific intent to deceive or defraud in order to manipulate a covered market

API and NPRA agree with the Commission's proposal to make scienter a prerequisite to violating Section 753. API and NPRA disagree, however, with the Commission's proposal to adopt a "recklessness" scienter requirement under Proposed Rule 180.1. For the reasons set forth below, the language of the statute supports a specific intent standard. Moreover, although a recklessness standard may be appropriate in the highly regulated securities context with its fiduciary duties and strict disclosure requirements, a recklessness standard under Section 753 would increase the costs of complying with a market manipulation rule and deter market participants from disclosing relevant information that helps markets to function more efficiently.

1. The language of Section 753 requires that the Commission issue a rule requiring the specific intent to defraud a covered market

The Notice proposes to adopt a "recklessness" scienter requirement consistent with the judicial interpretation of Exchange Act Section 10(b) and SEC Rule 10b-5.[26] API and NPRA submit that the language of Section 753 strongly suggests a different approach to scienter.

First, Proposed Rule 180.1, as written, would allow persons to be held liable for a legally impossible offense—"attempted recklessness." While Section 753 contains language similar to the Exchange Act, the Energy Policy Act of 2005, and the Energy Independence and Security Act of 2007—which confer anti-fraud authority on the SEC, Federal Energy Regulatory Commission ("FERC"), and the Federal Trade Commission ("FTC"), respectively—none of the other statutes or implementing rules explicitly permits liability based on mere attempts to defraud. Congress's decision to prohibit "attempted deceptive or fraudulent conduct" confirms that liability may not be based on

[26] Notice, 75 Fed. Reg. at 67,659.

anything less than specific intent. By its very nature, the act constituting the attempt must be done with the intent to engage in the particular conduct.[27]

Consistent with that understanding, the Commission's long-standing precedent interpreting and applying Section 9(a)(2) of the CEA requires specific intent for attempted manipulative conduct. For example, in *In re Indiana Farm Bureau Cooperative Ass'n, Inc. & Johnston*, the Commission concluded "that the requisite level of *mens rea* required to prove manipulation or attempted manipulation under the Commodity Exchange Act is that of 'specific intent.'"[28] While the decision did not articulate fully the reasons for adopting a higher scienter standard, the dissenting Commissioner noted that the majority's holding "developed a reasonable intent standard for attempted manipulation" by recognizing that "a higher standard of intent may be required for attempted violations than completed offenses."[29] Likewise, Congress's decision to prohibit attempted deceptive or fraudulent conduct suggests that any final rule promulgated under Section 753 should impose liability only upon a showing of specific intent in order to manipulate the futures or swaps markets.[30]

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[27] *See Braxton v. United States*, 500 U.S. 344, 351 n.* (1991) ("Since the statute does not specify the elements of 'attempt to kill,' they are those required for an 'attempt' at common law, which include a specific intent to commit the unlawful act. 'Although a murder may be committed without an intent to kill, an attempt to commit murder requires a specific intent to kill.'") (citations omitted); *United States v. Kenyon*, 481 F.3d 1054, 1069-70 (8th Cir. 2007) ("The common law definition of 'attempt' requires a showing that a criminal defendant acted with the specific intent to commit a particular offense.") (citations omitted); *Knapik v. Ashcroft*, 384 F.3d 84, 91 (3d Cir. 2004) ("Yet by its very nature acting recklessly is inconsistent with the *mens rea* required for attempt. A person cannot intend to commit a criminally reckless act. He or she either acts recklessly or does not.") (citations omitted). *See also Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993) (attempted monopolization under Section 2 of the Sherman Antitrust Act requires a specific intent to monopolize).

[28] *In re Ind. Farm Bureau Coop. Ass'n, Inc. & Johnston*, No. 75-14, 1982 WL 30249, at *5 (CFTC Dec. 17, 1982).

[29] *Id.* at *37.

[30] [30] API and NPRA also have certain reservations with the Commission's discussion of Proposed Rule 180.2. First, the Commission describes existing law under Section 9(a)(2) of the CEA to require the specific intent to "influence market prices." Notice, 75 Fed. Reg. at 67,660. That is inaccurate. The relevant specific intent must be to create an artificial price, not simply to influence market prices. *See In re Ind. Farm Bureau Coop. Ass'n, Inc. & Johnston*, 1982 WL 30249, at *5-*6. Second, the Commission's statement "that an illegal effect on price can often be conclusively presumed from the nature of the conduct" should be stricken to the extent that it suggests any weakening of the requirements to prove that the accused had the ability to affect market prices, an artificial price existed, and the accused caused the artificial price. *See* Notice, 75 Fed. Reg. at 67,661.

Second, unlike Section 10(b), Section 753 contains provisions that expressly prohibit reckless or negligent behavior. Congress's decision to include a lower scienter standard in certain provisions, but omit it in others, indicates that Congress intended for liability to be based on specific intent:

- Section 753(c)(1)(A)—"Special Provision for Manipulation by False Reporting"—provides that: "Unlawful manipulation … shall include … delivering, or causing to be delivered for transmission through the mails or interstate commerce, … a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, *or acting in reckless disregard* of the fact that such report is false, misleading or inaccurate."[31]

- Section 753 (c)(2)—"Prohibition Regarding False Information"—provides that: "It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, … or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, *or reasonably should have known*, the statement to be false or misleading."[32]

While Congress chose to impose a lower scienter requirement for false reporting and defrauding the Commission, Congress made no reference to reckless or negligent conduct in subsection (c)(1), the statutory authority for Proposed Rule 180.1. That provision makes it "unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, … any manipulative or deceptive device or contrivance."[33] API and NPRA believe that the omission of a recklessness or negligence standard indicates that new subsection (c)(1) should be interpreted as requiring a specific intent to deceive or defraud.[34]

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[31] Notice, 75 Fed. Reg. at 67,658 (emphasis added).

[32] *Id.* (emphasis added).

[33] *Id.* at 67,657.

[34] *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.") (internal quotation marks and citations omitted). *See also Freemanville Water Sys., Inc. v. Poarch Band of Creek Indians, P.C.I.*, 563 F.3d 1205, 1209 (11th Cir.2009) ("[W]hen Congress uses different language in similar sections, it intends different meanings.") (internal quotation marks and citations omitted). By contrast, the anti-fraud provisions of the Energy Policy Act of 2005, which FERC has interpreted to include recklessness, do

(continued…)

2. The Commission's proposed recklessness standard would reduce the efficiency of the commodities markets

API and NPRA support the Notice's recognition that "sufficient leeway must be given to permit application of the scienter standard under subsection 6(c)(1) and the Commission's implementing rule in a manner that comports with the purposes of the CEA and the functioning of the markets regulated by the CFTC."[35] Nevertheless, API and NPRA believe that making "reckless" conduct actionable under the Commission's anti-fraud rules could have wide-ranging adverse effects on market efficiency. At the very least, a recklessness standard would alter trading activity, potentially reducing the number of otherwise legitimate commodities transactions in order to mitigate perceived litigation risk.

Those risks are precisely why the Commission has required specific intent under Section 9(a)(2) before finding that an individual attempted to manipulate prices, corner a market involving a commodity, or knowingly make a false, misleading, or inaccurate statement regarding conditions or market information. In *In re Indiana Farm Bureau Cooperative Ass'n, Inc. & Johnston*, the Commission concluded that a scienter requirement less than specific intent would "wreak havoc with the market place" by failing to distinguish "otherwise lawful business conduct from unlawful manipulative activity."[36] According to the Commission, "a clear line between lawful and unlawful activity is required in order to ensure that innocent trading activity not be regarded with the advantage of hindsight as unlawful manipulation."[37] Rather than adopting the Rule 10b-5 case law adapted to the unique functions of securities markets, the Commission should follow the logic behind its own Section 9(a)(2) precedent.

In dynamic, fast-moving markets, such as those at issue here, the dividing line between statements or conduct that are reckless (reflecting an extreme departure from ordinary care) and those that are negligent (departing somewhat from ordinary care) can easily be debated, and different fact-finders may reach different results even on identical facts. Incorporation of a recklessness standard into Proposed Rule 180.1 would require market participants to guard against the possibility that the Commission (or

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not contain such particular language in one section of a statute but omit it in another section of the same Act.

[35] Notice, 75 Fed. Reg. at 67,659.

[36] 1982 WL 30249, at *6.

[37] *Id.*

courts) might unpredictably base liability on conduct that falls far short of intentional wrongdoing.[38]

This would substantially increase the cost of compliance with Proposed Rule 180.1 and might deter market participants from engaging in legitimate business activities. Corporate compliance programs typically seek to establish clear rules for employees who lack specialized legal training. A recklessness standard could cause firms to adopt compliance programs that severely limit the amount of information they disclose for fear that any inaccuracies would create a basis for liability. Restricting market information will make the markets less efficient as price discovery venues. This could reduce the amount of transactions by market participants, which in turn, further reduces market liquidity and impairs the price discovery function of the commodities markets.

We include below some examples to highlight the potential impact of the proposed rule:

- Example 1: A hurricane causes significant damage to oil and gas infrastructure in a part of the United States, severely disrupting transportation to refineries and damaging the refineries themselves. A major distributor of gasoline asks one of the refineries damaged by the storm to estimate when it will be in a position to resume supplies. Based on the information available to it at the time, a refinery employee replies that it will be unable to supply gasoline for the next four weeks. The distributor accordingly enters a long futures position in RBOB gasoline on the NYMEX, anticipating the higher cost of procuring and transporting gasoline for at least four weeks. It turns out that the refinery incurred less damage than originally thought, and it resumes operations two weeks after the storm. With more care or effort, might the refinery have provided a better estimate of when it would resume operations? Could the refinery's conduct and its resulting effect be claimed to be market manipulation under Proposed Rule 180.1?

- Example 2: In the above example, had the refinery employee checked his very recently received emails, he would have known that other firm employees working to repair the facility estimated that the repairs would take only two weeks. Did the employee's actions constitute a "reckless" failure to check a source of information, or a "reckless" failure to correct the misstatement after the first conversation, such that it could support a market manipulation violation?

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[38] *See, e.g.*, *SEC v. Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 495 (S.D.N.Y. 2002) (holding, in the context of a Rule 10b-5 enforcement action, "[t]he question is not whether he was 'duped' into believing Credit Bancorp's misrepresentations, but whether, as Trustee, he should have reasonably known otherwise.").

Further, the costs of a recklessness standard are increased by the tendency of courts during litigation to interpret and apply the recklessness standard under Rule 10b-5 in different ways. The Supreme Court has expressly reserved decision on whether recklessness is sufficient to meet the scienter requirement for a Rule 10b-5 violation.[39] In the absence of a definitive statement by the Supreme Court, the Courts of Appeals have adopted a number of different formulations as to precisely what constitutes recklessness. A Commission rule that adopts Rule 10b-5 precedents without modification would not prevent different circuits, guided by their respective Rule 10b-5 precedents, from applying different tests to establish scienter for the purposes of the Commission's anti-fraud rule.

3. In the alternative, the Commission should modify the Rule 10b-5 scienter standard to fit the specific functions of the commodities markets

For the reasons discussed above, API and NPRA believe that specific intent—defined with respect to Section 753 of Dodd-Frank as an intent to deceive or defraud in order to manipulate a covered market—is appropriate to limit the rule to the market-distorting conduct that Congress intended to address in Dodd-Frank. If the Commission nevertheless continues to believe that a recklessness scienter requirement is warranted, API and NPRA believe the Commission should make certain modifications to ensure that the final rule does not curtail beneficial conduct that has no potential to manipulate market conditions.

First, API and NPRA request that the Commission follow the FTC's lead and clarify that a finding of liability under the market manipulation rule requires a showing of "extreme recklessness, rather than ordinary recklessness or negligence."[40] Due to the broad and ambiguous language of Section 10(b) and Rule 10b-5, the issue of scienter has been the subject of extensive litigation over the years. The extreme recklessness standard adopted by several courts of appeals requires a showing that "suspicious events creating reasons for doubt that should have alerted [the respondent] to the improper conduct of the primary violator" or of "danger ... so obvious that the actor should have been aware."[41] Anything less than an "extreme recklessness" standard would encourage

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[39] *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007).

[40] 74 Fed. Reg. at 40,696.

[41] *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (quoting Graham v. SEC, 222 F.3d 994, 1006 (D.C. Cir. 2000); SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992)). *See also Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir.), *cert. denied,* 434 U.S. 875 (1977).

industry compliance regimes that sharply curtail efficiency-enhancing disclosures and discourage legitimate business activities.

Second, the final rule should clarify that the specific intent required for liability is not simply intent to deceive or defraud, but intent to deceive or defraud in order to manipulate the market. Under the Commission's anti-manipulation precedent, the intent element requires proof "that the accused acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand influencing futures prices in the particular market at the time of the alleged manipulative activity."[42] Proposed Rule 180.1 sweeps more broadly than this. If liability can be grounded on nothing more than a deceptive or fraudulent statement made in connection with a covered transaction, the rules will apply to conduct that entails no risk of market manipulation and that may already be actionable under state anti-fraud and other laws. This in turn will substantially complicate compliance and increase the regulatory costs associated with the final rule. By requiring intent to deceive or defraud in order to manipulate a covered market, the final rule will target only the sorts of deliberately manipulative conduct about which Congress was concerned when it enacted Section 753.

Third, the Commission should clarify that scienter may not be premised on the collective knowledge of an entire company, but instead must be based on the knowledge of the person participating in the deceptive or fraudulent conduct. In the Section 10(b) and Rule 10b-5 context, the majority of courts have rejected the collective scienter approach, and instead have required that a particular culpable employee responsible for the deceptive or fraudulent conduct possessed scienter.[43] This requirement is especially important in the commodities markets, where traders are not instantly privy to factors impacting production, processing, or distribution of the cash commodity underlying the futures market. By rejecting the idea that the collective knowledge of all of the corporation's employees may be aggregated to show intent, the Commission will ensure that market participants are not discouraged from engaging in legitimate transactions.

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[42] *In re Ind. Farm Bureau Coop. Ass'n, Inc. & Johnston*, 1982 WL 30249, at *7.

[43] *See United States v. Philip Morris USA Inc.*, 566 F.3d 1095, 1122 (D.C. Cir. 2009); *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 707-08 (7th Cir. 2008); *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190 (2d Cir. 2008); *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004); *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1435 (9th Cir. 1995); *First Equity Corp. v. Standard & Poor's Corp.*, 690 F.Supp. 256, 260 (S.D.N.Y. 1988); *Woodmont, Inc. v. Daniels*, 274 F.2d 132, 137 (10th Cir. 1959).

Finally, the Commission should eliminate liability for "attempts" in Proposed Rule 180.1(a)(2). As written, the proposed rule makes it an offense for a person to engage in an impossible act—an "attempt" to make an untrue or misleading statement of material fact. The Commission states in its Notice that an "attempt" under the CEA requires, at a minimum, that an individual (1) possess the requisite intent and (2) engage in an overt act in furtherance of that intent.[44] But there can be no offense of "attempted false statements" because the offense is fully completed by the overt act of a making a false statement of material fact. A person cannot attempt to make a false statement; he or she either makes the statement or does not.

D. The proposed rule should limit liability for omissions

1. Imposing liability for omissions will chill pro-competitive behavior by market participants

API and NPRA support the Commission's proposed determination that market participants are under no duty to disclose "nonpublic information that may be material to the market price, rate, or level of the commodity transaction."[45] We interpret the proposed rule to confirm that the CEA does not impose disclosure requirements akin to those arising in the context of the securities law. We urge the Commission to state explicitly that silence or pure omissions (omissions that do not relate to explicit representations), and "no comment" statements are not actionable. There should be no affirmative duty to convey information to a counterparty in the nature of the reporting and information requirements under securities law.

API and NPRA are concerned, however, with the Commission's prohibition on "partial" or "incomplete" omissions.[46] We acknowledge that Section 753 provides that no person shall be required to disclose "nonpublic information that may be material to the market price, rate, or level of the commodity transaction, *except as necessary* to

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[44] Notice, 75 Fed. Reg. at 67,660. API and NPRA note that the Commission's precedent on attempted manipulation is in tension with the law governing attempts in other contexts insofar as it does not require a dangerous probability of success. For example, to demonstrate attempted monopolization under Section 2 of the Sherman Act, the defendant must have predatory or anticompetitive conduct with specific intent to monopolize *and* there must be a dangerous probability of the defendant achieving monopoly power. *See Spectrum Sports*, 506 U.S. at 455-456.

[45] Notice, 75 Fed. Reg. at 67,662.

[46] *Id.* ("It shall be unlawful … to intentionally or recklessly make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading.").

make any statement made to the other person in or in connection with the transaction *not misleading in any material respect*."[47] Although the statutory language permits the Commission to prohibit intentional omissions of material facts which render otherwise true statements materially misleading, the statute does not affirmatively require the Commission to implement such a rule. In light of the discretion afforded by the statute, API and NPRA believe that excluding liability for partial or incomplete omissions would better balance the likely benefits and harms of a market manipulation regulation.

Before adopting a blanket prohibition on "partial" omissions similar to Rule 10b-5, the Commission should consider the implications of uncritically subjecting commodities markets to a rule that was developed to meet the particular and different challenges of the securities markets. As discussed earlier in these comments, courts in the Rule 10b-5 context impose liability for material omissions because regulated parties often have access to material non-public information about the issuer that may affect the true value of the security. In the securities context, retail investors are at a unique informational disadvantage to issuers and corporate insiders, and therefore are protected by detailed disclosure obligations.

By contrast, participants in futures and swaps markets typically are sophisticated commercial actors generally able to assess the accuracy of statements and who likely have the resources to fill any important informational gaps. As the Commission has observed:

> Numerous futures market participants may have legitimate access to what some may perceive as superior information. For example, hedgers, who comprise a substantial portion of the markets, also participate in the production, processing, distribution and/or consumption of the cash commodity underlying the futures market. By the nature of their businesses, many hedgers are privy to nonpublic information that may prove to be material in futures markets. Alternatively, speculators have knowledge of their own futures or cash market positions and some traders may have superior resources with which to purchase or develop research information. … Such access to superior or more timely information is inherent in the markets, and futures

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[47] *Id.* (emphasis added).

> market participants voluntarily accept this situation if they choose to trade.[48]

In other words, market participants are not only permitted but encouraged to trade on the basis of proprietary information that shapes their expectations about future supply risks and price volatility. One party may have knowledge that indicates future supply shortages and price increases, while the other may believe that supply and prices will remain stable. There are strong policy reasons to limit disclosure of production decisions, output constraints, or facility improvements. It is not the responsibility of either party to undercut business plans by sharing confidential and proprietary market information.

To base liability on partial omissions to commodities markets, and to enforce them based on securities industry precedents, will undermine the CEA's objective of "providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading."[49] Responsible market participants today disclose information that is valuable to trading partners while refraining from disclosures that could undercut business opportunities. If market participants are liable for "incomplete" disclosures, they may conclude that they cannot confidently comply with this section of Proposed Rule 180.1(a)(2) without moving either to a policy of "100% disclosure" or to a policy of "no comment," neither of which is desirable.

Where the risk of liability discourages voluntary disclosures, market participants will be deprived of valuable information that lawfully facilitates transactions today. The Supreme Court has made clear that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5."[50] In today's markets, many traders share supply intelligence without any intent to mislead. They do so in real time, making best efforts to provide clear and accurate information, without the necessity (or time) for input from counsel or high-level management. In emergency situations, they publish the best information they have, even if they are not able to verify its accuracy. A rule that imposes liability on an ill-defined set of omissions could lead market participants to adopt compliance policies that limit those disclosures, denying commodity markets the benefits of the information that is readily disclosed today.

Where market participants seek to comply with an omissions rule by disclosing more information, companies will have an incentive to exercise great caution, to ensure

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[48] CFTC Study at 53-54.

[49] 7 U.S.C. § 5(a).

[50] *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988).

that no affirmative statement may be subjectively considered misleading through any omission. Releases of information will come more slowly, may be formalized to avoid any misstep, and will undoubtedly be accompanied by disclaimers and caveats that might significantly undercut their value to the marketplace. Thus, costs will increase for all market participants, taxing the efficiency of the market without significantly benefiting the market or consumers to justify the costs. Suppliers will impose compliance programs and devote resources to avoid the risks of unintended violations. Market participants that today rely on this information to operate efficiently will be forced to spend more to find new sources of information and to interpret less-informative reports from cautious suppliers.

We include below some examples to highlight the potential impact of the proposed rule:

- Example 3: A supplier of crude oil enters negotiations to divest one of its oil producing assets to a competitor. Following standard practice, news of the divestiture negotiations is tightly held within the supply company to avoid a public leak that would be detrimental to the company's competitive position. A trader employed by the company, who knows of the possible future divestiture but has been instructed not to disclose it, alters his typical trading behavior to reflect the company's anticipated decrease in projected supply as a result of the divestiture and says nothing to swaps counterparties about the possible future divestiture but states very generally that given market conditions and the company's cash positions it chooses to do less hedging. Swaps counterparties taking note of the change in trading behavior, interpret the change as the trader's changing market view on expected prices and begin to factor this signal into their own pricing models. Could the employee's intentional failure to disclose confidential business plans support a market manipulation violation?

- Example 4: A refinery is long crude oil futures for its operations. The refinery also has excess crude available as a result of its operations, and sells the crude oil in the closing period of the cash markets, always at the market price. After a disruption to its operations, the available excess crude oil for the cash market decreases but the refiner continues to sell at its usual levels in the cash markets with the expectation that it will procure any crude oil needed to fulfill its obligations beyond its inventory. If the refinery ultimately must procure crude oil to satisfy its cash market transactions at a price higher than the sale price, has the refinery engaged in a deceit upon other participants such that is violated the market manipulation rule? If a counterparty asks about the company's trading and the trader says it is "business as usual" without disclosing the temporary supply interruption, has he violated the market manipulation rule?

The statutory safe harbor adopted in Proposed Rule 180.1(b) will not avoid these risks. While the statutory provision makes clear that market participants are not required to make affirmative disclosures, an omission is nevertheless considered "material if there is a substantial likelihood that the omitted fact would have been viewed by a reasonable person as having significantly altered the total mix of information available."[51] Thus, the proposed rule may require the disclosure of proprietary information if: (i) a market participant makes any statement at all; and (ii) the statement could be viewed as incomplete or misleading without the disclosure of proprietary information. A market participant transacting should not be held responsible for guessing as to what might be material to a counterparty, nor for conveying every piece of information available just to assure compliance with these rules. This is especially troublesome in commodities markets where each trader brings unique information to the market.

API and NPRA believe that the Commission should exercise its discretion to exclude partial omissions from any final rule. By leaving open the possibility of liability for "incomplete" disclosures, the proposed rule is likely to chill voluntary, pro-competitive disclosures by market participants, disrupt the flow of valuable information into the market, and impose new costs on sources and interpreters of market information.

2. The Commission should follow the lead of the FTC and clarify the scope of liability for material omissions

If the Commission continues to believe that a prohibition on partial omissions is appropriate in the final rule, API and NPRA believes that the Commission should, at a minimum, follow the lead of the FTC and clarify that: (a) liability for omissions is limited to situations in which a person intentionally makes or omits material information in order to mislead the counterparty; (b) liability for omissions is limited to conduct that distorts, or tends to distort, market conditions; and (c) market participants have no duty to update information.

First, the final rule should impose liability only when a person intentionally omitted information from a statement with the further intent to make the statement misleading.[52] As explained above, a recklessness standard is likely to create confusion over whether traders should disclose information when they are less than 100 percent certain that the information is accurate. This is a particularly difficult standard to apply in the omissions context, where rapidly changing circumstances of an emergency or

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[51] Notice, 75 Fed. Reg. at 67,660.

[52] 74 Fed. Reg. at 40,698.

other situations could affect the subjective understanding of other market participants. Without a specific intent standard, the unnecessarily broad scope of the proposed rule, combined with the severe penalties available under the CEA, risk triggering industry compliance regimes that sharply curtail efficiency-enhancing disclosures and other beneficial conduct.

Second, the final rule should clarify that "a statement made intentionally misleading by reason of the intentional omission of a material fact would violate the Rule only if its dissemination 'distorts or tends to distort market conditions' respecting any covered product."[53] As discussed earlier in these comments, Congress intended Section 753 to apply to deceptive or fraudulent conduct that manipulates a covered market, not to conduct with effects that do not extend beyond the transaction at issue. Given the heightened risks associated with liability for "incomplete" disclosures, the Commission should give market participants certainty that statements containing material omissions will not be challenged if they do not adversely threaten the reliability of data in the market.

Finally, the Commission should make clear that omissions can create a basis for liability only if they render a representation deceptive or fraudulent at the time the representation is made. In the Rule 10b-5 context, courts are split on whether there is a duty to correct prior statements if the statements were true when made.[54] Some circuits have recognized a limited duty to update where subsequent events altered the validity of an initial definitive statement, while others have determined that there is no such duty. In the commodities markets, a duty to update information would discourage traders from making disclosures in the first place, creating an unworkable and dangerous precedent. To further the goal of encouraging more disclosure of quality, timely and forward-looking information, the Commission should confirm that there is no duty to update statements that were truthful at the time that they were made.

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[53] *Id.* at 40,699.

[54] Some circuits have held that Section 10(b) and Rule 10b-5 do not impose a duty to update prior statements. *See Hillson Partners Ltd. P'ship. v. Adage, Inc.*, 42 F.3d 204 (4th Cir. 1994) (holding that no cause of action can arise from detrimental reliance on an issuer's projections of future results); *Stransky v. Cummins Engine Co.,* 51 F.3d 1329, 1332 (7th Cir. 1995) ("[Rule 10b-5] implicitly precludes basing liability on circumstances that arise after the speaker makes the statement."). Other decisions, however, may be read to support a narrow duty to update. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1430-34 (3d Cir. 1997); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267-68 (2d Cir. 1993); *Backman v. Polaroid Corp.*, 910 F.2d 10, 17 (1st Cir. 1990); *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1043 (11th Cir. 1986).

E. The Commission should expand the "good-faith mistakes" exception

API and NPRA support the Commission's decision to codify the "Good Faith Mistakes" safe harbor for the transmission of false or misleading information to a price reporting service.[55] The rule ensures that the Commission will not second-guess reasonable, good-faith disclosures of price information to market indices. API and NPRA believe, however, that the Commission should expand the safe harbor to all public statements or reports by a market participant or other communications covered by the proposed rule.

Raising the specter of market manipulation liability for public statements made in good faith without an intent to mislead or deceive, even those made outside the trading context, will cause firms to impose restrictions on what information is released to the market, with the potential to reduce market liquidity on regulated exchanges and swap execution facilities. As a result, the rule will severely undermine the efficiency of commodities markets in effectively moving supply to where it is urgently needed at the best price, an outcome that is detrimental to the U.S. economy, markets, and consumers.

Furthermore, the Commission should make clear that liability under Proposed Rule 180.1(a)(4) attaches only to "public" reports or statements, not to isolated private commercial dealings, either internally or with third parties. The goal of a market manipulation rule should be to protect the market, not the sophisticated buyers and sellers that transact in that market. The parties to individual transactions in commodities markets are sophisticated commercial parties that do not owe fiduciary duties to each other, and there is little risk of information asymmetry between the parties as to the true nature of the traded commodity. Moreover, private remedies for fraud and breach of contract are entirely adequate to address possible problems that may occur in individual transactions. Any damages are confined to the parties themselves, who have the right incentives to pursue private remedies where appropriate. Public statements, in contrast, may create adverse consequences for numerous participants, with no one party necessarily having an adequate incentive to pursue private remedies. Because the goal should be to protect the market rather than individual traders, the Commission should clarify that market participants will not be liable for information exchanged in private transactions.

More fundamentally, however, the language of Proposed Rule 180.1(a)(4) appears to make certain private communications to third parties illegal even if the

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[55] Notice, 75 Fed. Reg. at 67,658.

statement or report that is deemed inaccurate was not material to the third party, not fraudulent, not communicated to the market and in fact irrelevant to the party receiving the report or communication. The proposed rule should be clarified to require that a false report under subsection (4) to be actionable must have a manipulative purpose or effect. But at a minimum, it must be fraudulent.

Finally, the Commission should adopt a "good faith mistakes" exception to Subsection 6(c)(2), which prohibits false statements of material facts made directly to the Commission. Section 729 of Dodd-Frank imposes extensive reporting requirements for all swap participants, registered entities, designated contract markets, and swap exception facilities. In some instances, the reporting of data must be made in real time and directly to the Commission. With the contemplated increased reporting requirements under Dodd-Frank, and potentially enormous volume of transaction and price data that must be submitted, the Commission should clarify that a person will not be held liable if the person mistakenly transmitted, in good faith, inaccurate or misleading information to the Commission. Without such a good faith exception, a significant volume of transaction and price data would be subject to liability from unintentional errors. API and NPRA believe the Commission should not hold market participants liable for good faith efforts to comply with the reporting rules.[56]

The lack of a scienter requirement in Subsection 6(c)(2) makes a good-faith mistake exception particularly important. Subsection 6(c)(2) prohibits any person from making a false or misleading statement to the Commission if the person "reasonably should have known" the statement to be false. Courts of appeals have held that the phrase "reasonably should have known" does not require a culpable mental state, but is instead an objective standard of negligence, disregarding the person's actual state of mind.[57] If market participants may be subject to significant civil penalties and other remedies for accidentally providing inexact data or incomplete disclosures, the provision will lead to massive compliance costs and the possibility of punitive sanctions of as much as $1 million per violation on an industry that is attempting in good faith to comply with significant new reporting obligations.

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[56] *See also* Federal Energy Regulatory Commission, *Policy Statement on Natural Gas & Electric Price Indices*, 104 FERC ¶ 61,121 (Jul. 24, 2003). The FERC Policy Statement provides a "safe harbor" that presumes accurate and good faith transaction data-reporting by data providers that adopt and follow FERC-established standards for trade data reporting. FERC does not penalize such providers for inadvertent errors in reporting. This policy is now embodied in FERC's rules at 18 C.F.R. §§ 35.37 & 284.403.

[57] *Coston v. Plitt Theatres, Inc.,* 860 F.2d 834, 835-36 (7th Cir. 1988) (holding that "reasonably should have known" is essentially a negligence standard and inconsistent with a "reckless disregard" standard) (emphasis omitted).

F. The Commission should provide a 180-day effective date for compliance

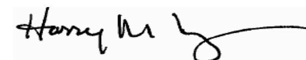
Any final rule should adopt a 180-day effective date to enable the industry to design and implement comprehensive compliance programs. Section 753(d) of Dodd-Frank provides the Commission with the discretion to establish a reasonable effective date. Given the breadth of the rule, a 180-day period will prove the minimum amount of time necessary to develop, test, and implement complex and stringent compliance programs and procedures.

IV. Conclusion

For the reasons described in its comments, API and NPRA are concerned that Proposed Rule 180.1 could impair the efficient operation of the commodities markets without providing benefits intended by Congress and the Commission. The adverse consequences of the proposed rule could include higher costs, reduced liquidity, and greater compliance risks and costs, all of which would encourage market participants to curtail trading activity, move trading offshore or reduce the free flow of information to the market. None of these outcomes is beneficial to the U.S. economy, markets, or consumers, and API and NPRA thus suggest that the Commission modify its propose rule in the ways described herein.

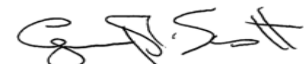
API and NPRA appreciate the opportunity to provide these comments. We will be pleased to provide additional information regarding our views on the proposed rule, and would welcome the opportunity to work with the Commission.

Sincerely yours,



Harry Ng

Vice President, General Counsel & Corporate Secretary, American Petroleum Institute



Greg Scott

Executive Vice President and General Counsel, National Petrochemical & Refiners Association

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Robert Pease, Counsel to the Director of Enforcement
Mark D. Higgins, Counsel to the Director of Enforcement

Appendix A

§ 180.1 Prohibition against manipulation.

(a) It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, with the intent to and effect of manipulating the price of any swap, contract for future delivery, or commodity market underlying such swap or contract for future delivery, to ~~intentionally or recklessly~~:

(1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud;

(2) Make, or cause to be made~~attempt to make~~, any untrue or misleading statement of a material fact ~~or to omit to state a material fact necessary in order to make the statements made not untrue or misleading~~;

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

(4) Deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate. ~~Notwithstanding the foregoing, no violation of this section shall exist where the person mistakenly transmits, in good faith, false or misleading information to a price reporting service.~~

(b) Nothing in this section shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.

(c) No violation of this section or section 6(c)(2) or (3) shall exist where a person mistakenly communicates or delivers in good faith false or misleading information to any person, including the Commission.

(d) Nothing in this section shall affect, or be construed to affect, the applicability of Commodity Exchange Act section 9(a)(2).