

State Bar of Texas

Volume 34, Number 2
December 2009



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OIL, GAS AND ENERGY RESOURCES LAW SECTION REPORT



**OFFICIAL PUBLICATION OF THE OIL, GAS AND ENERGY RESOURCES LAW SECTION OF THE STATE BAR OF TEXAS
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WHOLESALE PETROLEUM PRODUCTS BUYERS AND SELLERS BEWARE: NEW FTC ENERGY MARKET MANIPULATION RULE CREATES POTENTIAL LIABILITY

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A new Federal Trade Commission (FTC) rule, commonly known as the FTC Market Manipulation Rule, took effect on November 4, 2009, and could lead to the imposition of major fines on sellers and buyers at wholesale of crude oil, gasoline, jet fuel and petroleum distillates for either fraudulent statements and conduct or intentionally failing to disclose material facts.

As the FTC states, the Rule seeks to prohibit “market manipulation – that is, fraudulent or deceptive acts, practices, or courses of business – in the wholesale petroleum industry.”¹ The FTC has enforcement authority and can issue civil penalties up to one million dollars (\$1,000,000) per day per violation of the Rule.

Text of FTC Rule

The new FTC Rule makes it unlawful for any person or entity, directly or indirectly, in connection with the wholesale purchase or sale of crude oil, gasoline, jet fuel or petroleum distillates from:

- (a) Knowingly engaging in any act, practice, or course of business - including the making of any untrue statement of material fact - that operates, or would

¹ Federal Trade Commission, *Market Manipulation Rule*, <http://www.ftc.gov/ftc/oilgas/rules.htm> (last visited Nov. 5, 2009).

operate, as a fraud or deceit upon any person; or
(b) Intentionally failing to state a material fact that under the circumstances renders a statement made by such person misleading, provided that such omission distorts or is likely to distort market conditions for any such product.²

Products and Situations Covered by the FTC Rule

The key to understanding what entities, products and activities are covered and prohibited by the Rule is found through an examination of the Rule’s definitions and comments sections.

As required by Section 811 of Subtitle B of Title VIII of the Energy Independence and Security Act of 2007 (EISA),³ the FTC Rule applies to pipeline companies and their owners and affiliates to the extent their actions exceed acting solely as common carriers governed by the Interstate Commerce Commission.⁴

The term “wholesale” includes all purchases or sales of (i) crude oil or jet fuel (even if not for resale) and (ii) gasoline or petroleum distillates (other than jet fuel) including terminal rack sales, but does not extend to retail sales of gasoline, diesel fuels, or fuel oils to consumers.⁵

² Prohibitions on Market Manipulation, 74 Fed. Reg. 40,686, 40,686.

³ 42 U.S.C. § 17301 (2007).

⁴ Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,691.

⁵ FTC Market Manipulate Rule, 16 C.F.R. § 317.2(f) (2009); Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,692. Under the Rule, the term “petroleum distillate” includes, but is not limited to, jet fuels, diesel fuels and fuel oils. 16 C.F.R. § 317.2(e). The term “gasoline” means finished gasoline, including but not limited

The FTC intends the Rule to reach renewable fuels sold at wholesale (e.g. ethanol or biodiesel) or blending components (e.g. alkylate or reformate) that are not specifically identified in the definitions⁶ only if there is sufficient nexus between conduct involving those products and wholesale petroleum markets for the covered products.⁷ The FTC does not intend the Rule to apply to commodities whose predominant use is non-petroleum products, or to commodities that are inputs for ethanol, such as corn or sugar.⁸

What is “Knowing” Conduct?

The FTC set a high standard of “scienter” in the Rule that will make it difficult for a person or entity to violate the Rule innocently or inadvertently. Specifically, to violate the Rule, a person must engage in the proscribed conduct “knowing that it is fraudulent or deceptive.”⁹ “For example, a trader’s state of mind must encompass more than just carrying out the ministerial function of transmitting false information to a price reporting service. Rather, there must be evidence that the trader knew or must have known that the information transmitted was false.”¹⁰ Liability is established, however, if the trader acted at the behest of

to, conventional, reformulated, and oxygenated blends and conventional and reformulated blendstock for oxygenate blending. *Id.* at § 317.2(b).

⁶ Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,691.

⁷ *Id.* at 40,696.

⁸ *Id.* at 40,695. The term “crude oil” includes, but is not limited to, any mixture of hydrocarbons that exists in liquid phase in natural underground reservoirs and that remains liquid at atmospheric pressure after passing through separating facilities and as shale oil or tar sands requiring further processing for sale as refinery feed stock. 16 C.F.R. § 317.2(a).

⁹ *Id.* at § 317.3(a).

¹⁰ Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,696.

another person within the same organization “who knew or must have known” that the conduct would operate as a fraud or deceit.¹¹ Notwithstanding, the FTC “does not intend that the requisite state of mind be imputed across persons within an organization.”¹²

The FTC does not intend the Rule to cover inadvertent mistakes, unintended conduct or legitimate conduct in the ordinary course of business, and thus, for enforcement purposes, the FTC has determined that a showing of “extreme reckless is, at a minimum, necessary to prove the scienter element.”¹³

The Rule does not impose an affirmative duty to disclose information or a duty to correct or update information. Similarly, it is not a violation of the Rule to withhold market intelligence that a company gathered about market conditions.¹⁴ Also, the Rule does not impose any recordkeeping requirements,¹⁵ although entities may want to review their document retention policies to position themselves to defend against asserted violations of the Rule.

No Preemption of State Laws

The Rule contains a standard preemption provision that is found in other FTC rules, making it clear that the FTC does not intend to preempt the laws of any state or local government, except to the extent of conflict.¹⁶

Parallels In Other Agency Rules

The new FTC Rule is intended to “prevent the same types of fraudulent or deceptive

¹¹ *Id.*

¹² *Id.* at 40,696 n.128.

¹³ *Id.* at 40,691.

¹⁴ *Id.* at 40,698.

¹⁵ *Id.* at 40,693.

¹⁶ 16 C.F.R. § 317.4; Prohibitions on Market Manipulation, 74 Fed. Reg. at 40,700.

practices that the Securities and Exchange Commission,¹⁷ the Commodity Futures Trading Commission,¹⁸ and the Federal Energy Regulatory Commission (“FERC”) have pursued in the markets they respectively regulate.”¹⁹ The FERC, for example, acting pursuant to The Energy Policy of 2005,²⁰ adopted regulations that address market manipulation in the natural gas and electricity markets. Those regulations make it unlawful for “any entity, directly or indirectly, in connection with the purchase or sale of natural gas [or electric energy] or the purchase or sale of [natural gas] transportation [or electric transmission] services subject to the jurisdiction of the [FERC]” to

- “use or employ any device, scheme, or artifice to defraud;
- make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.”²¹

Although the text of the FERC’s market manipulation regulations do not match certain elements of the new FTC Rule which includes “*Knowingly* engage in any act” or

¹⁷ See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b); 17 CFR 240.10b-5.

¹⁸ See Commodity Exchange Act § 9(a)(2), 7 U.S.C. § 13(a)(2).

¹⁹ Prohibitions on Market Manipulation, 74 Fed. Reg. at 40689.

²⁰ Pub. L. No. 109-58, 119 Stat. 594 (2005) (EPA Act 2005) (amending, as applicable here, the Federal Power Act (FPA) and the Natural Gas Act (NGA)).

²¹ See 18 C.F.R. §§ 1.c.1—2 (2009).

“*Intentionally* fail to state a material fact,” the FERC has made it clear that “there can be no violation of [these market manipulation regulations] . . . absent a showing of the requisite scienter.”²²

The EISA authorizes the FTC to impose civil penalties of \$1 million per day per violation

²² *Prohibition of Energy Market Manipulation*, 114 FERC ¶ 61,047 at P 45 (2006). The FERC also has adopted Market Behavior Rules that require sellers of electricity products at wholesale in interstate commerce to

operate and schedule generating facilities . . . and commit or otherwise bid supply [in organized electricity markets] in a manner that complies with the [FERC]-approved rules, . . . provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the [FERC], and [FERC]-approved market monitors, [and] regional transmission organizations, . . . provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any . . . publisher[s] of electric or natural gas price indices, and] retain, for a period of five years, all data and information upon which it billed the prices it charged for the . . . electric energy products it sold . . . and the prices it reported for use in price indices.

18 C.F.R. § 35.41(a)-(d).

of the new FTC Rule.²³ The FERC has similar \$1 million per day per violation civil penalty authority.²⁴ The FERC aggressively enforces market manipulation. Last month, the FERC agreed to a \$30 million settlement to address allegations of manipulated physical wholesale natural gas prices.²⁵ In 2009, the FERC agreed to settlements and penalties in other fraud investigation cases.²⁶ The FERC has issued Policy Statements to apprise the energy industry of how the FERC views and intends to carry out its market manipulation authority. The Policy Statements discuss audits, investigations, discovery, settlements, treatment of self-reporting and choice of remedies including disgorgement of profits, compliance plans, non-monetary measures (such as conditioning, suspending or revoking authority to sell the FERC-regulated product) and civil penalties.²⁷ Entities seeking some indication of how the FTC Rule may be applied and enforced could look to the application of the FERC rules for guidance.

²³ See 42 U.S.C. § 17304.

²⁴ See 15 U.S.C. § 717t-1 (NGA); 16 U.S.C. §§ 825o-1, 823b (Part II of the FPA); 15 U.S.C. § 3414(b)(6) (Natural Gas Policy Act of 1978).

²⁵ See *Energy Transfer Partners, L.P., et al.*, 128 FERC ¶ 61,269 (2009) (settlement includes a \$5 million civil penalty and a \$25 million fund to disgorge alleged unjust profits to entities that file claims).

²⁶ *Amaranth Advisors L.L.C., et al.*, 128 FERC ¶ 61,154 (2009) (\$7.5 million civil penalty); *In re Tenaska Mktg. Ventures, ONEOK, Inc., Klabzuba Oil & Gas, F.L.P., Jefferson Energy Trading, LLC, et al.*, 126 FERC ¶ 61,040 (2009) (civil penalties ranging from \$300,000 to \$4.5 million, disgorgement of profits from prohibited activity as much as \$1.97 million and imposing compliance reporting programs).

²⁷ See *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156 (2008); *Policy Statement on Compliance*, 125 FERC ¶ 61,058 (2008).

Conclusion

Persons and entities that engage in the wholesale sale or purchase of crude oil, gasoline, jet fuel and petroleum distillates should be mindful of the new FTC Market Manipulation Rule that became effective November 4, 2009, and educate their employees accordingly. The Rule establishes a high bar for “knowing” and “intentional” conduct and statements, and thus persons and entities generally need not be concerned with innocent or inadvertent conduct in releasing false information. The more problematic provision in the Rule, however, may be the failing to state material information that renders statements made by such persons or entities misleading, where the omission is likely to distort market conditions for these products. Companies will need to monitor FTC proceedings closely to learn what the FTC considers an omission of material information leading to distorted market conditions. Although not required, companies may want to develop policies for compliance with the FTC Rule and recordkeeping to document compliance with the Rule.

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