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FERC Furthers Its Regulatory Reach In Recent Enforcements

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Recent Federal Energy Regulatory Commission victories and filings indicate that FERC will continue to push forward with a broad understanding of its enforcement authority. These matters suggest that FERC's enforcement reach and the deference it receives continue unabated by the limitations meted out by the D.C. Circuit in *Hunter v. FERC*.

In *Hunter*, the D.C. Circuit held that FERC lacks jurisdiction over the manipulation of natural gas futures contracts on the New York Mercantile Exchange even when FERC alleges that the manipulation affects FERC-jurisdictional markets because Congress granted the U.S. Commodities Futures Trading Commission exclusive jurisdiction over transactions conducted on futures markets like the Nymex.

The cases discussed below indicate that FERC will continue to enjoy ample jurisdiction even when there is overlap between physical and financial energy markets (except in the narrowly proscribed *Hunter* limitation) and that FERC remains committed to broadly pursuing its jurisdiction in a variety of forums with cases involving a wide range of behavior that affect energy markets.

This article looks at selected aspects of three FERC cases involving differing fact patterns and procedural postures:

1. *Barclays*, in which FERC seeks an order from a federal district court affirming FERC's decision to assess more than $400 million in civil penalties for trading electricity at hubs in the Western U.S. in order to manipulate prices at those hubs and profit on financial positions that depended on the prices at those hubs;
2. *BP*, in which FERC staff prevailed in a trial before a FERC administrative law judge involving allegations of a pattern of money-losing physical trades in the Houston Ship Channel ("HSC") in order to profit on financial trades involving the price spread between HSC and Henry Hub; and
3. *Powhatan*, in which FERC assessed civil penalties of nearly $30 million and recently filed a complaint in a federal court in Virginia seeking to affirm that assessment for engaging in large volumes of allegedly fraudulent up to congestion ("UTC") trades in order to receive an allocation of payments from PJM Interconnection LLC'smarginal loss surplus.

Like *Hunter*, the closely watched *Barclays* case involves trading in both physical and financial electricity products. Early this summer, a federal judge in California denied the defendants' (Barclays PLC and named individual Barclays traders) motions to dismiss FERC's case or transfer the case to New York. The judge later issued a procedural order that may foreshadow a ruling in FERC's favor on the scope of how that case will be tried. More recently, a FERC administrative law judge delivered a comprehensive initial victory for FERC in the *BP* natural gas market manipulation case. In between these rulings, FERC issued an order assessing civil penalties against Powhatan Energy Fund LLC and related parties in connection with a scheme that allegedly exploited tariff rules in the PJM electricity market and filed a case in federal district court to enforce that assessment. While each case involves different conduct, products and markets, they collectively provide insight on how FERC will exercise its enforcement authority going forward, 10 years after Congress gave FERC its current anti-manipulation and penalty authority.

FERC's Geographic Reach

FERC has shown that it will pursue its jurisdiction in advantageous venues where the impacts of the alleged market conduct is most significant. U.S. District Judge Troy L. Nunley's order denying the Barclays defendants' motion to dismiss rejected claims that the Eastern District of California was an improper and inconvenient venue and that the case should be transferred to New York, where Barclays' trading offices were located.

Judge Nunley found that FERC had selected a valid forum under Section 317 of the Federal Power Act, which allows FERC to bring suit either where "any act or transaction constituting the violation occurred" or where a defendant is an inhabitant. Judge Nunley found that FERC had shown that transactions at issue occurred in the Eastern District of California because Barclays had sold, taken title to or scheduled energy within that district and because energy deliveries were scheduled with the California Independent System Operator, which is located in that district.

It thus appears that Judge Nunley's opinion may support venue at trading zones, hubs and points where transactions occur; the location of the independent system operator/regional transmission organization in which the allegedly manipulative market activity occurs; and the locus of the accused or aggrieved parties. Judge Nunley rejected defendants' arguments that "the effects of manipulative trading" should not be "considered in a venue analysis." In his related rejection of defendants' motion to transfer, Judge Nunley found that some factors supported transfer, but ultimately sided with FERC's choice of venue because: (1) the effect of the alleged activity on electricity prices "relied on by market participants in this District" meant that the interests of justice weighed heavily against transfer; and (2) "the deference afforded to FERC's choice of forum." This holding means that future defendants might find themselves in unexpected and unfavorable venues as long as FERC has a plausible theory that the alleged violation had an effect on energy consumers in a given district.

In its complaint in the *Powhatan* case, FERC again relied on "the 'any act or transaction constituting the violation' clause of" FPA Section 317 to support its choice of venue in the Eastern District of Virginia. It stated that the defendants had manipulated electricity markets "in the mid-Atlantic United States" and pointed to the portion of that manipulation that specifically affected Dominion Virginia Power and customers located in the Eastern District of Virginia.[1] FERC thus suggests that venue would be proper throughout the region, but provided additional specific support for the specific district that it chose.

Venue was not an issue in the *BP* case because the Natural Gas Act, unlike the Federal Power Act, does not allow the election of a *de novo* proceeding before a federal district court. Instead, FERC litigated the

case on its home turf in front of Administrative Law Judge Carmen A. Cintron.

Judge Cintron's initial decision ruled against BP PLC and in favor of FERC's enforcement staff on every issue in the case. While this outcome may not have been dependent on the venue, and is subject to further proceedings and appeal, many defendants will continue to prefer to have their cases heard in federal district courts rather than before FERC administrative law judges, even though Judge Nunley's opinion suggests that FERC will enjoy wide latitude in selecting the court of its choice under the FPA and that it may receive factual deference, as described below.

Scope of *De Novo* Review

FERC has also sought to reduce companies' incentives for seeking review in federal district court by arguing before Judge Nunley that *de novo* review should not involve a re-presentation of the evidence that FERC relied upon in its investigation and in issuing an order finding a violation. The Barclays defendants argued that "FERC's interpretation would mean that a defendant that elects a district court *de novo* action gets fewer rights, and no adjudicative rights, compared to a defendant that elects an administrative hearing before an ALJ. This cannot be the case."

Judge Nunley has not yet ruled on this issue, but he issued a procedural order that suggests he favors FERC's view. In a procedural order seeking additional briefing on whether the amount of disgorgement should be tried separately from the rest of the case, the judge stated that "parties need not address the scope of *de novo* review." Though Judge Nunley did not state his views on the issue, he asked the parties to "assume a scenario in which the Court, for the purposes of reviewing civil penalties, conducts a review of the record identified by FERC ... [and that] briefing is completed in a manner similar to the schedule proposed by FERC."

This assumption suggests that Judge Nunley may intend for the bulk of the trial on liability and civil penalties to rely on the record compiled in the investigative stage, and summarized in the staff report attached to FERC's order to show cause (*Barclays Bank PLC*, 141 FERC ¶ 61,084 (2012)) as well as the pleadings filed at FERC following the order to show cause. Though the issue remains uncertain pending a formal ruling from Judge Nunley, if FERC has convinced Judge Nunley that the record at FERC is sufficient as a starting point for his *de novo* review of FERC's decision and if other judges follow his lead, then the upshot would be that *de novo* review may not liberate a company from what it feels is unfair treatment of the evidence during FERC's investigation. Given this possibility, defendants should ensure a full presentation of facts favorable to them during FERC's investigation. In the event a defendant views further discovery and adjudicative procedures as crucial to its defense, it might be forced to consider electing a hearing before a FERC administrative law judge instead of *de novo* review in a district court.

Scope of Activities Subject to FERC's Jurisdictional Reach Has Not Been Significantly Diminished by *Hunter*

Judge Nunley agreed with FERC that the role of financial trades in the allegations against Barclays did not undermine FERC's jurisdiction. His decision found that the mere involvement of financial instruments such as swaps is not determinative and that the D.C. Circuit's 2013 decision in *Hunter v. FERC* — which found that FERC lacks jurisdiction over areas within the CFTC's exclusive jurisdiction — was not applicable.

Instead, Barclays's trading strategy was subject to FERC jurisdiction because its alleged manipulation targeted physical transactions: "Defendants have not shown why swaps, as the benefiting position, are

relevant to jurisdiction, as opposed to the trades involving physical products, from which the swaps were priced. FERC's allegation is that the manipulation occurred in the physical market and the swaps benefited, not the converse."[2] Thus, defendants need to look to the instruments alleged to have been manipulated: if the manipulation is alleged to have occurred in financial markets subject to the CFTC's exclusive jurisdiction like futures and swaps, FERC will be barred from bringing an action even if it alleges that the activities affected its jurisdictional markets, while allegations of trading FERC-jurisdictional products will remain FERC's bailiwick.

In addition to limiting the impact of *Hunter v. FERC*, Judge Nunley accepted a broad view of FERC's jurisdiction over wholesale electricity contracts under the FPA that did not depend on whether the traded electricity was delivered. Judge Nunley found that FERC's allegations that the Barclays defendants traded wholesale electricity contracts and scheduled sales of electricity fit the "plain meaning" of FPA Sections 201(b) and 222. He rejected the defendants' argument that FERC lacks jurisdiction when electric energy is not delivered. FERC similarly rejected the argument that the congestion trading involved in Powhatan was beyond FERC's jurisdiction because it was "purely financial." In doing so, FERC cited its prior statements that it has jurisdiction over virtual transactions in RTO/ISO markets.

Judge Cintron likewise accepted a broad view of FERC's jurisdiction (under the "in connection with" language of NGA Section 4A), concluding that BP's manipulation of the HSC *Gas Daily* index was subject to FERC's jurisdiction because the price of jurisdictional cash out transactions was set based off of the index affected by BP's manipulation. In support of this conclusion, Judge Cintron quoted Judge Nunley for the proposition that "where 'markets in which Defendants traded were relied on by other market participants ... combined with the allegations of manipulation ... adequately establishes FERC's jurisdiction.'"

Types of Conduct FERC Has Targeted Are Broadly Applicable, Requiring All Types of Energy Companies to Develop a Sensitive Compliance Radar

FERC's recent enforcement activity shows both the variety of FERC's reach — with facts patterns involving interaction between physical trades and financial swaps in both electric and gas markets (*Barclays* and *BP*), the exploitation of tariff rules (*Powhatan*) and sudden changes in trading patterns (*BP* and *Powhatan*) — as well as its potential for extrapolating that reach by applying the same concepts to new market participants.

For example, the concept underlying the strategies targeted in *Barclays* and *BP* did not depend on one of the markets being financial or the use of an index. Instead, the key concept was a suboptimal or losing pattern in one market that improved a position in another interrelated market, and that concept could still apply much more broadly. As a result, even more traditional energy companies that are not primarily focused on financial trading must develop a compliance radar for market activities that reflect cross-market interactions or inconsistent approaches across markets.

This sensitivity is especially necessary if one segment of a company's market activity could be seen as losing money and if the company is changing the pattern of its market activity. In *BP*, Judge Cintron emphasized that a change in trading patterns was both evidence of a manipulative scheme and evidence of scienter, especially because the change from the prior trading pattern created losses in one market. In *Powhatan*, the interaction was not between two markets; instead the alleged manipulation involved the PJM UTC product, in which Powhatan submitted numerous trades that were essentially guaranteed to achieve neither profit nor loss (a suboptimal strategy that would ultimately lose money once

transaction costs are considered) in order to improve its position with respect to receiving an allocation of payments from PJM's marginal loss surplus. FERC highlighted the change in Powhatan's congestion trading strategy after it learned of the relationship between the congestion market and payments from the marginal loss surplus as evidence of both the strategy's fraudulent character and the defendants' scienter.

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[1] FERC also noted that the principal office of Powhatan (but not the other three defendants) was located in the district and that an agreement among a majority of the defendants (authorizing Chen and HEEP to place relevant trades on Powhatan's behalf) specified venue in the district in the event of disputes under the agreement.

[2] Judge Nunley also specifically distinguished *Hunter* because it involved futures contracts traded on Nymex, unlike Barclays' trades that were placed on the ICE ECM, which was not the subject of CFTC jurisdiction during the relevant time period. His decision suggests that this distinction may no longer apply because Congress altered the CFTC's jurisdiction in 2010.