

FERC's Continued Pursuit Of Individual Trader Liability

Law360, New York (September 8, 2016, 1:02 PM ET) --

On Sept. 1, 2016, the Federal Energy Regulatory Commission issued an order approving a settlement between its Office of Enforcement (OE) and National Energy & Trade LP (NET), resolving its investigation into NET's alleged manipulation of natural gas prices through bidweek trading at Tetco M3 and Henry Hub in order to benefit related financial positions.

On the same day, the commission also issued an order approving a settlement between the OE and David Silva, an NET trader, based on Silva's involvement in the Tetco M3 trading at issue. Through the settlements, NET — which wound down its operations in 2015 — agreed to pay a civil penalty of approximately \$1.15 million and to disgorge approximately \$300,000 in unjust profits, while Silva agreed to pay a civil penalty of \$40,000.[1]

The NET and Silva settlements involve similar allegations to those that the OE has made in other enforcement cases involving natural gas trading (i.e., manipulative bidweek trading to influence the value of financial positions), reflecting the agency's continued focus on "related-position" cases. The Silva settlement also reflects FERC's continued focus on pursuing liability (both civil penalties and trader bans) for individual traders — a trend that is unlikely to abate in light of several recent federal court decisions upholding FERC's authority to pursue individual liability. But, apart from reflecting these core FERC enforcement trends, these settlements are notable for additional reasons.

One is that the NET settlement reflects a rare instance in which FERC has approved a downward departure from its penalty guidelines, and it appears to be the first such departure in a market manipulation case. Another is that these settlements show the persistence with which FERC will pursue even relatively small manipulation cases — even when the case involves a company that no longer exists and the conduct had only limited effects on FERC's jurisdictional markets.

Allegedly Manipulative Bidweek Trading

The OE alleged that NET engaged in manipulative trading activities at two trading hubs during two time periods. First, the OE alleged that NET engaged in manipulative trading at Tetco M3 during January 2012 bidweek for February 2012 flow. NET sold financial basis at Tetco M3 the week before January 2012 bidweek. On Jan. 25, 2012, as bidweek opened, NET began offering to sell physical basis at 2:17 a.m., almost three hours before any other market participant submitted a bid or offer, and several hours



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before NET typically began trading. NET's opening physical-basis offer was approximately 10 cents below the most recent prices for consummated physical- and financial-basis offers, and, according to the OE, was not driven by any changes in fundamentals.

NET initiated the 20 lowest offers out of the 41 physical-basis offers made at Tetco M3 on Jan. 25, 2012, and NET's sales of physical basis at Tetco M3 were 63 percent of all sales that day. NET consummated all 25 of its physical-basis sales before beginning to repurchase the financial-basis position it sold the week before. The OE found that NET's physical-basis trading was unprofitable on its own, but had the effect of lowering the Inside FERC (IFERC) settlement index — on which NET's financial positions settled — by allowing NET to repurchase its financial-basis position at a lower price.

The OE also alleged that NET engaged in manipulative trading activities at Henry Hub during April 2014 bidweek for May 2014 flow. During April 2014 bidweek, NET made several sets of bids and offers for fixed-price monthly IFERC contracts at Henry Hub after the New York Mercantile Exchange (NYMEX) closed — a period during which there is generally very little physical trading.

NET submitted approximately 80 percent of all bids and offers for fixed-price monthly IFERC contracts after NYMEX had closed, and it made these bids and offers at very similar prices. According to the OE, these trades gave the impression that there was a market for such transactions when no such market existed. NET was ultimately responsible for consummating all of the fixed-price monthly trades at Henry Hub that occurred after NYMEX closed. The OE found that these trades allowed NET to move the IFERC settlement price higher, which benefited NET's financial positions (which included both basis swaps and index swaps).

Key Takeaways

First, these settlements reflect that the OE continues to pursue individual traders in enforcement cases, not just companies, and continues to seek to negotiate individual trader bans. The commission has increasingly sought to hold individuals accountable, particularly in market-manipulation cases. The commission's view, reflected in a recent order assessing civil penalties in a different matter, is that “[c]ompanies can manipulate markets only through the conduct of individuals, making it imperative that individuals be held accountable.”^[2] While many enforcement subjects questioned the commission's legal authority to bring enforcement cases against individuals, four federal district courts that have addressed this question over the past two years have sided with FERC, all but ensuring that the commission will continue to pursue individual liability.^[3]

The NET settlement also reflects FERC's continued interest in negotiating individual trader bans as part of market manipulation settlements. While FERC has legal authority to compel trader bans in Natural Gas Act (NGA) market manipulation cases only if it secures an injunction from a federal district court under Section 20 of the NGA,^[4] it has sought to negotiate trader bans voluntarily through settlement agreements. The OE's settlement with Silva provides that “[f]or a period of one year after the effective date, neither Silva nor any person or entity acting on his behalf, nor any entity, partnership, company or affiliate in which he has a financial interest, shall participate in any FERC-jurisdictional natural gas trading.”^[5]

Second, the NET settlement appears to be the first instance in which the commission has approved a downward departure from the penalty guidelines in a market manipulation settlement. FERC's penalty guidelines (PGs), which the commission issued in 2010, provide for the commission to apply a formulaic approach to determining the appropriate range of civil penalties in an enforcement case. In market

manipulation cases, the penalty range produced by the PGs is largely driven by the market harm caused by the violation and the duration of the violation. Although the PGs state in several places that they are just guidelines and are discretionary,[6] in practice, the commission almost never approves departures. This is a rare example of such an approval — and, as noted above, apparently the first in a market manipulation settlement.

FERC states that the approximately \$1.15 million civil penalty provided for in the NET settlement is below the bottom of the range provided by the PGs, finding that such a downward departure is warranted by the “circumstances of this matter, including the fact that [NET] is no longer a going concern.”[7] The NET case could signal that the commission may be more willing to apply the PGs flexibly in cases — even market manipulation settlements — where there are unique factors in play (such as the company no longer being operational).[8] But one instance does not make a trend.

Third, the NET case shows the persistence with which the OE will pursue market manipulation cases, even if the case is relatively small and there are factors in play that might caution in favor of not pursuing the matter (or closing the investigation without further action). Although the settlement states that the scope of the investigation was broader (see note 1 above), the specific violations addressed in the NET settlement occurred during relatively discrete time periods — just two bidweek trading periods — and allegedly caused market harm that, while not insignificant, pales in comparison to the harm alleged in many of the market manipulation cases that FERC has settled or brought. Moreover, the case concerned a company that was no longer operational and thus could not engage in further misconduct. Nevertheless, FERC continued to pursue this matter, ultimately reaching settlements with the company and one of its traders.

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Disclosure: David Applebaum had supervisory responsibility over this investigation while he was at FERC. The settlements were entered into and approved by FERC after Applebaum left the agency.

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[1] The NET order states that the OE's investigation examined NET's trading from Jan. 1, 2011, to Sept. 30, 2015, at four trading locations: Tetco M3, Henry Hub, Houston Ship Channel and Transco Zone 6 New York. However, the settlement does not allege violations associated with trading at Houston Ship Channel or Transco Zone 6 New York, and the alleged violations relating to Tetco M3 and Henry Hub involved activities during discrete time periods in 2012 and 2014.

[2] ETRACOM LLC, 155 FERC ¶ 61,284, at P 186 (2016).

[3] FERC v. Barclays Bank PLC, 105 F. Supp. 3d 1121, 1145-46 (E.D. Cal. 2015); FERC v. Silkman, No. 13-13054-DPW, 2016 WL 1430009, at **20-21 (D. Mass. April 11, 2016); FERC v. Maxim Power Corp., Mem. and Order re Procedures Applicable to FERC's Pet. and Respondents' Mot. to Dismiss at 27-29, No. 3:15-cv-30113-MGM (D. Mass. July 21, 2016); FERC v. City Power Marketing LLC, Mem. Op. at 32-36, No.

1:15-cv-1428-JDB (D.D.C. Aug. 10, 2016). In a fifth case, which FERC brought against Powhatan Energy Fund LLC, its trader Houlian “Alan” Chen and certain other entities, the court denied without prejudice Chen’s motion to dismiss, in which he argued, among other things, that FERC did not have the authority to bring an enforcement case against him in his individual capacity. *FERC v. Powhatan Energy Fund LLC*, Mem. Order, No. 3:15-cv-452-MHL (E.D. Va. Jan. 8, 2016).

[4] 15 U.S.C. § 717s(d) (2012). The Federal Power Act — which governs FERC enforcement actions involving electric markets — does not contain such a provision allowing a federal district court to ban a trader from FERC-jurisdictional electric markets in manipulation cases. Nevertheless, FERC has negotiated similar trader bans voluntarily in settlements involving electric market manipulation. See, e.g., *MISO Cinergy Hub Transactions*, 149 FERC ¶ 61,278, at P 3 (2014).

[5] 156 FERC ¶ 61,155, at P 22 (2016). We note that, while the one-year term of the trading ban is equal to, or shorter than, recent bans that FERC has included in settlements, the scope of the ban is unusually broad to the extent that it covers not just Silva but entities in which he “has a financial interest.” We will continue to monitor whether FERC intends to adopt such language in future settlements and, if so, how the agency interprets and applies the language.

[6] See, e.g., *Enforcement of Statutes, Orders, Rules, and Regulations*, 132 FERC ¶ 61,216, at P 3 (2010) (“[T]he modified [PGs] do not restrict our discretion to make an individualized assessment based on the facts presented in a given case.”); *id.* P 32 (“It may be appropriate to depart from applying the [PGs] where they do not account for significant circumstances surrounding a violation, which is why we include the flexibility to depart as necessary.”) (Revised Policy Statement on Penalty Guidelines).

[7] 156 FERC ¶ 61,154, at P 26 (2016).

[8] The \$40,000 civil penalty assessed to Silva is significantly less than what the commission has assessed against individuals in other market manipulation cases. Although Silva, as an individual, is not subject to the PGs, the commission stated in its order that the \$40,000 civil penalty factored in Silva’s financial resources and his agreement to a one-year trading ban.