

Enforcement Times Two

FERC and CFTC begin sharing information to target market manipulation in the energy industry.

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In 2005, Congress broadened enforcement authority at the Federal Energy Regulatory Commission (FERC) to reach the use of “any manipulative or deceptive device or contrivance” in connection with natural gas and electricity trading that is subject to FERC regulation.¹ Since then, FERC has significantly expanded its Office of Enforcement and has sent a strong signal that it intends to wield its new authority aggressively. Until recently, however, its enforcement efforts had been hampered by jurisdictional disputes with the Commodity Futures Trading Commission (CFTC) and, moreover, by the CFTC’s reluctance to share with FERC its sophisticated Large Trader Reporting System (“LTRS”) database containing detailed information on the futures, options, and swap positions of traders that exceed certain position limits or volume thresholds.²

It is well-known that FERC and the CFTC have disagreed for years about the scope of their respective jurisdictions over the energy markets.³ This disagreement has persisted despite the requirement in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) that FERC and the CFTC should have agreed on two memoranda of understanding (MOUs) by January 2011.⁴ Their unwillingness to share information drew expressions of concern from the U.S. Senate as recently as last year.⁵ In January 2014, however, three years after the initial deadline, FERC and the CFTC (jointly, the “Commissions”) issued

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MOUs addressing a number of outstanding jurisdictional issues and agreeing to share information on markets under each of the Commissions’

jurisdiction,⁶ including giving FERC access to the CFTC’s vast LTRS database.⁷ With these new understandings, improved cooperation between the Commissions seems a reality. Indeed, the Commissions announced on March 5, 2014, that they had actually begun sharing information, and had formed a joint data surveillance and analysis task force to help coordinate the use of analytical tools for “regulatory purposes.”⁸

This closer working relationship between the Commissions heightens the enforcement risk for companies engaged in trading physical and financial energy products. Data from CFTC-regulated financial markets, and access to the

6. Memorandum of Understanding between the Federal Energy Regulatory Commission and the Commodity Futures Trading Commission (Jan. 2, 2014), available at <https://www.ferc.gov/legal/mou/mou-ferc-cftc-jurisdictional.pdf>; Memorandum of Understanding between the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission Regarding Information Sharing and Treatment of Proprietary Trading and Other Information (Jan 2, 2014), available at <https://www.ferc.gov/legal/mou/mou-ferc-cftc-info-sharing.pdf>.
7. See Transcript, Committee on Banking, Housing and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection Hearing on Financial Holding Companies and Physical Commodities, 2014 WL 131193 (Jan. 15, 2014); Letter from Gary Gensler, Chairman, CFTC, to Cheryl A. LaFleur, Acting Chairman, FERC (Jan. 2, 2014), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcfercsideltr2014.pdf>.
8. See CFTC & FERC, Joint Press Release, CFTC, FERC Implement Information Sharing MOU (Mar. 5, 2014), available at <http://www.cftc.gov/PressRoom/PressReleases/pr6873-14>.

1. 16 U.S.C. § 824v; 15 U.S.C. § 717c-1.
2. 7 U.S.C. § 6t; Ownership and Control Reports, Forms 102/2012S, 40/40S, and 71, 78 Fed. Reg. 69,178 (Nov. 18, 2013) (codified at 17 C.F.R. pts 15, 17, 18, and 20).
3. See e.g., *Hunter v. FERC*, 711 F.3d 155, 156-57, (D.C. Cir. 2013); see also Suede Kelly, et al., Regulatory Uncertainty Remains in Energy Markets, New York Law Journal (Nov. 3, 2013), available at <http://nylawyer.nylj.com/adgifs/specials/110413compliance.pdf>.
4. 15 U.S.C. § 8308 (2012).
5. See Letter from Jon Wellinghoff, Chairman, Federal Energy Regulatory Commission to Senators Feinstein, Murkowski and Wyden (Aug. 29, 2013), available at http://www.feinstein.senate.gov/public/index.cfm/files/serve/?File_id=b431ada9-0ecf-4c10-8f16-23ead0ecc085.

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CFTC's powerful data analysis tools, will provide FERC with new weapons in its beefed-up anti-manipulation efforts. Moreover, as FERC becomes more adept at spotting and investigating wrongdoing, experience shows that it will also become more aggressive in referring such matters to the Department of Justice (DOJ) for criminal investigation and prosecution. And recent events reflect that the CFTC is also entering a phase of increased cooperation with DOJ. The improved relationship among regulators and prosecutors strongly suggests that participants in the energy markets will face new threats of criminal investigations, and perhaps prosecutions, launched by DOJ.

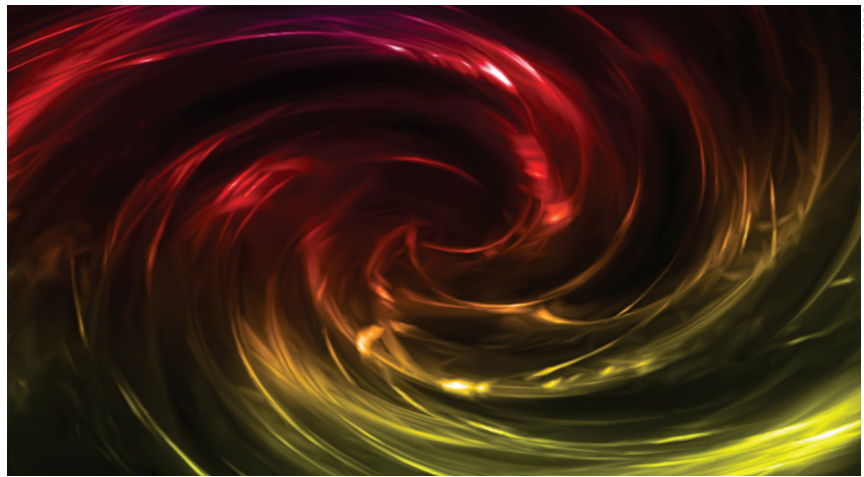
In the remainder of this article, we review developments in this area of the law and their likely impact on participants in the energy markets.

A New and Expanding Turf

Historically, neither the CFTC nor FERC was responsible for extensive policing of market manipulation. Until recently, the CFTC's enforcement authority was closely circumscribed, while FERC's limited enforcement powers focused on tariff and regulatory violations. But both Commissions gained new enforcement powers over the last decade, as Congress responded with new legislation to perceived wrongdoing and manipulation in the derivatives and energy markets. The Energy Policy Act of 2005 ("EPAAct")⁹ expanded FERC's enforcement authority and empowered FERC to impose civil penalties of up to \$1 million per day per violation.¹⁰ The enforcement and penalty provisions in EPAAct were largely a response to the Western Energy Crisis of 2000-

9. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

10. 16 U.S.C. §§ 824v, 825o-1 (2006); 15 U.S.C. § 717c-1.



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Access to CFTC's data analysis tools, will provide FERC with new weapons.

01, which was popularly attributed to energy market manipulation. For its part, the CFTC gained new authority over swaps and market manipulation under Dodd-Frank,¹¹ which was passed in reaction to the 2008 financial meltdown.

Notably, both EPAAct and Dodd-Frank modeled their anti-manipulation provisions after Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act")¹² to prohibit the use of "any manipulative or deceptive device or contrivance" in connection with their regulated markets.¹³ Similarly, both FERC¹⁴ and the CFTC¹⁵ implemented their new statutory authority by adopting "Anti-Manipulation Rules" modeled

11. Dodd-Frank § 753.

12. 15 U.S.C. § 78j(b). EPAAct not only uses language patterned after the Exchange Act, it expressly references Section 10b in its text.

13. 16 U.S.C. § 824v; 15 U.S.C. § 717c-1.

14. 18 C.F.R. pt. 1c (2013).

15. Prohibition on the Employment, or the Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,401 (July 14, 2011).

after Securities and Exchange Commission ("SEC") Rule 10b-5.¹⁶ There is a vast body of case law interpreting the SEC's broad powers under Section 10b and Rule 10b-5, and FERC has said that it intends to interpret the regulations "consistent with analogous SEC precedent that is appropriate under the circumstances."¹⁷ Nevertheless, it remains unclear how this case law will ultimately be applied to the energy, commodities, and derivatives markets.

Despite this uncertainty, the Commissions have scaled up their enforcement activities in accordance with their increased resources and authority. FERC identified three core enforcement functions in its Strategic Plan for FY 2014-FY 2018, two of which directly relate to market manipulation: (1) surveillance of the gas and electric markets to detect manipulation and (2) investigations of potential violations.¹⁸ In addition, FERC has expanded its Office of Enforcement to more than 200 staff members, and in

16. *Prohibition of Energy Mkt. Manipulation*, 114 FERC ¶ 61,047, at PP 2, 30 (2006).

17. *Id.* at P 2.

18. FERC, Strategic Plan at 12 (March 2014), *available at* <https://www.ferc.gov/about/strat-docs/strat-plan.asp>. The third priority, compliance audits, is more applicable to FERC's historical roles of overseeing reliability and tariff administration, although it is possible an audit might uncover a market manipulation scheme.

2013, assessed the two largest penalties in its history, which alone totaled nearly \$900 million in fines and disgorgement.¹⁹ Lastly, FERC also has begun to pursue individuals in addition to corporations, in one case imposing penalties of \$1 million on each of three energy traders and \$15 million on the supervising trader.²⁰

For its part, the CFTC filed over 200 enforcement actions in 2011 and 2012, or nearly as many as it had filed in 2006-2010 combined. It recently announced the appointment of a former federal prosecutor with over 20 years of experience litigating both criminal and civil matters as the new Director of Enforcement.²¹ The CFTC has also hired an SEC veteran to oversee the whistleblower program created by Dodd-Frank. The SEC's experience with its own Dodd-Frank whistleblower program suggests that many new investigations will be generated by whistleblower allegations.²² As with FERC, recent years have seen the CFTC impose the largest penalties in its history, leveling a fine for alleged manipulation of the London Inter-Bank Offered Rate (Libor) of \$200 million in 2012,²³ and fines of \$325 million²⁴ and

\$475 million²⁵ based on similar allegations in 2013. Although not energy related, the Libor investigations are the direct result of close cooperation between the CFTC and DOJ.

A Case-by-Case Approach

In testimony before Congress in January 2014, the putative FERC chairman testified that the “financial and physical natural gas and electric markets are interrelated” and that FERC’s then-existing “surveillance program has limitations because we do not have access

These new efforts will increase referrals to DOJ for criminal investigation.

at present to certain financial data from the related financial markets.”²⁶ But as noted, the recent issuance of the MOUs by the Commissions gives FERC long-desired access to the CFTC’s LTRS database. This development will provide FERC with a wealth of trading data to mine for irregularities.

By way of contrast, the MOUs did not resolve outstanding questions

involving the Commissions’ respective jurisdiction over financial energy products and the interactions of those products with physical markets. Although it is clear that FERC has jurisdiction over physical energy markets²⁷ and the CFTC has exclusive jurisdiction over transactions that involve futures contracts,²⁸ it is not always clear which agency has jurisdiction over alleged schemes that involve both physical and financial markets.²⁹ The MOUs’ jurisdictional provisions only require the Commissions to inform each other of matters that may fall within their overlapping jurisdictions, and, apparently on a case-by-case basis, to “develop an approach that meets both agencies’ regulatory concerns.” In essence, rather than craft broad jurisdictional rules to govern their regulatory authority generally, the Commissions elected to take such issues one case at a time.

Criminal Prosecution by DOJ?

Neither FERC nor the CFTC have authority to bring criminal charges for violations of the statutes they administer. Only DOJ can do that. The increased regulatory enforcement efforts undertaken by the agencies, however, are almost certain to lead to an increase in the number of matters referred to DOJ for criminal investigation. And, as the number of referrals increases, the number of matters that DOJ actually prosecutes can also be expected to rise.

In recent years, DOJ has shown a

19. *Barclays Bank PLC*, 144 FERC ¶ 61,041 (2013); *In re Make Whole Payments & Related Bidding Strategies*, 144 FERC ¶ 61,068 (2013).

20. *Barclays Bank PLC*, 144 FERC ¶ 61,041 (2013).

21. See “CFTC Chairman Massad Announces the Appointment of Aitan Goelman as Director of Enforcement”, Release PR6946-14, June 10, 2014, available at <http://www.cftc.gov/PressRoom/PressReleases/pr6946-14>.

22. 7 U.S.C. § 26.

23. See *Barclays PLC*, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, Docket No. 12-25 (June 27, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfbarclaysorder062712.pdf>.

24. *The Royal Bank of Scotland plc*, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions, Docket No. 13-14 (Feb. 6, 2013), available at

<http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfrbsoorder020613.pdf>.

25. *Coöperatieve Centrale Raiffeisen Boerenleenbank B.A.*, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act Making Findings and Imposing Remedial Sanctions, Docket No. 14-02 (Oct. 29, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfrabobank102913.pdf>.

26. *Regulating Financial Holding Companies and Physical Commodities: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 113th Cong. (2014) (testimony of Norman C. Bay, Director, FERC Office of Enforcement), available at <http://www.ferc.gov/CalendarFiles/20140115143216-Bay-testimony-01-15-2014.pdf>.

27. 16 U.S.C. § 824; 15 U.S.C. § 3431.

28. 7 U.S.C. § 2; *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).

29. See generally *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013); *Final Order in Response to a Petition From Certain Indep. Sys. Operators & Reg'l Transmission Orgs. to Exempt Specified Transactions*, 78 Fed. Reg. 19,880, 19,884 (Apr. 2, 2013); see also Suedeen Kelly, et al., *Regulatory Uncertainty Remains in Energy Markets*, *New York Law Journal* (Nov. 3, 2013), available at <http://nylawyer.nylj.com/adgifs/specials/110413compliance.pdf>.

willingness to partner with sophisticated regulatory agencies like the SEC to bring complex cases arising in highly-regulated industries. The partnership between the SEC and DOJ is likely to serve as a model for the future relationship among DOJ and the Commissions, particularly given DOJ's success in

bringing criminal cases triggered by the SEC's investigations. This likelihood will only grow as those agencies ramp up their enforcement efforts and the size and importance of the cases they refer for prosecution continues to increase.

It will take time for DOJ to develop confidence in the quality of the cases

that the Commissions refer, but as the Commissions' enforcement staffs prove that they can uncover significant wrongdoing and marshal evidence in support, they are likely to find a receptive partner at DOJ.

The industry should prepare itself for this changing enforcement landscape. 