November 5, 2012

FERC Issues Order Proposing Nearly a Half-Billion Dollars in Civil Penalties

On Halloween the Federal Energy Regulatory Commission (FERC) issued an order[1] (Order) directing Barclays Bank PLC (Barclays) and four individuals from its Western U.S. electricity trading operations (Traders) to show cause why they should not be found to have violated the Federal Power Act and FERC prohibitions against energy market manipulation. The FERC's Office of Enforcement (OE) proposed that Barclays be assessed a $435 million civil penalty and disgorge nearly $35 million in payments received. Further, OE proposed that the Traders be assessed individual civil penalties totaling $18 million ($15 million to the head of Barclays' Western U.S. power trading operations, and $1 million each to the remaining Traders). The Order is based on allegations, contained in an OE report, concluding that Barclays and its Traders engaged over a two-year period in a deliberate and coordinated strategy of trading physical electricity at an economic loss at four trading points in the Western United States in order to boost its financial positions at those same trading points. OE further alleged that Barclays' and Traders' conduct resulted in an estimated $139 million in financial losses to other market participants with positions settling off of the allegedly manipulated trading points. The Order presents yet another breathtaking reminder and valuable lessons for all participants in FERC-regulated energy markets to ensure that they have in place robust programs and controls carefully designed to ensure effective compliance with both the letter and the spirit of FERC rules and regulations. A participant's failure to do so puts both the company and its key individuals at risk of substantial liability.

Background

The period covered by the Order is November 2006 to December 2008, during which OE alleges that Barclays traded both physical and financial electricity products. The physical products included "dailies" (electricity sold at a specific fixed price and delivered or received, generally the next day, at a specific trading location) and "at index" power (electricity transacted at a price determined by calculating the average volume-weighted price of all electricity delivered at a specific physical location). The financial products most relevant to OE's investigation were "financial swaps," under which parties to the transactions assumed no obligation to deliver or receive physical electricity but where the buyer exchanged with the seller a fixed price for an indexed price. The financial swaps allowed the parties to hedge certain price risks and allowed the parties to speculate and benefit from changes in the expected direction of underlying physical prices.

The Order

The Order alleges that, during the 2006-08 period, Barclays established both significant physical and significant financial swap positions at the same four Western U.S. trading locations and proceeded, in a coordinated fashion, to produce significant losses in its dailies that resulted in increases in Barclays' financial swap positions that exceeded, by nearly $35 million, the dailies' losses. OE contends Barclays' trading was uneconomic because Barclays was willing to suffer dailies' trading losses to increase the value of its financial swap positions. Accordingly, OE contends that Barclays thereby conveyed false price information to, and operated a fraud on, other market participants who relied on the proper price formation of the impacted daily indices.

Investigative and Administrative Processes

The Order was preceded by lengthy investigative and administrative processes triggered initially by market participant calls to OE's Enforcement Hotline. Following a nonpublic preliminary investigation of Barclays' and Traders' activities, OE issued on

April 5, 2012, a notice of alleged violations (NoV), identifying its preliminary determinations that Barclays and each of the Traders had violated the FERC's prohibition against electric energy market manipulation.[2] OE reported that it engaged Barclays and Traders in settlement discussions following the NoV, but unable to make progress on a settlement with any of them, OE submitted to the Commission its report and recommendations (a copy of which was included as an appendix to the Order). The Commission responded nearly four months later with the Order.

Barclays and Traders have until November 30, 2012, to file their respective answers to the show cause order. In their answers, Barclays and Traders must choose either (i) to have the case heard before a FERC-appointed administrative law judge; or (ii) to be assessed an immediate penalty by the Commission, the assessment of which would be subject to a *de novo* review by a U.S. district court.

Lessons

The Order demonstrates clearly the continued priority that the FERC has placed on identifying, punishing and preventing fraud and energy market manipulation. The FERC has devoted significant resources to developing and implementing new surveillance tools and techniques to review available market data and identify behavior that may violate FERC rules, underscored very recently by the establishment of the Division of Analytics and Surveillance. As established in the *Amaranth* and *Hunter* cases, and reinforced this year in orders addressing the trading activity of Constellation and Deutsche Bank, it is clear that OE views uneconomic transactions that intentionally impact the price or value of other related transactions to be impermissible and subject to severe penalty.

It is instructive to note the magnifying impact that the size of the organization under scrutiny, as well as the deliberate and active participation by senior management, had in the FERC's proposed application of the penalty guidelines. Additionally, the Order appears to be the first in which prior adjudication of similar misconduct by another enforcement agency (in this case, Barclays' settlement with the Commodity Futures Trading Commission and Department of Justice concerning alleged manipulation of the London Interbank Offered Rate during the same period covered by the Order) was a contributing factor in the civil penalty assessed.

It is also worth noting that OE alleges that Barclay's compliance program was inadequate. OE notes that Barclays' commodities compliance department recognized that uneconomic trading raised serious legal and compliance issues and provided training to Traders on the importance of avoiding such trading. However, OE alleges that there were no procedures in place to detect such issues, that Barclays' compliance department missed opportunities to detect the issues and left responsibility for detecting uneconomic trading with Traders rather than the compliance department.

The Order provides yet another reminder that all market participants would be well-served to ensure that their compliance programs are properly structured and appropriately assign responsibilities to minimize the risk of market conduct that regulators might view, particularly in hindsight, as manipulation. OE has indicated it is placing a priority on, and has clearly demonstrated a commitment to, addressing market manipulation concerns. Our own experience working with clients on compliance matters reinforces this fact. Strong compliance programs reduce not only the risk of missteps but also the possible penalties if missteps occur. Further, in today's aggressive enforcement environment, compliance risks are enhanced due to regulatory encouragement of whistle-blowers, as this case amply illustrates.

Our attorneys have significant experience advising clients on designing, assessing and implementing compliance programs that mitigate and ameliorate energy market compliance risks. If you have any questions concerning the Order specifically or energy market compliance issues generally, please contact any of the attorneys listed in this alert.

[1] Barclays Bank PLC et al., 141 FERC ? 61,084 (2013) (Order).

[2] The NoV was issued pursuant to an earlier FERC order intended to increase the transparency of OE staff's investigations. *Enforcement of Statutes, Regulations, and Orders*, 129 FERC ? 61,247 (2009), *order on reh'g*, 134 FERC ? 61,054 (2011).