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## FERC Investigates Alleged Market Manipulation and Imposes Major Civil Penalties

On April 5, 2012, following recent enforcement actions concerning other energy market participants, the Federal Energy Regulatory Commission (“FERC” or “Commission”) issued a notice of a formal, non-public enforcement proceeding initiated by the Commission’s Office of Enforcement (“Enforcement Staff”) against a major financial institution and four of its traders alleging market manipulation in energy markets subject to the Commission’s jurisdiction.

FERC Enforcement Staff has preliminarily concluded that the financial institution and the four traders **each** violated the Commission’s rules prohibiting market manipulation by engaging in a coordinated scheme of trading certain physically settled electricity products in an effort to benefit the financial institution’s financially-settled swap positions on the Intercontinental Exchange (“ICE”). In particular, Enforcement Staff alleges that the financial institution and the four traders traded day-ahead fixed-price physical electricity at certain locations in the Western U.S. to benefit the financial institution’s ICE fixed-for-floating financial swap positions in those markets. Enforcement Staff alleges that the financial institution accumulated substantial physical positions in the opposite direction of its financial swap positions and that it flattened those physical positions in the next-day fixed-price physical markets to manipulate the ICE daily index settlement in a direction to benefit its own positions (i.e., upward if receiving the floating price in the swap and downward if paying the floating price). The alleged market manipulation took place several years ago – in 2007 and 2008.

The Commission’s notice sets forth Enforcement Staff’s preliminary findings. The Commission issues such a preliminary notice in an effort to provide the public with notice of, and information about, enforcement activities and to increase the transparency of Enforcement Staff’s nonpublic investigations.

The Commission issued the foregoing notice of Enforcement Staff’s preliminary findings less than a month after announcing a major settlement in a separate matter involving Constellation Energy Commodities Group Inc. (“Constellation”). Under the settlement, Constellation expressly did not concede to any claimed wrongdoing. However, Constellation agreed to pay a total of \$245 million that ended Enforcement Staff’s investigation of claims alleging that Constellation engaged in market manipulation in the day-ahead physical power markets in New York and neighboring regional energy markets. Pursuant to the terms of the settlement, Constellation agreed to pay \$135 million in civil penalties and to disgorge \$110 million in unjust profits, representing the largest enforcement penalty since the expansion of FERC’s enforcement authority in 2005.

FERC Chairman Jon Wellinghoff recently referenced the Constellation settlement in advocating for internal compliance programs:

Compliance, not penalties, remains my primary goal. To that end, the [Settlement] is instructive regarding the characteristics of a robust compliance program. Now based on that agreement, Constellation will institute a policy and process to monitor profit and loss concentrations in virtual transactions and physical schedules of electric energy and to review and document the purpose of virtual transactions.

According to Chairman Wellinghoff, energy companies' "senior management has an obligation to proactively monitor for market manipulation and to pursue concerns once brought to their attention." Chairman Wellinghoff further noted that the Commission intends to "be vigorous in using its anti-manipulation authority to protect consumers."

The Commission also recently issued a Notice of Enforcement's preliminary findings that Deutsche Bank Energy Trading, LLC ("DBET") has allegedly violated the Commission's market manipulation rules by scheduling and trading energy in the California market to benefit its Congestion Revenue Rights positions, which are financially settled rights associated with transmission congestion. Enforcement Staff also alleges that DBET violated the Commission's rules by creating schedules in which no power flowed.

In light of the scope, breadth and number of recent Commission enforcement actions, energy market participants, including companies that trade electricity and/or natural gas, should take a hard look at their current internal compliance procedures. Specifically, companies should determine whether they have sufficient protections in place to monitor trading activity, to provide compliance training to key personnel, and to address allegations of market manipulation should it become the subject of Enforcement Staff inquiries. This has become all the more important in light of the risk management verification procedures that are now required pursuant to the implementation of new FERC rules governing risk management and credit reforms in the wholesale electricity markets. In addition, the fact that Enforcement Staff is announcing its investigation of events that arose in some cases over five years in the past suggests that well-documented compliance programs, training and monitoring programs may provide important protections to companies for years to come.

This *GT Alert* was prepared by **Ken Minesinger**, **Doreen Saia** and **Rob Lamkin**. GT's Energy Practice Group has significant experience in FERC Enforcement matters. Questions about this information can be directed to:

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