GreenbergTraurig

Global Energy & Infrastructure | GT Alert

December 2015

Déjà vu: FERC's Etracom Show Cause Order and allegations of related trading, market manipulation, and CAISO software errors

On Dec. 16, 2015, FERC issued an Order to Show Cause and Notice of Proposed Penalty, directing Etracom LLC (Etracom) and its principal member and primary trader Michael Rosenberg, to show cause: (1) why they should not be found to have violated FERC's anti-manipulation rules and the Federal Power Act, by submitting virtual supply transactions at the New Melones intertie (New Melones) at the border of the California Independent System Operator (CAISO) wholesale electric market in order to affect power prices and economically benefit Etracom's Congestion Revenue Rights (CRRs) sourced at that location; (2) why Etracom should not pay a civil penalty in the amount of $2,400,000; (3) why Rosenberg should not pay a $100,000 civil penalty; and (4) why Etracom should not disgorge $315,072 in unjust profits.[1] Etracom criticized the Enforcement Staff report as illogical and erroneous and has indicated it will fight on.

If this sounds familiar, it is. This Show Cause follows the "trigger, target, nexus" framework used by FERC Enforcement Staff (the Staff) that has led to several other settlements of alleged manipulative "relational trading" conduct. This manipulative conduct often involves uneconomic virtual (or physical) trading in the day-ahead market (the "trigger") that contributes to price formation at the trading location (the "nexus") used to benefit congestion rights or other financial positions (the "target") settling against those prices. Some of these matters brought by the Staff included defenses that the suspect trading stemmed from CAISO software or model errors resulting in possibly errant price signals.

How the Investigation Started – Virtual Supply Trades Appear Related to CRRs

Etracom is a small financial trading company owning no physical energy assets. Rosenberg is a founding member of

[1] Order to Show Cause and Notice of Proposed Penalty, 153 FERC ¶ 61,314 (2015) (FERC Docket No. IN16-2). The Order also included the FERC Enforcement Staff report regarding its investigation.

ETRACOM and has a 75 percent ownership interest. The company only trades CRRs and virtual supply and virtual demand and only in CAISO. Virtual trades settle off locational marginal prices (LMP) and CRRs settle off the marginal congestion component (MCC) of the LMP in the day-ahead market. CAISO uses the LMP to establish the price for wholesale electric energy purchases and sales at specific locations. In May 2011, Etracom held a CRR position sourced at the New Melones intertie and sunk at an internal node within CAISO. The CRRs settle off the difference in day-ahead MCC between two locations (*e.g.,* (sink – source MCC) * volume) – thus, if the source is less than the sink, the CRR has a positive value).

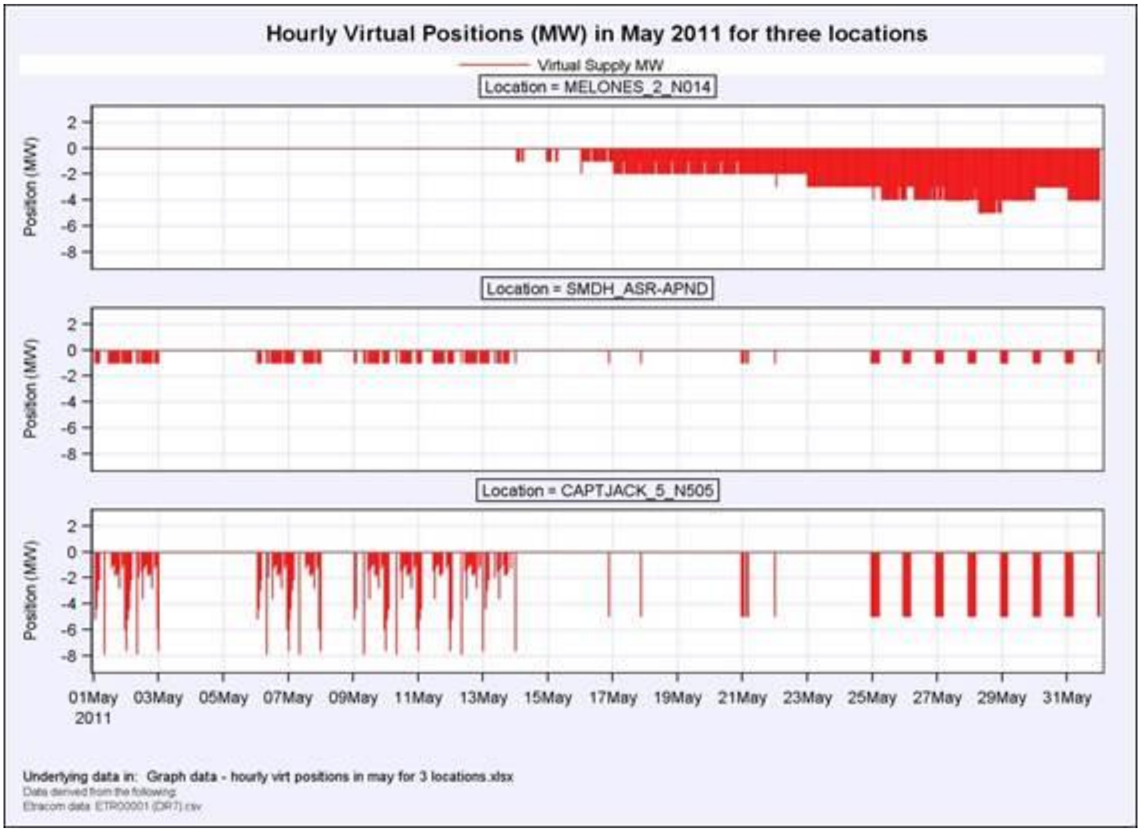
Also in May 2011, Etracom engaged in virtual supply offers at the New Melones intertie. Virtual supply and demand transactions are evaluated in CAISO's day-ahead market pricing alongside physical supply and demand transactions. The combination of Etracom's CRR positions and virtual supply offer behavior from May 14 to May 31, 2011, prompted the CAISO Department of Market Monitoring (DMM) to refer the matter to the FERC Enforcement.

FERC Enforcement Report Details – Trading Patterns as Proof of Manipulative Intent

The Staff concluded that in May 2011, Rosenberg developed a manipulative scheme in which Etracom intended to lower the day-ahead LMP at New Melones by submitting $0 or negative virtual supply offers. This created import congestion into CAISO, which would tend to lower the MCC at New Melones and thereby increase the profitability of Etracom's CRR positions sourced at New Melones. Specifically, the Staff concluded:

- in May 2011, Etracom held CRR positions sourcing at New Melones (approximately 35 MW peak and 25 MW offpeak);
- from May 1 through May 7, only import congestion into CAISO appeared on the New Melones Intertie (and Etracom's CRR position benefited);
- however, from May 8 through May 13, export congestion occurred most days in hours-ending 1-7 and 23-24, which caused Etracom to lose over $23,624 on its monthly CRR positions in those hours;
- Etracom never determined the cause of the export congestion, but according to the Staff, Etracom did react to it;
- prior to May 13, Etracom had not traded in virtuals at New Melones for two and a half months, but on May 13, Etracom started to trade virtual supply (ranging from 1 – 5 MW) based on a new virtual trading strategy that Rosenberg developed and implemented;
- on May 14 and May 15, Etracom placed $0 virtual supply offers for small volumes in hours in which export congestion had appeared in previous days;
- when Etracom's offers cleared, they were identical to the LMP, indicating that Etracom was the marginal bidder and that its offer set the LMP;
- export congestion also disappeared in every hour in which Etracom placed its virtual supply offers;
- in those hours, Etracom's CRR positions returned positive revenue (and export congestion remained when Etracom had not offered virtual supply);
- Etracom suffered a net loss of $52 on virtual trades over those two days while its CRR positions earned $28,059, significantly more than Etracom would have if its bids did not eliminate the export congestion (this also suggests financial leverage, discussed below);

Trading Patterns. The Staff also illustrated the "mirroring" of the virtual supply with the CRR position and attempted to demonstrate manipulative intent from Etracom's changing trading patterns. See, for example, the chart reproduced below that was included in Staff's Report. From May 16 through May 31, according to the Staff, Etracom implemented its virtual supply trading strategy to nearly every hour. The Staff also described that Etracom's virtual trading at New Melones in May 2011 was anomalous compared to its trading at all 21 other locations, where it never submitted continuous bids/offers for 24 hours a day. Indeed, in June 2011, Etracom held considerably smaller CRR positions sourced at New Melones than it had in May and its virtual activity in June also significantly reduced.



Financial Leverage. The Staff also describes Etracom's financial leverage (*i.e.,* losses on the "trigger" are outpace by benefit to the "target") as further evidence of its manipulative scheme. For example, in 379 out of 393 (96 percent) of the hours it traded at New Melones in May, Etracom's virtual transactions lost money in the total amount of $42,481. While on the other hand, Etracom's CRR positions more than doubled during that time. In total, Etracom earned over $690,122 in revenue in May on its New Melones CRR positions, with $517,423 (about 75 percent) earned between May 14 and May 31.

FERC Enforcement Rejects Etracom's Defenses

Etracom argued that its virtual trading strategy was intended to profit from a hydroelectric runoff event it anticipated in late May. However, the Staff concluded that nothing about the physical or market conditions reasonably supports Etracom and Rosenberg's claim that their virtual supply strategy was motivated by a significant hydro event. Etracom also contends that a software pricing error at New Melones, disclosed by the DMM in its referral, resulted in false price signals in early May 2011, leaving Etracom to believe it must place $0 or negative offers to clear virtual supply at New Melones. Indeed, in apparent reaction to these flaws, the CAISO ceased trading at New Melones soon after May 2011. The Staff concluded that the software pricing error does not explain Etracom's trading conduct for the relevant period of time.

Next Up – Etracom and Rosenberg To Respond

Etracom has indicated it will fight on. Etracom and Rosenberg now have 30 days to file an answer with the Commission explaining why they should not be found to have violated the anti-manipulation rules and should be penalized with respect to their trading at New Melones and FERC will have 30 days to reply. In addition, Etracom and Rosenberg have 30 days to choose to have an administrative hearing before a FERC Administrative Law Judge or a penalty assessment by the Commission, which if not paid would lead FERC to enforce the penalty assessment in federal court.

See also other related, recent GT Alerts:

- May 2015 Brings a Crop of FERC 'Loophole' Manipulation Civil Penalty Assessments
- FERC Assesses Penalties for Alleged No-Risk UTC Trading Against City Power and Its Founder

This *GT Alert* was prepared by **Gregory K. Lawrence** and **Mian R. Wang.** Questions about this information can be directed to:

- Gregory K. Lawrence | +1 617.310.6003 | lawrenceg@gtlaw.com
- Mian R. Wang | +1 617.310.6273 | wangm@gtlaw.com
- Or your Greenberg Traurig attorney

Albany
+1 518.689.1400

Amsterdam
+ 31 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Berlin¬
+49 (0) 30 700 171 100

Berlin-GT Restructuring¯
+49 (0) 30 700 171 100

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Delaware
+1 302.661.7000

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0)203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 55 5029.0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

New York
+1 212.801.9200

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+1 82-2-369-1000

Shanghai
+86 21 6391 6633

Silicon Valley
+1 650.328.8500

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+03.636.6000

Tokyo¤
+81 (0)3 4510 2200

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900