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FERC ENFORCEMENT ON MARKET MANIPULATION TESTING THE LAW’S LIMIT

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Contents

I. EXECUTIVE SUMMARY ........................................................................................................2
II. BACKGROUND FACTS ........................................................................................................3
   A. FERC’S POWER IN MARKET REGULATION....................................................................3
   B. THE CRR FINANCIAL MARKET.....................................................................................4
   C. DEUTSCHE BANK’S ALLEGED CONDUCTS.................................................................5
III. ANALYSIS ........................................................................................................................7
   A. ALLEGED RULES DEUTSCHE BANK VIOLATED.........................................................7
   B. MANIPULATIVE BEHAVIORS.........................................................................................8
   C. THE INTENT ELEMENT OF THE RULES .....................................................................8
   D. GOOD FAITH DEFENSE TO THE MANIPULATIVE BEHAVIOR....................................10
   E. FINANCIAL MARKET JURISDICTION ..........................................................................11
   F. WHEELING-THROUGH TRANSACTION ......................................................................13
   G. TRADING AGAINST INTEREST ..................................................................................16
IV. CONCLUSION ....................................................................................................................18
I. EXECUTIVE SUMMARY

A 2012 article from the New York Times\(^1\) reported that the Federal Energy Regulatory Commission (FERC) had taken aggressive steps against market manipulation in the electricity trading space against large investment banks. Notable cases were taken against Barclays\(^2\), JP Morgan\(^3\) and Deutsche Bank\(^4\).

The fine for Barclays was a steep $469.9 million, which the bank said it would contest. JP Morgan was ordered to suspend selling energy capacity for 6 months. Deutsche Bank, on the other hand, was only fined for $1.5 million. Yet, Deutsche Bank was ready to mount a vigorous defense at the time. Unfortunately without admitting or denying, Deutsche Bank chose to settle instead\(^5\), and gave up the best chance to push for an answer for what FERC could precisely define as market manipulation conducts.

This paper would specifically examine the issue contested by Deutsche Bank, that is, whether it is market manipulation per se when an entity engages in the physical transactions but for profit-seeking in the financial markets.

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4 Deutsche Bank Energy Trading, LLC, 140 FERC ¶ 61178 (Sept. 5, 2012) (hereinafter DBET Complaint).

5 Deutsche Bank Energy Trading, LLC, 142 FERC ¶ 61056 (Jan. 22, 2013).
II. BACKGROUND FACTS

A. FERC’S POWER IN MARKET REGULATION

FERC was created with jurisdiction over interstate electricity and natural gas sales and distribution. Some of the functions it performs are setting wholesale electricity and distribution rates, licensing hydroelectricity production, setting natural gas and oil pipeline distribution rates, etc.

Notable legislations granted powers to FERC over the recent history are the DOE Organization Act of 1977, the Public Utilities Regulatory Policy Act of 1978, the Energy Policy Act of 1992 and particularly the Energy Policy Act of 2005. In part as a response to the Enron manipulation that caused the California electricity market meltdown, Congress enacted the Energy Policy Act of 2005 to give FERC the additional responsibilities and powers. Some of these powers in the Energy Policy Act of 2005 related to this case are, regulation of interstate electricity transmission and wholesale sales, monitoring and investigation of energy markets, oversight of accounting and financial reporting for regulated companies, and more importantly, levying civil penalties and other means against energy organizations and individuals who violate FERC rules in the energy markets.\(^6\)

In its complaint against Deutsche Bank Energy Trading, LLC (hereinafter DBET), FERC alleged that DBET violated 18 C.F.R. § 1c.2 (2011) by scheduling and trading energy in California Independent System Operator Corporation (CAISO) to benefit its Congestion Revenue Rights (CRRs) positions, during the period from January 29, 2010 through March 24, 2010.\(^7\) FERC also alleged that DBET violated 18 C.F.R. § 35.41(b) (2011) by submitting paired bids in which no power flowed in or out of CAISO as Wheeling-


\(^{7}\) See supra DBET Complaint.
Through, contrary to the designation of such paired bids transactions defined by the CAISO Tariff. The two violated rules have parallel provisions in the CAISO Tariff, sections 37.7 and 37.5.\(^8\)

**B. THE CRR FINANCIAL MARKET**

Congestion Revenue Rights (“CRRs”), is the CAISO equivalent of Financial Transmission Rights (“FTRs”). The CRR market can be divided into export CRR and import CRR. A CRR is like an option - therefore, it reflects the price of electricity at a given terminal. For example, at the Silver Peak terminal for the CAISO market, the import CRR is like a call option, allowing the option holder to make money by importing cheaper electricity into CAISO to sell at a higher price. The export CRR, on the other hand, is like a put option, allowing the option holder to make money by exporting cheaper electricity out of the CAISO market. Therefore, the import CRR and export CRR are opposite in economic effect. A higher import CRR will drive down the export CRR, or vice versa.

When the demands for importing electricity increase, the importing CRR values increase, and the exporting CRR values decrease. It is possible that for a trader holding the export CRR position, to increase his export demand to counteract the decreasing export CRR, if he finds a legitimate buyer to enter into a profitable contract to buy the electricity exported by the trader. On the other hand, it has been ruled that it is market manipulation for a firm knowingly and intentionally to trade against its interest in one market (such as the physical electricity market) to benefit its position in another market (such as the CRR financial market). A notable case in that regard is *Transnor (Bermuda) Ltd. v. BP North American Petroleum*, 738 F.Supp. 1472, (S.D.N.Y. 1990) (holding that tax spinning transactions under which petroleum companies purchased and sold same futures contract at similar price did not render purpose of transactions legitimate under Commodity Exchange Act).

\(^8\) *Id.*
C. DEUTSCHE BANK'S ALLEGED CONDUCTS

Deutsche Bank Energy Trading, LLC (DBET), is a subsidiary of Deutsche Bank. DBET was created in 2004, as one of many energy trading intermediaries by Wall Street to fill the huge void left open after the Enron collapse in the early 2000s.

The following is taken from the DBET Complaint against Deutsche Bank\(^9\).

In January 2009, a few months before the start of CAISO's Congestion Revenue Rights (CRR) market, Deutsche Bank hired Federico Corteggiano to run its CAISO CRR business. Corteggiano had worked on creating the software the CAISO would use to optimize the CRR market and the allocation of CRR bids.

Once at Deutsche Bank, Corteggiano focused exclusively on trading CRRs and FTRs. Huber Salas, an analyst, assisted Corteggiano (together, the CRR traders). The CRR traders did not trade physical power. Their trading of CRRs in CAISO yielded Deutsche Bank almost $5 million in profits for the nine months in 2009 that the new CRR market was active.

As part of their CRR positions for 2010, Corteggiano and Salas determined that Silver Peak\(^10\) had been historically congested in the export direction and then obtained and built up a CRR position that would benefit Deutsche Bank if export congestion occurred at Silver Peak. This CRR position put Deutsche Bank at risk if import congestion occurred at Silver Peak.

For most of January 2010, no import congestion occurred at Silver Peak and Deutsche Bank's CRR position there was profitable.

Beginning on January 19, 2010, an unexpected event occurred that conflicted with Corteggiano's and Salas's initial expectations: CAISO derated the Silver Peak intertie and limited net scheduled flows. The derate caused import congestion at Silver Peak. Deutsche Bank's CRR position immediately (i.e., that very day) lost value. Corteggiano emailed the CAISO questioning the CAISO's process for accepting bids at Silver Peak. A CAISO customer service representative wrote in response that “the results are correct” and explained the process that set prices at Silver Peak. Corteggiano and Salas disagreed, arguing that CAISO should not have continued accepting bids at Silver Peak given the derate.

Unable to convince CAISO to change its process, and unwilling to accept the consequences of a position that did not go their way, Corteggiano and Salas resorted to self-help: they conceived and executed a scheme, which they called the “Export Strategy,” to restore the value of their CRR position at Silver Peak. The

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\(^9\) DBET Complaint, supra.

\(^10\) Located in Southern California.
Export Strategy entailed scheduling exports at Silver Peak to eliminate the import congestion at Silver Peak. The Export Strategy paired the export (purchase) at Silver Peak with an import (sale) at Summit\(^{11}\) of the same quantity.\(^{12}\)

Initially, some import and export pairs were scheduled independently; beginning on February 18, 2010, Deutsche Bank scheduled all imports and exports as Wheeling-Through transactions, which linked the imports and exports.

With a Wheeling-Through transaction, a Scheduling Coordinator tells the CAISO that it is wheeling power through California from the linked import point (Summit) to the linked export point (Silver Peak).\(^{13}\) But Deutsche Bank falsely submitted the Wheeling-Through transactions. In fact, Deutsche Bank was not wheeling power and its transactions did not have a resource or a Load outside the CAISO, as required by the Tariff. Instead, outside the CAISO on the Sierra Pacific Power (SPPC) system, Corteggiano and Salas scheduled power from Silver Peak to Summit, thus creating a circular schedule in which no power flowed to or from California.

The Export Strategy worked for Deutsche Bank: it increased the value of its CRR position. By exporting physical power at Silver Peak, Corteggiano and Salas eliminated the import congestion that had decreased the value of their CRR position. Having figured out how to avoid the consequences of their losing CRR position through false Wheeling-Through transactions, Corteggiano and Salas then sought to capitalize on this strategy beyond avoiding losses on previously-purchased CRR positions. They increased their CRR position for Silver Peak during the auction for March CRRs. The physical transactions at Silver Peak and Summit lost money each day, but the benefit to their CRR position outweighed this loss.

Corteggiano and Salas continued the Export Strategy until a CAISO customer service representative called on March 18, 2010 to ask about Deutsche Bank’s scheduling at Silver Peak. In response, on March 20, 2010, the CRR traders reduced exports at Silver Peak to 3 MW. When the CAISO Department of Market Monitoring (DMM) followed up with a phone call on March 23, 2010, Deutsche Bank ended the Export Strategy altogether, stopping the scheduling of exports at Silver Peak.

\(^{11}\) Located in Northern California.

\(^{12}\) This meant that DBET was buying power at the export price CAISO posted for Silver Peak, and selling power at the import price CAISO posted for Summit.

\(^{13}\) Wheeling-Through transaction simplifies the accounting by allowing CAISO to link the export and import transactions as a single transaction, and calculate a trader’s profit/loss based only on difference in the export and import pricings. In addition, Wheeling-Through transaction protects a trader’s position based on a single transaction, that is, if the import leg is cut by CAISO for any reason, the export leg is also cut, leaving no obligation or consequences to the trader. See DBET’s *ANSWER OF DB ENERGY TRADING LLC TO ORDER TO SHOW CAUSE*, at 25, November 5, 2012, available at http://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=13103097, (hereinafter DBET Answer).
FERC concluded that DBET made net of $123,198 of unjust profits received as a result of its energy and Congestion Revenue Rights transactions at the Silver Peak intertie, after $67,000 loss from the physical transactions. 14

III. ANALYSIS

A. ALLEGED RULES DEUTSCHE BANK VIOLATED

The first rule DBET allegedly violated is 18 C.F.R. § 1c.2, titled Prohibition of electric energy market manipulation. This rule says that “it is unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services, (1) To use or employ any device, scheme, or artifice to defraud, (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.” 15

The second rule DBET allegedly violated is 18 C.F.R. § 35.41(b), titled Market behavior rules. This rule says that “in communications, a Seller must provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercises due diligence to prevent such occurrences.” 16

14 DBET Complaint, supra.
15 18 C.F.R. § 1c.2 (2011).
16 18 C.F.R. § 35.41(b) (2011).
B. MANIPULATIVE BEHAVIORS

Under Order 670, the Commission will act in cases where an entity: (1) Uses a fraudulent device, scheme or artifice, or makes a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule or regulation, or engages in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity; (2) with the requisite scienter; (3) in connection with the purchase or sale of natural gas or electric energy or transportation of natural gas or transmission of electric energy subject to the jurisdiction of the Commission. Although supplanted by the broad anti-manipulation language in Order 670, the usefulness of Market Behavior Rule 2 lies in the fact that it had some specific examples:

Market Behavior Rule 2 “prohibits actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products.” Actions or transactions explicitly contemplated in Commission-approved rules and regulations of an organized market, or undertaken by a market-based rate seller at the direction of an ISO or RTO, however, are not violations of Market Behavior Rule 2. In addition, Market Behavior Rule 2 prohibits certain specific behavior: Rule 2(a) prohibits wash trades, Rule 2(b) prohibits transactions predicated on submitting false information, Rule 2(c) prohibits the creation and relief of artificial congestion, and Rule 2(d) prohibits collusion for the purpose of market manipulation.

C. THE INTENT ELEMENT OF THE RULES

“The EPAct 2005 specified that in adopting anti-manipulation and anti-deception rules, certain key terms be interpreted as they have been under section 10(b) of the Securities Exchange Act.”

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18 Id. at P 49.
5 is a broad rule implementing section 10(b).”\textsuperscript{22} “Accordingly, the FERC turned to rule 10b-5 as its model in adopting rules to implement its new authority under the Federal Power Act and the Natural Gas Act.”\textsuperscript{23} “The new rules are to be interpreted in light of Securities Exchange Act precedent, except to the extent the FERC adopts a different interpretation tailored to the energy markets.”\textsuperscript{24}

“In crafting rules to prohibit deception and manipulation, the FERC took into account the fact that rule 10b-5 prohibits only action taken with scienter.”\textsuperscript{25} “The FERC recognized that ‘scienter’ has been interpreted, in the context of rule 10b-5, to encompass both intentional and reckless conduct.”\textsuperscript{26}

“Securities law precedent establishes that in this context recklessness means, ‘highly unreasonable [conduct] involving . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.’”\textsuperscript{27}

In a Revising Order, the Commission said the following in justifying the heightened scienter as compared to the “foreseeability standard” existed in Market Behavior Rule 2:

The Commission finds it unnecessary to retain Rule 2. Congress prohibited market manipulation by any entity and defined manipulation to include the requirement of scienter. It would be inconsistent with Congress’ direction if foreseeability were retained as a lesser standard of proof for market manipulation perpetrated by public utility market-based rate sellers. To avoid the potential for uneven application of regulatory requirements based on whether an entity is a public utility under the FPA and a “non-jurisdictional” entity, or whether an entity is a public utility selling under market-based rate authority or selling at cost-based rates, the same standard of proof should apply to all entities and all jurisdictional sales for purposes of determining whether market manipulation has occurred.

\textsuperscript{22} Id.
\textsuperscript{23} Id.
\textsuperscript{24} Id. (citing Order 670).
\textsuperscript{25} Id. at 386 (citing Order 670, supra, at P 52 and Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-201, 212-14 (1976) (the Supreme Court held that section 10(b) of the Securities Exchange Act, pursuant to which rule 10b-5 was promulgated, reached only conduct reflecting scienter)).
\textsuperscript{26} Id. (citing Order 670, supra, at P 53) (“In rescinding Market Behavior Rule 2 the FERC noted that it would be inconsistent to retain that anti-manipulation rule with its negligence-based foreseeability test.” See node 162).
\textsuperscript{27} Id. (citing Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (cited by the FERC in Order 670, at P 53 n.109)).
manipulation occurred. It is not appropriate, as some commenters suggest, for the Commission to maintain a lesser standard of proof for only certain market participants or certain types of sales.\textsuperscript{28}

The FERC added that to violate the new rules, an entity “must have intended to affect, or have acted recklessly to affect, a jurisdictional transaction.”\textsuperscript{29} But the FERC said this was not to “incorporate a specific intent standard into the final rule.”\textsuperscript{30} Therefore, according to EPAct 2005, in analyzing the action against DBET for manipulation, only a general intent is necessary to find DBET culpable in connection in a FERC jurisdictional transaction. As alleged in the complaint, DBET admitted it transacted in the physical market with the intent to “self-help” its positions in the financial market.\textsuperscript{31}

\textbf{D. GOOD FAITH DEFENSE TO THE MANIPULATIVE BEHAVIOR}

In the Revising Order, the Commission said that “SEC Rule 10b-5 does not include provisions for ‘good faith’ defenses.”\textsuperscript{32} This seemed to be in accordance with precedents such as \textit{S.E.C. v. Infinity Group Co.}, 212 F.3d 180, 192 (3d Cir. 2000) (holding that good faith, without more, does not necessarily preclude a finding of recklessness)).\textsuperscript{33} However, the Commission further said that “in all cases, the intent behind and rationale for actions taken by an entity will be examined and taken into consideration as part of determining whether the actions were manipulative behavior.”\textsuperscript{34} “This is consistent with the statutory mandate that, when assessing a civil monetary penalty, the FERC shall take into consideration the ‘seriousness of the violation.’”\textsuperscript{35} Similarly, the Commission in the Revising Order rejected the “legitimate business purpose” affirmative defense, noting that “the reasons given by an entity for its actions are part of the overall facts and circumstances that will be weighed in deciding whether a

\textsuperscript{28} See Revising Order, \textit{supra}, at P 21.
\textsuperscript{29} Order 670, \textit{supra}, at P 22.
\textsuperscript{30} Order 670, \textit{supra}, at P 52.
\textsuperscript{31} See DBET Complaint, \textit{supra}.
\textsuperscript{32} Revising Order, \textit{supra}, at P 29.
\textsuperscript{33} See Horwich, \textit{supra}, at node 176.
\textsuperscript{34} Revising Order, \textit{supra}, at P 29.
\textsuperscript{35} Horwich, \textit{supra}, at 388.
violation of the new anti-manipulation regulation has occurred . . . [t]herefore, the Commission rejects calls for inclusion of a ‘legitimate business purpose’ affirmative defense.”

Good faith defense is distinguishable from the safe harbors and other affirmative defenses. The safe harbors existed under the Market Behavior Rules was for those actions resulted from simple human errors. In Order 670, the Commission gave the following guidance for safe harbors and other affirmative defenses:

The availability of safe harbor presumptions of compliance and affirmative defenses will be the same as is currently the case under the Market Behavior Rules. Thus, if a market participant undertakes an action or transaction that is explicitly contemplated in Commission-approved rules and regulations, we will presume that the market participant is not in violation of the final rule. If a market participant undertakes an action or transaction at the direction of an ISO or RTO that is not approved by the Commission, the market participant can assert this as a defense for the action taken. Therefore, it is not possible for DBET to argue under the safe harbors. But if DBET were to take advantage of on the “self-help” theory noted in the complaint, then DBET should argue that because it genuinely believed that CAISO anomaly was wrong but ignored, scheduling export to relieve harms to DBET’s CRR position was done on good-faith. But this argument could succeed only if DBET did not “trade against interest” and did not make the anomaly worse.

E. FINANCIAL MARKET JURISDICTION

As we can see in FERC’s complaint against DBET, there is an issue on whether FERC has jurisdiction over the CAICO CRR trading. In the complaint, FERC alleged that “[t]he CRR traders did not trade physical power” and that “[t]heir trading of CRRs in CAISO yielded Deutsche Bank almost $5 million in profits for the nine months in 2009 that the new CRR market was active.” The theory was that in early 2010, DBET entered the CAISO physical market but for to benefit its CRR positions in the counterpart financial

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36 Revising Order, supra, at P 29.
37 Order 670, supra, at P 27.
38 See supra note 9, at 5.
39 See infra G, at 15.
40 DBET Complaint, supra.
market. Therefore, FERC was asserting its regulatory power in the financial market because DBET had purposefully entered the physical market.

In a recent anti-manipulation case *Brian Hunter v. FERC, et al.*, the court ruled in favor of Hunter because “manipulation of natural gas futures contracts falls within the CFTC’s exclusive jurisdiction and because nothing in the Energy Policy Act clearly and manifestly repeals the CFTC’s exclusive jurisdiction.”

Similar to the DBET case, in *Hunter*, “FERC filed an administrative enforcement action against Hunter, alleging that he violated section 4A of the Natural Gas Act, which prohibits manipulation. 15 U.S.C. § 717c-1.” According to FERC, it and the CFTC “each have exclusive jurisdiction over the day-to-day regulation of their respective physical energy and financial markets, where, as here, there is manipulation in one market that directly or indirectly affects the other market, both agencies have an enforcement role.” The court rejected that argument, relying on the plaint text that “CEA section 2(a)(1)(A) vests the CFTC with ‘exclusive jurisdiction . . . with respect to accounts, agreements[,] . . . and transactions involving contracts of sale of a commodity for future delivery, traded or executed’ on a CFTC-regulated exchange. 7 U.S.C. § 2(a)(1)(A).” Next, FERC argued that the Energy Policy Act of 2005 contemplates complementary jurisdiction between it and the CFTC. “Beginning with section 4A’s text, FERC contends that it is empowered to prohibit manipulation not only in FERC-regulated markets but also when the manipulation coincides with—i.e., is ‘in connection with,’ ‘directly or indirectly’—FERC-jurisdictional gas transactions.” Again, the court said this argument was unpersuasive, added that “because FERC is free to prohibit manipulative trading in markets outside the CFTC’s exclusive

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42 Id. at 2.
43 Id. at 3.
44 Id. at 7 (quoting Respondent’s Br. 21 (internal quotation marks omitted)).
45 Id.
46 Id. at 10 (quoting Respondent’s Br. 18 (quoting 15 U.S.C. § 717c-1)).
jurisdiction, there is no ‘irreconcilable conflict’ between the two statutes and therefore no repeal by implication.”

Although in Hunter, the alleged manipulation happened in NYMEX, a CFTC-regulated exchange, one could argue that the CAISO CRR market is also under CFTC’s exclusive jurisdiction. This is evidenced in a recent order by the CFTC to exempt CFTC regulations to those markets administered by Tariff and approved by FERC. Therefore, even if DBET could argue in this case that the exclusive jurisdiction belongs to CFTC, it still would be subject to the same CFTC anti-manipulation rule under CEA 6(c)(1).

F. WHEELING-THROUGH TRANSACTION

The main part of FERC’s theory against DBET is hinged on the sham Wheeling-Through transaction.

As noted by FERC:

With a Wheeling-Through transaction, a Scheduling Coordinator tells the CAISO that it is wheeling power through California from the linked import point (Summit) to the linked export point (Silver Peak). But Deutsche Bank falsely submitted the Wheeling-Through transactions. In fact, Deutsche Bank was not wheeling power and its transactions did not have a resource or a Load outside the CAISO, as required by the Tariff. Instead, outside the CAISO on the Sierra Pacific Power (SPPC) system, Corteggiano and Salas scheduled power from Silver Peak to Summit, thus creating a circular schedule in which no power flowed to or from California.

Although 18 C.F.R. § 35.41(b) requires that “A Seller must provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional

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47 Id. at 10 (citing Posadas v. National City Bank, 296 U.S. 497, 503 (1936)).
48 Final Order in Response to a Petition From Certain Independent System Operators and. Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act, CFTC, RIN 3038–AE02, 78 FR 63.
49 See 7 U.S.C. § 9 (1) (“Prohibition against manipulation - It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate . . . ”) (emphasis added).
50 See supra note 9, at 5.
transmission organizations, Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercises due diligence to prevent such occurrences.” DBET therefore, violated this rule. But violation of it should not be confused as factual indicia for market manipulations. Even if the misrepresentation was part of the scheme to inflate the export CRR, it happened in the physical market and there was no physical market manipulation cause of action alleged in FERC’s complaint.

A case on point in a CEA enforcement action would be United States v. Radley. In Radley, defendants were charged with price manipulation in the TET propane market. Defendants entered into supply contracts for delivering TET propane at the end of February, 2004 for the prevailing market price. Afterward, beginning in early February, 2004, defendants started secretly accumulating large position to long the February TET propane futures. CFTC alleged that defendants placed “stacked bids” in the commodity Chalkboard in order to trick other market participants into believing the demand for commodity was strong to drive up the future prices. Yet, CFTC did not allege one of the two elements of cornering the market: a dominant position in futures contracts plus control of the underlying asset. The court affirmed the lower court’s finding for non-manipulation. In its finding, the court noted that CEA exempted forward contracts. The conditions require that the contract was “(1) entered into only between persons that are eligible contract participants at the time they enter into the agreement, contract, or transaction; (2) subject to individual negotiation by the parties; and (3) not executed or traded on a trading facility.” Therefore, because the stacked bids were legitimate offers for enforceable contracts, subject to negotiation, and not executed or traded on a trading facility, there was no violation to the CEA. In addition, regarding the defendants’ concealment on holding large long position, the court found that it was not an act of false reporting because defendants operated in an exempt OTC market.

51 United States v. Radley, 632 F.3d 177, 179 (5th Cir. 2011).
Applying the *Radley* analysis to this case, it is reasonable to find that entering Wheeling-Through transactions in the physical market does not in itself give rise to manipulation of prices in the physical market. First, based on the volume of the transaction, it is unlikely that DBET had cornered the market. That could explain why FERC did not base its market manipulation allegation in the physical market transactions. Second, nothing indicated in the FERC complaint, that Wheeling-Through transactions or even just circular transactions would be illegal. Third, even if Wheeling-Through was technically a misleading characterization of the physical transaction, it would not be a material fact for the CRR manipulation because CRR was not affected by the characterization of the export; rather it was affected by whether there was export scheduled at all. Granted, without the characterization of Wheeling-Through, DBET would have to enter into two separate export/import transactions to accomplish the same thing and would make it harder to execute their export strategy because they might be facing risk should one of the legs be cut. But the point is the same - there was a real and enforceable contract in exporting electricity out of Silver Peak. FERC should find market manipulation in this case only if either the export was misrepresented, or the misrepresented Wheeling-Through transactions had a manipulated effect in the physical market.

Still, one should not downplay DBET’s misrepresentation of Wheeling-Through in violating the CAISO tariff rules. On the other hand, the broad “directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services” language in 18 C.F.R. § 1c.2 would be tempting for one to use to punish a wrongdoer. In this case, FERC seemed to follow *Radley*, in transferring a wrongdoing from the physical market to justify the manipulation claim in the financial market. This would be advantages for FERC because that wrongdoing albeit not material in the physical market, might be material in the financial market. In FERC’s eyes, given that the export CRR value was materially tied to volume of export, DBET manipulated the CRR market because the volume of export was achieved by a shortcut in the execution. But without FERC citing a precedent in its complaint for
support, to use a fraud element in the physical market that did not materialize in manipulation in the physical market to supply an element of fraud in the financial market seems to be a stretch for testing the new rules.

G. TRADING AGAINST INTEREST

Arguably, the trading against interest would be the best argument FERC had against DEBT. In Transnor (Bermuda) Ltd. v. BP N. Am. Petroleum, the court held that if petroleum companies did obtain tax benefits due to declined petroleum prices, then genuine issues of material fact existed as to whether petroleum companies' tax-spinning transactions caused decline in petroleum princes, which constituted manipulative conduct in violation of CEA.

In Amaranth Advisors, the Commission’s statements on this issue reveals that intentionally “trading against interest” has been a key element of a manipulation:

[I]t is important to emphasize that the Commission does not consider high volume trading during the settlement period alone to be illegal or manipulative. Nor is it illegal to possess a large share of trading activity, to engage in speculation, or to wrongly predict the direction of markets. However, here a firm uses some combination of market power and trading activity, against economic interest in one sector, in order to benefit its position in a related financial instrument by artificially moving the price, the firm likely crosses the line into the realm of manipulation.

In Energy Trading Partners, the Commission reiterated that manipulation occurs “where a firm uses some combination of market power and trading activity, against its economic interest in one market, in order to benefit its position in another market by artificially moving the market price”.

In DC Energy, LLC v. H.Q. Energy Servs. (U.S.), Inc., the Commission ruled that HQ Energy did not engage in market manipulation because it “did not use a combination of market power and trading activity to act against its economic interest in one market in order to benefit its position in another

market by artificially moving the market price.” In reaching that decision, the Commission recognized that physical scheduling and trading activities can affect prices that apply to related contracts like CRRs.\(^{56}\)

As noted in the complaint, having figured out how to fixed the anomaly in the CRR market by scheduling export, DBET “increased their CRR position for Silver Peak during the auction for March CRRs,” notwithstanding the fact that “physical transactions at Silver Peak and Summit lost money each day,” for “the benefit to their CRR position outweighed this loss.”\(^{57}\) This might sound bad to begin with. But again, one would need to analyze the purported manipulation under the Commission’s own language - “uses some combination of market power and trading activity, against economic interest in one sector, in order to benefit its position in a related financial instrument by artificially moving the price.”

Absent from the FERC complaint is the allegation that DBET had market power. Based on the volume of the transactions, it is unlikely that DBET had the requisite market power. Without market power, the requisite “combination of market power and trading activity” would fail. Therefore, DBET could argue that it did not violate the rule against “trading against interest.” On the other hand, it is possible that DBET did have market power because of the import derate. That is because if import participants did get dissuaded because they did not believe import bids should be accepted – the same believe DBET originally had, then DBET could have a dominant market power in the export market, given its large export CRR position and the fact that DBET would be the only one to economically export additional power. If this line of discussion continues, then it is possible for DBET to counter argue that what it did was part of the price discovery process. After all, the arbitrage between the physical market and financial market that DBET discovered would be gone if more importers simply submit bids. Again, since

\(^{56}\) See \textit{id.} at 62,661 (“As a general matter, the fact that energy bidding may affect congestion, which in turn may affect the value of [Transmission Congestion Contracts], is known and unsurprising”); \textit{see also id.} (“HQ Energy’s transactions evidence the conduct staff would expect of a rational actor executing a legitimate commercial strategy.”).

\(^{57}\) See \textit{supra}, note 7, at 5.
some of the importers were in fact submitted bids, and some import CRRs did benefit from the import bids, it is unlikely that the price discovery mechanism did not exit.

IV. CONCLUSION

The DBET case illustrated a complex set of events that led to FERC taking action against DBET for market manipulation. Although DBET’s export strategy is striking similar to the much decried load shifting strategy employed by Enron in its attempt to inflate electricity prices, we should distinguish Enron from our case because Enron not only had the market power through collusion with other players, but the overall Enron controversies were much bigger in scope and worse in effects. One should be skeptical on using any particular issue from Enron on setting precedent in the DBET case because Enron was so odious and therefore, relying on regulatory disposition toward Enron might skew the legal analysis for DBET.

One should strive to use case laws and statutory interpretation as much as possible to narrow the inquisition into the DEBT case. Therefore, the core of the legal inquiry that could decide the present case is whether DBET acted in a scheme to defraud the CRR market by trading against interest in the physical market.

As seen in sections C and D of the analysis, DBET could defend itself easily in the challenged activities preceded March 2010 due to the lack of intent and the good faith defense. But subsequent activities in March 2010 were motivated by profit seeking (section C), conducted against interest (section G) and aided by misrepresentation (section F). The combination of these factors did push DBET

58 See FERC Staff, Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, FERC Docket No. PA02-2 (2003), at VI, available at http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=9666689 (“Load shift involves a company submitting an artificial load schedule in order to receive interzonal transmission congestion payments. Load shift involves deliberately creating congestion on a transmission line to increase the value of Enron’s transmission rights and is clearly an attempt to manipulate prices. This Enron trading strategy is particularly complicated and its success was dependent, in part, on the independent bidding behavior of other entities.”).
across the line of manipulation. But one would suspect that the overriding factors for FERC coming to a settlement with DBET was that DBET’s manipulation activities did not cause harms in the physical market; and even though the export CRR market prices were inflated, there were plenty of time and opportunities for market participants to counteract DBET’s confined scope of manipulation. On the other hand, if DBET were lucky to have another shot at the same anomaly, and took advantage of it without resorting to the technical infraction of Wheeling-Through, and somehow lucky enough just broke even in the physical market transactions, then arguably, DBET did not necessarily commit a foul play.