

REPORT OF THE COMPLIANCE & ENFORCEMENT COMMITTEE

This report of the Compliance & Enforcement Committee summarizes key federal enforcement and compliance developments in 2011 including certain decisions, orders, actions, and rules of the Federal Energy Regulatory Commission (FERC), the Commodity Futures Trading Commission (CFTC), the Federal Trade Commission (FTC), and the Department of Energy (DOE).*

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I. THE FEDERAL ENERGY REGULATORY COMMISSION

A. Reports and Rules

1. Annual Enforcement Report

On November 17, 2011, the FERC's Office of Enforcement issued its Annual Report of enforcement staff activities in fiscal year 2011.¹ Among the highlights featured were the report of the Southwest Task Force that investigated the causes of the February 2011 power outages and gas curtailments in New Mexico, Texas, and Arizona;² a new joint NERC-FERC investigation into a September 8, 2011 power outage affecting over two million customers in Southern California, Arizona, and Baja California, Mexico;³ the implementation of new penalty guidelines in three settlements;⁴ the approval of nine enforcement settlements resulting in over \$2.9 million in civil penalties and over \$2.75 million in disgorged unjust profits;⁵ review of 207 NERC Notices of Penalty (NOP) raising 1,392 potential or confirmed violations;⁶ receipt of 107 self reports;⁷ initiation of twelve non-self-reported investigations and two inquiries;⁸ and completion of seventy-two compliance audits.⁹

2. Find, Fix, Track and Report

On October 3, 2011, the FERC issued a notice of a petition filed by NERC to approve an alternative enforcement approach to address potential violations of lower risk to the Bulk Power System where the violator has filed monthly reports

1. STAFF OF THE OFFICE OF ENFORCEMENT, FERC, 2011 REPORT ON ENFORCEMENT: FERC DOCKET NO. AD07-13-004 (Nov. 17, 2011) [hereinafter 2011 REPORT].

2. *Inquiry into Recent Outages in Texas and the Southwest*, 134 F.E.R.C. ¶ 61,104 (2011).

3. 2011 REPORT, *supra* note 1, at 25.

4. *Id.* at 3, 12.

5. *Id.* at 7-12 and App. B.

6. *Id.* at 24-25. On July 28, 2011, NERC filed a NOP charging the Southwestern Power Administration (SWPA), a federal entity within DOE, a \$19,500 penalty. DOE and SWPA asked the FERC to determine whether it has the authority to enforce penalties against a federal government entity, and the FERC's review of the SWPA NOP remains pending. *North Am. Elec. Reliability Corp.*, 136 F.E.R.C. ¶ 61,135 (2011).

7. 2011 REPORT, *supra* note 1, at 12-19.

8. *Id.* at 19-24.

9. *Id.* at 27-33.

with the FERC on remediated issues.¹⁰ The proposed Find, Fix, Track and Report mechanism would replace the NOP process for certain possible violations.¹¹ On November 29, 2011, the FERC held a Reliability Technical Conference that focused on Find, Fix, Track and Report and other potential improvements to the compliance and enforcement process.¹²

3. Rulemaking Regarding Market Power Abuse Detection And Market Manipulation

On October 20, 2011, the FERC issued a Notice of Proposed Rulemaking (NOPR) proposing to require Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) to deliver electronic data “relating to physical and virtual offers and bids, market awards, resource outputs, marginal cost estimates, shift factors, financial transmission rights, internal bilateral contracts, and interchange pricing” to the FERC to enhance market power abuse detection, market manipulation, and ineffective market rules and assist the FERC in the development and evaluation of policies and regulations.¹³

On September 15, 2011, the FERC issued a NOPR proposing to terminate the semi-annual storage reports for interstate and intrastate natural gas pipelines under 18 C.F.R. §§ 284.13(e) and 284.126(c) because the FERC obtains the information in other reports, including Form 549D for intrastate pipelines, and the Form 549B index of customers.¹⁴ The NOPR followed a December 16, 2010 Notice of Inquiry responding to requests for rehearing of Order No. 735¹⁵ seeking the termination of duplicative storage reporting requirements.¹⁶

On April 21, 2011, the FERC issued a NOPR proposing “to require [NERC] to make available to [FERC] staff, on an ongoing basis, access to complete electronic tagging data used to schedule the transmission of electric power in wholesale markets” to assist the FERC in market monitoring, preventing market manipulation, assuring just and reasonable rates, “and monitoring compliance with certain [NAESB] business practice standards.”¹⁷

10. Petition Requesting Approval of New Enforcement Mechanisms and Submittal of Initial Informational Filing Regarding NERC’s Efforts to Refocus Implementation of its Compliance Monitoring and Enforcement Program, FERC Docket No. RC11-6-000 (Sept. 30, 2011).

11. *Id.* at 1-2.

12. *In re* Reliability Technical Conference, Commissioner-Led Reliability Conference, FERC Docket No. RC11-6-000 (Nov. 29, 2011).

13. Notice of Proposed Rulemaking, *Enhancement of Electricity Market Surveillance and Analysis Through Ongoing Electronic Delivery of Data from Regional Transmission Organizations and Independent System Operators*, F.E.R.C. STATS. & REGS. ¶ 32,681, at p. 34,355, 76 Fed. Reg. 66,211 (2011) (to be codified at 18 C.F.R. pt. 35).

14. Notice of Proposed Rulemaking, *Storage Reporting Requirements of Interstate and Intrastate Natural Gas Companies*, F.E.R.C. STATS. & REGS. ¶ 32,678, 76 Fed. Reg. 58,741 (2011) (to be codified at 18 C.F.R. pt. 284).

15. Order No. 735, *Contract Reporting Requirements of Intrastate Natural Gas Companies*, F.E.R.C. STATS. & REGS. ¶ 31,310, 75 Fed. Reg. 29,404 (2010) (codified at 18 C.F.R. pt. 285).

16. Notice of Inquiry, *Storage Reporting Requirements of Interstate and Intrastate Natural Gas Companies*, F.E.R.C. STATS. & REGS. ¶ 35,568, 75 Fed. Reg. 80,758 (2010).

17. Notice of Proposed Rulemaking, *Availability of E-Tag Information to Commission Staff*, F.E.R.C. STATS. & REGS. ¶ 32,675, at p. 34,251, 76 Fed. Reg. 23,516 (2011) (to be codified at 18 C.F.R. pt. 366).

The FERC also sought comments on whether it should make this information available to entities involved in market monitoring functions.¹⁸

On April 21, 2011, the FERC issued a NOPR proposing to increase price transparency in wholesale power markets by requiring certain non-public utilities with annual wholesales of more than 4 million MWh and non-public utility balancing authorities with 1 million Mwh or more in annual wholesales to file Electronic Quarterly Reports (EQRs).¹⁹ In addition, the FERC proposed to require all EQR filers to include transaction date and time, type of rate, whether the transaction was reported to an index publisher, the identity of any broker or exchange, and electronic tag identification data.²⁰

4. Transparency and *Texas Pipeline Ass'n v. FERC*

On October 24, 2011, the Fifth Circuit vacated the FERC's regulations, promulgated in Order Nos. 720 and 720-A,²¹ requiring certain major non-interstate natural gas pipelines to post flow data and receipt and delivery point information on public web sites, similar to the data posted by interstate natural gas pipelines (the Posting Rule).²² The court ruled that the FERC's jurisdictional basis for the posting requirement, section 23 of the Natural Gas Act (NGA),²³ was enacted subject to the preexisting jurisdictional exclusions in section 1(b) of the NGA²⁴ which prohibit the FERC from regulating entities involved solely in local distribution or other transportation of natural gas that is not in interstate commerce.²⁵ The court rejected the FERC's arguments that section 23 created new "transparency" jurisdiction distinct from, and not limited by, the NGA's original rate and certificate jurisdiction or the section 1(b) exclusions from such jurisdiction.²⁶ It further disagreed with the FERC's position that the applicability of section 23 to "any market participant" included the market participants excluded under section 1(b).²⁷ The court concluded that:

the NGA unambiguously precludes FERC from issuing the Posting Rule so as to require wholly intrastate pipelines to disclose and disseminate capacity and scheduling information. Indeed, other parts of the NGA, as well as its history, confirm our conclusion that Congress did not intend to regulate "the entire natural-gas field to the limit of constitutional power" but chose instead to leave regulation of certain entities, including intra-state transactions and pipelines to the states.²⁸

18. *Id.* at P 8.

19. Notice of Proposed Rulemaking, *Electronic Market Transparency Provisions of Section 220 of the Federal Power Act*, F.E.R.C. STATS. & REGS. ¶ 32,676 at P 69, 76 Fed. Reg. 24,188 (2011) (to be codified at 18 C.F.R. pt. 35).

20. *Id.* at PP 79-80.

21. Order No. 720, *Pipeline Posting Requirements Under Section 23 of the Natural Gas Act*, F.E.R.C. STATS. & REGS. ¶ 31,283, 73 Fed. Reg. 73,494 (2008) (codified at 18 C.F.R. pt. 284), *reh'g*, Order No. 720-A, F.E.R.C. STATS. & REGS. ¶ 31,302, 75 Fed. Reg. 5178 (2010).

22. *Texas Pipeline Ass'n v. FERC*, 661 F.3d 258, 260 (5th Cir. 2011).

23. 15 U.S.C. § 717t-2(a) (2006).

24. 15 U.S.C. § 717(b) (2006).

25. *Texas Pipeline Ass'n*, 661 F.3d at 262.

26. *Id.* at 262-63.

27. *Id.* at 263.

28. *Id.* (quoting *Northwest Cent. Pipeline v. State Corp. Comm'n of Kan.*, 489 U.S. 493, 510 (1989)).

On December 20, 2011, the court issued an order granting the FERC's request for clarification that the court did not vacate the FERC's rule as applicable to interstate pipelines.²⁹ The FERC did not seek rehearing of the court's ruling.

B. *Show Cause Proceedings*

1. *Kourouma*

On February 14, 2010, the FERC issued an order to show cause (OSC) to Moussa Kourouma, an individual, directing him to show cause why he did not violate 18 C.F.R. § 35.41(b) by knowingly submitting misleading information and omitting material facts regarding "Quntum Energy, LLC" in filings with the FERC and PJM, a FERC-approved regional transmission organization, and why the FERC should not impose on him a proposed \$50,000 civil penalty.³⁰ On January 7, 2011, the Commission's Office of Enforcement staff submitted to the Commissioners an "Enforcement Staff Report and Recommendations" laying out the allegations on which the OSC would be based and a copy of which was attached to the OSC.³¹ The report claimed, among other things, that to avoid the effects of a non-compete agreement with his prior employer, Kourouma listed in his filings his then one-year old daughter and an acquaintance as having management and ownership roles in the Quntum company and made other misstatements or omissions in order to hide his role in the company.³²

The order represented the first occasion (since the enactment of new civil penalty authorities under EAct 2005) for the Commission to afford a respondent to an OSC under the Federal Power Act an "election" either to proceed before a FERC Administrative Law Judge (ALJ) prior to the assessment by the FERC of a penalty (presumably followed by rehearing and appellate court review opportunities), or, if the Commission found a violation, an immediate assessment of a penalty followed by an opportunity for *de novo* review in a district court.³³ Kourouma answered the OSC, moved for summary disposition arguing there were no issues of fact to be tried, and "elected" ALJ proceedings.³⁴

In June 2011, the FERC issued an order finding that Kourouma violated the regulation.³⁵ The order directed Kourouma to pay a penalty of \$50,000.³⁶ On the procedural "election" issue, the FERC found that Kourouma had been afforded a reasonable opportunity to present his arguments in answering the OSC and, notwithstanding his "election" of ALJ proceedings, those arguments presented no material issues of fact and thus no reason for a hearing before an

29. Court Order Granting Motion to Clarify Opinion, *Texas Pipelines Ass'n*, 661 F.3d 258 (Dec. 20, 2011).

30. *Kourouma*, 134 F.E.R.C. ¶ 61,105 at P 1 (2011).

31. *Id.* at P 2, P 2 n.6.

32. *Id.* at P 2.

33. *Id.* at P 3. The penalty provisions of the Natural Gas Act under which the FERC's other post-EAct 2005 OSCs were issued, 15 U.S.C. §§ 717t to 717t-1, do not contain a specific election procedure.

34. Motion for Summary Disposition and Answer of Moussa I. Kourouma to Order to Show Cause and Notice of Proposed Penalty, and Election for Administrative Hearing, FERC Docket No. IN11-2-000 (Mar. 13, 2011).

35. *Kourouma*, 135 F.E.R.C. ¶ 61,245 (2011).

36. *Id.* at p. 62,399.

ALJ.³⁷ In so holding, the FERC observed that, even though section 316(a) of the FPA requires an “opportunity” for a hearing before an ALJ and notwithstanding its prior order that if Kourouma “elect[ed] an administrative hearing before an ALJ, the Commission [would] issue a hearing order,”³⁸ Kourouma had been given such an “opportunity” and had declined it by arguing in the first instance that there were no factual issues in dispute.³⁹

On the merits, the FERC also found that violating section 35.41 does not require a finding of intentional misrepresentation to the FERC but only the submission of “false or misleading information,” though the regulation “grants an exception to sellers that exercised due diligence [efforts] to prevent the submission of such [false] information.”⁴⁰ Thus, intent is not an element of the offense, but in cases where the statements were not intentional, a defense is available for those who took steps to avoid the misstatements.⁴¹ The FERC then found that the references to the one-year old and the acquaintance were clearly both “false” and “misleading.”⁴² As to the due diligence exception, the FERC held Kourouma not only “failed to exercise due diligence to prevent the submission of these statements” but also that he had submitted them “to conceal his involvement with the company.”⁴³ The FERC also rejected arguments that section 35.41 is unconstitutionally vague, overbroad, or discriminatory, dismissing the notion that, in order to be charged, a respondent must reasonably understand all the consequences that may flow from a violation.⁴⁴ Instead, the FERC held it is sufficient that a regulation give notice of what is required to comply.⁴⁵

In assessing the penalty, the Commission rejected Kourouma’s arguments that he should not be penalized because the conduct would not likely recur, he had already suffered severe financial harm, and that the conduct resulted in little or no harm.⁴⁶ Staff had responded that even a “minor market participant” can harm the market and that, based on the number of misrepresentations Kourouma made and “knew to be false,” a penalty was warranted.⁴⁷ Moreover, staff claimed it had already taken Kourouma’s financial circumstances into account by proposing an installment payment plan.⁴⁸ The FERC focused on the seriousness with which it views misrepresentations to it and to one of its organized markets and affirmed the penalty, allowing Kourouma to pay the \$50,000 in installments over a number of years.⁴⁹ The penalty was not assessed

37. *Id.* at P 10.

38. 134 F.E.R.C. ¶ 61,105 at P 3.

39. 135 F.E.R.C. ¶ 61,245 at P 12.

40. *Id.* at P 20.

41. *Id.* at PP 21-22.

42. *Id.* at P 24.

43. *Id.* at P 26.

44. *Id.* at PP 34-36.

45. *Id.* at P 34.

46. *Id.* at P 39.

47. *Id.* at P 41.

48. *Id.*

49. *Id.* at P 55.

under the FERC's recently issue Revised Penalty Guidelines because those Guidelines do not, by their terms, apply to natural persons.⁵⁰

Kourouma sought and was denied rehearing by the FERC on a number of grounds and has sought review of his case in the United States Court of Appeals for the D.C. Circuit.⁵¹ He also filed motions with the FERC to stay enforcement of the civil penalty pending the outcome of his petition.⁵² The FERC initially denied the motion for stay, but after further briefing on Mr. Kourouma's ability to pay and evidence of financial hardship, the FERC subsequently granted the stay pending judicial review.⁵³

2. The Gas Pipeline Open Season Cases: *National Fuel Marketing Company* and *Seminole Energy Services*

As reported in the last Committee Report, in January 2008, the FERC initiated OSCs "against two groups of affiliates over allegations of market manipulation" and violations of FERC natural gas capacity release/shipper-must-have-title regulations

associated with bidding in Cheyenne Plains Natural Gas Company's March 2007 open season for new pipeline capacity.⁵⁴ In March 2007, Cheyenne Plains posted an open season stating that if the bids exceeded the available capacity, the capacity would be allocated pro rata among all of the highest bidders.⁵⁵ While forty-seven bidders were each awarded a pro rata share of the capacity, the FERC's Enforcement Staff found that five entities with multiple affiliates accounted for twenty-seven of the winning bids and 57% of the capacity.⁵⁶ Staff believed that multiple affiliate bidding intended to game an open season in order to gain an unfair allocation of capacity is a fraud under the Commission's market manipulation rules.⁵⁷ The FERC settled with several of the companies involved,⁵⁸ but issued [OSCs] to two groups who did not⁵⁹

settle: National Fuel Marketing Company, LLC, NFM Midstream, LLC, NFM Texas Pipeline, LLC, and NFM Texas Gathering, LLC (collectively NFM) and Seminole Energy Services, LLC, Seminole Gas Company, LLC, Seminole High Plains, LLC, Lakeshore Energy Services, LLC, and Vanguard Energy Services, LLC (collectively Seminole).⁶⁰ These were the first OSCs issued under a new policy mandating an "enforcement staff report" attached to a summary OSC, rather than an OSC in which the Commission makes preliminary determinations.⁶¹

50. *Id.* at P 42 n.77.

51. *Kourouma*, 137 F.E.R.C. ¶ 61,205 at P 6 (2011).

52. *Id.* at P 1.

53. *Id.* at PP 1, 7.

54. *See generally, Seminole Energy Servs., L.L.C.*, 126 F.E.R.C. ¶ 61,041 (2009); *National Fuel Mktg. Co.*, 126 F.E.R.C. ¶ 61,042 (2009).

55. *See generally, Tenaska Mktg. Ventures*, 126 F.E.R.C. ¶ 61,040 at P 5 (2009).

56. *Id.* at P 10.

57. *Id.* at P 8.

58. *Id.* at P 37.

59. *Report of the Compliance & Enforcement Committee*, 32 ENERGY L.J. 181, 191 (2011) [hereinafter *2011 Report*].

60. 126 F.E.R.C. ¶ 61,040 at App. A.

61. Revised Policy Statement on Enforcement, *Enforcement of Statutes, Regulations, and Orders*, 123 F.E.R.C. ¶ 61,156 at PP 35-36 (2008).

Two of the then-sitting five Commissioners dissented from the orders.⁶² Commissioners Moeller and Spitzer raised concerns that penalizing the conduct was unfair because it might have been viewed as actually consistent with the FERC's policies or at the very least penalties would violate fairness principles because the FERC was not consistent "over a period of time, sending a "mixed message" with regard to multiple-affiliate bidding practices."⁶³ Subsequently, one of the Commissioners who voted for the OSCs (then-Chairman Kelliher) departed from the Commission and thus an evenly divided Commission presided over the rehearing request filed by NFM and Seminole. The FERC "tolled" the rehearing request to allow it further to consider the request. The matter remained pending in 2009 and 2010 – though the records in the dockets reflect a number of congressional inquiries in 2009 into the FERC's handling of the matters.⁶⁴

On April 7, 2011, the Commission approved settlements in both matters – between Enforcement and NFM and between Enforcement and Seminole.⁶⁵ NFM and Seminole neither admitted nor denied violation of the Commission's shipper-must-have-title requirement and agreed to pay \$290,000 and \$300,000 civil penalties respectively.⁶⁶ NFM also agreed to submit compliance monitoring reports.⁶⁷ Seminole disgorged \$271,315 of unjust profits arising from the transactions at issue, and also agreed to submit compliance monitoring reports.⁶⁸ Because NFM experienced a net loss on the transactions at issue, it did not have unjust profits subject to disgorgement.⁶⁹ There was no mention of alleged market manipulation as a basis for the settlement in the orders.

The order approving the settlement held that the settlements "mooted" the OSCs and terminated the dockets,⁷⁰ and in a footnote to those sentences, the FERC observed that it was that day also issuing a NOPR on *Bidding by Affiliates in Open Seasons for Pipeline Capacity*.⁷¹ In that rulemaking docket, the FERC issued a final rule that "prohibit[s] multiple affiliates of the same entity from bidding in an open season for pipeline capacity in which the pipeline may allocate capacity on a pro rata basis, [except in cases in which an] affiliate has an independent business reason for submitting a bid."⁷²

62. 126 F.E.R.C. ¶ 61,040, at pp. 61,247-48 (Moeller & Spitzer, Comm'rs, dissenting); *see also*, 2011 Report, *supra* note 59, at 191.

63. 2011 Report, *supra* note 59, at 191; *see also*, 126 F.E.R.C. ¶ 61,040, at pp. 61,247-48.

64. *See, e.g.*, Comments of US Senator Tom A. Coburn and James M. Inhofe Expressing Concerns Regarding Transportation Capacity on the Cheyenne Plains National Gas Company, FERC Docket No. IN09-7-000 (Aug. 6, 2009).

65. *Seminole Energy Servs.*, 135 F.E.R.C. ¶ 61,010 (2011); *National Fuel Mktg. Co.*, 135 F.E.R.C. ¶ 61,011 (2011).

66. 135 F.E.R.C. ¶ 61,010 at P 16; 135 F.E.R.C. ¶ 61,011 at P 16.

67. 135 F.E.R.C. ¶ 61,011 at P 16.

68. 135 F.E.R.C. ¶ 61,010 at P 16.

69. 135 F.E.R.C. ¶ 61,011 at P 17.

70. *Id.* at P 12.

71. *Id.* at P 12 n.3; Notice of Proposed Rulemaking, *Bidding by Affiliates in Open Seasons for Pipeline Capacity*, F.E.R.C. STATS. & REGS. ¶ 32,673, 76 Fed. Reg. 20,571 (2011) (to be codified at 18 C.F.R. pt. 284).

72. Order No. 894, *Bidding by Affiliates in Open Seasons for Pipeline Capacity*, F.E.R.C. STATS. & REGS. ¶ 31,325, at p. 31,493, 76 Fed. Reg. 72,301 (2011).

C. *Enforcement Litigation and Adjudications*

1. *Brian Hunter*

In *Brian Hunter*, the Commission affirmed an ALJ's decision finding that former Amaranth Advisors LLC trader Brian Hunter violated the Commission's prohibition on market manipulation and ordered Hunter to pay a \$30 million civil penalty.⁷³ By way of brief background, in July 2007, the Commission ordered Amaranth Advisors, L.L.C., several of its affiliates, and two of its former traders, Brian Hunter and Matthew Donohoe, to show cause why they should not be found to have violated the Commission's anti-manipulation regulations for alleged manipulation of the monthly NYMEX natural gas futures contract settlement price in order to benefit certain derivatives positions.⁷⁴ The Commission's Office of Enforcement staff settled with the Amaranth affiliates and Matthew Donohoe.⁷⁵ In January 2010, an ALJ found that Brian Hunter had engaged in market manipulation.⁷⁶

On April 21, 2011, the Commission affirmed the ALJ's findings. The Commission found that "Hunter's trading practices [in the natural gas futures market during the settlement periods on] expiration days were fraudulent or deceptive, undertaken with the requisite scienter, and carried out in connection with FERC-jurisdictional natural gas transactions."⁷⁷ In particular, the Commission affirmed the ALJ's findings that Hunter sold significant numbers of natural gas futures contracts during the settlement periods of three months with the intent to drive down the settlement price for the contract in order to benefit related financial swap positions that increased in value as the settlement prices declined.⁷⁸

On November 18, 2011, the Commission denied Hunter's request for rehearing.⁷⁹ The Commission affirmed its previous findings that: (a) the Commission has personal jurisdiction over Hunter;⁸⁰ (b) "open market" trading violates the Commission's regulations when there is manipulative intent;⁸¹ (c) an artificial price is not an element of the Commission's market manipulation regulations;⁸² (d) the Commission has jurisdiction over futures transactions that impact jurisdictional physical natural gas markets;⁸³ (e) the burden of proof was properly placed on Office of Enforcement Litigation staff;⁸⁴ (f) Hunter acted with sufficient scienter;⁸⁵ (g) Hunter acted with reckless disregard to the impact

73. *Brian Hunter*, 135 F.E.R.C. ¶ 61,054 (2011) (Affirming Order), *order on reh'g*, 137 F.E.R.C. ¶ 61,146 (2011) (Rehearing Order).

74. *Amaranth Advisors, L.L.C.*, 120 F.E.R.C. ¶ 61,085 at PP 1-2 (2007).

75. *Amaranth Advisors, L.L.C.*, 128 F.E.R.C. ¶ 61,154 at P 1 (2009).

76. *Brian Hunter*, 130 F.E.R.C. ¶ 63,004 at P 1 (2010).

77. *Brian Hunter*, 135 F.E.R.C. ¶ 61,054 at P 3 (2011).

78. *Id.* at P 53.

79. *Brian Hunter*, 137 F.E.R.C. ¶ 61,146 at P 1 (2011).

80. *Id.* at P 10 n.13.

81. *Id.* at PP 12-13.

82. *Id.* at PP 15-17.

83. *Id.* at P 10.

84. *Id.* at PP 32-34.

85. *Id.* at P 35.

of his conduct upon Commission-jurisdictional transactions;⁸⁶ (h) Hunter had proper notice that trading with an intent to affect market prices could constitute market manipulation;⁸⁷ and (i) the Commission's penalty assessment could be calculated based on the number of futures contracts used to accomplish the manipulation.⁸⁸ The matter is now pending in federal appeals court.⁸⁹

2. *Richard Blumenthal, Attorney General for the State of Connecticut v. ISO New England, Inc.*

In *Richard Blumenthal, Attorney General for the State of Connecticut v. ISO New England, Inc.*, the Commission affirmed an ALJ's initial decision⁹⁰ that the third-party complainants had failed to support their allegations of market manipulation against certain capacity importers into ISO-NE.⁹¹ This proceeding addressed the issue of whether any of the respondents' energy supply offers at or near the ISO-NE's

\$1000/MWh price cap constituted: (1) a fraudulent device, scheme, or artifice; (2) a material misrepresentation or a material omission as to which there was a duty to speak under a Commission-filed tariff, Commission order, rule, or regulation; or (3) any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.⁹²

The Commission ultimately found that the "Respondents fully intended to deliver their capacity-backed energy in the unlikely event ISO-NE called on it, and that each of them had procedures in place to ensure the energy actually could be delivered if necessary."⁹³

3. *Allegations of Market Manipulation of the Electric Energy Markets in the West*

In *Allegations of Market Manipulation of the Electric Energy Markets in the West*, a witness refused to comply with a Commission-issued subpoena and failed to appear at a deposition in a non-public investigation.⁹⁴ The Commission's Office of Enforcement filed a petition to enforce the subpoena in the United States District Court for the District of New Jersey.⁹⁵ In January 2011, the court issued an order to show cause, which required the witness to appear and show cause why he should not be compelled with comply with the

86. *Id.* at P 66.

87. *Id.* at PP 72-75.

88. *Id.* at PP 85-92.

89. *Hunter v. FERC*, No. 11-1477 (D.C. Cir. filed Dec. 12, 2011).

90. *Richard Blumenthal, Att'y Gen. for Conn. v. ISO New England Inc.*, 132 F.E.R.C. ¶ 63,017 (2010) (Initial Decision).

91. *Richard Blumenthal, Att'y Gen. for Conn. v. ISO New England Inc.*, 135 F.E.R.C. ¶ 61,117 at P 1 (2011) (Affirming Order).

92. *Id.* at P 13.

93. *Id.* at P 36.

94. Brief in Support of Petition by FERC for an Order to Show Cause at 5, *FERC v. Rainess*, No. 3:10-CV-06733 (D.N.J. Dec. 22, 2010) (referencing *Allegations of Market Manipulation of the Electric Energy Markets in the West*, FERC Docket No. IN08-8-000).

95. *Petition, FERC v. Rainess*, No. 3:10-CV-06733 (D.N.J. filed Dec. 22, 2010).

subpoena.⁹⁶ In response to the court's order to show cause, the witness agreed to testify under oath, so the Office of Enforcement withdrew its petition.⁹⁷

4. Hydropower License Complaint

In February 2011, the Commission's Office of Enforcement sought an injunction in the United States District Court for the Northern District of Indiana to enforce the terms of a compliance order issued by the Commission's Office of Energy Projects to address deficiencies under a Commission-issued hydropower license.⁹⁸ The compliance order found that the licensee failed to properly operate and maintain a hydroelectric generation facility and required the licensee to undertake certain remediation measures.⁹⁹ After the Office of Enforcement filed the complaint, the licensee resolved the outstanding compliance issues.¹⁰⁰ The Office of Enforcement withdrew its complaint upon confirmation by the Office of Energy Projects that the licensee had satisfied the terms of the compliance order, which terminated the action and investigation.¹⁰¹

D. Reliability Enforcement Actions

1. Western Electricity Coordinating Council

This is the first of two enforcement settlements relating to an event that occurred on February 14, 2008, involving a disturbance on the Bulk Electric System (BES) in Utah.¹⁰² The event involved the unintentional actuation of a transformer fire control system leading to a fault followed by the misoperation of a relay.¹⁰³ This resulted in the loss of four 345 kV transmission lines and a period of time during which several entities on the Western U.S. grid worked to restore the system to normal operations.¹⁰⁴ The event involved loss of more than 2,000 MW of generation and over 183 MW of load affecting over 74,000 customers.¹⁰⁵ On July 7, 2011, the FERC approved a settlement involving the FERC, NERC, and the Western Electricity Coordinating Council (WECC) relating to WECC and PNSC's (a WECC predecessor) role as the regional Reliability Coordinator (RC).¹⁰⁶ WECC is also a designated Regional Entity under NERC with responsibility for enforcement of Reliability Standards.¹⁰⁷ The FERC and NERC claimed that as the RC for this region, "PNSC violated

96. Order to Show Cause, *FERC v. Rainess*, No. 3:10-CV-06733 (D.N.J. Jan. 10, 2011).

97. Opinion & Order, *FERC v. Rainess*, No. 3:10-CV-06733 (D.N.J. Jan. 31, 2011) (ordering the petition moot).

98. Complaint, *FERC v. Star Mill, Inc.*, No. 1:11-CV-49 (N.D. Ind. Feb. 4, 2011) (requesting enforcement through injunction of *Star Mill, Inc.*, 128 F.E.R.C. ¶ 62,164 (2009)).

99. *Id.* at ¶ 16.

100. Motion to Dismiss Complaint with Prejudice, *FERC v. Star Mill, Inc.*, No. 1:11-CV-49 (N.D. Ind. June 16, 2011).

101. *Id.*

102. *Western Elec. Coordinating Council*, 136 F.E.R.C. ¶ 61,020 (2011); *see also PacifiCorp*, 137 F.E.R.C. ¶ 61,176 (2011).

103. 137 F.E.R.C. ¶ 61,176 at P 5.

104. *Id.* at P 8.

105. *Id.* at PP 4, 12.

106. 136 F.E.R.C. ¶ 61,020, at p. 61,097.

107. *Id.* at P 4.

nine requirements of five Reliability Standards” in the IRO, EOP, and COM chapters of the Reliability Standards.¹⁰⁸ The case included the allegation that PNSC failed to respond adequately to the disturbance related Area Control Error (ACE) performance, did not properly handle energy emergency alerts, and did not engage in direct-repeat-acknowledge or so-called “three-part” communication, as well as violated requirements related to overall monitoring of the status of the grid.¹⁰⁹ WECC agreed to pay a \$350,000 civil penalty, divided equally between the U.S. Treasury and NERC, and the settlement also recited that WECC had undertaken several remedial measures to improve performance in this area.¹¹⁰

2. *PacifiCorp*

This case involved the same February 14, 2008 event as *WECC*.¹¹¹ PacifiCorp serves as a Balancing Authority for an area including Utah and parts of Idaho and Wyoming.¹¹² On December 1, 2011, the FERC approved a settlement involving the FERC, NERC, and PacifiCorp based on allegations that, in connection with the February 14, 2008 event, “PacifiCorp violated 23 Requirements in 15 Standards” in the BAL, TOP, COM, EOP, PER, PRC chapters of the Reliability Standards.¹¹³ Some alleged violations related to conditions that resulted in the line losses, including allegations of inadequate protection system maintenance and testing, operations planning, and the training and authority of operations personnel.¹¹⁴ The FERC and NERC also focused some of the allegations on PacifiCorp’s “response to the disturbance” including what the FERC and NERC termed as PacifiCorp “leaning on the [i]nterconnection” in the minutes and hours following the fault because of delays or other problems with remedial actions such as purchasing power or shedding load to restore ACE.¹¹⁵ The settlement also seems to have rested, in part, on the FERC and NERC’s views of the actions of a PacifiCorp manager in the control center who was not NERC certified and who instructed the system operator at one point during the event to “hold off” shedding load that would have helped to restore ACE to the system.¹¹⁶ PacifiCorp agreed to pay a civil penalty of \$3,925,000 divided equally between the U.S. Treasury and NERC, was already engaged in a number of reliability enhancement activities, and agreed to additional mitigation measures.¹¹⁷

3. *Grand River Dam Authority*

On August 29, 2011, the FERC approved a settlement between the FERC, NERC, and the Grand River Dam Authority (GRDA) resolving violations of

108. *Id.* at P 11.

109. *Id.* at PP 12-16.

110. *Id.* at PP 1-2.

111. 137 F.E.R.C. ¶ 61,176 at P 1.

112. *Id.* at P 3.

113. *Id.* at P 14.

114. *Id.* at P 19.

115. *Id.* at P 7.

116. *Id.* at P 19.

117. *Id.* at P 23.

fifty-two requirements in nineteen Reliability Standards.¹¹⁸ “The GRDA is an agency of the [S]tate of Oklahoma” and owns and operates a “transmission system . . . within the Southwest Power Pool (SPP)” footprint in the Eastern Interconnection.¹¹⁹ The settlement proceeded from a prior settlement between NERC and the GRDA in lieu of a “Remedial Action Directive” that NERC was poised to issue to the GRDA in 2009 in order to compel certain immediate actions.¹²⁰ The violations identified in the FERC/NERC settlement related to requirements in the TOP, COM, EOP, FAC, TPL, PRC, and PER chapters of the Standards, and the GRDA’s ability to see and control its transmission system, maintenance and testing of protection systems, long term system planning, facility ratings, facility connection requirements, emergency operations planning, and personnel training.¹²¹ As part of the FERC and NERC settlement, the GRDA agreed to pay a \$350,000 penalty, one-half to the U.S. Treasury and one-half to NERC.¹²² The GRDA also agreed to continue mitigation measures already undertaken, to submit to a compliance monitoring program, and to expend at least \$2 million in a significant additional compliance program.¹²³

II. THE COMMODITY FUTURES TRADING COMMISSION

A. Energy-Related Enforcement Cases

In 2011, the CFTC filed two energy-related enforcement cases. First, the CFTC filed a manipulation and attempted manipulation case involving West Texas Intermediate (WTI) NYMEX futures contract and physical holdings.¹²⁴ Second, the CFTC filed a trade practices case concerning wash trades in Reformulated Gasoline Blendstock for Oxygen Blending (RBOB) gasoline futures.¹²⁵ The manipulation case is pending in U.S. district court and the wash trade case settled for a civil penalty.¹²⁶

1. Manipulation and Attempted Manipulation

In May 2011, the CFTC filed a civil enforcement action against three companies and two of their traders; Parnon Energy Inc. of California, Arcadia Petroleum Ltd. of the United Kingdom, Arcadia Energy (Suisse) SA of Switzerland, James T. Dyer of Australia, and Nicholas J. Wildgoose of California, charging them with manipulating and attempting to manipulate NYMEX crude oil future prices from late 2007 to April 2008 in three different episodes.¹²⁷ The complaint alleged Dyer and Wildgoose conducted a

118. *Grand River Dam Auth.*, 136 F.E.R.C. ¶ 61,132 at P 6 (2011).

119. *Id.* at P 3.

120. *Id.* at P 6.

121. *Id.* at PP 5-23.

122. *Id.* at P 24.

123. *Id.* at PP 25-26.

124. Complaint, CFTC v. Parnon Energy Inc., No. 1:11-cv-03543 (S.D.N.Y. May 24, 2011) [hereinafter WTI Complaint].

125. Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act (CEA), Making Findings and Imposing Remedial Sanctions, *In re Cantor Fitzgerald & Co.*, CFTC Docket No. 11-08 (Feb. 22, 2011) [hereinafter Cantor Order].

126. *Id.*; WTI Complaint, *supra* note 124.

127. WTI Complaint, *supra* note 124, at ¶¶ 3-5.

manipulation involving West Texas Intermediate (WTI) crude oil designed to exacerbate the tight supply of crude oil at Cushing, Oklahoma.¹²⁸ The CFTC alleged the defendants executed the strategy by:

1. Building a dominant physical position in WTI to be delivered the next month at Cushing;
2. “[C]ontemporaneously[,] establishing a long near month/next month WTI Derivatives calendar spread position on the NYMEX and ICE with the intent to artificially inflate the value of [the] position;”
3. Withholding their physical crude oil from the market to create a tight supply environment and selling long spread positions at a profit;
4. Establishing a short spread position at artificially high price; and
5. Surprising the market by dumping their physical position in order to drive down prices and profit from short spread position.¹²⁹

The CFTC alleged the defendants successfully manipulated prices on twelve days between January and March 2008 and were planning to continue this cycle of price manipulation except that on April 17, 2008, “Parnon/Arcadia received the CFTC’s request for documents relating to their trading activities.”¹³⁰ The complaint claimed their scheme led to a physical position trading loss of \$15 million but a derivative gain of \$50 million.¹³¹

By engaging in this conduct, the CFTC alleged, Parnon/Arcadia violated sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act.¹³² The CFTC acknowledged “assistance of the Financial Services Authority of the United Kingdom and the Australian Securities & Investments Commission.”¹³³ Arcadia Petroleum filed a motion to dismiss based on jurisdictional arguments on September 29, 2011 and a supporting memorandum on October 4, 2011,¹³⁴ and currently, the case is pending in the U.S. District Court for the Southern District of New York.

2. Trade Practices (Wash Sales & Fictitious Trades)

In February 2011, the CFTC issued an order filing and simultaneously settling charges against Cantor Fitzgerald & Co. for engaging in wash sales and causing the execution of noncompetitive transactions.¹³⁵ The CFTC alleged that from March through April 2007, an employee of the company received and executed orders “on behalf of the same customer[] to buy and sell” hundreds of RBOB gasoline futures contracts for the same price, quantity, and contract month.¹³⁶

128. *Id.* at ¶¶ 2-4.

129. *Id.* at ¶¶ 3, 25.

130. *Id.* at ¶¶ 49-51.

131. *Id.* at ¶ 52.

132. *Id.* at ¶ 5 (citing 7 U.S.C. §§ 9, 13b, 13(a)(2) (2006)).

133. Press Release, CFTC, CFTC Charges Parnon Energy Inc., Arcadia Petroleum Ltd. and Arcadia Energy (Suisse) SA with Price Manipulation in the Crude Oil Market (May 24, 2011), available at <http://www.cftc.gov/PressRoom/PressReleases/pr6041-11>.

134. Memorandum of Law in Support of Defendants’ Motion to Dismiss, CFTC v. Parnon Energy Inc., No. 1:11-cv-03543 (S.D.N.Y. Sept. 29, 2011).

135. Cantor Order, *supra* note 125, at 1.

136. *Id.* at 2.

“In each instance, [the CFTC alleged] the employee prearranged to have the identical orders executed opposite each other.”¹³⁷ The CFTC charged that because “these trades were [allegedly] intended to negate market risk and avoid a bonafide market transaction,” they violated section 4c(a) of the Commodity Exchange Act.¹³⁸ Furthermore the CFTC alleged the trades “were noncompetitive transactions in violation of Regulation 1.38(a).”¹³⁹ The CFTC alleged that because the “employee undertook his actions within the scope of his employment, Cantor is liable for the employee’s acts, omissions and failures in violation of Section 4c(a) of the Act and Regulation 1.38(a) pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. 5 2(a)(1)(B) (2006).”¹⁴⁰ The CFTC and Cantor Fitzgerald settled the case for a civil penalty of \$100,000.¹⁴¹

B. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or Act), signed into law on July 21, 2010,¹⁴² established a comprehensive framework for the regulation of the over-the-counter derivatives market.¹⁴³ Title VII of the Act, the Wall Street Transparency and Accountability Act, grants the CFTC and the Securities and Exchange Commission (SEC) expansive new authority to regulate swaps and security-based swaps, respectively.¹⁴⁴ Swaps are defined broadly in the Act to include, among other things, currency, equity, interest rate, foreign exchange, and commodity swaps, including energy swaps.¹⁴⁵ Security-based swaps are defined as swaps on a narrow-based security index, a single security or loan, or events relating to a single issuer or narrow-based security index.¹⁴⁶ The Act includes similar provisions for swaps and security-based swaps and mandates coordination between the SEC and the CFTC.

During 2011, the CFTC continued to undertake the task of implementing the Dodd-Frank Act and extending deadlines and comment periods as needed. The general effective date for certain provisions in the Act that did not require rulemaking was July 16, 2011, unless an effective date was specifically provided.¹⁴⁷ The CFTC granted temporary exemptive relief in two parts for provisions of the CEA that will or may apply to certain agreements, contracts, and transactions.¹⁴⁸ For part one, the exemption was granted to “provisions that are self-effectuating (i.e., do not require rulemaking) and reference terms that require further definition (i.e., ‘swap,’ ‘swap dealer,’ ‘major swap participant,’ or

137. *Id.*

138. *Id.* (citing 7 U.S.C. § 6c(a) (2006)).

139. *Id.* (citing 17 C.F.R. § 1.38(a) (2010)).

140. *Id.*

141. *Id.* at 6.

142. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

143. Notice of Proposed Order and Request for Comment, Effective Date for Swap Regulation, 76 Fed. Reg. 35,372, 35,372 (2011) (to be codified at 17 C.F.R. ch. 1).

144. *Id.*

145. Dodd-Frank at sec. 721(a)(21), 124 Stat. 1376, 1666-69.

146. *Id.* at sec. 761(a)(6), 124 Stat. 1376, 1756-57.

147. 76 Fed. Reg. 33,675, at 35,372.

148. *Id.*

‘eligible contract participant’).¹⁴⁹ For part two, the exemption was granted to “provisions that are self-effectuating (i.e., do not require rulemaking) and repeal provisions of current law, but that do not reference terms that require further definition.”¹⁵⁰ The original exemption was granted through December 31, 2011,¹⁵¹ and has subsequently been extended to July 14, 2012.¹⁵² Based on these extensions, the CFTC rulemaking process will continue well into 2012. Selected Dodd-Frank Act derivatives reform rulemakings relevant to enforcement and energy market participants are summarized below.

1. Anti-Manipulation

Section 753 of the Dodd-Frank Act expands the CFTC’s reach to prohibit manipulative and fraudulent behavior in futures, swaps, and commodities markets.¹⁵³ The new manipulation standard, contained in section 753, is similar to the standard presently used by other federal agencies, *e.g.*, the FERC, the SEC, and the FTC. Additionally, with respect to swaps, the Act prohibits market manipulation and reporting false information. Among other things, section 753 of the Dodd-Frank Act amends CEA section 6(c) to include a new subsection 6(c)(1), which is fraud-based and modeled after the provisions of section 10(b) of the Securities Exchange Act of 1934.¹⁵⁴ Section 753 also adds a new subsection 6(c)(3) to the CEA, which prohibits price manipulation and attempted price manipulation for commodities, swaps, and futures contracts.¹⁵⁵ The Commission’s existing manipulation authority under CEA section 9(a)(2) was also extended to swaps.¹⁵⁶

The CFTC proposed two new rules implementing the new anti-manipulation provisions on October 26, 2010, with a comment period that extended until January 3, 2011. On July 14, 2011, the CFTC approved the final rules which are codified at 17 C.F.R. part 180.¹⁵⁷ The final rules took effect on August 15, 2011.¹⁵⁸

Rule 180.1 granted new power to the CFTC in the form of the fraud-based manipulation rule fashioned after section 10(b) of the Securities Exchange Act of 1934.¹⁵⁹ Specifically, Rule 180.1 makes it unlawful to

- (1) [u]se or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud; (2) [m]ake, or attempt to make any untrue or misleading statement of a material fact or to omit to state a material fact . . . ; (3) [e]ngage, or attempt to engage in any act, practice, or course of business, which operates or

149. *Id.* at 42,509.

150. *Id.* at 42,510.

151. *Id.*

152. Final Order, Amendment to July 14, 2011 Order for Swap Regulation, 76 Fed. Reg. 80,233 (Dec. 23, 2011).

153. Dodd-Frank at sec. 153, 124 Stat. 1376, 1750.

154. *Id.* at sec. 753, 124 Stat. 1376, 1750-54.

155. *Id.*

156. *Id.* at sec. 741(b)(6), 124 Stat. 1376, 1731.

157. Final Rules, Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices - Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,398 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

158. *Id.*

159. *Id.* at 41,399-400.

would operate as a fraud or deceit upon any person; or, (4) . . . [knowingly or recklessly deliver a] false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.¹⁶⁰

The new manipulation standard, contained in Rule 180.1, parallels those presently used by other federal enforcement agencies, *e.g.*, the FTC, the FERC, and the SEC. Under this new rule, the CFTC eliminated the requirement to show artificial price and lowered the scienter standard to recklessness for fraud-based manipulation. Recklessness is defined by the CFTC “as an act or omission that ‘departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing.’”¹⁶¹ The new rule does not reach inadvertent mistakes, negligence, or legitimate market activity undertaken in good faith.¹⁶² The CFTC also provided additional guidance on the interpretation of “in connection with,” interpreting the words “broadly, not technically or restrictively.”¹⁶³ Addressing comments regarding cross-market manipulation, the Commission stated it “intends to apply final Rule 180.1 to the fullest extent allowed by law when determining whether conduct in one market is ‘in connection with’ an activity or product subject to the jurisdiction of the Commission.”¹⁶⁴

Rule 180.2 preserved the CFTC’s long standing anti-manipulation authority.¹⁶⁵ Under 180.2, it is unlawful to “manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.”¹⁶⁶ The CFTC affirmed that under Rule 180.2, it would follow the four-part test for manipulation developed in case law arising under prior CEA sections 6(c) and 9(a)(2): “(1) That the accused had the ability to influence market prices; (2) that the accused specifically intended to create or effect [an artificial price]; (3) that artificial prices existed; and (4) that the accused caused the artificial price.”¹⁶⁷ The CFTC reaffirmed that due to the specific intent requirement, “recklessness will not suffice to prove a violation of 180.2 as it will under . . . 180.1.”¹⁶⁸ Finally, the CFTC stated that “extensive economic analysis *may* not be necessary to prove that an artificial price existed” and in some cases an artificial price will “follow inescapably from proof of the actions of the alleged manipulator.”¹⁶⁹

The new rule will continue to allow trading on non-public information; however, a person is liable for trading on the basis of non-public information if it breaches a pre-existing fiduciary duty or information is obtained through fraud

160. *Id.* at 41,410.

161. 76 Fed. Reg. 41,398, at 41,404 (citing *Drexel Burnham Lambert Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988)).

162. *Id.* at 41,405.

163. *Id.*

164. *Id.* at 41,406.

165. *Id.* at 41,407.

166. *Id.*

167. *Id.* (footnotes omitted).

168. *Id.*

169. *Id.* at 41,408 (quoting Notice of Proposed Rulemaking, Prohibition of Market Manipulation, 75 Fed. Reg. 67,657, 67,660 (2010)) (emphasis in original).

or deception.¹⁷⁰ The CFTC stated that a pre-existing fiduciary duty can be “established by another law or rule, or agreement, understanding, or some other source.”¹⁷¹ Concern has been raised about the meaning of “understanding”, but no further guidance has been offered. The new rule does not create increased disclosure obligations between counterparties, unless that information is necessary to make a statement previously made to a counterparty not misleading.¹⁷² Silence, absent a pre-existing duty to disclose, does not constitute deception.¹⁷³ Civil penalties are up to the greater of \$1 million or triple the monetary gain and restitution per violation.¹⁷⁴ The term of “violation” is not defined by the rule.

2. Disruptive Trading Practices

Section 747 of the Dodd-Frank Act (Act) amended the Commodity Exchange Act (CEA) section 4c(a) to expressly prohibit certain trading practices that it determined to be disruptive to fair and equitable trading.¹⁷⁵ The disruptive trading practice authority granted to the CFTC makes it unlawful to engage in three specific disruptive trading practices on a registered entity; these include (i) “violat[ing] bids or offers; [(ii)] demonstrat[ing] intentional or reckless disregard for the orderly execution of transactions during the closing period; and [(iii)] . . . ‘spoofing’ (bidding or offering with the intent to cancel the bid or offer before execution).”¹⁷⁶ The Act also grants the CFTC broad authority to adopt rules as “reasonably necessary to prohibit the [enumerated practices] and any other trading practice that is disruptive of fair and equitable trading.”¹⁷⁷

On November 2, 2010, the CFTC issued an Advanced Notice of Proposed Rulemaking (ANPR) to assist them in promulgating rules and regulations to meet the requirements of section 747.¹⁷⁸ The ANPR asked nineteen specific questions and requested comments no later than January 3, 2011.¹⁷⁹ The CFTC received twenty-eight submissions and hosted a round table discussion concerning the ANPR.¹⁸⁰ After considering the comments and the roundtable discussion, the CFTC terminated the ANPR and issued a Proposed Interpretive Order offering interpretive guidance regarding the three statutory disruptive practices.¹⁸¹ The comment period for the Proposed Interpretive Order closed

170. *Id.* at 41,403.

171. *Id.*

172. *Id.* at 41,408.

173. *Id.*

174. *Id.* at 41,406.

175. Dodd-Frank at sec. 747, 124 Stat. 1376, 1739.

176. *Id.*

177. *Id.*

178. Advanced Notice of Proposed Rulemaking: Request for Comments, Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301 (2010) (to be codified at 17 C.F.R. ch. 1).

179. *Id.* at 67,302.

180. Proposed Interpretive Order, Antidisruptive Practices Authority, 76 Fed. Reg. 14,943, 14,944 (2011).

181. *Id.*

on May 17, 2011.¹⁸² Under the Act, the prohibition against disruptive trading practices became effective July 16, 2011.¹⁸³

Under Dodd-Frank, the new disruptive trading practice rules apply to trading, practices, or conduct on or subject to the rules of a registered entity;¹⁸⁴ based on the CFTC's interpretation, the rules "will not apply to block trades or exchanges for related positions [(EFRPs)]."¹⁸⁵

Concerns were raised about concepts such as violating bids and offers and the scienter requirement for each of the three violations.¹⁸⁶ In regard to violating bids and offers, "the Commission interprets section 4c(a)(5)(A) as prohibiting any person from buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price."¹⁸⁷ Intent is not a required element of a violation; the Commission asserts that it is "not required to show that a person violating bids or offers did so with any intent to disrupt fair and equitable trading."¹⁸⁸ If, however, a participant is unable to violate a bid or offer based on the structure of the trading environment, then the rule does not apply. Further, the Commission stated that, the rule "does not create any sort of best execution standard across multiple trading platforms . . . rather, a person's obligation . . . is confined to the specific trading venue."¹⁸⁹ The rule also does not apply where a participant is "buying the board," referring to the practice of "executing a sequence of trades to buy all available bids or offers on that order book."¹⁹⁰

In the Proposed Interpretive Order, the CFTC also provided guidance on the orderly execution of transactions during the closing period. In the view of the Commission, the scienter requirement of a market participant must at least be considered reckless; accidental or negligent conduct will not suffice. The closing period was "defined as the period in the contract or trade when the daily settlement price is determined under the rules of the trading facility."¹⁹¹ The Commission specifically noted that "disruptive conduct outside that period may nevertheless form the basis for an investigation . . . under this section and other sections under the Act."¹⁹² Violations may include "executed orders as well as bids and offers submitted . . . for the purposes of disrupting fair and equitable trading."¹⁹³ The Commission viewed orderly markets as characterized by attributes such as a "rational relationship between consecutive prices, a strong correlation between price changes and volumes of trades, levels of volatility that do not materially reduce liquidity, accurate relationships between the price of a

182. *Id.* at 14,943.

183. *See generally* Dodd-Frank at sec. 747, 124 Stat. 1376, 1739; *see also id.* at sec. 754, 124 Stat. 1376, 1754.

184. *See id.* at sec. 747, 124 Stat. 1376, 1739.

185. 76 Fed. Reg. 14,943, at 14,945.

186. *Id.*

187. *Id.* at 14,945-46.

188. *Id.* at 14,946.

189. *Id.*

190. *Id.*

191. 76 Fed. Reg. 14,943, at 14,946.

192. *Id.*

193. *Id.*

derivative and the underlying . . . , and reasonable spreads between contracts for near months and remote months.”¹⁹⁴

The CFTC also provided guidance on the definition and application of the ban on “spoofing,” new CEA section 4c(a)(5)(C).¹⁹⁵ Spoofing is defined as “bidding or offering with the intent to cancel the bid or offer before execution.”¹⁹⁶ In the view of the Commission, a spoofing violation “requires that a person intend to cancel a bid or offer before execution.”¹⁹⁷ The market participant must act with some degree of scienter; “reckless trading, conduct, or practices will not result in violations.”¹⁹⁸ Order modifications or cancellations will not be spoofing if submitted legitimately and in good faith in attempt to consummate a trade. Partially filled orders are not exempt from the classification of spoofing “if a person’s intent when placing the bid or offer was to cancel the entire bid or offer prior to execution.”¹⁹⁹ The CFTC further defined spoofing to include “(i) [s]ubmitting or cancelling bids or offers to overload the quotation system of a registered entity, (ii) submitting or cancelling bids or offers to delay another person’s execution of trades; and (iii) submitting or cancelling multiple bids or offers to create an appearance of false market depth.”²⁰⁰ Finally, the Commission clarified that non-executable market communications are not covered by this provision.

3. Whistleblower Incentives and Protection

Pursuant to section 748 of the Dodd-Frank Act, new section 23 of the Commodity Exchange Act (CEA) generally directs the CFTC to pay awards to whistleblowers who voluntarily provide the CFTC with original information about violations of the CEA that leads to successful enforcement action that results in monetary sanctions exceeding \$1,000,000.²⁰¹ New section 23 also provides protection for whistleblowers against retaliation for their cooperation.²⁰² On August 25, 2011, the CFTC published a final rule defining terms and establishing procedures related to the new whistleblower incentives and protection.²⁰³

Recognizing that an enforcement “action” is a prerequisite to any whistleblower award, the CFTC defined the term “action” to mean “two or more proceedings arising out of the same nucleus of operative facts.”²⁰⁴ It rejected, as the definition for “action,” “a single captioned judicial or administrative proceeding.”²⁰⁵ The CFTC also explained that it will interpret the term “to include all claims against all defendants or respondents that are brought” as part

194. *Id.*

195. 76 Fed. Reg. 14,943, at 14,947.

196. *Id.*

197. *Id.*

198. 76 Fed. Reg. 14,943, at 14,947.

199. *Id.*

200. *Id.*

201. Dodd-Frank at sec. 748, § 26(b)(1).

202. *Id.* § 26(h)(1)(A).

203. Final Rule, Whistleblower Incentives and Protection, 76 Fed. Reg. 53,172 (Aug. 25, 2011) (to be codified at 17 C.F.R. pt. 165).

204. *Id.* at 53,174.

205. *Id.* at 53,173.

of an action, regardless of whether the specific defendants or respondents, or specific claims, were included “as a result of the information provided by the whistleblower.”²⁰⁶ The CFTC rejected concerns raised by one commenter that this definition will encourage the reporting of minor or insignificant violations that could overwhelm the CFTC’s resources; it explained, “any violation, even those that may appear relatively minor . . . may upon investigation be symptomatic of more significant violations.”²⁰⁷

The CFTC also defined “original information” to include information that is derived from the “independent knowledge or independent analysis of a whistleblower.”²⁰⁸ The Commission enumerated six specific circumstances in which an individual would not be considered to have independent knowledge:

1. the information is publicly available;
2. the information “was obtained through a communication that is subject to the attorney-client privilege” (unless the disclosure is otherwise permitted by the applicable federal or state attorney conduct rules);
3. the information was obtained in connection with the would-be whistleblower’s legal representation of a client (unless the disclosure is otherwise permitted by the applicable federal or state attorney conduct rules);²⁰⁹
4. the whistleblower was an officer, director, trustee, or partner of an entity and learned of the information in connection with the entity’s processes for identifying, reporting, and addressing possible violations of law;
5. the whistleblower was an employee whose principal duties involved compliance or internal audit responsibilities;²¹⁰ or
6. the information was obtained by means or in a manner that is determined by a United States court to violate applicable federal or state criminal law.²¹¹

However, exceptions 4 and 5 will not apply if: (i) the whistleblower has a reasonable basis to believe that reporting the information is “necessary to prevent conduct that is likely to cause substantial injury” to the financial interest or property of the entity or its investors; (ii) the whistleblower has reason to believe that “the entity is engaging in conduct that will impede an investigation;” or (iii) “at least 120 days have elapsed since the whistleblower reported the information internally,” and the entity has not disclosed the information to the CFTC.²¹² The CFTC “declined to revise the rule to extend an exclusion to an employee of a public accounting firm.”²¹³

With regard to protection from retaliation against the whistleblower, the CFTC acknowledged that it lacks statutory authority to treat retaliation against a

206. *Id.*

207. *Id.*

208. *Id.* at 53,175.

209. *Id.*

210. *Id.*

211. *Id.* at 53,175-76.

212. *Id.* at 53,177.

213. *Id.*

whistleblower as “a separate and independent violation of the CEA.”²¹⁴ Instead, “only an individual who alleges retaliation in violation of being a whistleblower may bring such a cause of action.”²¹⁵

Finally, the CFTC established a two-step process for the submission of information by a whistleblower and established procedures for evaluating submissions and making payment where applicable. In this regard, the CFTC indicated that it intends to continue to treat information obtained during an investigation, including the identity of the whistleblower, confidential and non-public during any investigation, except to the extent that the Commission is legally required to disclose the information (*e.g.*, in a criminal prosecution) or if disclosure is necessary for the protection of market participants.²¹⁶ Moreover, whistleblowers may provide information anonymously, although their identity must be disclosed to the CFTC prior to the payment of any award.²¹⁷

4. Anti-Evasion

The CFTC has substantial authority to prevent evasion of its regulation of swaps under the Dodd-Frank Act. Section 721(c) of the Dodd-Frank Act empowers the CFTC to further define the terms “swap,” “swap dealer,” “major swap participant,” and “eligible contract participant,” in order “[t]o include transactions and entities that have been structured to evade” the CFTC’s regulation of swaps under Title VII of the CEA.²¹⁸ Pursuant to this authority, on May 23, 2011, the CFTC proposed new rule 1.3(xxx)(6) to further define “swap” to include any “agreement, contract, or transaction that is *willfully* structured to evade” any provision of the Dodd-Frank Act or CFTC regulations applicable to swaps.²¹⁹ In its proposal, the CFTC avoided providing a bright-line test for evasion, explaining that “would-be evaders could simply restructure their transactions or entities to fall outside any rigid boundar[ies].”²²⁰ The CFTC further explained that “in determining whether a transaction has been willfully structured to evade, neither the form, label, nor written documentation of the transaction shall be dispositive;” rather, the CFTC intends to look “beyond the form of the transaction to examine its actual substance.”²²¹

214. *Id.* at 53,182.

215. *Id.*

216. *Id.* at 53,184.

217. *Id.*

218. 15 U.S.C. § 8321 (Supp. 2011). Other provisions of the Dodd-Frank Act also prohibit evasion. For example, section 722(d) of the Dodd-Frank Act provides for the CFTC to “prescribe or promulgate [rules or regulations] as necessary or appropriate to prevent the evasion” of CFTC regulations through activities outside the United States. Also, section 741(b) of the Dodd-Frank Act provides that any designated contract market, swap dealer, or major swap participant “that knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of . . . 2(h) [of the CEA] shall be liable for a civil monetary penalty in twice the amount otherwise available for a violation of Section 2(h).” Section 741(b) amended section 6(e) of the CEA and does not require any rulemaking to effectuate the prohibition. The CFTC’s proposed rule reaches beyond the registrants covered by section 741(b) of the Dodd-Frank Act.

219. Joint Proposed Rules, Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 Fed. Reg. 29,818, 29,875 (2011) (emphasis added).

220. *Id.* at 29,866.

221. *Id.*

While reserving its ability to consider facts on a case-by-case basis, the CFTC proposed to provide interpretive guidance as to two circumstances that may constitute evasion.²²² First, the CFTC will consider the business purpose behind the structuring of a transaction or entity. The CFTC explains,

“absent other indicia of evasion, the CFTC would not consider transactions, entities, or instruments structured in a manner solely motivated by a legitimate business purpose to constitute evasion, [but] . . . , to the extent a purpose in structuring an entity or instrument or entering into a transaction is to evade the requirements of Title VII with respect to swaps, the structuring of such instrument, entity, or transaction may be found to constitute evasion.”²²³

Second, based on the Internal Revenue Service’s distinction “between tax evasion and legitimate means . . . to minimize, reduce, avoid, or alleviate” tax liabilities, the CFTC will consider “the extent to which the conduct involves deceit, deception, or other unlawful or illegitimate activity.”²²⁴

III. THE FEDERAL TRADE COMMISSION

The Federal Trade Commission (FTC) generally is responsible for preventing unfair methods of competition and unfair acts or practices in or affecting commerce.²²⁵ In addition to its general authority to police “unfair or deceptive acts or practices in or affecting commerce” under section 5 of the FTC Act,²²⁶ the FTC is specifically authorized to prohibit fraud, manipulation, and false reporting in connection with petroleum wholesale markets.²²⁷ During 2011, the FTC opened multiple investigations, issued several reports, and conducted general rulemakings. However, as of December 31, 2011, it had not brought any formal complaints regarding deceptive, anticompetitive, or manipulative conduct in the energy markets.

A. *Inter-Agency Cooperation*

In April, the FTC and CFTC signed a Memorandum of Understanding (MOU) to facilitate the sharing of non-public information between the two agencies.²²⁸ The MOU is intended to increase inter-agency cooperation on issues of common regulatory interest, such as market manipulation in petroleum markets.²²⁹ The MOU creates no binding obligations but enables the agencies to share information on a case-by-case basis pursuant to the confidentiality terms of the agreement.²³⁰

222. *Id.* at 29,867.

223. *Id.*

224. *Id.*

225. *See, generally*, Federal Trade Commission Act (FTC Act), 15 U.S.C. §§ 41-58 (Supp. 2010).

226. 15 U.S.C. § 45(a)(1) (Supp. 2010).

227. Energy Independence and Security Act of 2007, Pub. L. No. 110-140, Title VIII, Subtitle B, 121 Stat. 1492 (2007) (codified at 42 U.S.C. §§ 17301-05).

228. Memorandum of Understanding Between the CFTC and the FTC Regarding Information Sharing in Areas of Common Regulatory Interest (Apr. 2011), *available at* <http://www.ftc.gov/os/2011/04/110412ftccftc-mou.pdf>.

229. *Id.*

230. *Id.*

B. Investigations into Anticompetitive and Manipulative Conduct

In addition to participating in the Oil and Gas Price Fraud Working Group established by the Attorney General, the FTC opened an investigation in June 2011 to determine whether any market participants “have engaged . . . in anticompetitive or manipulative practices or . . . provided any federal department or agency . . . false or misleading information related to the wholesale price of crude oil or petroleum products.”²³¹ This inquiry was prompted, in part, by reports that U.S. refining margins “increased more than 90 percent” during the first half of 2011 while refiners were using less of their capacity in early May 2011 than during the same period in 2010.²³² The agency has indicated that it is considering, among other things, “utilization and maintenance decisions, inventory holding decisions, product supply decisions, product margins and profitability, and capital planning.”²³³

In addition, the FTC also has looked into other conduct in the oil and natural gas industries, made inquiries related to propane, and investigated “possibly anticompetitive or possibly deceptive conduct at various stages of the refined petroleum products business.”²³⁴ According to a report to the Congressional Appropriations Committees, the FTC received and examined four complaints submitted in the first half of 2011 by the public pursuant to its 2009 “Guide to Complying with Petroleum Market Manipulation Regulations” and shared information from complaints that concerned activity in futures markets with the CFTC.²³⁵

C. Appliance Energy Consumption Disclosures and Civil Penalties

Section 325 of the EISA authorized the FTC to require energy cost disclosures for televisions and certain other consumer electronics.²³⁶ Acting under this authority, on January 6, 2011, following notice and comment, the FTC issued final amendments to its Appliance Labeling Rule.²³⁷ The amendments require manufacturers to affix an EnergyGuide label to televisions, which disclose the units’ estimated annual energy cost and a comparison of energy cost to similar units.²³⁸ They also require paper catalogs and websites to disclose the energy information for televisions that are offered for sale.²³⁹ The amendments took effect on July 11, 2011.

The FTC’s Appliance Labeling Rule requires online retailers to post EnergyGuide information on their websites to inform consumers about the

231. REPORT OF THE FTC ON ACTIVITIES IN THE OIL AND NATURAL GAS INDUSTRIES at 2 (June 2011), available at <http://www.ftc.gov/os/2011/06/1106semiannualenergyreport.pdf>.

232. *Id.*

233. *Id.* at 3.

234. *Id.*

235. *Id.*

236. Energy Independence and Security Act of 2007, Pub. L. 110-140, 121 Stat. 1492, 1595 (codified at 42 U.S.C. § 6294 (Supp. 2010)).

237. 16 C.F.R. § 305.1 (2011).

238. *Id.* § 305.2.

239. *Id.* § 305.2(l)(12).

energy use of major home appliances they sell.²⁴⁰ The Energy Policy and Conservation Act authorizes the FTC to assess civil penalties for knowing violations of the Rule.²⁴¹ Applying that authority for the first time, on November 1, 2010, the FTC announced that it had secured agreement from three online retailers “to pay [over] \$400,000 in [civil] penalties to settle . . . charges that they failed to post EnergyGuide information on their websites.”²⁴² The FTC also announced that it had issued notices of proposed penalties totaling \$640,000 to two other online retailers that refused to settle with it.²⁴³

IV. THE DEPARTMENT OF ENERGY - ENERGY EFFICIENCY COMPLIANCE AND ENFORCEMENT

A. *Minimum Energy Efficiency Standards*

The Department of Energy (DOE) is tasked with monitoring and enforcing compliance with the energy and water conservation standards for covered consumer products authorized in the Energy Policy and Conservation Act of 1975 (EPCA) and set forth in 10 C.F.R. § 430, subpart C.²⁴⁴ The EPCA and its accompanying regulations give DOE authority to assess civil monetary penalties for violations of the Act.²⁴⁵ Under 10 CFR § 430.73, DOE also has authority to seek a judicial order restraining further distribution of a non-compliant product.²⁴⁶

B. *ENERGY STAR Program*

DOE and EPA have renewed their focus on compliance with ENERGY STAR program requirements.²⁴⁷ A 2009 DOE-EPA Memorandum of Understanding clarified the division of responsibility between the two agencies, assigning DOE the lead role in monitoring compliance with ENERGY STAR criteria while designating EPA the program “brand manager” responsible for setting performance criteria, conducting marketing and outreach, and maintaining the master list of eligible products.²⁴⁸

240. LABELING FAQs, FTC, <http://www.ftc.gov/bcp/online/edcams/eande/faq.htm> (last visited Mar. 10, 2012).

241. Energy Conservation Program for Consumer Products Other than Automobiles, 42 U.S.C. §§ 6291-6309 (Supp. 2010).

242. Press Release, FTC, FTC Fines Online Retailers for Failing to Post EnergyGuide Information for Appliances (Nov. 1, 2010), *available at* <http://www.ftc.gov/opa/2010/11/appliancelabel.shtm>.

243. *Id.*

244. 42 U.S.C. §§ 6302-03 (Supp. 2010); 10 C.F.R. § 430.31 (2011).

245. 42 U.S.C. §§ 6302-03; 10 C.F.R. § 430.61.

246. 10 C.F.R. § 430.73.

247. Press Release, EPA, EPA, DOE Announce New Steps to Strengthen ENERGY STAR (Mar. 19, 2010), *available at* <http://yosemite.epa.gov/opa/admpress.nsf/bd4379a92ceceac8525735900400c27/f721f69419064539852576eb0065e109!OpenDocument>.

248. SUMMARY OF EPA-DOE PARTNERSHIP 2 (Sept. 30, 2009), *available at* http://www.energystar.gov/ia/partners/downloads/mou/Summary_of_EPA-DOE_Partnership.pdf.

C. *New Steps*

DOE and EPA took a number of steps in 2011 regarding enforcement of EPCA's conservation standards and the requirements of the ENERGY STAR program.²⁴⁹

1. Rules to Improve Energy Efficiency Enforcement

On February 7, 2011, DOE "adopted final rules to improve the enforcement of [its] efficiency requirements for appliances, lighting, and other products."²⁵⁰ "[T]he new rules are designed to encourage compliance and prevent manufacturers who break the law from gaining a competitive advantage."²⁵¹ Among other changes, the rules required annual certification of covered products and equipment, and allow the Department to test products on its own initiative to determine whether they comply with DOE's efficiency standards.²⁵²

2. Enforcement Guidance on Showerheads

On March 4, 2011, DOE withdrew a draft interpretative rule setting out the Department's views on the definition of a "showerhead" for purposes of the water conservation standard enacted by Congress in 1992.²⁵³ Instead, the Department issued enforcement guidance, clarifying that a showerhead with multiple nozzles is a single showerhead subject to a single water use limit.²⁵⁴ Further, the guidance provides manufacturers a two-year grace period before certain enforcement action will be taken.²⁵⁵

D. *Enforcement Actions*

Between January 2010 and December 2011, DOE took "more than 200 enforcement actions, removed over 80 products from the market, and collected more than \$800,000 in civil penalties."²⁵⁶ In April 2011, DOE brought twenty certification enforcement actions, settling seventeen and dismissing three by June 2011. Civil penalties from these cases totaled approximately \$100,000.²⁵⁷

249. Energy Conservation Program: Certification, Compliance, and Enforcement for Consumer Products and Commercial and Industrial Equipment, 6450-01-P, DOE Docket No. EERE-2010-BT-CE-0014 (Feb. 7, 2011) RIN: 1904-AC23 (to be codified at 10 C.F.R. pts. 429, 430, 431), available at http://energy.gov/sites/prod/files/gcprod/documents/CCEFinalRule_020711_FinalAsSigned.pdf; see generally General Counsel News, *DOE Adopts Rules to Improve Energy Efficiency Enforcement*, U.S. DEP'T OF ENERGY (Feb. 7, 2011), <http://energy.gov/gc/articles/doe-adopts-rules-improve-energy-efficiency-enforcement>.

250. General Counsel News, *supra* note 249.

251. *Id.*

252. *Id.*

253. General Counsel News, *DOE Withdraws Interpretive Rule and Provides Enforcement Guidance on Showerheads*, U.S. DEP'T OF ENERGY (Mar. 4, 2011), <http://energy.gov/gc/articles/doe-withdraws-interpretive-rule-and-provides-enforcement-guidance-showerheads>; see generally, *Showerhead Enforcement Guidance*, U.S. DEP'T OF ENERGY (Mar. 4, 2011), http://www1.eere.energy.gov/buildings/appliance_standards/residential/pdfs/showerhead_guidance_3-4-2011.pdf [*Showerhead Guidance*].

254. *Showerhead Guidance*, *supra* note 253.

255. *Id.*

256. Steven Mufson, *Light Bulb Standards Won't Be Dimmed by Congress's Actions*, WASH. POST (Dec. 17, 2011), at A10.

257. General Counsel News, *DOE Office of Enforcement Resolves 20 Energy Efficiency Enforcement Cases*, U.S. DEP'T OF ENERGY (June 3, 2011), <http://energy.gov/gc/articles/doe-office-enforcement-resolves-20-energy-efficiency-enforcement-cases>.

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