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**ENERGY COMMODITY TRADING,
COMPLIANCE & ENFORCEMENT:**
WHAT MARKET PARTICIPANTS SHOULD KNOW FOR 2021

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Presenters



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General Overview

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Enforcement Authorities

- Federal Power Act (FERC)
- Natural Gas Act (FERC)
- EPCRA 2005 (FERC)
- Energy Independence and Security Act (EISA)
- Commodity Exchange Act (CFTC)
- Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)

Types of Violations

- Violation of Market Behavior Rules (FERC)
 - Inaccurate communications to FERC, RTO/ISO, independent market monitors, *even if unintentional*
 - Tariff violations
- Fraudulent and Manipulative Conduct (FERC & CFTC)
 - Inaccurate communications
 - Spoofing (may also constitute manipulation)
 - “Banging the Close”
 - Uneconomical trading (used to benefit unrelated positions)
 - Pre-arranged “wash trades”
- Spoofing (CFTC)
- Disruptive Trading (CFTC)
 - Uneconomical trading (used to benefit unrelated positions)
 - “Banging the close”

Enforcement Expectations

- FERC and CFTC expect companies trading in regulated markets to take compliance seriously. This includes (among others):
 - Established standards & procedures to prevent & detect violations;
 - Personnel that oversees the compliance program;
 - Mechanisms to exclude employees who have engaged in violations from positions of substantial authority;
 - Ongoing training & dissemination of compliance-related information;
 - Mechanisms to enforce compliance program;
 - Promotion of compliance through incentives and disciplinary measures; and
 - Responding appropriately to violations that are detected.

Penalties

- For violations of the:
 - Federal Power Act (FERC)
 - Natural Gas Act (FERC)
 - Commodity Exchange Act (CFTC)
 - CFTC / FERC Regulations
- Civil penalties, restitution, disgorgement, revocation of market-based rate authority (FERC), changes to compliance practices.
- Criminal penalties (referral to DOJ)
- Can be held personally liable



2020: A Look Back at Enforcement

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FERC's Response to COVID-19

- FERC OE took the following steps in response to covid-19
 - Worked with subjects of continuing non-public investigations and audits to provide flexibility with deadlines (e.g., discovery) through July 31, 2020.
 - Suspended the initiation of new audits until July 31, 2020.
 - Postponed contacting entities regarding surveillance inquiries, except those involving market behavior that could result in significant risk of market harm.
 - Delayed for 60 days the requirement to self-report inadvertent errors producing no significant harm to markets, ratepayers, or market participants
 - Suspended depositions in almost all instances
- FERC OE is beginning to emerge to its prior level of functioning – albeit virtually.

CFTC's Response to COVID-19

- CFTC took the following steps in response to the onset of covid-19
 - The Division of Swap Dealer & Intermediary Oversight granted temporary, targeted no-action relief regarding (a) recording of oral communications, (b) time-stamp requirements on communications, (c) the requirement to be located on the premises of a designated contract market, and (d) considering energy-related commodity swaps in determining whether insured depository institution must register with the CFTC as a major swap participant.
 - The Division of Market Oversight granted temporary, targeted no-action relief for (a) recording of oral communications and (b) audit trail and related requirements for Designated Contract Markets.
- CFTC's Div. of Enforcement filed in FY 2020 "more enforcement actions (113) than any other year in the agency's history" and "aggressively pursued fraud occurring during the COVID-19 pandemic."

FERC Enforcement in 2020

- Focus on electric power sector
 - 10,594 screen trips in gas sector – 26 surveillance inquiries – 0 referrals
 - 399,755 screen trips in electric sector – 39 surveillance inquiries – 5 referrals
 - Continued emphasis and reliance on market monitor referrals
 - 13 new investigation referrals
 - 6 new investigations opened
 - 6 market manipulation violations
 - 10 market behavior violations (6 tariff violations, 4 communication violations)
- Focus on areas that are difficult to monitor for compliance
 - FTR and CRR trading
 - Issues intersecting with operational need of units.
- But . . . “Concerned that [the Commission has] gone AWOL . . . *I think it's at least worth asking if the commission remains committed to its enforcement responsibilities. I have my doubts.*”
 - Commissioner Glick: November 19, 2020, Open Meeting

CFTC Enforcement in 2020

- Division of Enforcement pursued “more enforcement actions (113) than any other year in the agency’s history” despite impact of covid-19.
 - The 5-year prior average ~68 cases per year.
 - Recent focus on covid-19 related frauds, with 29 covid-19 related cases since March 2020.
- Continued focus on anti-manipulation and spoofing violations.
 - second or third largest type of enforcement actions
- Continued emphasis on coordination and parallel actions with criminal authorities and other regulatory agencies.
- Expect continued high levels of enforcement actions and continued focus on anti-manipulation and spoofing violations in the coming year.



2021: What Can We Expect from FERC Enforcement?

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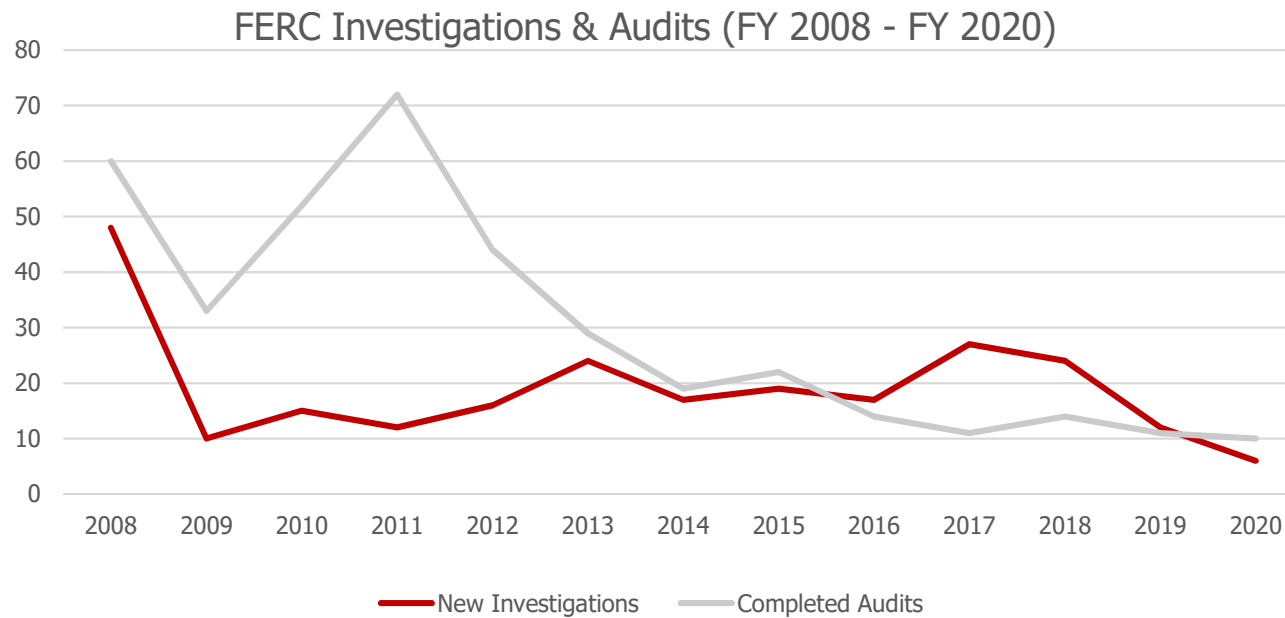
FERC Composition

- Chatterjee demoted
- Danley promoted
- Two nominations received Senate approval this month;
- Chatterjee's term expires June 30,2021.
- But wait! Will he get renominated as a "friendly" republican?
- Also consider the "trickle-down" impact into the Office of Enforcement (i.e. Director, Branch Chiefs, etc.)



FERC Enforcement in 2021

- FY 2019 and FY 2020 were historic lows.



FERC Enforcement in 2021

- FERC will likely return to pre-COVID-19 levels of investigations.
- Changes in Chairman & Commission makeup may result in more enforcement actions and larger penalties.
 - Comm’r Glick, expected to be Chairman, said last month that he has doubts about FERC’s commitment to its enforcement responsibilities.
 - Noted only \$550,000 in settlements, compared to millions or tens of millions in previous years. May signal harder line on settlements.
- Potential greater focus on oil & gas investigations.
- Market manipulation will likely remain the most common allegation.
- But, don’t sleep on market behavior rule violations, secondary market gas transport violations, or issues concerning reliability-related matters.



2021: What Can We Expect from CFTC Enforcement?

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CFTC Enforcement in 2021

- Level of enforcement activity not expected to change (may even dip slightly).
 - 113 new investigations in FY 2020 is nearly double historic average.
- But, manipulative conduct & spoofing investigations will likely remain steady.
 - 16 to 18 new investigations each year since 2018.
- Continue filing of enforcement actions in parallel with criminal referrals.

CFTC Enforcement in 2021

- Insider Trading, whistleblowers, and retaliation
 - CFTC announced in late 2018 a new “Insider Trading & Information Protection Task Force” to prosecute abuse of confidential information.
 - Potential for more investigations for manipulative schemes & fraud involving trades made with:
 - Misuse of confidential information (classic insider-trading liability)
 - Confidential information obtained through corrupt payments (including to foreign sources) (tipper/tippee insider-trading liability)
 - Other theories of insider trading liability (misappropriation / affirmative misrepresentation).
 - Continued emphasis on incentivizing whistleblowers; will we see first instances of exercising anti-retaliation authority?
- Potential investigations resulting from increased remote work / work from home.
 - Harder to supervise trading compliance
 - CFTC loosened rules regarding recording communications and on-site supervision.



Takeaways

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Practical Thoughts

- The same conduct can be viewed as legal or illegal based upon “intent”
- Intent is in the trader’s head and must be inferred through circumstances unless the trader writes it or speaks it— if written or spoken regulators may take comments out of context and view them with a “dirty mind”. Now recklessness is sufficient
- If a Trader pays more than he/she has to or sells for less than he/she could have gotten, (even if profitable) the CFTC may infer the price was artificial or uneconomic
 - May not make (or attempt) uneconomic trades in one market to cause a greater gain in a second market.
- If economics of a trade and thought process are not recorded contemporaneously, regulators may view later explanations as self-serving —“if you are explaining, you are losing”
- A legitimate economic trade coupled with a secondary “bad intent” can be a problem
- Be extra careful when making/taking delivery of futures & trading during the delivery period
- Be wary of requests to assist third parties - “no good deed goes unpunished”
- Make Self Reports. These are often concluded without further action if:
 - no material harm or have already agreed to remedy the harm;
 - already taken corrective measures to remedy the violation; and
 - taken steps to prevent future violations by implementing enhancements to the compliance program.

Practical Supervisory Tips

- Understand what your traders are doing and why they are doing it
 - Be wary of trades outside of a traders normal practice and expertise
- If involved in an investigation, cast a wide net for the litigation hold
- Be proactive with personnel; don't simply react
 - Anticipate issues and questions the regulator may raise. Get in front of them so you can frame your case
- Understand Enforcement Staff's goals in a deposition
 - Testing candor
 - Exploring knowledge
 - Identifying new areas for investigation
 - Intentionally developing the testimony to support their theories of the case
 - Is a deposition truly fact finding?
- Monitoring trading of difficult-to-police areas is critical

Remote Trading Issues

- Issue 1: Effective Supervision of Trading Personnel
 - Continue to provide ongoing training and should schedule meetings or “check-ins” with their supervised personnel.
 - WFH presents challenges in monitoring traders.
 - Supervisors should more frequently review trading personnel’s correspondence.
 - Supervisors should continue to monitor for insider trading (family, friends, guests may have access to material, nonpublic information).
- Issue 2: Compliance Access to Traders and the Floor
 - Compliance needs visibility and direct & physical access to trading personnel throughout a trading day, and ability to review potential transactions or strategies in near-real time.
- Issue 3: Recordkeeping Compliance
 - Ensure employee awareness of recordkeeping requirements
 - Confirm records are transferred to company recordkeeping systems
 - Review protocols to determine whether they assume trading, scheduling, and transaction consummations occur at the office, on company network drives, or through company telecommunications equipment

Remote Trading Issues (con't.)

- Issue 4: Audit Trail Integrity
 - Use of personal devices & non-company IM platforms for trading functions;
 - Ability to adhere to recording policies, memorialize communications or retrieve data in a timely manner in response to an inquiry.
- Issue 5: Electronic Security
 - Home networking software may not reflect the most current security updates.
 - Phishing activities targeted to members of an employee's household can be used as a tool to access and exploit company information.
- Issue 6: Potential Insider Trading
 - CFTC's COVID-19 related relaxation of voice recording requirements for some regulated could make it difficult for compliance personnel to detect & prevent potential insider trading that was facilitated on the non-recorded lines.
 - Information may be obtained from new sources, creating a risk that the new source is unaccustomed to handling the nonpublic price-sensitive information.

Biography



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Levi McAllister advises clients on regulatory compliance and transactional matters in the natural gas, petroleum, and electric power sectors of the energy industry. Levi's practice focuses on regulatory provisions administered by the Federal Energy Regulatory Commission (FERC), the Commodity Futures Trading Commission (CFTC), and state public utility commissions that affect the energy industry. He also advises clients on transactional matters concerning acquisitions, divestitures, mergers, and development of gas, petroleum, and electric generating infrastructure, with a particular focus on energy storage resources and distributed energy resources.

Biography



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Patrick R. Pennella assists in the representation of major energy industry participants, including electric utilities, nuclear plant operators, and oil and gas pipelines. Patrick assists electric utilities in civil litigation in the Court of Federal Claims in claims against the government for breach of contract relating to disposal of spent nuclear fuel. He advises electric and natural gas clients on regulatory compliance issues, ratemaking proceedings, and enforcement matters before the Federal Energy Regulatory Commission (FERC) and also represents clients involved in rate, tariff, and investigatory proceedings before FERC. Additionally, he provides regulatory advice on energy-related commercial transactions.

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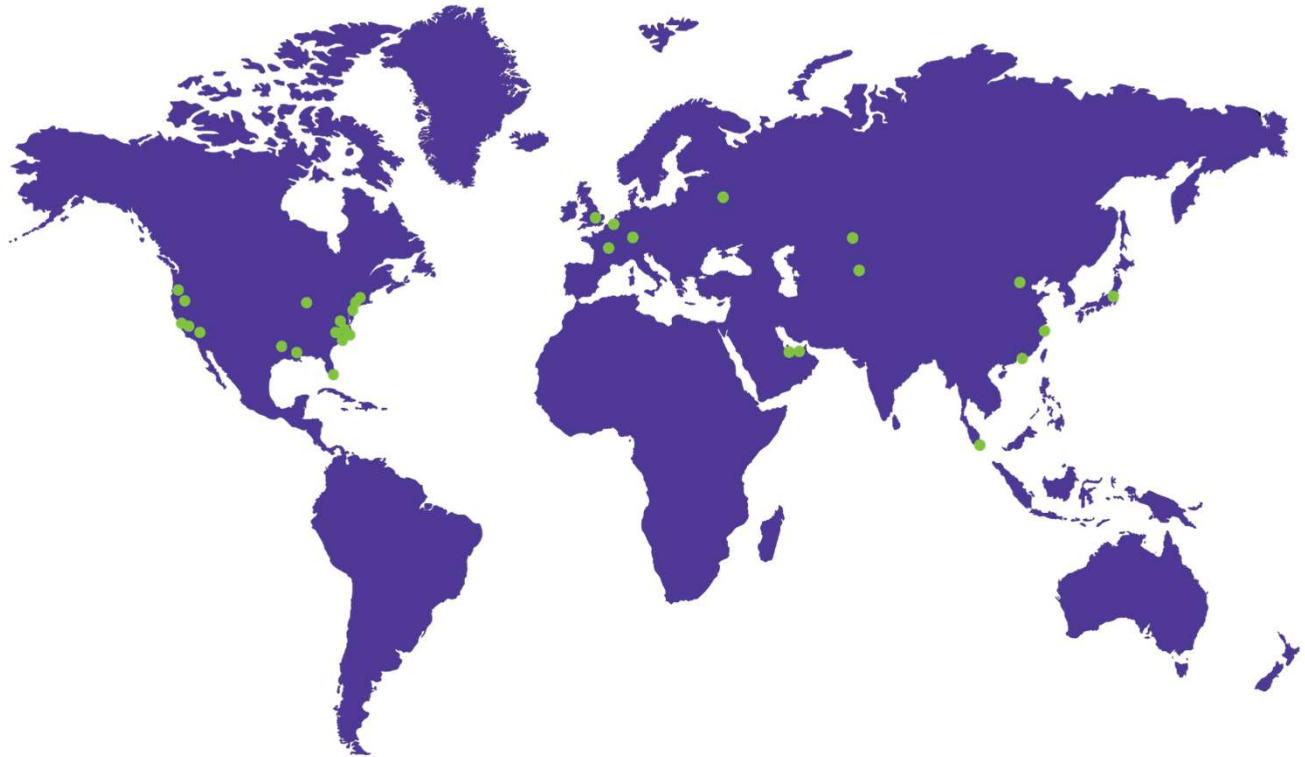
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