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FERC Issues Show Cause Order Proposing $6.8M in Civil Penalties to Vitol Inc. and Individual Trader and $1.2M Disgorgement for Alleged CAISO Market Manipulation

By Mark R. Haskell, George D. Billinson, and Lamiya N. Rahman*

Recently, the Federal Energy Regulatory Commission issued an order to show cause why Vitol Inc. and its co-director of financial transmission rights trading should not be found to have engaged in market manipulation by selling physical power in CAISO at a loss to eliminate expected losses on Vitol's Congestion Revenue Rights. The Order directed Respondents to show cause why they should not be found to have committed market manipulation, pay civil penalties, and disgorgement, as well as to make an election under Federal Power Act § 31(d)(1) whether to proceed before an administrative law judge or opt to have the commission assess a penalty and then proceed with de novo review by a federal district court. The authors of this article discuss the order to show cause.

The Federal Energy Regulatory Commission ("FERC" or "Commission") issued an order to show cause and notice of proposed penalty ("Order")[1] to Vitol Inc. and Vitol's co-head of financial transmission rights ("FTR") trading, Federico Corteggiano ("Corteggiano") (together, "Respondents"), directing the Respondents to show cause why they should not be found to have violated the anti-manipulation provisions of the Federal Power Act ("FPA")[2] and the Commission's regulations.[3]

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1 *Vitol Inc. and Federico Corteggiano*, 168 FERC ¶ 61,013 (2019).

2 FPA § 222 (2018).

3 18 C.F.R. § 1c.2 (2019).

BACKGROUND

The Order arises from allegations by FERC's Office of Enforcement ("Enforcement") that Respondents engaged in a "cross-product market manipulation scheme" by selling physical power at a loss in the California Independent System Operator ("CAISO") day-ahead market to avoid even greater losses on their positions in a separate financial product—congestion revenue rights ("CRRs"). Enforcement's factual allegations and legal analysis, resulting from an investigation into Respondents' trading, are detailed in the Enforcement Staff Report and Recommendation included with the Order.[4] The investigation was prompted by a report from a CAISO market participant regarding Vitol's activity.

Corteggiano purchased CRRs sourcing at the Cragview node in CAISO's annual 2013 CRR auction. According to Enforcement staff, the locational marginal price ("LMP") at Cragview reflects 100 percent of congestion on the Cascade intertie. Enforcement staff explains that on October 18 and 19, 2013, CAISO partially derated capacity at the Cascade intertie, derating exports to zero megawatts ("MW") while allowing imports. The derate significantly increased LMP to $388.11/MWh (megawatt hour), with approximately $350/MWh of that price resulting from export congestion. Enforcement staff notes that Respondents lost approximately $240,000 on their CRRs as a result of this congestion.

THE ALLEGATIONS

To protect against further losses during identical derates scheduled to take place from October 28 to November 1, 2013, Enforcement staff claims that Respondents bought physical power in the Pacific Northwest and offered it for import in the day-ahead market. Enforcement staff alleges that these import transactions were intended to prevent export congestion that would cause losses on the CRRs and were made without regard to market fundamentals. Enforcement staff asserts that Corteggiano "acquired the knowledge of how to manipulate congestion costs at partially derated CAISO interties in 2010, when he was working at Deutsche Bank," and that Enforcement staff had investigated his conduct at Deutsche Bank in connection with the investigation that led to Deutsche Bank's settlement of market manipulation allegations.[5]

Specifically, Enforcement staff alleges that Corteggiano (who was not authorized to buy physical power) enlisted other Vitol employees in arranging

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[4] Order at app. A.

[5] *Id.* at 3 and n.6 (citing *Deutsche Bank Energy Trading, LLC*, 142 FERC ¶ 61,056 (2013) (order approving settlement, involving $1.5 million civil penalty and $172,645 disgorgement plus interest)).

the import of power at Cragview in the day-ahead market in advance of the October 28–November 1 derates. Enforcement staff claims that Corteggiano received approval for the import trades from Vitol's General Counsel and a compliance advisor, but that he failed to disclose certain key facts (*e.g.*, unprofitability of the imports and benefits to CRRs) that legal/compliance did not understand or seek to understand prior to approval. After receiving the approval, Vitol allegedly entered into two purchase transactions to acquire physical power (at $46/MWh and $48/MWh), which Vitol thereafter offered at Cragview for $1/MWh in the day-ahead market. Enforcement staff argues that these import trades eliminated congestion costs and resulted in LMPs averaging approximately $40/MWh during the week. According to Enforcement staff, Respondents lost a total of approximately $4,500 on the import transactions, but avoided over $1.2 million in losses on their CRRs. The alleged market harm resulting from these trading activities totaled $2,515,738, comprised of reduced funding of CAISO's CRR balancing account and losses experienced by holders of counter-flow CRR positions at Cragview.

Enforcement staff argues that Respondents violated FERC's Anti-Manipulation rule[6] by engaging in a cross-market scheme similar to those conducted in prior FERC enforcement cases.[7] In doing so, Enforcement staff alleges that Respondents injected false information into the day-ahead market. As Enforcement staff claims, Respondents obstructed the day-ahead market because their power trades were not intended to profit the physical power imports but rather to reduce Cragview LMPs to benefit Respondents' CRR positions. Enforcement staff alleges various indicia of scienter, including Corteggiano's knowledge of the outcome of his conduct, that his real concern was avoiding losses in CRRs instead of profiting from the power imports, and

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[6] 18 C.F.R. § 1c.2 (Prohibition of Electric Energy Market Manipulation) provides:

(a) It shall be 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 subject to the jurisdiction of the Commission,

(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.

[7] *See, e.g., Barclays Bank, PLC*, 144 FERC ¶ 61,041 (2013); *ETRACOM LLC and Michael Rosenberg*, 155 FERC ¶ 61,284 (2016).

that the import transactions "deviated from Respondents' normal trading in numerous ways . . . ."[8]

PROPOSED PENALTIES

Respondents potentially face civil penalties of $6,000,000 (Vitol) and $800,000 (Corteggiano). The Order also proposes disgorgement of $1,227,143, plus interest, equating to the losses Vitol allegedly avoided on their CRRs. Along with the market manipulation allegations, Respondents were required to show cause why they should not be assessed the proposed civil penalties and disgorgement and may seek modification of these amounts under Section 31(d)(4) of the FPA.

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[8] Order, app. A at 38.