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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

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Editor-in-Chief, Editor & Board of Editors

Hydraulic Fracturing Developments
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FERC Issues Penalty Assessment in Vitol CAISO Market Manipulation Proceeding

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

The Federal Energy Regulatory Commission has issued an Order Assessing Civil Penalties, imposing approximately $1.5 million in civil penalties on Vitol Inc. and $1 million in penalties on a Vitol trader. In a departure from prior cases, the Commission assessed penalties well below Enforcement Staff's recommended $6 million penalty for the company, in light of the individual trader's significant involvement in the alleged scheme. After Vitol and the trader failed to pay the penalties, the Commission filed an action in the U.S. District Court for the Eastern District of California to collect the civil penalties. That action will involve de novo review.

The Federal Energy Regulatory Commission ("FERC" or "Commission") has issued an Order Assessing Civil Penalties ("Order"), imposing civil penalties of $1,515,738 against Vitol Inc. ("Vitol") and $1 million against Federico Corteggiano, a Vitol trader, in connection with an alleged market manipulation scheme in the California Independent System Operator Corporation's ("CAISO") markets.[1] Additionally, the Commission ordered Vitol to disgorge unjust profits, plus interest, of $1,227,143.

The Commission began this proceeding by issuing an Order to Show Cause and Notice of Proposed Penalty to Respondents on July 10, 2019. In that order, the Commission directed Vitol and Corteggiano to show cause why they should not be assessed civil penalties of $6 million and $800,000, respectively, and why Vitol should not be required to disgorge unjust profits of $1,227,143, plus interest. Respondents elected to have the Commission assess an immediate penalty if it finds a violation and then proceed with de novo review before a federal district court.

In the instant Order, the Commission found that Vitol and Corteggiano (together, "Respondents") violated the anti-manipulation prohibitions in the

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* Mark R. Haskell is a partner at Blank Rome LLP advising clients on matters related to the U.S. Federal Energy Regulatory Commission, including investigations, litigation and related court appeals, and Commodity Futures Trading Commission investigations affecting the energy industry. George D. Billinson is of counsel at the firm focusing his practice on energy and commodities compliance and enforcement, complex litigation, and antitrust matters. Lamiya N. Rahman is an associate at the firm representing energy companies and financial institutions before government agencies in a variety of regulatory and litigation matters. The authors may be reached at mhaskell@blankrome.com, gbillinson@blankrome.com, and lrahman@blankrome.com, respectively.

[1] Vitol Inc., Order Assessing Civil Penalties, 169 FERC ¶ 61,070 (2019).

Federal Power Act ("FPA") and FERC's Anti-Manipulation Rule[2] through a cross-market scheme in which Respondents sold power at a loss in the CAISO wholesale electric market to avoid greater losses in Vitol's positions in a separate financial product—congestion revenue rights ("CRRs").[3]

VIOLATION OF ANTI-MANIPULATION RULE

Generally, a violation of the Anti-Manipulation Rule consists of the following elements: (1) a fraud, scheme, or artifice;[4] (2) with the requisite scienter; (3) in connection with the purchase, sale, or transmission of electric energy subject to FERC's jurisdiction.

With respect to fraud, the Commission concluded that Respondents engaged in a fraudulent device, scheme, or artifice to defraud CAISO and its market participants by submitting physical import bids at the Cascade intertie in order to eliminate congestion at Cragview, resulting in a lower Cragview LMP and preventing losses in Respondents' CRRs sourced at Cragview. The Commission noted that it has on several occasions found fraud in the context of cross-market schemes.[5] Here, the Commission cited the following evidence as indicia of such a scheme:

(1) The timing and pattern of Respondent's physical import transactions at Cragview during the relevant period, which diverged significantly from Respondents' normal trading activity and correlated with dates on which their CRRs would be affected;

(2) Respondents' indifference to the profitability of their physical im-

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[2] FPA § 222 (2012); 18 C.F.R. § 1c.2 (2019).

[3] Specifically, the Commission found Respondents intentionally engaged in fraudulent physical energy imports during the period October 28-November 1, 2013, at the Cascade intertie to relieve congestion at Cragview, which in turn lowered the Cragview locational marginal price ("LMP") and economically benefitted Vitol's CRRs sourced at that location. Order at P 34.

[4] Specifically, the Anti-Manipulation Rule prohibits ". . . 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."

18 C.F.R. § 1c.2.

[5] Order at P 60 (citing ETRACOM LLC, 155 FERC ¶ 61,284 (2016); Barclays Bank PLC, 144 FERC ¶ 61,041 (2013)).

ports at Cragview;

(3) Communications, testimony, and evidence substantiating the existence of a scheme to defraud; and

(4) Respondents' inability to offer credible and relevant explanations for the imports.

The Commission reiterated that an entity "need not violate a tariff, rule, or regulation to commit fraud."[6] The Commission disagreed that Office of Enforcement ("OE") Staff was required to provide evidence of material misrepresentations, omissions, or employment of deceptive devices (such as wash trades). According to the Commission, simply engaging in trades undertaken for a manipulative purpose injected false information into the market and constituted a fraud or deceit. The Commission was also unpersuaded by Respondents' arguments that no manipulation violation occurred because CAISO is a flawed market, or because the transactions at issue were "open market" transactions.

Regarding the second element, the Commission concluded, based on contemporaneous communications, testimony, and trade data, that Respondents acted with the requisite scienter. The Commission again pointed to Respondents' divergence from normal trading activity and indifference to profitability of the physical trades as indicia of manipulative intent. The Commission additionally found that Corteggiano had the requisite knowledge and understanding of the market to execute the scheme. Although Respondents highlighted the fact that Corteggiano consulted with Vitol's in-house counsel and compliance advisors on the transactions, the Commission emphasized that Corteggiano did not fully disclose material information regarding the transactions or follow legal counsel's guidance.

Furthermore, the Commission disagreed that it is required to show there was no lawful purpose for the transactions, noting that "a manipulative purpose, even if mixed with some non-manipulative purpose, satisfies the scienter requirement."[7]

Finally, the Commission found that it has jurisdiction over the applicable transactions—i.e., day-ahead physical offers and CRR positions under CAISO's FERC-approved Tariff.

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[6] *Id.*

[7] *Id.* at P 183 (quoting Barclays, 144 FERC ¶ 61,041 at P 70).

PENALTY ASSESSMENT

The Commission is authorized to assess civil penalties of up to $1 million per day,[8] per violation for violations of Part II of the FPA, including violations of the anti-manipulation prohibition.[9] In determining the penalty, the Commission must consider "the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner."[10]

For violations committed by companies, the Commission is generally guided by its Penalty Guidelines, under which it establishes a penalty range based on (1) a Base Penalty amount (based on factors relating to the seriousness of the violation, including harm caused); and (2) several culpability factors, such as efforts to remedy violations, that adjust the Base Penalty amount. The Commission evaluates the specific facts of the case to determine the appropriate penalty within (or, as in this case, outside of) this range that it will ultimately assess.

For violations by individuals, the Commission considers the following factors:

(1) Seriousness of the violation;

(2) Commitment to compliance;

(3) Self-reporting;

(4) Cooperation; and

(5) Reliance on OE Staff guidance.

The Commission's adoption of a $1,515,738 penalty for Vitol fell significantly below OE Staff's recommended $6 million penalty. According to the Commission, the penalty range under the Penalty Guidelines was $2,515,738 to $5,031,476, derived based on the following considerations:

- The seriousness of the violation: Specifically, the Commission indicated that Respondents caused $2,515,738 in market harm in the form of (a) $2,429,385 in reduced funding of CAISO's CRR Balancing Account, and (b) $86,353 in losses suffered by the holders of CRR counter-flow positions; that Respondents' manipulative trades operated as a fraud and deceit on the CAISO market and its participants; and that Respondents' conduct was willful.
- Aggravating and mitigating culpability factors: The Commission added

[8] Adjusted for inflation, this number is currently over $1.2 million per day.

[9] 16 U.S.C. § 825o-1(b).

[10] Order at P 189 (citing 16 U.S.C. § 825o1-(b)).

points to Vitol's culpability score due to the involvement of high-level personnel in the manipulative transaction; reduced points based on Vitol's compliance program, but also identified certain shortfalls in the program;[11] and reduced one point for Vitol's cooperation in the investigation.

However, the Commission decided to depart from the Penalty Guidelines. Although the Commission assessed a total civil penalty of $2,515,738 on Respondents (i.e., the bottom of the Penalty Guidelines range), the Commission reduced Vitol's penalty to $1,515,738 to reflect the $1 million penalty attributed to Corteggiano, whom the Commission noted was the primary actor involved in the alleged scheme. The Commission cited to Corteggiano's role in devising the scheme, proposing it to other employees, facilitating its approval, benefiting CRRs booked to his account, withholding information from compliance personnel, as well as the fact that he engaged in similar behavior at a prior company investigated by FERC. Based on these facts, the Commission concluded that a "strict application of the Penalty Guidelines to Vitol's conduct would, considering all of the facts and circumstances in this matter, be unfair and unreasonable and apportion too large a penalty to Vitol because it would not adequately account for conduct that was conceived of and primarily carried out by an individual trader."[12] The Commission's divergence from OE Staff's recommendations and the Penalty Guidelines is a departure from its practice in prior manipulation cases.[13]

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[11] For example, the Commission noted that the compliance program provided insufficient training for compliance officers to identify problematic transactions and lacked procedural or substantive guidelines to assist compliance in determining whether cross-market trades should be allowed. *Id.* at P 220.

[12] *Id.* at P 225.

[13] For example, in all but one electric market manipulation cases in the last six years, the Commission adopted OE Staff's civil penalty recommendations based on the Penalty Guidelines or the Commission's Revised Policy Statement on Enforcement. *See* ETRACOM, LLC, Order Assessing Civil Penalties, 155 FERC ¶ 61,284 (2016) (adopting OE Staff's recommended $2.4 million civil penalty for the company, and $100,000 penalty for individual); Coaltrain Energy, L.P., Order Assessing Civil Penalties, 155 FERC ¶ 61,204 (2016) (adopting OE Staff's recommended $26 million penalty assessment against company, and $5 million, $1 million, and $500,000 penalties against individuals); Maxim Power Corp., Order Assessing Civil Penalties, 151 FERC ¶ 61,094 (2015) (adopting OE Staff's recommended $5 million civil penalty for companies, and $50,000 for individual); City Power Marketing, LLC, Order Assessing Civil Penalties, 152 FERC ¶ 61,012 (2015) (adopting OE Staff's recommended $14 million penalty against company, and $1 million penalty for individual); Powhatan Energy Fund, LLC, Order Assessing Civil Penalties, 151 FERC ¶ 61,179 (2015) (adopting OE Staff's recommended penalties of $16.8 million, $10.08 million, and $1.92 million for companies, and $1 million for

Meanwhile, in light of the "serious and intentional" nature of his conduct, the $1 million penalty assessed on Corteggiano exceeded OE Staff's recommended $800,000 penalty.

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individual); Barclays Bank PLC, Order Assessing Civil Penalties, 144 FERC ¶ 61,041 (2013) (adopting OE Staff's recommended $435 million civil penalty against company, and penalties of $1 million and $15 million for individual traders). In the one case where the Commission diverged from OE Staff's recommendation, it adopted an increased penalty assessment. Lincoln Paper & Tissue, LLC, Order Assessing Civil Penalty, 144 FERC ¶ 61,162 (2013) (assessing a civil penalty of $5 million—$600,000 higher than OE Staff's proposal—due to denial of cooperation credit).