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Federal District Court Denies Barclays Motion to Dismiss FERC Petition Which Alleges Manipulation and Assesses Significant Penalties

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For the past two years we have been tracking and reporting on an enforcement proceeding brought by the Federal Energy Regulatory Commission ("FERC") against Barclays Bank PLC ("Barclays"), Daniel Brin, Scott Connelly, Karen Levine, and Ryan Smith (collectively, the "Traders" and together with Barclays, "Defendants") for alleged manipulative trading in the western electricity markets from November 2006 to December 2008. Yesterday, the United States District Court for the Eastern District of California denied a motion by the Defendants to dismiss the manipulation action. Although the court's order did not address the merits of the manipulation charge, the court's order is significant because it is the first judicial ruling on the scope of FERC's enforcement authority over the physical electricity markets and the court found that FERC can pursue civil penalty actions against individuals as well as companies. Pursuant to the Federal Power Act ("FPA"), Barclays elected to seek *de novo* review of FERC's penalty determination in U.S. Federal District Court rather than adjudicating the claims through a hearing at FERC. Following this election, on July 16, 2013, FERC assessed a record civil penalty against the Defendants, fining Barclays $435 million and assessing significant individual penalties against each Trader. Barclays was also ordered to disgorge $34.9 million in profits. For more information on the notable assessment of penalties and the unique procedural posture of the case, see our previous post from July 2013.***[1]*** On October 9, 2013, FERC filed a petition in the Eastern District of California to affirm the assessed civil penalties. Shortly thereafter, on December 16, 2013, the Defendants filed a motion to dismiss and to transfer. While Barclays made various arguments in support of dismissal (or in the alternative, a transfer of venue), of particular interest were Barclays' arguments asserting that the Commission did not have jurisdiction over the alleged manipulative scheme, which threatened to significantly curtail FERC's enforcement authority going forward. We discussed the implications of the Defendants' motion to dismiss in a previous post on January 6, 2014.***[2]*** On January 16, 2014, the District Court stayed discovery in the case and declined to issue a briefing schedule, pending a ruling on the Defendants' motion. In February of this year, the court heard oral argument on the Defendants' motion and yesterday issued an order denying the motion. The major findings of the court are summarized below, in the same order in which they were discussed in the order: Statute of Limitation In their motion to dismiss, the Defendants argued that alleged violations occurring before December 26, 2007 were time-barred by the relevant five year statute of limitation. The court disagreed, finding that FERC's issuance of a Notice of Alleged Violation ("NAV"�) did not terminate the parties' tolling agreement and that the proceedings before FERC (despite the lack of a formal hearing with discovery and the presentation of evidence) constituted an administrative process sufficient to accrue the claims. Venue/Motion to Transfer Venue in this case is governed by the FPA. The Defendants argued that venue in the Eastern District of California was improper because during the relevant timeframe, neither the company nor the individuals were ever an inhabitant of the District and the swap contracts at issue were purely financial transactions entered into and executed by the Defendants from Barclays' trading desks in New York. The Court found that FERC met its burden of establishing an "act or transaction constituting the violation"� occurred within the Eastern District.*[3]* Further, although it agreed that the case could have been brought in the Southern District of New York, the court found that the Defendants did not carry their burden of proving that relevant factors, such as the convenience of the parties and witnesses and the interests of justice, favor transfer. FERC's Jurisdiction under FPA §§ 201 and 222 In our January 2014 post, we discussed at great length how if Barclays had prevailed on its motion to dismiss, FERC's jurisdiction would have been significantly narrowed, as Barclays was claiming that actual physical delivery of power was required for FERC to have jurisdiction. Barclays asserted it had not itself actually delivered or received energy and thus its trades were not sufficiently connected to the physical electricity markets to have its transactions be FERC jurisdictional. If Barclays had prevailed with this interpretation, FERC would have essentially been deprived of all enforcement authority over virtual transactions. However, the court did not agree with the Defendants and instead held that Barclays taking title to the electricity and scheduling it for delivery with other market participants was significant enough involvement with the physical transfer of energy so as to make the transactions FERC jurisdictional, despite the fact that Defendants had a flat position and only were involved in *flash title* transactions(simultaneously taking and making delivery of physical energy). FERC vs. CFTC Jurisdiction In their motion to dismiss, the Defendants argued that the main benefitting positions in the alleged manipulation were financial swaps which were or involved futures contracts subject to the exclusive jurisdiction of the Commodity Futures Trading Commission ("CFTC"�). The court found that Defendants did not show in their motion how the swaps were actually futures, nor did they show why swaps, as the benefitting position, were relevant to jurisdiction instead of the trades involving physical products which affected how the swaps were priced. Ultimately, the court agreed with FERC that because the manipulation occurred in the physical market, jurisdiction by FERC was proper. The court distinguished the case of *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013), which held that the CFTC had jurisdiction over alleged manipulation of the market for natural gas, when a hedge fund employee sold natural gas contracts on NYMEX to benefit positions held in assets in the gas market. Specifically, the court stated that in *Hunter* the key was that the manipulation itself occurred in the futures market. Here, FERC is asserting that Barclays and the Traders manipulated the physical market to benefit its swap positions. As such, the court's jurisdictional analysis turns on where the alleged manipulation occurred- in the physical market or the futures market, rather than where the defendant may have benefited. Individual Liability Under FPA § 222 FPA § 222 provides that it shall "be unlawful *for any entity*"¦to use or employ"¦any manipulative or deceptive device or contrivance"¦"� (emphasis added). The Defendants argued that the plain meaning of "entity" does not include natural persons, citing the Energy Policy Act interpretation of "entity" as guidance, and therefore all of the claims against the individual Traders should be dismissed. Not persuaded by the Defendants' arguments, the court held that including natural persons in the definition of "entity" under the FPA was more consistent with the goals of FPA § 222 and with the surrounding statutory scheme. Thus, FERC is not barred from bringing manipulation claims against the individual Traders. Manipulative Conduct In their motion to dismiss, the Defendants claimed that FERC had not alleged manipulation because trades involving willing counterparties cannot be actionable when made in the open market. Further, they argued that trades that are not inherently misleading can also not be actionable. The court found these arguments to be unsupportable. *What does this all mean?* Having prevailed against the majority of the Defendants' arguments and ultimately having rejected their motion to dismiss, FERC can now move forward with the case and seek affirmation of its assessment of civil penalties against Barclays and the Traders. Yet, it is important to stress that this order relates only to Defendants motion to dismiss and thus does not represent a substantive ruling on the merits of FERC's allegations.[4] As such, yesterday's order should not be misinterpreted as a finding of Barclays' guilt - going forward, FERC will still need to prove its manipulation claims. Although this order does not go to the merits of the case, it still has significant ramifications for FERC enforcement and market participants alike. In its order, the court reviewed and addressed significant threshold arguments raised by the Defendants that would, as a matter of law, have precluded FERC from bringing the manipulation action. Specifically, the court reviewed and held that the following do not, as a matter of law, preclude FERC from bringing a claim: 1) that an entity had a flat position and thus did not itself physically move electricity, 2) that manipulation of a physical market was designed to benefit a futures position, 3) that the defendant is an individual (natural person), or 4) that the transactions alleged to have been manipulative were made in the open market and were not inherently misleading. Unless and until another court opines on these issues, the District Court's decision on these threshold issues is precedential in the Eastern District of California, which is the only court in the country to have addressed these issues to date. It is unlikely that Barclays will appeal this order. In order to potentially have this order overturned, Barclays would have to seek an interlocutory appeal, and such appeals are rarely granted. The outstanding question is whether Barclays and FERC will now settle the case. [1] *See* David Perlman & Bob Pease, ***FERC Assesses Record Civil Penalty But the Story is Just Beginning*** (July 17, 2013). [2] *See* David Perlman et al., ***Barclays Motion to Dismiss Raises Significant Issues About FERC Jurisdiction*** (Jan. 6, 2014). [3] The court agreed with FERC that the transactions at issue involved Barclays taking title to and scheduling delivery of electricity with other market participants, which had some involvement with the physical transfer of electricity in the District and that the alleged manipulation affected ICE index prices, which were relied upon by other market participants, including load-bearing entities in the District. [4] In ruling on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), a court must accept a petitioner's allegations as true and must deny a motion to dismiss if, based on the facts alleged, a claim is plausible on its face.