

INSIGHTS

Court Provides Further Clarity Regarding Scope of FERC's Enforcement Authority

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On March 30, 2018, the U.S. District Court for the Southern District of Ohio issued an opinion granting in part and denying in part motions to dismiss the Federal Energy Regulatory Commission's ("FERC") action seeking to enforce its assessment of civil penalties against Coaltrain Energy, L.P. ("Coaltrain"), the two co-owners of Coaltrain, and three other individuals (collectively, the "Defendants"). FERC alleges that the Defendants: manipulated the PJM Interconnection, L.L.C. market by placing virtual transactions for the purpose of increasing Coaltrain's eligibility for Marginal Loss Surplus Allocation ("MLSA") payments; and violated the prohibition on false and misleading statements contained in Section 35.41(b) of FERC's regulations by making false and misleading statements to FERC enforcement staff during the investigation of Coaltrain's conduct. With limited exceptions discussed below, the court largely dismissed the motions to dismiss and found that FERC's allegations, if true, were sufficient to demonstrate that the Defendants had engaged in market manipulation and violated the prohibition on false and misleading statements. Although the court's reasoning generally followed the lead of other courts that have recently opined on the scope of FERC's enforcement authority, there are a number of elements worth noting:

- First, the court largely accepted FERC's theory that trading in a manner inconsistent with the purpose of a particular product constitutes market manipulation. In their motion to dismiss, the Defendants argued that FERC had failed to demonstrate that they had "used or employed a fraudulent device, scheme or artifice" or engaged in a course of conduct that "operated as a fraud or deceit" within the meaning of the market manipulation prohibition because there was no allegation that the Defendants had deceived PJM about the nature of their trades or otherwise committed deceptive or manipulative acts. The Defendants added that there was nothing fraudulent or deceptive about taking eligibility for MLSA payments into account when placing their virtual trades. The court rejected these arguments and accepted FERC's assertion that placing virtual transactions for the "sole or primary purpose" of obtaining MLSA payments—rather than for the purpose of profiting from differences between the day-ahead and real-time markets—constitutes market manipulation. The court follows the decision of other district courts that have endorsed FERC's arguments that market participants have a duty to trade in a manner consistent with market design and that, the failure to do so, can constitute prohibited market manipulation.

- Second, the court agreed with the Defendants that the prohibition on market manipulation does not extend to those that merely “aid or abet” an allegedly manipulative scheme, but found that FERC alleges that the Defendants were directly involved in the transactions at issue. In their motion to dismiss, the Defendants argued that FERC could not pursue market manipulation actions against Coaltrain’s owners because they had not executed any of the allegedly manipulative transactions, but merely helped develop and implement the trading strategy at issue. Following the U.S. District Court for the District of Massachusetts’ decision in *FERC v. Richard Silkman*, the court agreed that the prohibition on market manipulation does not extend to the development or creation of a scheme but only to the execution of a fraudulent scheme. Nevertheless, the court emphasized that actually executing trades is not the only manner in which a market participant can violate the prohibition on market manipulation and that FERC has sufficiently alleged that the owners had either executed trades or helped decide (or mandated) which trades would be executed. Accordingly, the court found that FERC had alleged sufficient evidence that the owners were directly involved in the manipulative scheme. The court’s decision affirms that FERC may only pursue enforcement actions against individuals that participate directly in the manipulative scheme and may insulate from market manipulation claims employees not involved in the decision to execute or actual execution of a company’s trading.
- Finally, the court found that Coaltrain’s owners could not be held jointly and severally liable for violations of the prohibition on false and misleading statements set out in Section 35.41(b) of FERC’s regulations. In its order assessing civil penalties, FERC had held the owners jointly and severally liable for the penalties assessed against Coaltrain, including for allegations that Coaltrain violated Section 35.41(b). The Defendants argued, however, that the owners could not be held jointly and severally liable for any violations of Section 35.41(b) because that rule applies only to “sellers” (i.e., persons that have been granted authorization to make sales at market-based rates). In response, FERC argued that the U.S. Court of Appeals for the D.C. Circuit decision in *Kourouma v. FERC*, 723 F.3d 274 (D.C. Cir. 2013) affirming the assessment of a civil penalty against an individual for alleged violation of Section 35.41(b) supported joint and several liability for the owners. The court, however, distinguished *Kourouma* and granted the motion to dismiss the claims against the owners for violation of Section 35.41(b). Notably, the court found that while the defendant in *Kourouma* was presumed to be a “seller” and had been the person that had made the false statements at issue, FERC had conceded that neither of the co-owners was liable for violation of Section 35.41(b) in their individual capacities. Noting that it was “axiomatic” that an individual party may only be held jointly and severally liable for damages if it is individually liable for the violation at issue, the court explained that it was “hard-pressed to see how [the owners] can be forced to bear a portion of the penalty for a violation for which they are not liable.” For that reason, the court found that neither owner could be held liable for any violations of Section 35.41(b) by the company. Unlike FERC’s market manipulation rule, which has been interpreted to extend to natural persons that participate in a manipulative scheme, Section 35.41(b) generally is understood to only apply to market-based rate sellers and not to individual employees of a company in their personal capacity. Importantly, FERC’s market manipulation rule also contains a prohibition against false or misleading statements, but FERC has endorsed the interpretation that Section 35.41(b) “is somewhat broader than [its market manipulation rule] as it applies to all communications, not just those that are material in furtherance of a fraudulent or deceptive scheme.”