

INSIGHTS

## Barclays Motion to Dismiss Raises Significant Issues About FERC Jurisdiction

January 6, 2014

By: [David M. Perlman](#)

After an investigation of actions in the western electricity markets by Barclays Bank PLC (“Barclays”), Daniel Brin, Scott Connelly, Karen Levine, and Ryan Smith (collectively, the “Traders” and together with Barclays, “Defendants”), the Federal Energy Regulatory Commission (“FERC”) issued an order finding the Defendants in violation of FERC’s anti-manipulation regulations and assessing Barclays a \$435 million civil penalty, assessing each Trader an individual civil penalty, and requiring disgorgement of \$34.9 million plus interest in unjust profits.<sup>1</sup> In accordance with the Defendants’ election of a trial *de novo* in federal district court, on October 9, 2013 FERC filed a petition in the United States District Court for the Eastern District of California requesting an order affirming its assessment of penalties.

In response to FERC’s petition, on December 16, 2013, the Defendants filed a motion to dismiss the complaint.<sup>2</sup> The Defendants moved to dismiss the complaint, as a matter of law, on the grounds that venue is not proper and that FERC has failed to state a claim upon which relief can be granted.

This is the first time a FERC electric market manipulation claim is being adjudicated in a federal district court.<sup>3</sup> The Defendants have responded in a quite robust fashion to FERC’s allegations and choice of venue.<sup>4</sup> While all aspects of this matter are of interest, the substantive legal arguments regarding FERC’s authority merit particular attention as their resolution may significantly affect the scope of FERC’s enforcement authority going forward.

In support of their motion to dismiss, the Defendants argue that FERC has no jurisdiction over the alleged manipulative scheme. Specifically, they contend:

- The Commodity Exchange Act (“CEA”) grants the Commodity Futures Trading Commission (“CFTC”) exclusive jurisdiction and anti-manipulation authority over transactions involving commodity futures contracts. The Defendants assert that the swap contracts Barclays traded on ICE ECM were futures contracts as a matter of law and therefore within the CFTC’s exclusive jurisdiction.
- The Federal Power Act (“FPA”) expressly limits FERC’s jurisdiction over the transmission and sale of electric energy to electric energy transmitted in interstate commerce. Barclays does not own or operate any electrical generation facilities, instead it only

operated as an intermediary purchasing and selling equal and offsetting amounts of electricity to market participants therefore avoiding any obligation to physically deliver or receive electricity. The Defendants assert that FERC has no jurisdiction under the FPA unless physical electricity was actually transmitted or delivered.

- The anti-manipulation section of the FPA expressly prohibits “any entity” from using a “manipulative or deceptive device or contrivance” in connection with the purchase or sale of wholesale electric energy or transmission services. Individuals are not entities and therefore FERC lacks jurisdiction to bring claims against the individual traders.
- FERC lacks jurisdiction over transactions consummated in the open market between willing sellers and buyers, without any showing of fraud. The Defendants note that Supreme Court, as well as Ninth Circuit, precedent holds that “manipulation” is a term of art referring to practices that are intended to mislead investors by artificially affecting market activity.<sup>5</sup> In contrast, in this case FERC failed to allege an inherently manipulative, false, or deceptive trades, and instead focused only on legitimate trading activity, done with willing counterparties, in the open market, consistent with Barclays’ normal course of business.

## **Discussion**

The Defendants have provided quite an array of arguments for the court to sort out. This discussion will focus on the areas where they allege FERC is without authority.

### **CFTC Exclusive Jurisdiction**

The Defendants appear to argue that if a manipulative scheme includes CFTC jurisdictional contracts, then the holding of the *Hunter*<sup>6</sup> case applies and the CFTC has exclusive jurisdiction. In *Hunter*, FERC was found to be without jurisdiction over a manipulative scheme involving futures contracts but affecting FERC jurisdictional natural gas contracts. Thus, the Defendants argue that, like in *Hunter*, an alleged manipulative scheme involving physical power contracts but also including and benefiting futures and swaps is also within the CFTC’s exclusive jurisdiction and outside of FERC’s. Assuming the Defendants were to prevail, FERC’s authority would be limited to activities solely within physical markets, while any cross-market (physical/financial) actions would solely be within the CFTC’s jurisdiction. Given the nature of commodities markets, such a holding would significantly constrain the scope of FERC enforcement actions.

### **Physical Delivery Requirement**

The Defendants also appear to argue that unless physical power is transmitted or delivered, FERC has no jurisdiction over the alleged manipulation claim. The power market contains multiple physical contracts that may not result in delivery, including (1) forward power transactions that are “booked out” or subject to other market arrangements; (2) dispatchable power purchase agreements involving power plants that do not result in the physical delivery of power unless the plant is dispatched; (3) options on the physical sale/delivery of power that will not result in physical delivery of power unless exercised; (4) capacity products and markets that represent the ability to generate power but of themselves do not involve physical deliveries; and (5) virtual markets in FERC regulated RTOs.

Assuming the Defendants were to prevail, FERC's authority would be limited to transactions in which power was actually transmitted or delivered. Such a holding would not only significantly impact the scope of FERC enforcement but would also raise questions regarding the scope of FERC's jurisdiction under its rate authority. Effectively, unless and until power flowed over a transmission line or was delivered under a contract, FERC would have no enforcement authority.

#### **Individuals Are Not Entities**

According to the Defendants, the plain meaning of the term "entity" does not include natural persons and Congress' use of the term "entity" elsewhere in the FPA confirms that it intended the term to have its ordinary meaning throughout the statute. On the other hand, FERC, beginning with its first Policy Statement on Enforcement in 2005 through the *Hunter* case, has continuously maintained that "individuals are subject to prosecution under criminal provisions of our statutes and to civil remedies." FERC may have a difficult time equating the statutory term "entity" with a natural person.

Assuming the Defendants were to prevail, FERC would be precluded from bringing a manipulation claim against a natural person.

#### **Open Market Transactions**

The Defendants appear to claim that they could not have violated FERC's fraud-based anti-manipulation rule because the trades at issue were transacted between competent market participants in an open and transparent market.

Assuming the Defendants were to prevail, for FERC to bring a manipulation claim the transactions at issue would need to involve direct fraud. More indirect "manipulations," such as those alleged here, would not be properly brought. It appears that the Defendants are arguing that a scheme involving losing money in open market transactions with willing counterparties to benefit other positions in other markets is too attenuated to be actionable manipulation under FERC's authority.

#### **What Is At Stake**

When the totality of the Defendants' arguments are considered, one can see that in effect the legal sufficiency of FERC's enforcement regime for power markets has been placed in question. If FERC does not have jurisdiction over manipulative schemes that (1) touch on futures and swaps; (2) do not involve the actual physical transmission or delivery of power; and (3) involve "open market" transactions in which there is a willing buyer, FERC will be left with a limited scope of activities to supervise under its manipulation authority. Its scope will largely be fraudulent transactions in physically transmitted and/or delivered power in which the buyer/seller was defrauded (as long as no futures or swaps are involved).

The Defendants' arguments are not without merit and we expect the court will carefully consider them. As this is a case of first impression, how these arguments are addressed by the court will be of great significance to those regulated by FERC.

It is important to note that any manipulation claim that is found to be beyond FERC's jurisdiction for the reasons given by the Defendants could very well be properly brought by the CFTC. In 2010, Congress required that the FERC and CFTC enter into a memorandum of understanding (MOU) to clarify their jurisdictional boundaries. On January 2, 2014, such a

MOU was agreed upon. However, as the MOU does not address the issues raised in the motion, it appears that the courts, as in the *Hunter* case, will resolve these issues.

We will continue to follow this case and update as further developments occur.

---

<sup>1</sup> See David Perlman & Bob Pease, [Ferc Assesses Record Civil Penalty But the Story is Just Beginning](#) (July 17, 2013).

<sup>2</sup> Notice of Motion and Motion to Dismiss, *FERC v. Barclays Bank PLC et al.*, No. 2:13-cv-02093-TLN-DAD (E.D. Cal. Dec. 16, 2013).

<sup>3</sup> Natural gas claims must be adjudicated before a FERC ALJ.

<sup>4</sup> With respect to venue, the Defendants claim the acts in question did not occur in the district where the case was filed, there was no delivery of electricity in the district and that the case, if not dismissed, should be transferred to the Southern District of New York.

<sup>5</sup> Notice of Motion and Motion to Dismiss, *FERC v. Barclays Bank PLC et al.*, No. 2:13-cv-02093-TLN-DAD (E.D. Cal. Dec. 16, 2013)(quoting *Santa Fe Industries Inc. v. Green*, 430 U.S. 462, 476 (1977)).

<sup>6</sup> *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).