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# FERC to Traders: “Those Who Do Not Learn From History Are Doomed to Repeat It”

*By Norman C. Bay, Paul J. Pantano, Jr., and Alexandra K. Calabro\**

*The authors explore the implications of a settlement between the Federal Energy Regulatory Commission’s Office of Enforcement and Shell Energy North America (US), L.P.*

The Federal Energy Regulatory Commission (“FERC” or the “Commission”) has approved a stipulation and consent agreement (“Consent Agreement”) between the Office of Enforcement (“OE”) and Shell Energy North America (US), L.P. (“SENA”).<sup>1</sup> The Consent Agreement resolves the OE investigation into whether SENA violated Section 4A of the Natural Gas Act (“NGA”)<sup>2</sup> and the Commission’s Anti-Manipulation Rule<sup>3</sup> when it allegedly engaged in a related-positions fraudulent scheme during the May 2016 bidweek. SENA agreed to pay a civil penalty of \$951,683 and to disgorge \$48,317 plus interest. SENA stipulated to the facts set forth in Section II of the Consent Agreement, but neither admitted nor denied the alleged violations set forth in Section III.<sup>4</sup>

SENA trades physical natural gas and natural gas derivatives.<sup>5</sup> The trading conduct at issue in OE’s investigation involved a junior trader (“Junior Trader”) at SENA who engaged in physical trading at the Southern California (“SoCal”) Border Kern River Station (“KRS”) hub as well as the PG&E Citygate hub to allegedly benefit the trader’s related speculative positions.<sup>6</sup>

OE’s investigation focused on published Natural Gas Intelligence (“NGI”) indices, which represent the volume-weighted average price of fixed-price and physical basis transactions during bidweek (the last five business days of the

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<sup>1</sup> *Shell Energy North America (US), L.P.*, 175 FERC 61,201 (2021) (“Order”).

<sup>2</sup> 15 U.S.C. § 717c-1.

<sup>3</sup> 18 C.F.R. § 1c.1.

<sup>4</sup> Consent Agreement at pp. 1–2.

<sup>5</sup> *Id.* at p. 4.

<sup>6</sup> *Id.* at p. 20.

month immediately preceding the delivery month). Particularly relevant to the investigation were both the PG&E Citygate monthly NGI index and the SoCal Border monthly NGI index.<sup>7</sup>

SENA's Junior Trader had executed speculative basis and index swap transactions that settled against May 2016 NGI monthly index prices. The swap positions were profitable when the PG&E Citygate May 2016 NGI price increased and when the SoCal Border May 2016 NGI price decreased.<sup>8</sup>

Notably, prior to the May 2016 bidweek, a supervisor instructed the Junior Trader to zero out SENA's May 2016 exposure in the Junior Trader's speculative book. Despite this instruction, the Junior Trader largely retained the May 2016 long exposure to the PG&E Citygate NGI monthly index, as well as all of the short exposure to the SoCal Border NGI monthly index.<sup>9</sup>

During the May 2016 bidweek the Junior Trader entered into nine physical fixed-price gas transactions at the KRS trading hub. Ultimately, these trades had the effect of lowering the published NGI monthly index price at the SoCal Border, which benefitted the Junior Trader's speculative positions.<sup>10</sup>

The Consent Agreement noted a number of apparent incongruities in the Junior Trader's activity, pointing out that:

- (1) The Junior Trader opened and closed SENA's physical baseload positions two times (resulting in net obligations of 0 MMBtus/day);
- (2) On three of the five days during the May 2016 bidweek the Junior Trader's transactions were the only consummated transactions on the Intercontinental Exchange ("ICE") at the KRS hub; and
- (3) One trade by the Junior Trader was the lowest consummated transaction price at all SoCal Border points reported to NGI that bidweek.<sup>11</sup>

During the May 2016 bidweek, the Junior Trader also entered into five fixed-price gas purchases at the PG&E Citygate trading hub. These transactions all took place in just over an hour, and each trade lifted existing offers to sell.<sup>12</sup> According to the Consent Agreement, shortly after engaging in these purchases, SENA switched to selling and entered into five sales, two of which were priced

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<sup>7</sup> *Id.* at p. 6.

<sup>8</sup> *Id.* at p. 8.

<sup>9</sup> *Id.* at p. 9.

<sup>10</sup> *Id.* at pp. 10–11, 14.

<sup>11</sup> *Id.* at pp. 12–13.

<sup>12</sup> *Id.* at p. 15.

lower than what it had just paid to purchase the gas.<sup>13</sup> The purchasing activity at the PG&E Citygate trading hub had the effect of increasing the published NGI monthly index price at PG&E Citygate, thus benefitting the Junior Trader’s speculative positions.<sup>14</sup>

The Consent Agreement observed that SENA’s compliance program did not include sufficient FERC-specific compliance training to ensure that its natural gas traders understood FERC’s rules, SENA did not have a sufficient compliance presence in its San Diego office where the trading took place, and overall SENA lacked adequate oversight of the Junior Trader.<sup>15</sup>

### ALLEGED VIOLATIONS

OE’s Division of Analytics and Surveillance referred this matter to OE for investigation. OE alleged that SENA engaged in related-positions fraud by engaging in physical trading at KRS and PG&E Citygate trading hubs during the May 2016 bidweek that was designed to manipulate the related monthly index prices to benefit the Junior Trader’s swap positions. OE concluded that SENA intended to manipulate the PG&E Citygate and SoCal Border monthly indices for the May 2016 bidweek, in violation of Section 4A of the NGA<sup>16</sup> and the Commission’s Anti-Manipulation Rule.<sup>17</sup>

OE further concluded that inadequacies in SENA’s compliance program contributed to the violations, including the failure to supervise the Junior Trader’s activity and failing to take appropriate action to address the Junior Trader ignoring a supervisor’s instructions to zero out SENA’s May 2016 exposures.<sup>18</sup>

Section 4A of the NGA states, in relevant part, that it is unlawful “for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas . . . any manipulative or deceptive device or contrivance . . . in contravention of such rules and regulations as the Commission may prescribe.”

The Commission’s Anti-Manipulation Rule states, in relevant part, that:

It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of natural gas . . . [t]o use or employ any

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<sup>13</sup> *Id.* at p. 16.

<sup>14</sup> *Id.* at p. 17.

<sup>15</sup> *Id.* at p. 18.

<sup>16</sup> 15 U.S.C. § 717c-1.

<sup>17</sup> Consent Agreement at p. 20–22.

<sup>18</sup> *Id.* at 23.

device, scheme, or artifice to defraud, . . . or . . . [t]o engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.<sup>19</sup>

For purposes of settling the claims arising from OE's investigation, SENA agreed to pay a civil penalty of \$951,683, as well as to disgorge \$48,317 plus interest in unjust profits to: National Trading II, LLC, Enstor Energy Services, LLC, Macquarie Energy LLC, Noble Americas Gas & Power Corp., and ConocoPhillips Company.<sup>20</sup> Additionally, SENA also agreed to submit to OE an annual compliance monitoring report for two years following the date of the Consent Agreement. The report must:

- Identify known violations of the NGA or Commission regulations;
- Describe the measures and procedures SENA has implemented related to compliance with the NGA and Commission regulations; and
- Describe the Commission-related compliance training SENA has administered.

Furthermore, upon request, SENA must provide OE documentation supporting the contents of its annual compliance monitoring reports.<sup>21</sup>

## CONCLUSION

In some respects, this settlement is reminiscent of other FERC enforcement actions involving an allegation of related-positions manipulation in which uneconomic physical trading is used to benefit a financial position that settles based upon an index comprised of physical prices. But there are several noteworthy aspects of the settlement.

First, the investigation apparently was triggered by the Division of Analytics and Surveillance in OE, which uses algorithms to screen market data to detect anomalous trading behavior.

Second, the trading activity appears to have been fairly limited; it is hardly as dramatic as the facts of *Hunter v. FERC*, which involved trading during the close of three different settlement periods for gas futures contracts.<sup>22</sup> Here, there is no clear allegation that the physical trading was uneconomic, though SENA lifted five offers at PG&E Citygate and then made five sales, two of which were priced lower than what it had just paid to purchase the gas.

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<sup>19</sup> 18 C.F.R. § 1c.1.

<sup>20</sup> Consent Agreement at pp. 25–26.

<sup>21</sup> *Id.* at pp. 27–28, 30.

<sup>22</sup> *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).

Third, the Junior Trader was neither named nor the subject of an enforcement action, though it is not clear why. Perhaps the settlement with SENA resolved any potential claims against the Junior Trader, or perhaps the Commission did not view the Junior Trader’s conduct as sufficiently culpable. Regardless, this settlement underscores the importance of a robust compliance and supervisory program.

Even a relatively limited amount of activity by a trader can trip a Division of Analytics and Surveillance screen and result in a protracted and costly investigation, as well as significant potential liability. As is often the case in life, an ounce of prevention is worth a pound of cure.