BRACEWELL

INSIGHTS

An Autumn Gleaning: Insights from October 2019 decisions in Kraft Foods, Vitol Manipulation Cases

October 28, 2019

By: ***Michael W. Brooks*** *and* ***Joshua Robichaud***

For those interested in the contours of the Commodity Futures Trading Commission's (CFTC) and the Federal Energy Regulatory Commission's (FERC) anti-manipulation authority, three October 2019 decisions in two pending cases create opportunities for continued litigation over the scope of the agencies' authority. The reopening of the CFTC case against Kraft Foods and FERC's assessment of civil penalties against Vitol Inc. create the opportunity for further judicial refining of the agencies' rules. In the meantime, while these developments provide no new insights as to the substance of market manipulation, they are noteworthy due to their implications for future settlements and penalty assessments.

CFTC v. Kraft Foods

First, on October 22, 2019, the U.S. Court of Appeals for the 7th Circuit ***granted*** the CFTC's petition to stop the U.S. District Court for the Northern District of Illinois, Eastern Division (District Court) from holding individual CFTC commissioners or staff in ***civil contempt*** for statements made related to a ***settlement*** reached between Kraft Foods Group and the CFTC. Specifically, while allowing the District Court to proceed against the Commission (as the party to the settlement), the 7th Circuit panel granted mandamus to prevent punishment of individuals and to prevent the District Court from forcing individuals to appear before it to address the remaining civil contempt motion against the CFTC. In response, on October 23, 2019, the District Court vacated its prior consent order, wiping out the settlement, and scheduled a motion hearing for November 20, 2019. In a minute entry, the judge explained, "[i]f the parties still wish to settle this matter short of a trial, they remain free to do so and may submit a new proposed consent order for this Court's review."

Putting aside the drama of the contempt proceeding, this series of events breathes new life into a controversial ***case*** in which the CFTC alleged market manipulation based on allegations that Kraft Foods intentionally caused the convergence of a wheat futures contract and a local cash market by signaling to the market that it intended to take delivery of the futures rather than procuring its supply through the cash market. The case ***settled*** in March 2019 with Kraft's affiliate agreeing to pay a civil penalty of $16 million. With the settlement vacated, there is another opportunity for the merits of the case to be litigated and the CFTC's theory of manipulation tested in court. Alternatively, the parties might agree to settle the case again, arguably revealing the perceived value of the clause prohibiting public statements by the Commission.

Regardless of the ultimate outcome in *Kraft*, the Commission's public statements about the provision of the settlement limiting its public statements, and the saga that followed, reinforce expectations that the Commission will be reluctant to entertain similar provisions in the future. Meanwhile, the 7th Circuit's decision may undermine the CFTC's own boilerplate limitation on public statements by parties to settlements. As a result, parties in the future appear to have a sound basis for rejecting any attempt by the CFTC to silence non-parties such as agents and employees of the respondents.

Vitol Inc.

In an October 25, 2019 ***Order Assessing Civil Penalties***, FERC assessed civil penalties against Vitol and an individual trader for allegedly trading physical energy in the California Independent System Operator (CAISO) to benefit a related congestion revenue rights (CRR) position. While the facts of this case of this case could lead to interesting new case law regarding what constitutes manipulation and the government's burden of proof in cases alleging manipulation, for now the penalty assessment is most noteworthy for the Commission's substantial reduction of the penalty from the $6 million penalty proposed by FERC staff to $1,515,738. The Commission made two adjustments.

First, by adjusting the credit given to Vitol for its compliance program to give partial credit consistent with FERC staff's assessment in other cases, the Commission reduced the penalty range calculated pursuant to its Penalty Guidelines from $3,018,885.60 - $6,037,771.20 (as calculated by staff) to $2,515,738 - $5,031,476. The Commission then further reduced the penalty assessment by deviating from the Penalty Guidelines to assign a portion of the penalty to the trader involved, leaving Vitol with a penalty of $1,515,738 and increasing the trader's penalty from $800,000 proposed by staff to $1,000,000.

This deviation is consistent with the Commission's Policy Statement on Penalty Guidelines, which provides "deviations in penalties may be necessary to account for the specific facts and circumstances of a violation." However, it is the first time the Commission has publicly approached a deviation in this manner and it results in a penalty significantly lower than the level proposed initially.

The Commission justified the penalty reduction by concluding that the Penalty Guidelines "would not adequately account for conduct that was conceived of and primarily carried out by an individual trader … [who] devised the scheme, proposed it to others, worked to facilitate its approval, and intended to, and did, benefit a CRR position that was booked to his account." The Commission further noted that the individual trader "had previously engaged in similar behavior … [and] deliberately withheld material information about the manipulative scheme from Vitol's compliance officers." Notably, Vitol has disputed this last point.

Observers should be careful about drawing broad conclusions about the Commission's willingness to penalize companies for their traders' conduct or reading into this order any new policy to reduce penalties generally. This order is consistent with prior FERC orders. In fact, it should not go unnoticed that the amount sought is almost identical to the civil penalty sought under very similar facts in 2013 against Deutsche Bank. And, in case there might be confusion as to that Commission's appetite for penalties, the same commissioners who sought $1,500,000 against Deutsche Bank also sought $285,000,000 against ***JP Morgan*** the same year. Although Vitol is alleged to have benefited more from the activity than Deutsche Bank, and benefit and

harm to market significantly impact the Penalty Guidelines calculation, it does not seem like an extreme departure from prior decisions when put side-by-side with the ***Deutsche Bank Order to Show Cause*** (and ***settlement*** for the same amount).

Like Deutsche Bank, this case involves allegations that a trader engaged in physical transactions that appeared profitable based upon then-present market price signals but that benefited a related CRR position by alleviating "phantom" congestion caused by a market design flaw. Unlike Deutsche Bank, here the trader (same trader) claims the related position was not a motivating factor, and there does not appear to be a tariff violation that can serve as low-hanging fruit for the regulator. That makes this an interesting test case for the bounds of FERC's anti-manipulation authority.