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CFTC Settles Gas Index Manipulation Claim While FERC Allegations Remain

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CFTC Order Accepting Settlement with Total Gas & Power North America, Inc. & Therese Tran for Attempted Manipulation of Natural Gas Monthly Index Settlement Prices On December 7, 2015, the Commodity Futures Trading Commission ("CFTC" or the "Commission") issued an order instituting *proceedings,* making findings, and imposing sanctions ("***Settlement Order***") to resolve charges against Total Gas & Power North America, Inc. ("TGPNA") and one of its natural gas traders, Therese Tran, for attempted manipulation of natural gas monthly index settlement prices. The Settlement Order represents a settlement between the CFTC and TGPNA and requires TGPNA and Tran to jointly pay a $3.6 million civil monetary penalty and imposes other sanctions, including a bid-week trading limitation for two years; reporting requirements; and a documents/communications preservation requirement. ***Unaddressed Compliance Red Flags Used as Evidence*** The alleged scheme in this case is nothing new, and the details disclosed in the Settlement Order are limited, but the evidence cited in the Settlement Order is worth special note. According to the Settlement Order, TGPNA management and compliance identified a compliance risk and a process to address the risk, but stopped short of questioning or disciplining traders. First, the Settlement Order highlights an email by a TGPNA manager years prior to the conduct at issue that noted the compliance benefit of reports generated by TGPNA's risk control group that showed TGPNA's estimated market share at trading locations during bid-week. The manager suggested that middle/back office investigate instances where TGPNA traded more than 40% of the overall volume at a single point, concluding, "[t]his should be a written exercise where the concerned trader will be able to explain his/her motivation." According to the Settlement Order, "TGPNA's management, however, never questioned or disciplined traders "¦ for having high market share at any particular hub location." Second, the Settlement Order states that TGPNA's compliance officer performed an "in-depth analysis" of TGPNA's price reporting, its impact on published index prices, and its associated profit and losses. The compliance officer issued a report to management prior to the conduct in question, recommending: "TGPNA Management may wish to contemplate ramping down its fixed price and physical basis trading in the markets in which it has a large share. Consider compliance both in terms of fact and appearance." According to the Settlement Order, "Again, TGPNA's management never questioned or disciplined any traders "¦ in connection with their large presence in the physical price setting market during bid-week." When compliance concerns are raised, regulators expect them to be fully vetted and resolved, and regulators expect companies to comply with their own compliance processes, even when the processes are voluntary. ***Scienter Based on Knowledge of Impact of Trading on Related Position*** This settlement may also be an example of the CFTC applying its anti-manipulation authority to a case appearing to involve circumstantial evidence of intent. Here, although the Settlement Order repeatedly concludes the trades in question were intended to benefit TGPNA's related financial positions, the Settlement Order provides very little evidence of specific intent. It focuses primarily on TGPNA's knowledge of the relationship between its physical trading and financial positions and states TGPNA "took overt acts in furtherance of [its] intent to affect the monthly index settlement prices at the relevant hubs *by establishing financial positions prior to bid-week at the relevant hub locations and by actively trading in the fixed-price market during bid-week, despite having no material customers, assets, or transportation in these regions*."(*emphasis added*) The Commission found that TGPNA and the trader "at a minimum acted recklessly or with reckless disregard for the potential impact of their trading on natural gas prices and the integrity of the natural gas market." According to the Settlement Order, despite the fact that they knew their fixed-price trading during bid-week could potentially affect the monthly index prices, according to the Settlement Order they still undertook their bid-week trading "in an attempt to influence their concurrently held financial positions." Without knowing more facts, market participants might draw the conclusion that actively trading in a price setting mechanism while maintaining a related financial position may be characterized as manipulation even absent allegations of trading at a loss in the price setting mechanism or engaging in trading patterns designed to mislead or otherwise influence price other than by participation in the market. ***Background and Facts*** The Commission found that during the bid-weeks for September and October 2011 and March and April 2012, TGPNA, through Tran and its other traders, attempted to manipulate monthly index settlement prices of natural gas at four major trading hubs in Texas and the Southwest, including the El Paso Natural Gas Co., Permian Basin, El Paso San Juan Basin, Southern California Gas Co., and West Texas, Waha, through their physical fixed-price trading during bid-week. According to the Settlement Order, TGPNA used fixed-price trading in an attempt to favorably affect the monthly index settlement prices to benefit its related financial positions, including basis swap and index swap positions. The Commission highlighted that TGPNA was one of the largest players in the fixed-price market during the target periods "“ TGPNA's trading accounted for a substantial percentage of the total market by volume at each of the relevant hubs, despite the fact that TGPNA had no material customer business, assets, or transportation at the hubs. The Commission determined that during the relevant period, TGPNA traded fixed-price natural gas in such a way that would benefit its related financial positions. Specifically, the trading desk acquired large print risk exposure prior to the start of bid-week. Then, depending on the direction of the print risk exposure (long or short), TGPNA executed enough fixed-price trades during bid-week with the intent to favorably affect monthly index settlement prices at the relevant hubs. ICE and TGPNA transaction data indicated that the desk's fixed price trades accounted for "well over half of the total market by volume" during the relevant period, despite the fact that TGPNA had no material customer business, physical assets, or transportation at the relevant hubs. TGPNA's data also showed a "strong correlation between increased print risk and increased fixed-price market share during bid-week." ***Settlement Terms*** Pursuant to the Settlement Order, TGPNA and Tran are ordered to pay, jointly and severally, a civil monetary penalty totaling $3.6 million. Additionally, TGPNA and Tran are prohibited from trading physical basis or physical fixed-price natural gas for next month delivery during bid-week at hub locations when TGPNA also holds, prior to and during bid-week, any financial natural gas position whose value is derived in any material part from natural gas bid-week index prices. This trading limitation is imposed for a period of two years, but includes exceptions related to marketing of Total E&P USA, Inc.'s (TGPNA's affiliate) physical bid-week natural gas, and any related financial trading, in the Barnett Shale or Utica Shale regions, and also excludes the company's physical bid-week trading of natural gas or financial trading in connection with the Sabine Pass LNG terminal. Additionally, TGPNA will be required to preserve documents related to its domestic natural gas trading and make quarterly reports to the Division of Enforcement for a period of two years. ***FERC Investigation*** On September 21, 2015, the Federal Energy Regulatory Commission ("FERC") issued a Notice of Alleged Violations ("***Notice***") announcing FERC Enforcement has made a preliminary determination that TGPNA, Tran (also known as Nguyen), and another supervisor, Aaron Hall, violated the Natural Gas Act by manipulating the price of natural gas in the southwest United States during bid-week between June 2009 and June 2012. The conduct in question appears to be similar to and in some cases the same as the conduct at issue in the Settlement Order, but FERC has named a second individual and identified a broader time period. The Settlement Order limited the CFTC authority to conduct occurring on or after August 15, 2011. Although FERC's anti-manipulation authority extends prior to 2011, its civil penalty authority is limited by a 5-year general statute of limitations.