

SEC Enforcement in the Energy Industry

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THE SEC'S INCREASED SCRUTINY

- The SEC is increasing scrutiny of the energy industry with an emphasis on:
 - Accurate reserve reporting
 - Impairments
 - Accounting errors
 - Deficient internal controls
 - Untimely or delinquent filings
 - Anti-bribery and corruption



SEC INVESTIGATION ISSUES

- Accounting and the Fraud Task Force
- Valuation of Reserves and Property
- Misleading Statements and Use of Proceeds
- Smaller “Broken Windows” and Delinquent Filings
- FCPA Actions for Bribery or Deficiencies in Internal Controls

ASSET VALUE AND PROJECTIONS

- Use of Reserve Reports with other than fair market value
- Fixed asset values and reporting
- Estimates of well profitability
- Disclosures of reserves including original oil in place without disclosing difference to recoverable oil
- Porosity percentages
- Value “per barrel” for speculative drilling compared to producing wells



ACCOUNTING, BOOKS AND RECORDS

- Assets and Liabilities
- Mischaracterization of revenue
 - Accounting for sale of working interests
- Revenue recognition
 - Timing
 - Loan proceeds
- Expense items



MISLEADING STATEMENTS

- Flow rate for wells, pipelines and spills
- Joint venture proceeds and use of funds
- Unregistered sellers – finders and commission-based employees
- Risk disclosures
- Return estimates and “guarantees”
- Understatements of expenses



PRIVATE OFFERING ISSUES

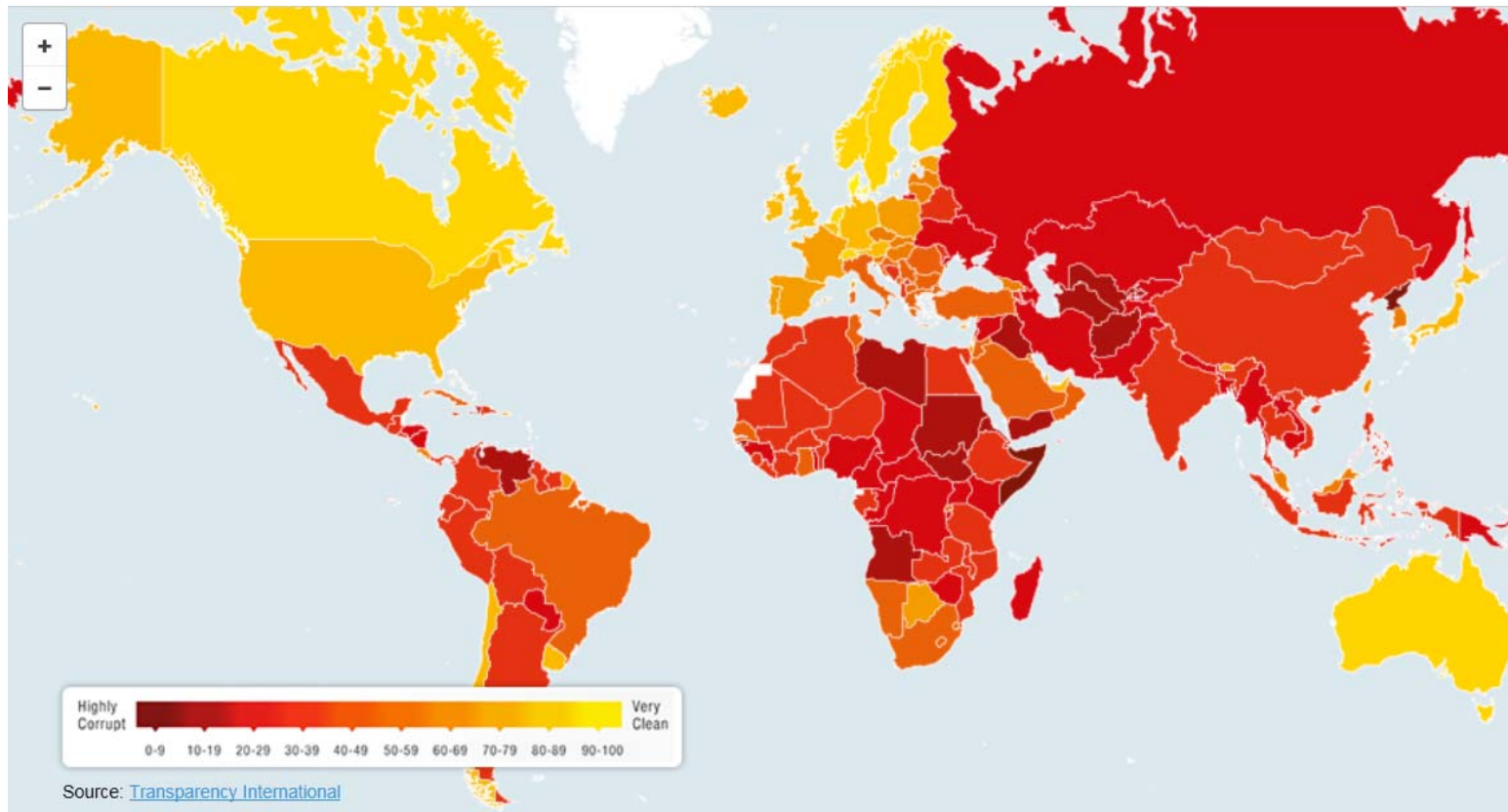
- From Aug 2012 to present there have been over 20 enforcement actions filed against energy-related private companies and individuals
 - Majority of cases filed in Federal District Courts in Texas
- Common Themes
 - Misuse of investor funds
 - Misrepresentation about potential returns and risk
 - Unregistered offerings
 - Misrepresentation about qualifications/experience
 - Accounting misrepresentations
 - Misrepresentation of the state or value of well reserves
 - Omission of material information

BROKEN WINDOWS CONCEPT

- Delinquent periodic filings
- Late filings of ownership reporting
- Form 8-K failures



TI's Corruption Perception Index 2014



Source: http://en.wikipedia.org/wiki/Corruption_Perceptions_Index#/media/File:Transparency_international_2014.png

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MAJOR RISK AREAS

- Global risk: compliance with foreign anti-corruption laws



- Insufficient internal controls
- M&A transactions – successor liability
- Intermediaries & third parties
- Gifts, meals, and entertainment

FCPA ENFORCEMENT ACTIONS

- BHP Biliton (\$25 million penalty)
- Layne Christensen (\$4.76 million disgorgement and interest plus \$375,000 penalty)
- Weatherford Int'l (\$67 million penalty to the SEC; \$87 million penalty to DOJ; and \$100 million fines to three Other Agencies)
- Total, S.A. (\$153 million in disgorgement to the SEC; \$245.2 million penalty to DOJ; Deferred Prosecution Agreement)
- Parker Drilling Co. (\$3.05 million disgorgement to the SEC plus \$1.04 million interest; \$11.76 million penalty to DOJ)
- Noble Corp. and three executives (\$8 million to the company; injunctions and penalties against executives)

INTERNAL CONTROLS EXPANSION

- The FCPA require issuers to adopt accounting controls that “provide **reasonable assurances** that . . . transactions are executed in accordance with management’s authorization.”
- Enforcement agencies interpret this to require companies to adopt robust anti-corruption compliance programs.
- Recent enforcement actions by the SEC have focused on the requirement that companies adopt internal controls sufficient to “**prevent and detect**” violations of the books and records provisions of the FCPA.
 - Archer Daniels Midland Co. \$54 million settlement
 - Goodyear \$16 million settlement

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2015 Government Enforcement in the Energy Industry

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Criminal Antitrust Proceedings

- A. Historical Context – Antitrust and the Energy Industry
- B. Key Distinctions Between Antitrust and Other Investigations
 - 1. Criminal Penalties
 - 2. Crisis Response
 - 3. Corporate Leniency
- C. Ethical Considerations
- D. Corporate Compliance Tips

Historical Context

- A. Standard Oil – 1911
- B. Industry Cycles/Downturns – 1980s-1990's – Price Fixing, Bid Rigging, Market Allocations
- C. Industry Collaborations
 - 1. April 2011 – DOJ Oil and Gas Price Fraud Working Group
 - 2. June 2011 – FTC Market Manipulation Investigation (Refiners, Producers, Transporters, Marketers, Traders)
 - 3. February 2012 – Gunnison Energy – SG Interests (Natural Gas Leases)
 - 4. 2012 – Present – Chesapeake Energy -- Encara

Key Distinctions in Antitrust Proceedings

A. Criminal Penalties

1. Corporate
2. Individuals



Crisis Response

- A. Subpoena
- B. Drop-in Interviews
- C. Search Warrants
- D. Dawn Raids



Corporate Leniency Policy

- A. Part A – First-in; No government investigation (Marker System)
- B. Part B – First-in; Some government knowledge
- C. “Amnesty Plus”
- D. “Penalty Plus”
- E. Late To The Game “Benefits”
- F. Individual Leniency

Ethical Considerations

- A. Who is the Client?
- B. Joint Defense Arrangements
 - 1. Individuals
 - 2. Competitors
- C. Attorney-Client Privilege
 - 1. Waiver Not Required
 - 2. Non-Waiver Agreement



Corporate Compliance Tips

- A. Training, Training, Training
- B. Whistleblower Program
- C. Crisis Response Policy/Procedures



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Environmental Enforcement and Investigations

Trends and Tips

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How environmental investigations start

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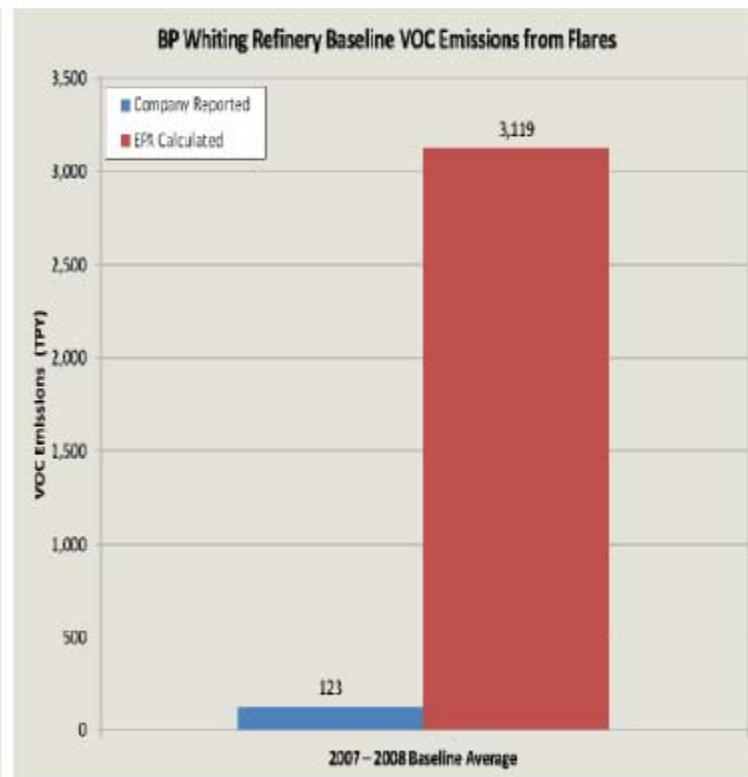
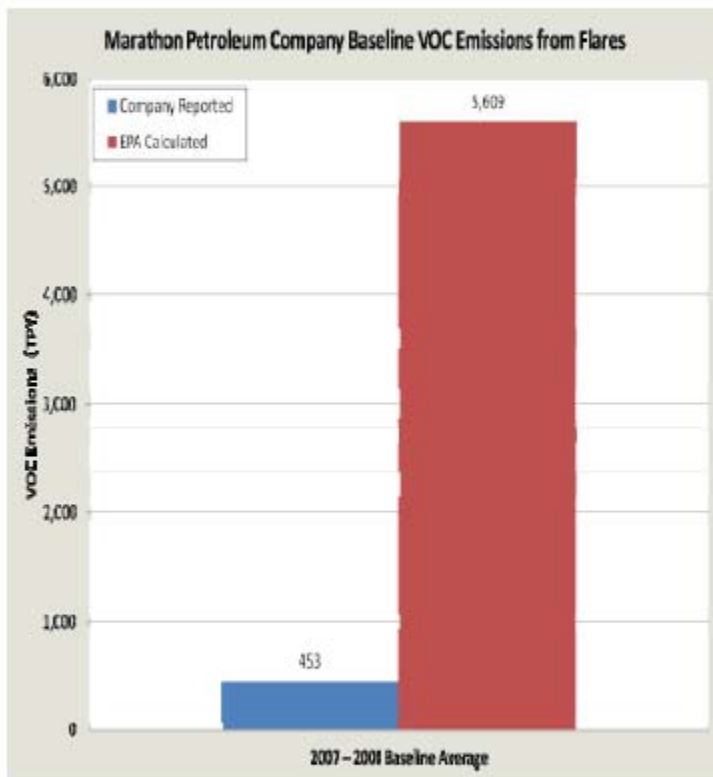


LOVE THY NEIGHBOR

Where is the agency getting its information

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Example: Advanced monitoring in flare enforcement –
 ‘Estimating v. Knowing’ - BP Whiting and Marathon CAA CDs



PFTIR data showed that actual emissions (in red) at Marathon and BP were *25 times and 10 times greater*, respectively, than the companies’ best engineering estimates (in blue)



DOING MORE WITH LESS

Next Generation Enforcement

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SPEAK SOFTLY...

Tips and pitfalls of negotiating with EPA

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2015 Government Enforcement in the Energy Industry - Commodities Transactions and Trading

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Commodities Transactions and Trading

- Discussion
 - Steve Corso, Partner, Houston, TX
 - Diana Liebmann, Partner, San Antonio, TX
 - Phil Lookadoo, Partner, Washington, DC
 - Kirsten Polyansky, Partner, Houston, TX



Agenda

- Market Manipulation
 - CFTC’s and FERC’s fraud-based rules
- Disruptive Trade Practices
 - “Spoofing”
 - “Banging the close”
 - Violating bids and offers
- Prohibited Transactions
 - Wash sales
 - Accommodation trades
 - Fictitious sales
- Other Rules
 - End user exception
 - Failure to register as a commodity trading adviser (CTA)

Manipulation – CFTC & FERC Fraud-Based Rules

- Dodd-Frank amended the CEA
 - Provided CFTC with broad new authority to prohibit manipulation
 - Patterned after SEC Rule 10b-5
 - Rule 180.1
 - Intentional or reckless
 - Use of manipulative device, scheme, or artifice to defraud
 - False or misleading statements of material fact or material omissions
 - Act, practice, or course of business which operates or would operate as fraud or deceit
 - Delivery of false or misleading reports concerning market information
- Lower standard of proof
- Untested in federal court

Manipulation – CFTC & FERC Fraud-Based Rules

- FERC vested with similar authority
- Patterned after SEC Rule 10b-5
 - Rules 1c.1 and 1c.2
 - Unlawful for any entity, in connection with the purchase or sale of natural gas/electric energy or the purchase or sale of natural gas transportation/electric transmission services
 - Use device, scheme, or artifice to defraud
 - Untrue statements of material fact or material omissions
 - Act, practice, or course of business that operates or would operate as a fraud or deceit



FERC v. Barclays

- Allegation
 - Violation of anti-manipulation rule
 - Traded physical power at a loss to benefit financial position on ICE
- Penalties
 - Barclays
 - \$435 mil penalty and \$34.9 mil disgorgement
 - Head of trading desk
 - \$15 mil penalty
 - Traders
 - \$1 mil each
- Review in federal court
 - FERC jurisdiction
 - Claims against individual traders
 - Legal and factual sufficiency

Kraft Foods Group, Inc.

- CFTC civil complaint
 - Violations of
 - Anti-manipulation rule
 - Acquired huge long position in wheat futures contract to increase futures price and decrease cash price
 - Speculative position limits
 - No hedge exemption
 - No bona fide commercial need
 - Motion to Dismiss
 - Kraft used trading strategy to buy wheat at lower price
 - Trading was transparent

GDF Suez Energy North America, Inc.

- Private civil complaint
 - CEA 22
- Claim
 - Generator withheld power during peak demand to increase prices in ERCOT to benefit financial position on ICE
- Dismissed by District Court
 - Filed rate doctrine
 - Exemption from private right of action
- Appeal to 5th Circuit
 - CFTC clarified it had no intent to limit private right of action
 - Object of manipulation was position outside of ERCOT
- Potential for FERC or CFTC enforcement action

Disruptive Trade Practices

- CEA 4c(a)(5)
 - Unlawful
 - Violate bids or offers
 - “Bang the close”
 - “Spoof”

Panther Energy Trading/Coscia

- Settlement in anticipation of CFTC administrative proceedings
- Charge
 - “Spoofing”
 - Algorithmic trading
 - Rapidly placing bids and offers in the market and canceling them prior to execution
 - » Light Sweet Crude Oil futures contracts
 - Benefit positions on other side of the market
- Penalty
 - \$1.4 mil penalty and \$1.4 mil disgorgement
 - Trading ban
- Indictment in NDIL
 - Commodity Fraud, 18 USC 1348
 - Spoofing, 7 USC 6c(a)(5)(C) & 13(a)(2)

Prohibited Anti-Competitive Transactions

- CEA 4c(a)
 - Unlawful to offer to enter into, enter into, or confirm the execution of a
 - “Wash sale”
 - “Accommodation trade”
 - Fictitious sale
 - Other transaction used to report, register, or record a price that is not bona fide



Rules

- End user exception
- Failure to register as a commodity trading adviser (CTA)

Conclusion

- Regulatory attention
 - Trading in a product/market to benefit position in another product/market
 - Providing inaccurate information
 - Exploiting market design flaws
 - “Spoofing”
 - Wash trading



Conclusion

- Investigative focus
 - Market fundamentals versus trades
 - Uneconomic activity
 - Buying/selling at less than competitive prices
 - Incurring losses
 - Foregoing profits
 - Affecting index prices
 - Affecting settlement prices
 - Patterns
 - Large volumes
 - Sudden reversals or swings in positions
 - Emails, IMs, recorded trading lines



Conclusion

- Fraud is largely a question of fact
 - Determined by all of the circumstances of a case
- Please don't hesitate to pick up the phone

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