United States Court of Appeals for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
October 20, 2022
Lyle W. Cayce
Clerk

No. 16-60604
CONSOLIDATED WITH
No. 21-60083

BP America, Incorporated; BP Corporation North America, Incorporated; BP America Production Company; BP Energy Company,

Petitioners,

versus

Federal Energy Regulatory Commission,

Respondent.

Petitions for Review of Orders of the
Federal Energy Regulatory Commission
Agency Nos. IN13-15-000, IN13-15-001, IN13-15-002

Before Jolly, Willett, and Oldham, *Circuit Judges*.

E. Grady Jolly, *Circuit Judge*:

Hurricane Ike made landfall over southeastern Texas on September 13, 2008. Although more than a decade has elapsed since the hurricane's passage, there yet remains some legal rubble for this court to clear.

The Federal Energy Regulatory Commission (FERC) has brought this enforcement action against BP, alleging the company capitalized on the hurricane-induced chaos in commodities markets by devising a scheme to manipulate the market for natural gas.[1] Now, years later, BP seeks judicial review of FERC's order finding that BP engaged in market manipulation and imposing a $20 million civil penalty.

BP makes a bevy of arguments as to why FERC's order should be overturned, but all are meritless save one. Contrary to FERC's position, we hold that the Commission has jurisdiction only over transactions in interstate natural gas directly regulated by the Natural Gas Act (NGA). Specifically, we reject FERC's broader theory that its authority to address market manipulation extends to any natural gas transaction which affects the price of a transaction under the NGA. Otherwise, however, we uphold the Commission's order. Nevertheless, because FERC predicated its penalty assessment on its erroneous position that it had jurisdiction over all (and not just some) of BP's transactions, we must remand for reassessment of the penalty in the light of our jurisdictional holding. Thus, we GRANT in part and DENY in part BP's petition for review and REMAND to the agency for reassessment of the penalty.

I

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To understand BP's scheme, some background on the natural gas industry is necessary. In addition to producing and selling their own oil and gas, participants in the natural gas market are permitted to engage in a variety of trades. In general, traders may make either "physical" or "financial"

[1] In reality, FERC brought its enforcement action against various BP-related entities, but we refer to these entities collectively as BP.

transactions. Physical trading involves the purchase or sale of actual natural gas, which must then be physically delivered from one party to another. Financial trades, on the other hand, are more in the nature of bets on the future price of gas; a financial transaction can be settled in cash without the need for any natural gas to actually change hands.

Shortly before Hurricane Ike arrived, traders on BP's Texas team had amassed a significant financial position known as a "spread." The value of this spread position was determined by the difference in natural gas prices at Henry Hub, a major natural gas market in Louisiana frequently used as a national benchmark, and Houston Ship Channel (HSC), a gas hub in Houston. When gas prices at Henry Hub were higher than those at HSC, BP's financial position became more valuable; the greater the difference, the more money BP stood to make.

When the hurricane hit, natural gas prices at HSC plummeted, causing BP to realize a sizeable profit. And amidst the tumult in the market, BP spied an opportunity; the company would make millions more if the price differential between HSC and Henry Hub persisted after the hurricane became history. According to FERC, BP capitalized on this opportunity by engaging in a glut of physical gas sales at HSC, intending to depress the prices on which the value of its financial position depended. BP's task was eased by the fact that it did not need to cause a sudden spike or dip in prices—a change which would have been easily detected by regulators—but only needed to delay the market's return to normal following the hurricane.

Central to BP's plan was the Houston Pipeline (HPL). The HPL connects HSC to Katy, another natural gas hub approximately thirty miles away. BP had purchased the right to transport a certain amount of natural gas on the HPL per day in order to satisfy its various business needs, but the pipeline was generally underutilized. BP thus allowed its Texas trading desk to engage in arbitrage using the HPL; when there was a price difference between Katy and HSC, traders could transport gas accordingly between the two to make a profit while incurring only minor transportation costs. According to FERC, however, BP traders effectively abandoned their arbitrage strategy after the hurricane, instead using the HPL to transport significant quantities of natural gas from Katy to HSC, thereby lowering prices at the latter. Although BP incurred some losses in its physical trading by buying at Katy and selling at HSC regardless of whether it was economical to do so, these losses were dwarfed by the increase in value to BP's financial position. Access to transportation capacity on the HPL was therefore essential to the BP traders' scheme.[2]

The Texas trading desk's machinations went undetected until November 5, 2008. On that day, Clayton Luskie, a junior member of the Texas team, was attending a BP assessment program designed to determine whether aspiring traders were qualified for advancement in the company. While there, Luskie described the team's trading strategy to a member of BP's senior management, who became concerned that what Luskie had described "could be perceived as market manipulation." Alarmed, Luskie called Gradyn Comfort, a senior member of the Texas team and primary trader in charge of transactions at Katy and HSC. Because Luskie called Comfort at his trading desk, BP recorded the call, which is laid out in pertinent part below:

> LUSKIE: So I was telling [the senior BP executive] how we, you know, what we are doing at Ship Channel this month. And you know, he just started asking me about, you know, what,

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[2] Although BP theoretically could have depressed prices without the HPL by simply buying large quantities of natural gas at HSC and then selling the same gas at lower prices, such a strategy would have been both easier to detect and far more costly.

kind of what we do and strategy and what not. And I was telling him about our HPL transport. And the way I explained it was not very good. And I came off sounding like we either transport or don't transport solely on the—kind of how we think it's going to affect the index and help our paper position. Which as I was explaining, I realized that's not right and that's the exact same thing that we're sort of accusing [a rival company] of currently. So how would you explain our dealings on HPL and with our paper position that don't make it sound like we're—

COMFORT: [Interposing] Clayton, Clayton—

LUSKIE: —manipulating the index.

COMFORT: Clayton.

LUSKIE: Yeah.

COMFORT: I think . . .

[Fifteen second pause]

COMFORT: Most of the time we ship economically.

LUSKIE: Right.

COMFORT: And the—

LUSKIE: [Interposing] I mean, it's just that we're not—

COMFORT: [Interposing] Clayton, Clayton.

LUSKIE: Yeah.

[Ten second pause]

COMFORT: You know, the—there's times we can't unwind all of our positions, but most of the time we tend to ship economically.

LUSKIE: Right.

COMFORT: Okay?

LUSKIE: Is it just that we're not—

COMFORT: [Interposing] Clayton.

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