

Energy Alert

July 27, 2016

Key Points

- FERC modified a controversial September 2015 proposal to collect “connected entity” data (i.e., various information concerning corporate affiliates and other business relationships) from wholesale electric market participants in connection with its market surveillance and enforcement functions.
- The revised proposal would require all MBR sellers and entities that trade virtual products or FTRs to provide connected entity data.
- FERC also proposed certain reforms to the substance and format of information submitted by MBR sellers in connection with the Commission’s MBR program.



FERC Revises Market Surveillance Data Collection Proposal and MBR Filing Proposal

On July 21, 2016, the Federal Energy Regulatory Commission (FERC or “Commission”) issued a [Notice of Proposed Rulemaking](#) (NOPR) proposing to (1) collect a wide range of “connected entity” data for market surveillance and enforcement purposes from market-based rate (MBR) sellers and entities trading virtual products or financial transmission rights (FTRs), and (2) revise the substance and format of information submitted by MBR sellers in connection with the Commission’s MBR program. The July 21 NOPR modifies and consolidates connected entity and MBR NOPRs issued in Docket Nos. [RM15-23](#) and [RM16-3](#) last year.¹

The connected entity component of the NOPR reflects a modified version of a September 2015 NOPR to collect connected entity data from market participants. In the September 2015 NOPR, the Commission explained that, while it had greatly enhanced its surveillance capabilities in recent years through the use of automated screens of market activities and analytical procedures, connected entity data was necessary to understand market participant relationships and determine whether seemingly anomalous conduct has a legitimate explanation or, alternatively, whether it may reflect market manipulation, fraud or abuse. The modified connected entity proposal is substantially similar to the Commission’s prior proposal in many respects, and it reflects a continuing commitment by the Commission to further develop its internal market surveillance and analytics tools. If adopted, the connected entity proposal would have

¹ In concurrent issuances, the Commission withdrew the proposed rules announced in these dockets.

substantial impacts on market participants—increasing overall enforcement scrutiny of market conduct, creating new and revised reporting obligations, and introducing new sources of compliance risk.

The proposed MBR reforms are also important, since they introduce changes to the format and substance of information that MBR sellers are required to submit.

FERC's Proposal

In the NOPR, FERC proposes to require MBR sellers (i.e., entities holding MBR authority) and entities that trade virtual products or FTRs in FERC-jurisdictional organized wholesale electric markets (i.e., the ISOs and RTOs) to provide connected entity data and, if applicable, MBR data, in a streamlined manner through a relational database. Market participants will be required to submit information for the database using an “extensible markup language” (XML) schema, which will permit automated organization of the data. FERC states that use of a relational database will eliminate duplication of information collected for market surveillance (i.e., connected entity data) and MBR purposes, and render the data more usable and accessible to the Commission and its staff.

Below we summarize the substantive components of FERC's proposal:

Connected Entity Data

In the September 2015 NOPR, the Commission proposed to collect a wide range of data on market participants' connected entities, including information on ownership, employment, debt and contractual relationships. The September 2015 NOPR met substantial resistance from market participants, who criticized it as being, among other things, overly broad and incongruent with MBR reporting obligations. In the revised proposal, FERC has clarified and, in certain instances, narrowed the scope of connected entity data to be collected from market participants. FERC has also revised the proposal so that connected entity data would be provided by market participants directly to FERC alongside MBR data, rather than to the ISOs and RTOs. As explained below, the Commission also expanded the scope of entities that would be required to report connected entity data to now include market participants that do not participate in the ISO and RTO markets.

The parameters of the revised connected entity proposal are summarized below:

- **Scope of Filers:** The proposal requires all MBR sellers and virtual/FTR traders to report connected entity data. The proposed scope of filers is different than what FERC proposed in September 2015, which included all organized electric market participants. On the one hand, the revised scope is broader in that it covers all MBR sellers—including those that do not participate in organized electric markets. This expansion is significant in that it affects a wide range of MBR sellers that do not participate in organized markets, including smaller entities, such as qualifying facilities greater than 20 MWs who may sell to a single utility under a single power purchase agreement. On the other hand, the revised scope excludes certain market participants potentially covered by the September 2015 NOPR—namely, FPA Section 201(f) entities (principally municipalities and cooperatives), as

well as entities such as demand response providers who participate in organized markets, but are not required to hold MBR authority.

- **Legal Entity Identifier:** The proposal requires MBR sellers and virtual/FTR traders to each acquire a Legal Entity Identifier (LEI) and include their LEI when reporting connected entity data. An LEI is a unique, 20-digit alphanumeric code that is currently required by certain financial regulators, such as the Commodity Futures Trading Commission and the Securities and Exchange Commission.
- **Ownership and Control:** The proposal tracks FERC's "affiliate" definition from the MBR regulations and would limit upstream, downstream and common ownership/control relationship reporting to affiliates that are (1) ultimate affiliate owners of the entity, as defined in FERC's regulations; (2) participants in FERC-jurisdictional organized wholesale electric markets; or (3) entities that purchase or sell financial natural gas or electric energy derivative products (e.g., swaps or futures) that settle off of the price of physical electric or natural gas energy products. The proposed ownership and control reporting requirements no longer include passive owners, holders of nonvoting stock or limited partners, as proposed in the September 2015 NOPR. The revised NOPR also no longer requires covered entities to report information regarding debt interests and structured transactions.
- **Employees:** The proposal limits reportable employees or contactors to include only "traders," defined to include a person "who makes, or participates in, decisions and/or devises strategies for buying or selling physical or financial commission-jurisdictional electric products or physical natural gas." Reportable employees no longer include chief executive officers, chief financial officers or chief compliance officers, as proposed in the September 2015 NOPR.
- **Contracts:** The proposal requires covered entities to report any agreement that "confers control over an electric generation asset that is used in, or offered into, wholesale electric markets." Agreements that confer control are those that grant one of the parties the right to make trading decisions for an electric generation asset of another party or to offer an electric generation asset into the wholesale electric markets. The September 2015 NOPR defined reportable contracts more broadly, covering any contract relating to the management of resources that participate in FERC-jurisdictional markets or that otherwise relate to operational or financial control of such resources.

MBR Data

The Commission proposes a number of changes to the information requirements for its MBR program as well. First, the Commission proposes changes to the ownership information that MBR sellers must provide. Pursuant to Order No. 697-A, MBR sellers currently have to identify **all** upstream owners and identify the business activities of such owners. Under the new rule, MBR sellers would be required to provide information on only certain "affiliate owners," which the Commission proposes to define as owners that meet the definition of affiliate as provided in 18 C.F.R. § 35.36(a)(9). MBR sellers would need to identify only those affiliate owners that (1) are an "ultimate affiliate owner," meaning the furthest upstream affiliate owner in the ownership chain; (2) have a franchised service area; (3) have MBR authority; or (4) directly own or control generation, transmission or intrastate natural gas transportation; storage or distribution facilities; or physical coal supply sources or ownership of, or control over, who may access transportation of coal supplies. The Commission also proposes to require MBR sellers to identify any

foreign government that directly or indirectly owns or controls the MBR seller (including political subdivisions of foreign governments or any corporation that is owned in whole or in part by a foreign government or subdivision).

The relational database will create a unique identifier for an entity that is identified as an “affiliate owner” by an MBR seller. The Commission will publish on its website a list of all of these entities and their unique identifiers, and all MBR sellers will use this unique identifier to identify their affiliate owners in future filings. The database will be able to use this information to generate a corporate organizational chart, and, accordingly, the Commission proposes to eliminate the requirement, adopted in Order No. 816, that MBR sellers submit corporate organizational charts.

The NOPR also contemplates changes to the “asset appendix” information that MBR sellers submit. Currently, the Commission requires MBR sellers to submit an asset appendix containing information about long-term firm purchases and assets that they and their affiliates own or control. The Commission proposes to no longer require MBR sellers to report assets owned by affiliates with MBR authority. Instead, the Commission will rely on “baseline submissions” from all MBR sellers (discussed below) that will identify each individual MBR seller’s asset information. These baseline submissions will create the relational database and will allow the Commission to view affiliate relationships. MBR sellers will have to identify assets that are owned or controlled by an affiliate that does **not** have MBR authority, however, since these entities will not necessarily be required to make a baseline submission. The Commission proposes a number of other minor changes to the asset appendix information as well, including a requirement that MBR sellers identify generators on a unit-by-unit (rather than facilitywide) basis.

Implementation

NOPR contemplates that each virtual/FTR participant and MBR seller will make a baseline informational filing soon after the issuance of the final rule, which will be used to create the relational database. The baseline submission would set forth the entity’s connected entity information and, where applicable, MBR information. Both MBR sellers and virtual/FTR participants would incur an ongoing obligation to update connected entity information within 30 days of a change. MBR sellers will also have to update the relational database on a quarterly basis to reflect any changes in MBR data that did not trigger a “change in status” filing.

Implications

While the MBR-related implications are principally administrative in nature, the Commission’s connected entity proposal will likely have three key implications for market participants: (1) increased and more sophisticated enforcement scrutiny of market participant conduct; (2) increased compliance burdens; and (3) increased compliance risks, particularly for FTR and virtual traders.

Increased and More Sophisticated Enforcement Scrutiny

The proposal to collect connected entity information from market participants would provide the Commission’s Office of Enforcement (OE) with a substantial amount of new data regarding market participants and their relationships to use in carrying out OE’s market analytics and surveillance program.

Ever since the Commission established the Division of Analytics and Surveillance (DAS) within OE in 2012, the Commission has sought to further develop its internal capabilities to surveil jurisdictional markets and identify potentially manipulative or otherwise improper market conduct. Having access to connected entity data will allow DAS to scrutinize market participant conduct in new and more sophisticated ways. This could lead to a greater number of OE investigations and inquiries into market participant conduct, and potentially new and more creative theories of wrongdoing.

Increased Compliance Burdens

The proposal would also increase the compliance burdens faced by MBR sellers and FTR and virtual traders. In addition to the required baseline submissions, covered entities will be required to track changes in their connected entity data and report changes in connections to the Commission in a timely manner. The burdens of complying with connected entity reporting requirements will likely be substantial and involve more than simply administrative recordkeeping. Certain categories of connected entity data are likely to require detailed analysis to determine what is and is not reportable. For example, with respect to reportable employees, there is likely to be inherent subjectivity in determining the range of employees that “make[], or participate[] in, decisions and/or devise[] strategies for buying or selling physical or financial commission-jurisdictional electric products or physical natural gas.” Likewise, at times, there could be ambiguity as to whether a contract “confers control over an electric generation asset that is used in or offered into wholesale electric markets” and is therefore reportable.

Increased Compliance Risk

The proposal also creates a new source of compliance risk for MBR sellers and FTR and virtual traders subject to the new reporting obligations. While FERC explained in the NOPR that it would not seek to penalize inadvertent errors in data reporting, FERC made clear that the intentional or reckless submission of inaccurate or misleading information could lead to the imposition of civil penalties or other sanctions.

FTR and virtual traders face a particularly significant increase in compliance risk as a result of the NOPR. In the NOPR, FERC proposes to make FTR and virtual traders subject to the same duty of candor requirements to which MBR sellers are currently subject under Section 35.41(b) of the Commission’s regulations—that is, the obligation to provide accurate information, and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved organized electric markets or jurisdictional transmission providers, unless the entity exercises due diligence to prevent such occurrences. Notably, this duty of candor extends to communications that go well beyond the submission of connected entity data that is at issue in the NOPR, and it introduces a new source of compliance risk for FTR and virtual traders in **all** communications with the Commission, as well as market monitors, organized markets and transmission providers. FERC has aggressively enforced Section 35.41(b) in recent years against several MBR sellers accused of providing the Commission or market operators with inaccurate or misleading information. Therefore, the expansion of Section 35.41(b) requirements to virtual and FTR traders is significant.

Next Steps

Comments on the NOPR are due 45 days after publication in the Federal Register.

In addition to seeking comments, the Commission intends to conduct substantial outreach with the industry, including meetings and technical workshops. The **first workshop** will take place at FERC headquarters on August 11, 2016.

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