

# Energy Regulation, Markets and Enforcement Alert

November 21, 2016

## Key Points

- On November 17, 2016, FERC released its 10th annual Report on Enforcement, detailing the agency's Enforcement-related surveillance, investigation and litigation efforts in 2016.
- Key highlights are that Enforcement priorities remain the same; the number of new investigations is down, but there are still many ongoing, unresolved investigations that were opened in prior years; and the agency is busy litigating federal court enforcement actions throughout the country.
- For the first time, FERC Enforcement published white papers on energy trading compliance and market manipulation law (which we link to below, but will analyze in a separate client alert).



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## FERC Enforcement Releases 2016 Annual Report

On November 17, 2016, the Federal Energy Regulatory Commission's (FERC or "Commission") Office of Enforcement ("Enforcement") released its annual [Report on Enforcement](#) (the "2016 Report"). This year's report is the 10th such report to be issued. Enforcement began the practice in November 2007 in the wake of Congress' passage of the Energy Policy Act of 2005 ("EPAAct 2005"), which substantially expanded the Commission's enforcement authority and the commission's promulgation in 2006 of its rule prohibiting market manipulation (the "Anti-Manipulation Rule"). FERC's current and former chairmen and commissioners have consistently implored FERC-regulated entities to study the annual report for guidance on how the Commission approaches compliance and enforcement.

Contemporaneous with its release of the 2016 Report, Enforcement also released two white papers—one on [energy trading compliance](#) practices and one on Enforcement's [anti-manipulation enforcement efforts](#). These white papers are significant, since they mark the first time Enforcement has publicly provided detailed guidance on best compliance practices and an analysis of what staff believes are core market manipulation law principles that the Commission has developed since EPAAct 2005. We intend to address these white papers, including their implications for market participants, in a separate alert.

Below we provide an overview of key highlights from the 2016 Report:

## **2016 Report Generally Consistent with Prior Reports**

The 2016 Report is generally consistent with reports in recent years in terms of how it describes Enforcement's work and priorities. It states that Enforcement had the same priorities in 2016 as it had in previous years—namely, a focus on matters involving (1) fraud and market manipulation, (2) serious violations of the Reliability Standards, (3) anticompetitive conduct and (4) conduct that threatens the transparency of FERC-regulated markets. The 2016 Report states that Enforcement does not intend to change these priorities in 2017. Although the composition of the Commission itself will change in 2017 when the new administration selects three new Republican commissioners (which will result in some changes to senior FERC staff), we think these enforcement priorities are indeed likely to remain the same over the coming year and that, institutionally, FERC Enforcement is likely to continue to focus its investigative efforts on similar issues and in similar ways as it has done in the recent past.

## **Modest Number of New Investigations, but Old Investigations Remain**

The 2016 Report states that Enforcement opened 17 new investigations in 2016. This is down slightly from 2015, when Enforcement opened 19 new investigations. Of the 17 new investigations (some of which involve more than one type of potential violation), 12 involve potential market manipulation, 11 involve potential tariff violations, one involves potential violations of the Standards of Conduct, and one involves potential violation of a Commission filing requirement. None of the new investigations involve potential Reliability Standards violations, likely reflecting the Commission's and Enforcement's continued deference to the North American Electric Reliability Corporation (NERC) on reliability enforcement matters outside of major reliability events.

While the number of new investigations in 2016 was relatively modest, that does not reflect the full scope of the Commission's enforcement activities. Because most investigations take longer than one year to resolve, Enforcement's active investigations generally include many matters that were opened in prior years. This is reflected in the 2016 Report, which notes that Enforcement's Division of Analytics and Surveillance (DAS)—which, among other things, provides analytical support to the Division of Investigations (DOI)—“worked on more than 40 investigations” in 2016. In fact, the number of active investigations is almost certainly even greater than 40, since DAS generally focuses on market manipulation investigations and is less likely to be involved in other types of investigations (such as tariff violations). It is also worth noting that, through its surveillance program, DAS continues to conduct inquiries into potential misconduct outside of DOI's investigations program. These inquiries can—but often do not—lead to referrals to DOI for investigation. Therefore, the number of DOI investigations (both new and old) does not reflect the full scope of Enforcement's inquiries into market-participant conduct.

## **A Year of Litigation, not Settlement**

As most followers of FERC's Enforcement program already know, Enforcement is currently litigating several market manipulation cases in federal district court pursuant to the Federal Power Act's (FPA) Section 31(d)(3) review procedures, which allows an enforcement subject to elect to have a penalty assessment reviewed de novo in district court. These cases are the first ones in the modern enforcement era (i.e., post-EPAAct 2005) to be litigated in federal court under the FPA's de novo review procedures. In

2016, Enforcement litigated eight such cases, all of which involved alleged market manipulation, in district courts in California, D.C., Maine, Massachusetts, Ohio and Virginia. Two of these cases settled during 2016, while the other six remain ongoing.

These cases continue to consume substantial staff resources, which could potentially contribute to other investigations moving more slowly and taking longer to resolve. It is worth noting that Enforcement closed only 11 investigations in 2016 through settlement or no action—down significantly from 22 in 2015 and potentially reflecting the effect of the district court cases on staff resources. The staff resources required to litigate these cases will, if anything, increase moving forward in light of recent decisions in several of the district court cases holding that the FPA de novo review procedures include the full procedural protections of civil litigation, including discovery and a trial, rather than a more narrowly tailored review proceeding as Enforcement had advocated.

Of the 11 investigations that staff closed in 2016, six were resolved through settlements, while Enforcement closed five with no action. The settlements totaled approximately \$12.25 million in civil penalties and approximately \$5.7 million in disgorgement. The settlements resolved allegations of market manipulation, tariff violations, market behavior rule violations and Reliability Standards violations. The market manipulation settlements involved allegations of cross-product manipulation (i.e., “related positions”), misrepresentations to grid operators, manipulative ISO/RTO bidding conduct and fraudulent demand response conduct. The five investigations that Enforcement closed all involved potential market manipulation of electric or natural gas markets, including several cross-product manipulation cases. Enforcement closed these investigations after determining, based on trade data, communications, testimony and interviews, that there was no (or insufficient) evidence of fraudulent intent.

### **Enforcement Continues to Promote Self-Reporting and Closes Most Self-Reports with No Action**

One of the most valuable aspects of annual Enforcement reports is the discussion on self-reporting, since it is the only time that Enforcement or the Commission offers any granular information on how Enforcement has handled self-reported violations. The Commission and Enforcement have long encouraged self-reporting of violations, and the 2016 Report states that Enforcement “views self-reports as showing a company’s commitment to compliance.” The 2016 Report reflects that Enforcement continues to close the vast majority of self-reported violations without taking any enforcement action. Enforcement has received approximately 470 self-reports over the past five years, including 110 in 2016. Enforcement closed 126 self-reports in 2016, which included some self-reports submitted in previous years. Enforcement closed the majority of those reports because, for example, there was no material harm (or the harm had been remedied), and the companies had taken corrective measures to both remedy the violation and avoid future violations through compliance improvements. In 2016, Enforcement received self-reports for a variety of violations, including violations of FPA Sections 203 and 205 filing requirements, market-based rate requirements, tariff provisions, natural gas transportation rules, Standards of Conduct and interlocking director rules. Many self-reports are submitted by ISOs and RTOs themselves for minor violations of their tariffs resulting from software errors or human errors. Notably,

Enforcement received one self-report in 2016 for potential market manipulation after a trader placed virtual bids into an ISO/RTO day-ahead market for identical amounts of purchases and sales at the same node, matching the pattern of a prohibited wash trade. Enforcement closed this self-report without action after determining that the trades were due to an error and resulted in the company losing money with no apparent manipulative intent.

## Contact Information

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