

# Energy Regulation, Markets and Enforcement Alert

November 30, 2017

## Key Points

- On November 16, 2017, the Federal Energy Regulatory Commission released its 11th annual Report on Enforcement, detailing the agency's Enforcement activities in 2017.
- Key highlights are that Enforcement priorities were the same as prior years; the number of new investigations went up, while many investigations opened in prior years remain unresolved; and the agency continues to litigate several manipulation cases in federal courts throughout the country.
- The Report provides similar types of information as prior years, but with increased transparency into Enforcement's market surveillance program.
- The Report largely reflects Enforcement activities carried out under the prior Commission, and thus does not reflect changes the new Commission has made or intends to make to its Enforcement program.



On November 16, 2017, the Federal Energy Regulatory Commission's (FERC or "Commission") Office of Enforcement (Enforcement) released its annual [Report on Enforcement](#) for fiscal year 2017 (FY2017 Report or "Report"). The FY2017 Report is consistent with reports in recent years in terms of how it describes Enforcement's work and priorities, provides statistics on Enforcement activities, and includes examples of non-public Enforcement matters that were closed without action. Many FERC Commissioners have implored FERC-regulated entities to study the annual report for guidance on how the Commission approaches compliance and enforcement.

Below we provide an overview of key highlights from the FY2017 Report.

### **Enforcement's Priorities Remain the Same under New Commission**

The Report states that Enforcement's priorities in FY2017 were the same as in previous years, which includes 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 FY2017 Report states that Enforcement does not intend to change these priorities in FY2018. This statement regarding Enforcement's FY2018 priorities was not unexpected but is significant because it is the one aspect of the FY2017 Report that is forward looking. Most of the activities

summarized in the Report occurred before two of the four current Commissioners (including Chairman Neil Chatterjee) took their positions, and thus for the most part reflect activities that occurred under the oversight of the prior Commission and Chairman. The statement that Enforcement's FY2018 priorities will remain the same shows that FERC's new leadership—including Chairman Chatterjee and senior staff he has hired—agree these should be Enforcement's priorities. We would be surprised if Kevin McIntyre—who will soon join FERC and take over as Chairman<sup>1</sup>—stakes out different Enforcement priorities. While we continue to think the new Commission will revisit certain Enforcement policies and consider changes to its Enforcement program, FERC has prioritized these four high-level compliance and enforcement areas for years, and we do not expect that to change.

### **Busy Year for District Court Litigation**

The Report notes that Enforcement spent substantial time in FY2017 litigating enforcement cases in federal district courts across the country.<sup>2</sup> These are all electricity market manipulation cases in which the subject(s) elected to have the matter adjudicated in federal district court pursuant to the Federal Power Act's *de novo* review provision rather than at FERC before an Administrative Law Judge.<sup>3</sup> While expected, the Report confirms that litigated matters continue to consume significant Enforcement resources, which could have collateral effects across other areas of Enforcement (for example, by potentially causing Enforcement to take longer to resolve pending investigations and self-reports).

Many practitioners and market participants are familiar with these cases, and from a transparency perspective, the Report's discussion of them is less significant since they are all public matters. While two of these cases have recently settled—one during FY2017 (*City Power*) and one at the beginning of FY2018 (*Barclays*)<sup>4</sup>—other cases (*Silkman and Etracom*) have moved into the discovery phase. Practitioners and market participants will continue watching these cases closely as they reflect the first instances in which market participants (and Enforcement staff) have been able to conduct discovery in federal court under the Federal Rules of Civil Procedure. How the courts decide discovery issues and disputes in these cases could have impacts that go beyond the individual cases and potentially affect how Enforcement conducts investigations going forward.

### **Increased Number of New Investigations**

The Report states that Enforcement's Division of Investigations (DOI) opened 27 new investigations in FY2017, up from 17 investigations opened in FY2016. This marks the most investigations opened in a single fiscal year since FY2008. Of these 27 investigations (some of which involve more than one type of violation or multiple subjects), 15 involve potential market manipulation, 16 involve potential tariff violations, four involve potential violations of a FERC order and two involve potential violations of a FERC filing requirement. The raw number of investigations is only one data point and not always reflective of the overall level of new Enforcement activity. For example, some investigations may be closed quickly after a limited inquiry into discrete conduct, while others, such as large trading investigations, can involve multiple subjects, a wide range of activities and extensive investigative discovery through data requests and testimony. Nevertheless, 27 is a large number of investigations to be opened in a single year. The Report also states that the "vast majority" of these new investigations arose from referrals from

Enforcement's Division of Analytics and Surveillance (DAS), which surveils electricity and natural gas trading markets, and Independent System Operator (ISO) and Regional Transmission Organization (RTO) market monitors. We know from the Report's section on DAS's activities (discussed further below) that DAS referred six matters to DOI in 2017, meaning that the majority of new investigations appear to have arisen from ISO/RTO market monitor referrals.

### **Notable Investigation Closures**

The Report notes that Enforcement closed 16 investigations in FY2017, up from 11 in FY2016. Five of the closed investigations resulted in settlements, with the largest being an \$81.8 million settlement with GDF SUEZ Energy Marketing NA, Inc. in a "gaming"-type manipulation case involving an offering strategy allegedly intended to target out-of-market lost opportunity credits in the PJM Interconnection, L.L.C. energy market—a settlement discussed in detail [here](#).<sup>5</sup> The other 11 investigations were closed without further action because Enforcement concluded the evidence did not support finding a violation.

While all of the illustrative examples of closed investigations in the Report can provide useful guidance on how Enforcement analyzes cases and makes decisions, two closures are particularly noteworthy. First, Enforcement disclosed that it closed a publicly-announced investigation into certain bidding behavior in ISO New England's (ISO-NE) eighth annual Forward Capacity Auction (FCA 8). The FCA 8 auction was notable in that the results went into effect by operation of law after FERC's four sitting commissioners deadlocked on whether to accept the auction results (while issuing statements explaining why they would or would not have voted to accept the auction results).<sup>6</sup> The Report notes that, following a referral from ISO-NE and its market monitor regarding potential tariff violations and market manipulation, Enforcement conducted an investigation but determined that there was insufficient evidence of intent to manipulate and insufficient evidence to substantiate a tariff or rule violation.

Another noteworthy closure involves an investigation into whether a natural gas company engaged in market manipulation by improperly and selectively reporting natural gas transactions to an index publisher. Staff concluded that the company either failed to report or erroneously reported thousands of reportable trades over a period of several years, but that the behavior was the result of sloppiness and a lack of internal controls rather than an intent to manipulate. This matter is noteworthy because the company self-reported the conduct to Enforcement. As discussed in more detail below, self-reports of potential market manipulation are rare, though in this case the self-report contributed to Enforcement's decision to close the investigation without action.

### **Many Investigations Remain Unresolved**

While Enforcement closed more investigations in FY2017 than FY2016, many investigations remain unresolved. The Report does not provide data on the number of pending investigations, but states that DAS worked on approximately 50 investigations during FY2017. DAS works with DOI on many, but not all, of its investigations, meaning that there were likely more than 50 investigations open during FY2017, with only a subset resolved during the year. Many DOI investigations take years to resolve, with larger and more complex cases requiring the most time. Recent federal district court decisions in market

manipulation enforcement actions may lead Enforcement to complete its investigations more quickly—a development investigation subjects would welcome.<sup>7</sup>

### **Continued Emphasis on Self-Reporting—But Will FERC Follow the CFTC’s Lead?**

FERC has long encouraged self-reporting of violations. In the November 16, 2017 FERC Open Meeting, in which Enforcement presented the Report, Chairman Chatterjee noted that he thinks self-reporting is “tremendously valuable” and can be indicative of a market participant’s “robust compliance program.” Market participants regularly self-report potential violations to Enforcement, having made 80 self-reports in FY2017 and approximately 452 from FY2013-FY2017. The Report notes that Enforcement continues to close the vast majority of self-reports without any enforcement action (meaning that it is better to self-report a violation than for FERC to discover the violation on its own), and that when self-reports do lead to enforcement action, the Penalty Guidelines mitigate penalties (in the form of a reduction in the “culpability” score for having self-reported). Most self-reports involve inadvertent technical and administrative-type violations. For example, market participants frequently self-report missed regulatory filings, tariff violations, and inadvertent violations of FERC rules and regulations such as the Standards of Conduct and natural gas transportation rules (e.g., the Shipper-Must-Have-Title rule). Self-reports of serious wrongdoing such as fraud or market manipulation have been rare.

While Enforcement’s practice of closing most self-reports without further action is widely supported by the industry, some have questioned whether more could be done to incentivize and reward self-reporting, particularly with respect to more serious violations that Enforcement may not be inclined to close without further action. As noted above, FERC’s Penalty Guidelines do credit market participants for self-reporting, but the credit is relatively small and, in the view of many market participants, insufficient. The Commodity Futures Trading Commission (CFTC) recently implemented a **new policy** to promote self-reporting by promising companies that promptly self-report and fully and proactively cooperate with staff, among other things, “substantially reduced” penalties and shorter, more streamlined investigations.<sup>8</sup> Practitioners and market participants will be closely following the CFTC’s implementation of this new policy. We expect FERC Enforcement—which coordinates with the CFTC on natural gas matters over which they share jurisdiction—to also pay close attention to the CFTC’s experience with this new policy and consider whether FERC should take similar action.

### **Greater Transparency into DAS Surveillance Program**

The Report provides increased transparency into DAS’s market surveillance program. DAS’s surveillance program uses automated screens, involving a range of transactional (physical and financial), operational and fundamentals-based data sources, to detect anomalous activities in electricity and natural gas markets that might reflect potential manipulation or anti-competitive conduct. DAS analyzes screen “alerts” to determine whether to initiate a surveillance inquiry, which generally involves contacting the market participant to request additional information and explanations for conduct. The Report—for the first time since DAS was created in 2012—includes statistics on the surveillance program and illustrative examples of DAS surveillance inquiries that were closed without referrals to DOI for investigations. While DAS screens for various types of conduct, including conduct that would fall under Enforcement’s “gaming”

theories of manipulation (e.g., targeting out-of-market payments in ISO/RTO markets), the examples show a continued emphasis on uneconomic trading theories of manipulation in which a market participant trades uneconomically in one market to benefit a related position. Enforcement has long pursued such cases, and the illustrative examples reflect DAS screening for such conduct across all types of jurisdictional markets (i.e., natural gas markets, bilateral electricity markets and organized electricity markets (ISOs/RTOs)).

The surveillance statistics show that DAS's screens produce a large number of alerts, but relatively few lead to surveillance inquiries by DAS staff. In FY2017, DAS's natural gas surveillance screens produced 4,744 alerts. However, DAS was able to resolve all but 17 of these alerts without initiating a surveillance inquiry. Of the 17 surveillance inquiries, 15 were resolved without further action, with only two inquiries referred to DOI for investigations. There was a much larger number of electricity market alerts (314,824)—likely reflecting the greater number of electricity-related products and payment streams and the overall complexity of ISO/RTO markets—but still relatively few surveillance inquiries (31) and referrals to DOI (4).

While market participants and their counsel instinctively take DAS inquiries seriously, this data highlights the need to do so. Only a very small minority of DAS alerts lead to surveillance inquiries, and when that happens, it means that DAS staff has studied the matter closely but has been unable to understand or explain the conduct. This effectively places the burden on the market participant to answer DAS's questions and explain the activity, or risk a costly and burdensome DOI investigation. DAS inquiries are in a sense informal investigations—conducted by DAS analysts rather than DOI attorneys and relying on informal phone interviews and information requests instead of in-person testimony and formal data requests. But unlike DOI investigations—where it is Enforcement's burden to prove a violation rather than the subject's burden to disprove one—DAS inquiries do not seek to prove a violation, but rather to determine whether an investigation is warranted. Therefore, it is incumbent on subjects to explain the conduct in a manner that convinces staff that a DOI investigation is unnecessary. In three of the four illustrative examples included in the Report, DAS closed the inquiry after the market participant provided staff with additional information regarding its trading, including its physical trading needs and objectives and overall market outlook.

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<sup>1</sup> FERC is currently led by Chairman Neil Chatterjee, who was sworn in as a Commissioner in August 2017. President Trump designated Mr. Chatterjee to be Chairman until Kevin McIntyre joins the Commission. Mr. McIntyre was recently confirmed by the Senate and is expected to be sworn in shortly.

<sup>2</sup> *FERC v. Barclays Bank PLC*, No. 2:13-cv-2093 (E.D. Cal.); *FERC v. City Power Marketing, LLC*, No. 1:15-cv-1428 (D.D.C.); *FERC v. Silkman*, No. 1:13-cv-13054 (D. Me.); *FERC v. Powhatan Energy Fund LLC*, No. 3:15-cv-00452 (E.D. Va.); *FERC v. ETRACOM LLC*, No. 2:16-cv-01945 (E.D. Cal.); *FERC v. Coaltrain Energy L.P.*, No. 2:16-cv-00732 (S.D. Ohio).

<sup>3</sup> 16 U.S.C. § 823b(d) (2012).

<sup>4</sup> *City Power Mktg., LLC*, 160 FERC ¶ 61,013 (2017); *Barclays Bank PLC*, 161 FERC ¶ 61,147 (2017).

<sup>5</sup> The Barclays settlement was larger (\$105 million) but, as noted above, occurred in FY2018.

<sup>6</sup> See Cheryl A. LaFleur, Chairman, Fed. Energy Reg. Comm'n, Statement on Forward Capacity Auction 8 Results Proceeding (Sept. 16, 2014), <https://www.ferc.gov/media/statements-speeches/lafleur/2014/09-16-14-lafleur.asp#.WhyXrdF0yZ0>; Philip Moeller, Comm'r, Fed. Energy Reg. Comm'n, Statement on FERC's Lack of Action in Docket No. ER14-1409-000 (Sept. 16, 2014), <https://www.ferc.gov/media/statements-speeches/moeller/2014/09-16-14-moeller.asp#.WhyYP9F0yZ0>; Tony Clark, Comm'r & Norman Bay, Comm'r, Fed. Energy Reg. Comm'n, Joint Statement on ISO-New England's Forward Capacity Market Case (Sept. 16, 2014), <https://www.ferc.gov/media/statements-speeches/clark/2014/09-16-14-clark.asp#.WhyVmdF0yZ0>. In October 2016, the United States Court of Appeals for the D.C. Circuit found that it did not have jurisdiction to review FERC's failure to issue an order on the FCA 8 results. *Pub. Citizen, Inc. v. FERC*, 839 F.3d 1165 (D.C. Cir. 2016).

<sup>7</sup> There are two key reasons Enforcement may complete investigations more quickly. First, federal district courts have rejected FERC's position that district court "de novo review" proceedings should entail a review of the Commission's order assessing penalties and the administrative record, and instead found that such cases should proceed as ordinary civil actions. See *FERC v. Barclays Bank PLC*, 247 F. Supp. 3d 1118 (E.D. Cal. 2017); *FERC v. Maxim Power Corp.*, 196 F. Supp. 3d 181 (D. Mass. 2016); *FERC v. City Power Marketing, LLC*, 199 F. Supp. 3d 218 (D.D.C. 2016); *FERC v. Silkman*, 233 F. Supp. 3d 201 (D. Me. 2017); *FERC v. ETRACOM LLC*, 2017 U.S. Dist. LEXIS 33430 (E.D. Cal. Mar. 8, 2017). Given the availability of additional discovery by both defendants and Enforcement staff in court and the

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additional time that the federal court process will take before a matter can be resolved, the Commission may react to these court decisions by altering both the investigative and Order to Show Cause processes so that cases get to court sooner than they do now. Second, a district court recently determined that, for purposes of *de novo* review proceedings, the five-year statute of limitations is satisfied when FERC files its enforcement action in federal district court—and not, as Enforcement argued, when FERC issues an Order to Show Cause to commence the agency’s internal penalty assessment process (which precedes—sometimes by years—the federal court enforcement action). See *FERC v. Barclays Bank PLC*, 2017 WL 4340258 (E.D. Cal. Sep. 29, 2017). This decision will likely force Enforcement to move investigations more quickly so that the agency penalty assessment process can be completed, and the federal court enforcement action can be filed, within five years of the conduct.

<sup>8</sup> James McDonald, Dir. of the Div. of Enf’t, Commodity Futures Trading Comm’n, Speech Regarding Perspectives on Enforcement: Self-Reporting and Cooperation at the CFTC (Sept. 25, 2017), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald092517>