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INSIGHTS

FERC Enforcement - What to Expect in 2015

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The Federal Energy Regulatory Commission's (FERC's) Office of Enforcement (Enforcement) recently released its annual report on enforcement activities for 2014. As is typical, Enforcement identified its primary concerns as detecting and deterring fraud and manipulation in its markets and ensuring the safety and reliability of the grid. Enforcement also released statistics on its 2014 settlements ($25 million in civil penalties, $4 million in disgorgement) but those statistics concern cases that began years earlier and shed little light on what market participants should expect in 2015.[1] In order to predict what we are likely to see in 2015, and the potential risks that companies may face from Enforcement actions, it is helpful to examine the currently pending cases and to understand the most recent internal changes within Enforcement. Also relevant to predicting what market participants can expect in 2015 are the following: the reach of FERC's manipulation authority is being challenged in the courts, the Department of Energy's Inspector General (IG) is examining FERC's enforcement process and FERC will have a new Chairman and head of Enforcement in 2015. The current pending cases and these developments shed more light on what to expect in 2015 than the statistics FERC released concerning 2014. In 2014, market participants, for the first time, showed a willingness to challenge Enforcement actions instead of settling. Five companies have refused to pay assessed civil penalties and settle thereby causing Enforcement to go to Federal court or to an administrative law judge to enforce the penalty and manipulation claims.[2] These cases present the first court challenges to the reach of FERC's anti-manipulation authority. We should expect more challenges in 2015 because another company has publicly vowed to challenge FERC should FERC proceed with a charge of manipulation.[3] However, unless and until the courts narrow Enforcement's reach, we should expect that Enforcement will continue to be aggressive in its prosecutions. In addition to the obvious benefit of having court rulings on FERC's manipulation authority that we can expect will provide useful data points to the industry, there are two significant consequences from these court challenges that will be felt in 2015. First, having two cases in active litigation can severely compromise the ability of Enforcement to timely investigate and prosecute new investigative matters. FERC Enforcement has assigned 8 to 10 staff members to each of the BP and Barclays litigation cases. DOI only has approximately 50 staff members and not all of those are lawyers. Despite investigating BP for over 6 years, DOI has also recently sought and received over 38 subpoenas in the BP administrative proceeding. It will be a significant challenge for DOI to staff multiple, highly active court cases while also timely investigating new allegations of wrongdoing. FERC only closed 15 investigations in 2014, eight by settlement with seven matters dropped with no agency action either because there was no violation found or insufficient evidence to support a violation. We have noticed delays in active investigations. These delays result in higher costs for any company under investigation, including additional costs to maintain documents related to the investigative period, missed market opportunities because of uncertainty caused by the activity being investigated, and senior company officials having a cloud over their time and their companies while the investigation drags on. Responding to an investigation is extremely disruptive to the operations of any company under review and to the morale of employees involved with underlying events and the investigatory process. Slower processing by DOI and investigations dragging on longer simply increases the disruptive impact of an investigation on the targeted company. The constraint on Enforcement staff resources could result in FERC challenging market activities years after the activity occurred. We do not know, and may not know for a long time, what market activities FERC believes are improper because of this type of delay in resolving already on-going investigative matters. FERC will not ignore activity that it considers improper but it may be a long time in the future before the company knows that FERC thinks its past acts were questionable and even longer before there is any public guidance on the issues. Because of the delay in bringing investigations to timely resolution, market participants are at risk of finding out many months or years later that what they thought was permissible behavior, was instead viewed as off-sides by FERC. FERC's organizational structure also provides companies with an insight to FERC's 2015 priorities. FERC has committed significant resources to computerized surveillance of the energy markets which will result in enhanced scrutiny of market participants, even if untimely. Enforcement's Division of Analytics and Surveillance (DAS) consists of approximately 50 employees who participate in investigations, make referrals, and conduct market surveillance on the energy markets using sophisticated algorithms.***[4]*** DAS screens focus on what FERC calls cross market manipulation "“ which FERC essentially defines as losing money in one market in order to make money in another. DAS also has, thanks to a new Memorandum of Understanding with the CFTC, access to the large trader data which includes all open financial positions for natural gas and electricity products traded on exchanges for each large trader. DAS believes that it now has a "virtual trading book"� of each market participant including both physical and financial transactions. DAS uses this wealth of data to look for manipulation and gaming in FERC's markets. Another staff issue to consider is that FERC has an acting head of Enforcement and that Commissioner Norman Bay will become Chairman Bay in April of 2015. Do not expect any significant changes here. Commissioner Bay was the head of Enforcement until becoming a Commissioner. He took an expansive view of FERC's manipulation authority then and we expect that expansive view will continue as Chairman. Once he becomes Chairman, he will most likely hire a former prosecutor like himself to run the Office of Enforcement. The IG investigation is also not likely to result in meaningful change. The investigation, initiated at the request of several Senators, will focus on FERC's investigative process and its alleged lack of fairness and transparency. A case can be made that FERC's enforcement process may be one of the most transparent process in the federal government, at least in terms of a respondent under investigation. Unlike most other enforcement agencies, FERC provides a respondent with a detailed, written document outlining staff's views to the respondent long before FERC brings any charges. Thus we expect that the IG investigation will not find material unfairness or lack of transparency.

Expect minor changes to result from the IG report. The 2014 FERC Enforcement review informs us that in 2015 we should continue to expect aggressive enforcement scrutiny of market participants but with significant investigative delay. Final resolution of the pending cases in court will not only help define the limits of FERC's manipulation authority, it will help alleviate the investigative delays. **OUR TEAM** Our Energy Regulatory team has experience with Federal Energy Regulatory Commission (FERC) and Commodity Futures Trading Commission (CFTC) compliance and enforcement issues. We provide full-service to our clients in these matters relating to the electric and natural gas industries. Clients retain us to conduct independent investigations, audits and reviews of their compliance with federal energy regulations, either as part of our clients' general "commitment to compliance" efforts, in preparation for a FERC audit, or in defense of a FERC or CFTC investigation. Our goal, like our clients', is to avoid compliance problems that lead to activity by the Office of Enforcement. To that end, we have focused on education. We have prepared comprehensive compliance programs for our clients including the preparation of federal regulatory and state compliance manuals and written procedures, the preparation of compliance audit procedures, and the conduct of training sessions on topics such as Electric Quarterly Report Filings, Anti-Market Manipulation Rules, Standards of Conduct Compliance, Affiliate Restrictions, Capacity Release Rules, and Open Season Procedures, among others.

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[1] Indeed, the largest penalty settlement concerned activity that occurred in 2011. See July 8, 2014 blog post, ***FERC Approves $3.25 Million in Civil Penalty in Southwest Blackout Case***, for further details.

[2] Barclays Bank, PLC; Daniel Brin; Scott Connelly; Karen Levine; and Ryan Smith, Docket No. IN08-8-000; BP America Inc., BP Corporation North America Inc., BP America Production Company, and BP Energy Company, Docket No. IN13-15-000; Richard Silkman Docket No. IN12-13-000; Lincoln Paper and Tissue, LLC Docket No. IN12-10-000; and Competitive Energy Services, LLC Docket No. IN12-12-000. After FERC issues a Notice of Proposed Penalty, the company has sixty days to pay the penalty. If the company does not pay, FERC Enforcement then brings an action in either Federal district court of before an administrative law judge to enforce the penalty. Where FERC brings the action depends on whether it brings the action under the Federal Power Act of the Natural Gas Act for each statute has different enforcement procedures. See February 26, 2014 blog post, ***FERC Responds to Barclays Motion to Dismiss as Without Merit and so Aggressive that if Granted it Could "Eviscerate" FERC's Ability to Regulate Wholesale Power Markets***, for further details.

[3] On December 17, 2014 FERC issued an Order to Show Cause to Powhatan Energy Fund, LLC, Docket No. IN15-3-000. See August 6, 2014 blog post, ***FERC Alleges PJM Manipulation by Powhatan***, for further details.

[4] In contrast, the Commodity Futures Trading Commission devotes less than half that number of staff to conduct surveillance over all commodity markets.