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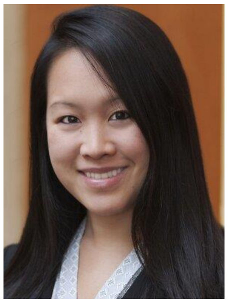
Parsing 2023's Energy Markets Enforcement

By **Pamela Wu, Levi McAllister and Patrick Pennella** (December 15, 2023, 5:01 PM EST)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The Federal Energy Regulatory Commission and the Commodity Futures Trading Commission each released their annual enforcement reports for fiscal year 2023.

These reports highlight the significant enforcement activities, litigation pursued and settlements reached by both agencies in the last year, as well as the agencies' respective strategic goals and focus areas.

FERC's Office of Enforcement continued to focus on matters involving fraud and market manipulation, serious violations of the reliability standards, anti-competitive conduct, threats to the nation's energy infrastructure and associated impacts on the environment and surrounding communities, and conduct that threatens the transparency of regulated markets.

In addition, FERC's Division of Analytics and Surveillance conducted enhanced surveillance into two recent disruptive weather events — December 2022's Winter Storm Elliott, and the winter 2022 and 2023 Western energy price spike — both of which are continuing and have resulted in referrals to the investigations team.

The CFTC Division of Enforcement's results highlighted a continued focus on manipulation and spoofing actions, a record-setting number of digital asset cases, and numerous actions to hold registrants to their regulatory obligations. Its uptick in cases stemmed largely from a near doubling of fraud-related cases.

Both agencies continue to open new investigations and inquiries at a rapid pace and pursue enforcement actions alleging a broad range of violations that result in substantial civil penalties, restitution and disgorgement.

Continued aggressive enforcement actions and efforts by both agencies should be expected in this fiscal year. The areas of focus may continue to evolve and expand, and enforcement actions involving manipulation and fraud of voluntary carbon credits may begin to emerge from the CFTC this fiscal year.

FERC Enforcement

FERC's Office of Enforcement continues to open investigations into a range of violations including cross-market manipulation, violations of the market behavior regulations, tariff violations, and violations of the Federal Power Act and Natural Gas Act.

Nineteen new investigations were opened during this fiscal year, of which at least 11 involved potential market manipulation, six involved potential tariff violations and three involved potential violations of the commission's market behavior rules.

The Division of Analytics and Surveillance opened inquiries stemming from its enhanced surveillance related to two disruptive weather events and has referred matters to the Division of Investigations. The investigations are ongoing.

The Division of Investigations negotiated 12 settlements that were approved by the commission, which resulted in nearly $27 million in civil penalties and nearly $26 million in disgorgement.

These settlements resolved investigations concerning physical trading that benefited related financial positions, i.e., cross-market manipulation; bidding by demand response aggregators of quantities that were not actually available; and other alleged violations.

FERC's Office of Enforcement also participated in a joint inquiry with the North American Electric Reliability Corp. and all six regional reliability entities to determine the cause of the outages, derates and failures to start that occurred during Winter Storm Elliott.

The resulting unplanned generation outages represented the largest controlled firm load shed recorded in the history of the Eastern Interconnection, and the fifth in the last 11 years caused by unplanned cold weather-related generation outages.

The inquiry attributed 96% of all outages, derates and failures to start to freezing issues (31%), fuel issues (24%) and mechanical/electrical issues (41%). Eleven recommendations were made to prevent future occurrences.

CFTC Enforcement

The CFTC's Division of Enforcement filed 96 enforcement actions in 2023 charging a range of violations in a variety of markets that resulted in more than $4.3 billion in civil monetary penalties, restitution and disgorgement. Both metrics show an increase from last year, when the commission initiated 82 enforcement actions and imposed more than $2.5 billion in restitution, disgorgement and penalties.

Nearly half of the enforcement actions filed in fiscal year 2023 involved conduct related to digital asset commodities. The CFTC also remains focused on misconduct that undermines market integrity, such as fraud, manipulation, spoofing (i.e., bidding or offering with the intent to cancel before execution), or other forms of disruptive trading.

It continues to pursue enforcement actions and file complaints in federal court alleging manipulative and deceptive conduct, including spoofing and other conduct that sends false signals to the market.

The CFTC also continued vigorous enforcement of compliance with reporting practices. In 2023, the CFTC filed and settled charges against entities that failed to properly record and retain communications of transactions, and against entities whose supervisors failed to stop employees from using unapproved communications to conduct trading activities and themselves engaged in internal and external communications using forms of communications that were not approved by the company.

In the last two years, the CFTC has imposed more than $1.1 billion in penalties for these types of recordkeeping, reporting and supervision failures.

Expectations for Fiscal Year 2024

Aggressive enforcement activities by both FERC's Office of Enforcement and the CFTC's Division of Enforcement are expected to continue in this fiscal year.

With respect to CFTC enforcement actions, the industry may begin to see even larger civil penalties, an increase in the use of monitors or consultants, and settlements in which the respondent admits to the violation.

In October, the CFTC issued an enforcement advisory to assist its enforcement staff in recommending future enforcement resolutions to the CFTC. The advisory provides guidance to

- Ensure that civil monetary penalties assessed are at the level necessary to achieve general and specific deterrence, which may result in the Division of Enforcement recommending higher penalties in cases involving recidivism;

- Recommend the use of monitors or consultants in cases where the Division of Enforcement lacks confidence that an entity will remediate misconduct on its own; and

- Clarify that a no-admit, no-deny resolution is no longer the default and provide factors that may be applied to assess whether admissions are appropriate in an enforcement case.

In addition, enforcement actions involving voluntary carbon credits may begin to emerge from the CFTC. Over the last year, the CFTC has devoted significant resources and directed coordination among various offices within its Division of Enforcement to oversee the voluntary carbon markets. The CFTC's whistleblower program is actively seeking tips from whistleblowers of potential violations of the Commodity Exchange Act that are connected to fraud or market manipulation in the carbon markets.

In addition, the Environmental Fraud Task Force was established to combat environmental fraud and other misconduct in both the regulated derivatives markets and also the relevant spot markets, including the voluntary carbon markets.

Most recently, on Dec. 4, the CFTC issued proposed guidance for exchanges that list derivatives contracts with voluntary carbon credits as the underlying commodity. This guidance outlines characteristics that should be considered in the development of the terms and conditions of a voluntary carbon credit futures contract to reduce the susceptibility to manipulation, prevent price distortion and promote accurate pricing.

These characteristics include:

- Quality standards, e.g., transparency, additionality, permanence, risk of reversal, and robust quantification of emissions reductions or removals;

- Delivery procedures, e.g., governance framework, tracking mechanisms and measures to prevent double counting of the carbon crediting program for the underlying voluntary carbon credits; and

- Third-party validation and verification.

Companies transacting energy commodities that are subject to FERC's jurisdiction and/or the CFTC's jurisdiction must remain vigilant in their conduct and oversight of their market and trading activities.

Maintaining and implementing an effective and robust compliance program is essential. The compliance program should foster a culture of compliance that begins at the executive level and permeates throughout the organization. It should be tailored to the company's specific size, region, organizational structure, operations and business activities.

In addition, the compliance program should ensure that the company's staff and management receive adequate and appropriate training and resources that enable them to detect potential issues in a timely manner and remain apprised of the latest compliance trends and issues. These measures can help prevent or mitigate violative conduct.

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