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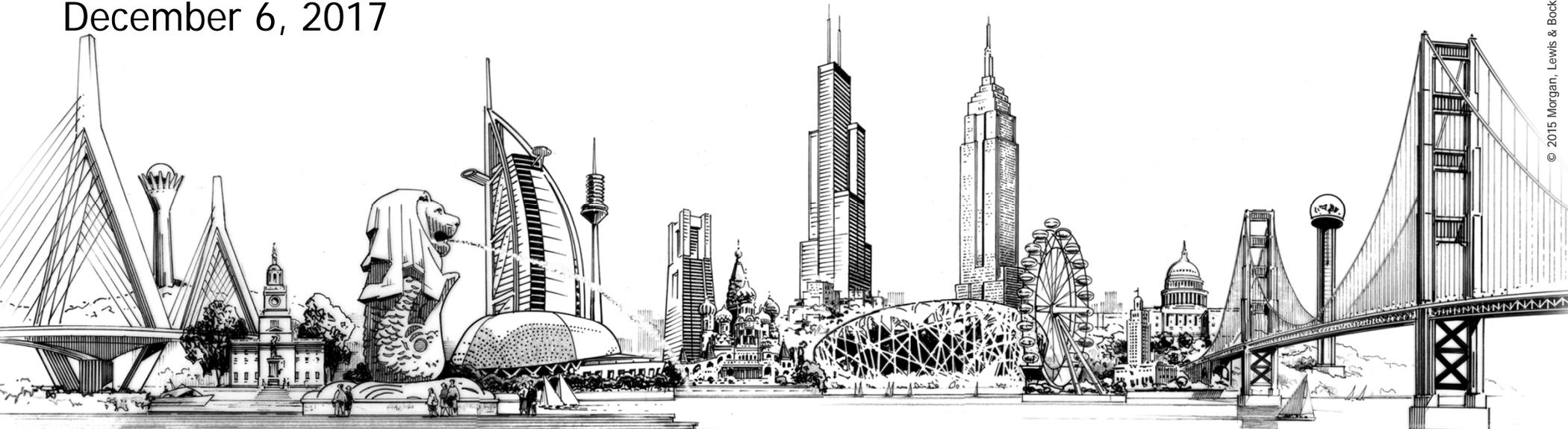
2017 FERC ENFORCEMENT YEAR IN REVIEW

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Agenda

- Enforcement Priorities in 2017
- Federal Court Cases Arising from FERC Enforcement
- FERC 2017 Enforcement Report
- FERC Guidance on Trading Compliance Practices
- The Impact of a Trump Administration on FERC Enforcement Policy
- Questions

ENFORCEMENT PRIORITIES IN 2017

Enforcement Priorities

Market Behavior

- Fraud and market manipulation
- Anticompetitive conduct
- Conduct that threatens market transparency

Reliability

- Serious violations of Reliability Standards

Indicia of Fraud in FERC Regulated Markets

- FERC has continued to demonstrate key indicia it deems relevant to determining whether fraud has occurred in violation of its Anti-Manipulation Rule and market behavior regulations. Key indicia include:
 - *Illicit Purpose* – The purpose underlying market behavior can determine whether that behavior is fraudulent. In three recent orders addressing Up-To Congestion trades in PJM, the Commission found it significant that trades engaged in had no relationship to the purpose of UTC trades. *See, e.g., Houlian Chen*, 151 FERC ¶ 61,179, at P 80 (2015).
 - *Uneconomic Conduct* – When an entity knowingly engages in behavior that loses money on a stand-alone basis (or is indifferent to such losses) but engages in that behavior anyway to serve an ulterior purpose. However, profitability by itself is not dispositive. *See, e.g., BP America, Inc.*, 156 FERC 61,031, at PP 22, 131-34 (2016).
 - *Inconsistency with Market Fundamentals* – Participants in energy markets should have as their price signal supply and demand fundamentals, not ancillary considerations that bear no relation to underlying market fundamentals.

Types of Market Manipulation

- EAct 2005 granted FERC a flexible and broad statutory framework to prohibit and penalize manipulative conduct.
- *Cross-Market Manipulation Schemes* – Trading in one market with the intent to move prices in a particular direction to benefit positions in a related market.
- *Gaming of Market Rules* - Reflected in FERC's broad definition of fraud and includes behavior that circumvents or takes unfair advantage of market rules or conditions in a deceptive manner that harms the proper functioning of the market and potentially other market participants or consumers.
- *Misrepresentations and Omissions* – Where an entity voluntarily provides information or where the entity is required by a tariff or a Commission statute, order, rule or regulation to provide information, and the entity then misrepresents or omits a material fact such that the information provided is materially misleading.

FY2017 Settlements

- To date, FERC has approved five settlement agreements in 2017. Three of those settlements involved alleged manipulative conduct and/or improper market behavior within the electric energy sector:
- **Gaming of Market Rules**
 - *GDF SUEZ Energy Marketing NA, Inc.* (IN17-2)
 - Improperly targeted and inflated receipt of lost opportunity credits (LOCs) in the PJM market.
 - PJM awarded LOCs to generator units to encourage them to keep their resources in the PJM markets.
 - GDF Suez inflated the amount of LOCs it would receive by offering generation resources at below-cost offers when the units would otherwise be out of money, and when it knew would have a low likelihood of being dispatched.
 - \$41,000,000 Civil Penalty; \$40,800,000 Disgorgement of Profits
 - ***Indicia of Fraud – Illicit Purpose***

FY2017 Settlements (continued)

- **Cross Market Manipulation**

- *FERC v. City Power Marketing* (IN15-5)

- Scheme to use PJM Up to Congestion (“UTC”) transactions at certain pricing nodes as a pretext to reserve unprofitably large volumes of transmission to earn a larger share of Marginal Loss Surplus Allocation (“MLSA”) under PJM rules.
- Particularly, instead of making arbitrage trades based on expert predictions about likely price differentials involving UTC, Tsingas and City Power sought trades with minimal or no price changes as a vehicle to divert MLSA from other market participants.
- In September 2015, FERC filed suit in federal district court to enforce the penalty order. Following District Court’s decision to treat case as a “standard civil action” governed by the FRCP, defendants entered into a settlement.
- Tsingas - \$1.42 million Civil Penalty; \$1.3 Disgorgement; ban from trading in FERC jurisdictional markets for three years
- City Power - \$9 million Civil Penalty
- ***Indicia of Fraud – Uneconomic Conduct***

FY2017 Settlements (continued)

- **Misrepresentations or Omissions**

- *Westar Energy, Inc.* (IN15-8)

- Improperly submitted inaccurate cost inputs for its mitigated energy offer curves (EOCs) in the SPP Market that were inconsistent with cost parameters on file with SPP's Market Monitoring Unit.
- SPP awarded "make-whole" payments for resources that offer mitigated EOCs into its market because they are typically committed to dispatch but they do not "clear" in the market based on specific costs for providing energy.
- SPP awarded Westar \$60,000 in a make-whole payment that it would otherwise had not received had it not been for its inaccurate cost input submissions.
- Westar cooperated throughout the investigation and promptly responded to OE requests for data and testimony
- \$180,000 Civil Penalty; \$0 Disgorgement (Westar already refunded the amounts)
- ***Indicia of Fraud – Illicit Purpose (maybe)***

FY2017 Settlements (continued)

- **Other Issues**

- *Covanta Haverhill Associates LP* (IN17-3)

- Failed to provide instantaneous metered data from a remote terminal unit as was required by the ISO-NE Tariff.

- Sellers in ISO-NE are required to provide such data under its Tariff obligations, and Enforcement noted that failure to provide such instantaneous data can affect system reliability.

- \$36,000 Civil Penalty

- *American Transmission Company, LLC* (IN17-5)

- Violation of FPA 203 by transferring 21 jurisdictional assets prior to obtaining Commission authorization.

FY2017 Administrative Hearings

- Enforcement noted that there are currently two order to show cause proceedings that are still pending during FY2017. Both proceedings are in the gas sector and involve alleged cross market manipulation schemes.
- **Cross Market Manipulation**
 - *BP America Inc., et al.* (IN13-15)
 - Alleged, and initial decision found, that BP's Texas team had engaged in market manipulation by flooding Houston Ship Channel with next day gas to benefit corresponding short financial positions.
 - A request for rehearing is still pending; however, on September 7, 2016 BP appealed the Commission's original order setting the matter for hearing before an ALJ to the U.S. Court of Appeals for the 5th Circuit.
 - *Total Gas & North America, Inc., et al.* (IN12-17)
 - Allegations of manipulative conduct in violation of the NGA by trading to affect natural gas index prices to benefit their derivative positions.
 - District court challenges to the Commission's enforcement actions rejected.
 - Currently pending before the Commission.

FEDERAL COURT CASES ARISING FROM FERC ENFORCEMENT

De novo review of FERC enforcement actions in federal court

- FPA section 316A provides FERC with civil penalty authority for violations of Part II of the FPA (up to \$1 million, per violation, per day)
 - Those civil penalties must be assessed under section 31 of the FPA
- Section 31 allows entities subject to civil penalty action to choose:
 - ALJ hearing at FERC or
 - FERC assessment of penalty, followed by action in federal district court to affirm the assessment of the civil penalty
- Key language: “The court shall have authority to review *de novo* the law and the facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part, such assessment.”
- Including all pending federal court matters and two NGA OSC proceedings, OE sought to recover \$806,865,000 in civil penalties and \$53,987,678 in unjust profits through seven litigation proceedings.
- Last year, in *FERC v. Maxim Power Corp et al. (D.Mass)*, the District Court held that the *de novo* provision of the FPA requires “treating this case as an ordinary civil action governed by the Federal Rules of Civil Procedure that culminates, if necessary, in a jury trial.” The case has since been settled between FERC Enforcement and Maxim Power.

FERC v. City Power Marketing, LLC (D.D.C.)

- FERC alleged market manipulation by City Power in the PJM market, with proposed civil penalty of \$14 million for City Power, a \$1 million civil penalty for the individual involved, and \$1.2 million in disgorgement
- City Power decided to contest allegations in federal district court
- District court rejected motions to dismiss filed by the respondent, but also addressed the issue of *de novo* review
 - City Power argued for full civil procedures, including discovery and a jury trial, if necessary
 - FERC argued that the court need only examine FERC's own record and the order assessing the civil penalties
- District court decided to treat this as a “standard civil action” governed by the FRCP
 - Explicitly followed the *Maxim Power* decision
 - Expressed concern over City Power's inability to subpoena records or depose witnesses
 - Refused to rule on entitlement to a jury trial
- FERC and City Power subsequently agreed to settle for a \$9 million civil penalty for City Power and a \$1.4 million penalty for individual involved (160 FERC 61,013)

FERC v. Barclays Bank PLC (E.D.CA)

- FERC alleged market manipulation by Barclays in an around the California energy market and sought civil penalties and disgorgement totaling \$487.9 million
- Barclays selected district court procedure
- On March 31, 2017 district court concluded that “in agreement with every other federal court that has expressly addressed this issue, that Defendants are entitled to conduct discovery under the Federal Rules of Civil Procedure.”
- District court explained that:
 - This does not give defendant a “do-over,” instead this is first change to cross-examine witnesses, compel discovery, and make case before a neutral
 - “Basic fairness also works against FERC’s interpretation of statute” because FERC Staff had always told Barclays that federal court procedures would allow for discovery
 - “Issue exhaustion” does not apply because there was no final agency action, existing process only sufficient to put issue to district court
 - No legal support for FERC’s position that district court’s review should be left to the administrative record
 - Imposing a half-billion penalty and disgorgement without giving defendants “the opportunity to defend themselves in a contested, adjudicatory setting before a neutral decision-maker” presents potential constitutional concerns
- FERC and Barclays subsequently agreed to settle for a \$70 million civil penalty and \$35 million in disgorgement. Barclays also surrendered its market-based rate authority effective June 2015 (161 FERC 61,147).

FERC v. Silkman (D. Maine)

- FERC alleged market manipulation in ISO-NE by a consulting firm (Competitive Energy Services) and its managing member (Silkman), seeking \$10 million in total penalties and \$166k in disgorgement.
- Silkman and firm selected district court procedure
- On January 26, 2017, district court concluded that “it will treat this matter as an ordinary civil action subject to the Federal Rules of Civil Procedure”
- Court found that:
 - Statutory language is ambiguous
 - FERC’s changing opinion on the *de novo* language is not binding
 - The structure of the statute indicates that the court should look to more than the administrative record
 - “a district court may use its discretion to adjust the scope of its *de novo* review based in part on the proceedings that occurred below”
 - Concluded that in the “individualized circumstances of this case,” additional fact-finding is appropriate, but that is not mandated by the statute in every instances

FERC v. ETRACOM LLC (E.D. Ca.)

- FERC alleged that ETRACOM and an individual manipulated the CAISO market, seeking \$2.4 million in penalties from ETRACOM and \$100,000 from the individual, along with disgorgement of \$315k.
- ETRACOM and individual selected district court review process.
- On March 8, 2017 District Court found that normal civil rules would apply.
 - No Congressional intent to exempt FPA civil actions from the FRCP.
 - Similar statutory language in other statutes (National Energy Conservation Policy Act and Powerplant and Industrial Fuel Use Act) have legislative history indicating the full de novo review is expected.
 - Other district court cases have determined to use normal civil procedure.

What does this mean going forward?

- Not the last we have heard of this issue, but every court that has ruled so far has concluded that full de novo review is required.
 - Same issue remains pending in
 - *FERC v. Powhatan Energy Fund LLC* (E.D. Va)
 - *FERC v. Coaltrain Energy, L.P.* (S.D. Ohio)
 - No appellate cases . . . yet
- FERC's enforcement authority has traditionally avoided court review due to:
 - FERC's ability to settle its allegations
 - FERC's ability to pursue market manipulation under statutory authority without de novo review
- Court review on a *de novo* basis could have several implications for FERC's enforcement processes
 - Greater reliance on federal courts to resolve allegations of significant non-compliance with the FPA?
 - Revisions to FERC's enforcement processes to streamline proceedings likely to go to district court?
 - Will FERC push for the *Silkman* approach and provide greater discovery rights during enforcement to minimize any discovery in a court proceeding?
 - Reductions in aggressive interpretations of FERC's anti-manipulation authority?
 - Greater clarity on the scope of FERC's anti-manipulation authority?
 - Different information gathering techniques due to application of Federal Rules of Evidence?
 - Is FERC more likely to settle on reasonable terms when faced with regular discovery rules?

FERC'S 2017 ENFORCEMENT REPORT

FY2017 Enforcement By-The-Numbers

- Analytics and Surveillance
 - Participated in approximately 50 investigations
 - Reviewed “numerous instances” of possible misconduct
- Investigations
 - 27 new investigations opened
 - 5 investigations closed through settlement
 - 16 investigations closed without action because no violation occurred or lack of evidence
 - Settlements resulted in \$51 million in penalties and more than \$42 million in disgorgement
- Audits
 - 11 audits completed of oil pipelines, public utilities, and natural gas companies
 - 300 total audit recommendations
 - Refunds totaling \$13 million
- Court proceedings
 - Excluding settled matters, 5 matters in U.S. federal courts
- To-date under its EAct 2005 enforcement authority, FERC has assessed penalties and required disgorgement of amounts totaling more than \$1 billion

Division of Analytics and Surveillance

Illustrative Examples

- This year, OE provided illustrative examples of DAS inquiries that were closed with no referral for enforcement action. Examples of this included:
 - Natural gas market participant buying gas at elevated prices and with a high market concentration during bidweek.
 - Staff contacted the market participant, who explained why it took particular financial and physical positions. After reviewing the market participant's internal documentation pertaining to weather progression and verifying the pricing information, the inquiry was closed with no referral to DOI.
 - Natural gas market participant in the cash market trading early, buying at elevated levels, and engaging in concentrated trading.
 - DAS reviewed the market participant's trading and positions over time and perceived that the trading did not always align with its index positions, and that the financial benefit was modest on average. The matter was closed without referral.
 - Electric energy market participant was identified as engaging in elevated, early session sales in fixed-price next-day contracts at a bilateral hub.
 - Market participant explained that the entity was flattening physical index exposure created to hedge an off-take agreement from a generation facility. After verification, the inquiry was closed without referral.

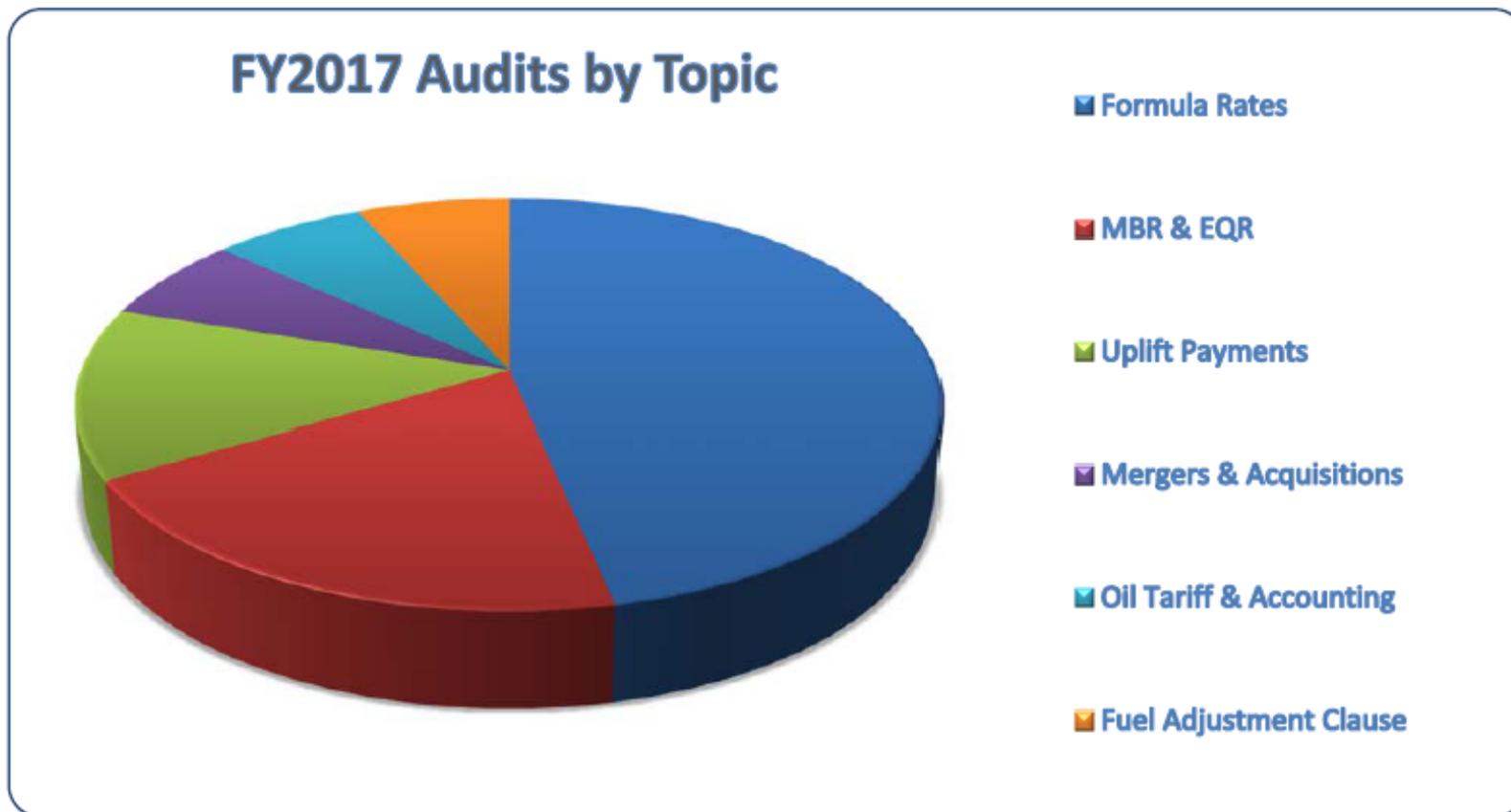
Self-reports

- Self-reports continued to be the largest source of potential allegations of noncompliance
 - 80 new self-reports in FY2017
 - 121 self-reports closed in FY2017
- Vast majority of self-reports closed without opening an investigation due to “absence of significant harm to the relevant market.” Examples include:
 - RTO/ISO Violations: minor violations of ISO/RTO tariffs resulting from software errors or human errors where harm as relatively small and inadvertent and steps taken to fix issue and avoid recurrence
 - EQR Violations: An electric utility self-reported that it failed to file four transmission interconnection agreements and two generation dispatch agreements, as required by Section 205 of the Federal Power Act and did not include the agreements in EQR submissions. The utility filed the agreements simultaneously with its submission of the self-report, will include them in future EQRs and will amend past EQRs.

More self-reports closed without further action

- QF Certification Failure: Several owners of small generating facilities separately self-reported that they made jurisdictional sales of electricity without first self-certifying as a QF by filing Form No. 556.
- Electric Market Trading Violation: A company reported that due to manual error it placed erroneous offers which were not in dispatchable range in an RTO/ISO market violating tariff rules. The company implemented procedures to prevent future occurrences, the violation was limited, inadvertent, promptly reported, and did not result in market harm.
- Natural Gas Billing: A company reported that it incorrectly billed customers for firm transmission service due to its manual selection of an incorrect delivery point due to poor labeling. The company immediately corrected labeling errors, issued refunds, and the events were isolated and inadvertent.
- FPA Section 205 Violation: Company failed to file certain jurisdictional agreements relating to charges for construction of a new transmission line as required by FPA Section 205. After an internal investigation, the company promptly filed the agreements and reported the late filings to Enforcement. It also provided enhanced training to personnel responsible for making the filings. The late filing did not adversely affect ratepayers or other parties to the agreements according to OE.
- Violations of Standards of Conduct: Non-public transmission function information was inadvertently sent to marketing function employees; closed without action after marketing function employees were directed to delete the email, and because the violation was limited, unintentional, and did not result in any identifiable harm.

Division of Audits activities in FY2017



FERC GUIDANCE ON TRADING COMPLIANCE PRACTICES

Effective Trading Compliance Practices

- An organization and its executive officers must be committed to promoting compliance at all levels by devoting resources, enforcing rules, and ensuring employees understand compliance obligations. FERC identified the following features for an effective compliance program:
 - *Organizational Structure and Composition* – Compliance personnel should have a variety of expertise, including legal, day-to-day operations, risk management, and trading.
 - *Human Resources* – Hire traders that are able and willing to learn and adhere to the rules that apply to their trading activities. And a trader compensation structure should be created which incentivizes compliance, not just profitability.
 - *Training* – Employ a training program that is appropriate for: (1) an organization's size; (2) its trading activities; and (3) the experience level of the traders. Traders should be aware of any changes in rules or requirements to that apply to them on a timely basis.
 - *Information Technology Resources* – Commit sufficient resources to an organization's compliance program to purchase, maintain, and operate IT resources that will make their compliance programs more efficient and effective.

Implementing and Enforcing Effective Practices to Deter and Detect Misconduct

- FERC Staff identifies that organizations struggle the most in monitoring their traders' activities to identify potential misconduct, FERC Staff suggests the following methods to achieve this:
 - *Establish Appropriate Trading Rules and Restrictions* - Place appropriate restrictions on trading activities which limit the traders' ability and incentives to manipulate or engage in other misconduct. This could include:
 - Maintaining a list of prohibited trading strategies.
 - Documenting trading strategies.
 - Requiring traders to obtain approval from compliance or upper management before trading new products or at new locations
 - Implementing restrictions that discourage or prevent traders from using price-setting instruments to benefit open financial positions.
 - *Monitoring Trading Activity* – Monitoring methods that could prove effective include automated surveillance tools or algorithms that track trading data and communications. Staff notes that whatever monitoring tools are used, it is important that they are used routinely and that all potential issues are taken seriously.
 - *Enforcing Rules and Restrictions* – This could include: (i) following up on all alerts of possible misconduct; (ii) documenting resolution taken in response to alerts; (iii) establishing appropriate disciplinary action; and (iv) disciplining employees for all instances of noncompliance.

Regularly Assessing Compliance Program Performance

- In accordance with FERC's Penalty Guidelines, Staff suggests that an organization take reasonable steps to periodically evaluate the effectiveness of an organization's compliance program.
- Regular evaluations help to: (1) ensure the program's compliance tools continue to be effective; (2) uncover compliance gaps and failures; and (3) identify where updates are necessary.
- Suggested steps to achieve this include:
 - Performing regular performance audits of an organization's compliance program.
 - Taking action on all issues identified in compliance program's performance program. An organization should document all of the issues identified during its performance audits and take action to improve the compliance program.

Ineffective Trading Compliance Practices

- Staff also identified ineffective compliance practices it observed as part of its investigative and surveillance efforts which generally reflect an organization's failure, among other things, to (i) tailor compliance programs to the needs of its trading operations; (ii) keep the compliance program up-to-date; (iii) follow through on monitoring for violations and enforcing compliance-related rules.
- Staff recommended that organizations *do not* employ the following ineffective practices:
 - **Heavily relying on standardized and long annual training.** Traders are less likely to absorb pertinent information from standardized trainings that cover too many topics that may or may not be applicable to a trader's responsibilities.
 - **Heavily relying on attorneys for training without including operational staff.**
 - **Providing insufficient funding for an organization's compliance program.**
 - **Allowing commercial trading staff to overrule compliance advice**
 - **Failing to regularly reassess and update compliance practices as circumstances change.**
 - **Failing to monitor for violations or discipline those who violate compliance-related rules in a meaningful way.**
 - **Implementing policies that inhibit or prohibit retention of trader communications.**

THE IMPACT OF A TRUMP ADMINISTRATION ON FERC ENFORCEMENT POLICY

Changes in Commissioners

- Current commission (quorum):
 - Chairman Kevin J. McIntyre (R) (term expires June 30, 2023)*
 - Commissioner Richard Glick (D) (term expires June 30, 2022)
 - Commissioner Neil Chatterjee (R) (term expires June 30, 2021)
 - Commissioner Cheryl A. LaFleur (D) (term expires June 30, 2019)
 - Commissioner Robert Powelson (R) (term expires June 30, 2020)
- Resignations
 - Commissioner Norman Bay (D) (resigned January 26, 2017)
 - Commissioner Colette Honorable (D) (resigned June 30, 2017))
- Filling seats requires presidential appointment and senate confirmation (42 USC 7171(b))
 - No more than three members of any political party
 - President also has ability to designate the Chairman

Changes in Enforcement Policy

- Room for significant changes given language of statutes and FERC's regulations
 - Much enforcement policy developed through settlement, with supporting guidance
- Appetite for change in enforcement area will depend on the goals and objectives of FERC Commissioners
 - Each Chairman's priorities differ and set the agenda for FERC
 - Enforcement actions are inherently an exercise of executive discretion
- Possible areas for change?

Questions?

2017 FERC Enforcement Year In Review

December 6, 2017

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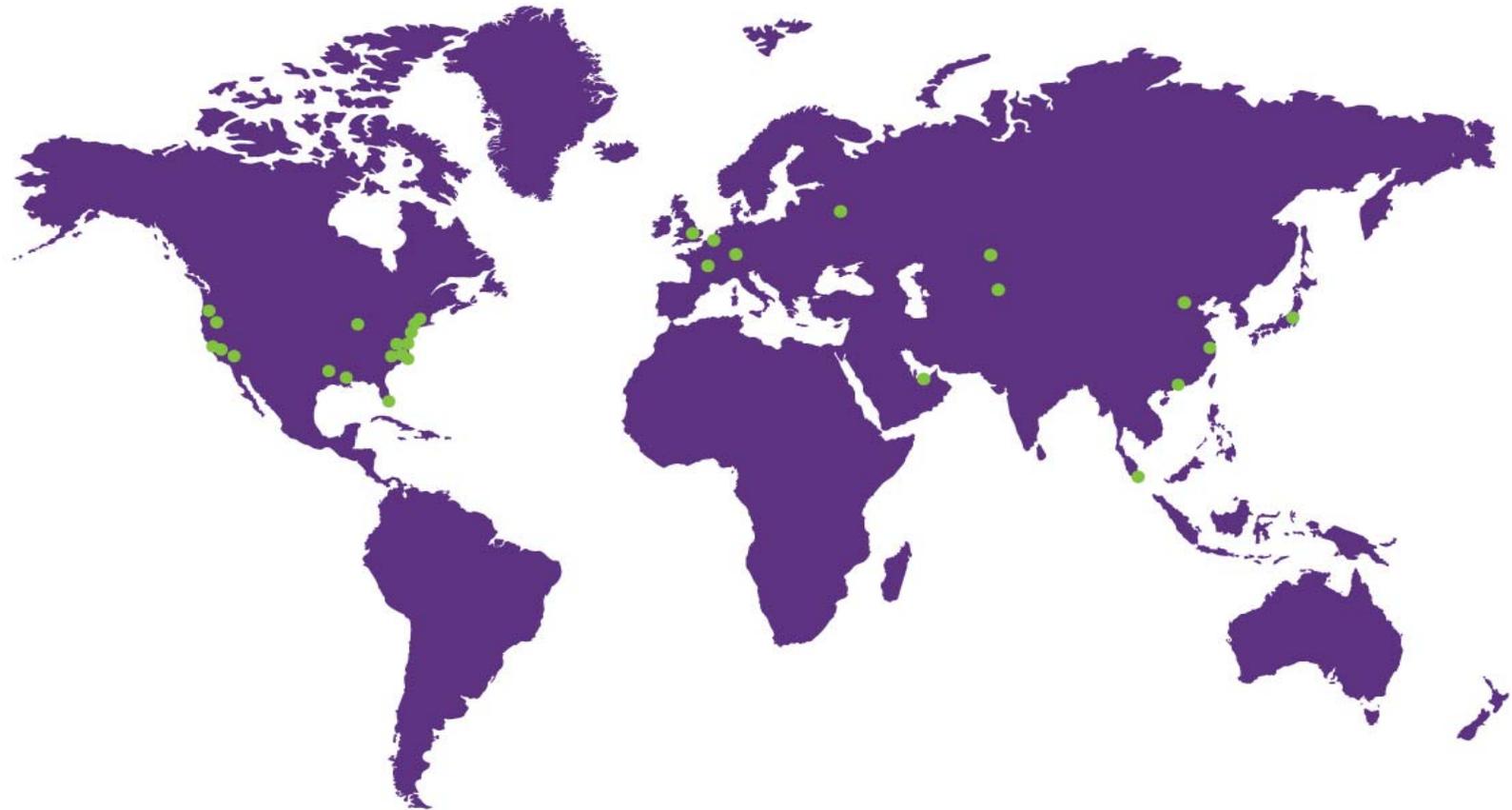
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Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
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