FERC Investigations and Enforcement Remain Focused on Market Manipulation

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The Office of Enforcement (OE) of the Federal Energy Regulatory Commission (FERC) recently released its annual report for the past fiscal year. The report provides FY2015 statistics on the investigative and enforcement activities conducted by OE's four divisions-Investigations, Audits and Accounting, Energy Market Oversight, and Analytics and Surveillance. View the full report.

As in previous years, the report confirms that OE's investigation and enforcement priorities for FY2016 and the foreseeable future will continue to focus on matters involving (1) fraud and market manipulation, (2) serious violations of reliability standards, (3) anticompetitive conduct, and (4) conduct that threatens the transparency of regulated markets.

Specific statistics in the report include the following:

- FERC opened 19 investigations in FY2015, 14 of which involved market manipulation. More than half of these 19 new investigations arose from referrals based on conduct observed by FERC surveillance staff or market monitoring units of independent regional grid operators.
- FERC received 122 new self-reports from a variety of market participants in FY2015. FERC closed 78 self-reports that had been submitted in FY2015 and previous years. One of the various factors OE staff considered in closing self-reports was the absence of significant harm to the market.
- FERC issued five notices of alleged violations in FY2015, four of which involved alleged market manipulation. View a list of all notices of alleged violations.
- FERC approved settlement agreements in FY2015 that resolved allegations of market manipulation by six entities, including corporate entities and individual traders. The settlements assessed a total of $3.25 million in civil penalties and disgorgement of nearly $1 million. The settlement agreements required the implementation of new compliance policies and associated processes aimed specifically at detecting potentially manipulative trading.
- FERC issued three orders to show cause (OSCs) in FY2015, all of which involved alleged market manipulation. The OSCs proposed a total of $49.85 million in penalties and

disgorgement of nearly $6 million. FERC is seeking to enforce these OSCs, as well as others from previous years, in federal district court. As a result, FERC currently is litigating seven such actions-the most ever in the course of one year.

Background

Since 2007, FERC has issued annual enforcement reports that provide insight into its largely non-public investigation work. These annual reports provide summary statistics of FERC's entire enforcement program, as well as descriptions of significant recent cases.

Interest in FERC's investigation and enforcement program has increased since the passage of the Energy Policy Act of 2005 (EPAct 2005), which amended both the Federal Power Act and Natural Gas Act to enhance FERC's authority to prohibit market manipulation and assess significant penalties where manipulation was determined to have occurred.

In April 2015, Norman Bay, a former federal prosecutor and former head of OE, became FERC Chairman. Chairman Bay's ascension to his current position led to widespread expectations that FERC's enforcement efforts would intensify.

Concerns over these expectations led a group of US senators to ask the US Department of Energy Office of the Inspector General (OIG) to investigate FERC's enforcement program. In September 2015, the OIG's report concluded, “nothing came to our attention to indicate that OE had not performed enforcement activities in accordance with relevant policies and procedures.” The OIG did not evaluate the fairness of the enforcement program, but instead stated: “concerns related to what was essentially the basic fairness of FERC's enforcement authority/processes . . . were public policy questions which, as important as they may be, are best addressed by policy makers and as such, were outside the purview of the OIG.”

The contours of FERC's authority over market manipulation-as well as the types of activities that constitute fraud or manipulation-remain in flux. In 2013, the DC Circuit ruled that FERC lacks jurisdiction over manipulation of natural gas futures contracts, and that the Commodity Futures Trading Commission (CFTC) instead has exclusive jurisdiction over the trading of derivatives. The scope and extent of that ruling, as well as due process and other jurisdictional issues, currently are being litigated by FERC and several recipients of OSCs in pending district court actions. In addition, FERC's jurisdiction to commence an enforcement action over allegedly manipulative activity related to participation in demand response programs at the wholesale level remains in question, pending the resolution of a challenge to FERC Order 745 that was argued in a US Supreme Court case in October 2015.

Implications

1. While the boundaries of FERC's jurisdiction remain subject to further definition, FERC has made clear that it will continue to aggressively investigate and enforce against entities that allegedly engage in manipulative conduct in energy markets. With the exception of FY2012,

FERC has never issued more than three OSCs in one fiscal year since the passage of EPAct 2005.

2. As FERC continues to take action against market manipulation, a body of case law is developing that will provide more clarity on FERC's jurisdiction and what types of activities (such as uneconomic trading) constitute “manipulation” in the energy context. Regulated entities should continue to monitor ongoing cases and incorporate new precedent into their compliance programs.
3. The FY2015 annual report confirms the importance that strong internal compliance programs, coupled with self-reporting actions, continue to play in FERC decisions to enter into settlement agreements, as well as to significantly reduce proposed penalties from the amount that otherwise could be assessed under its existing policies.

WilmerHale's Energy, Environment and Natural Resources Practice actively monitors developments at FERC, the CFTC and other entities with jurisdiction over energy markets, advises regulated entities on the development and implementation of compliance programs, and represents entities in investigation and enforcement actions.

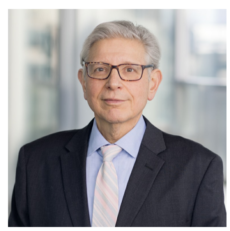
Authors

H. David Gold

SPECIAL COUNSEL

david.gold@wilmerhale.com

+1 617 526 6425



Paul M. Architzel

RETIRED SENIOR COUNSEL

+1 202 663 6000