

Law Seminars International

Energy Markets and Regulation

FERC ENFORCEMENT PROGRAM

Presentation by

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Disclaimer

The views expressed in this presentation are those of the presenter and do not necessarily reflect the views of the Federal Energy Regulatory Commission, its Chairman, or any individual Commissioner.



Energy Policy Act of 2005

Pub. L. No. 109-58, 119 Stat. 594 (2005)

- **Sections 316 and 1281** expanded FERC's authority to facilitate transparency in gas and electric prices, and specifically directed FERC and the CFTC to conclude a memorandum of understanding to ensure that information requests to markets are properly coordinated to minimize duplicative information requests and to address the treatment of proprietary trading information.
- **Sections 315 and 1283** expanded the FERC's authority to police the use of any manipulative or deceptive device in connection with the gas and electric markets.
- **Sections 314 and 1284** increased the criminal and civil penalties for violations of FERC gas and electric rules and regulations. The civil penalties, for example, went from \$10,000 to \$1 million for each day a violation continues. These sections also extended penalty authority over violations of **all** of Federal Power Act Part II and **all** of the Natural Gas Act.



Post-EPAct FERC Actions

Overview

- To assist the Commission in enforcing its statutes, regulations, and policies (**codification of enforcement rules**)
- To assist the Commission in obtaining adequate information to enforce its statutes, rules, regulations, and policies (**access to information**)
- To provide greater due process to companies and the individuals subject to Commission investigations and audits (**greater due process**)
- To provide greater clarity to companies and the general public in understanding the exercise of the agency's prosecutorial discretion (**greater clarity**)



Codification of Enforcement Rules

- ***Prohibition of Energy Market Manipulation***, Order No. 670, RM06-3-000, 114 FERC ¶ 61,047 (Jan. 18, 2006), *order on reh'g*, 114 FERC ¶ 61,300 (March 22, 2006).
- ***Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations***, EL06-16-000, 114 FERC ¶ 61,165 (Feb. 16, 2006), *order on reh'g*, 115 FERC ¶ 61,053 (April 17, 2006)(electric).
- ***Conditions for Public Utility Market-Based Rate Authorization Holders***, Order No. 674, RM06-13-000, 114 FERC ¶ 61,163 (Feb. 16, 2006)(electric).
- ***Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates***, Order No. 673, RM06-5-000, 114 FERC ¶ 61,166 (Feb. 16, 2006)(gas).



Access to Information

- **Memorandum of Understanding** Between the **Federal Energy Regulatory Commission** and the **Commodity Futures Trading Commission** Regarding Information Sharing and Treatment of Proprietary Trading and Other Information (Oct. 12, 2005).
- *Revisions to Record Retention Requirements for Unbundled Sales Service, Persons Holding Blanket Marketing Certificates, and Public Utility Market-Based Rate Authorization Holders*, RM06-14-000, Notice of Proposed Rulemaking, 114 FERC ¶ 61,164 (Feb. 16, 2006).



Greater Due Process

- *Interpretive Order Regarding No-Action Letter Process*, PL06-4-000, 113 FERC ¶ 61,174 (Nov. 18, 2005).
- *Interpretive Order Modifying No-Action Letter Process* (October 19, 2006)
- *Procedures for Disposition of Contested Audit Matters*, Order No. 675, 71 Fed. Reg. 9,698 (February 27, 2006), FERC Stats. & Regs. ¶ 31,209, *order on reh'g*, Order No. 675-A, 71 Fed. Reg. 29,779 (May 24, 2006) FERC Stats & Regs. ¶ 31,217 (2006).



More Clarity

- *Enforcement of Statutes, Orders, Rules, and Regulations*, Policy Statement on Enforcement, PL06-1-000, 113 FERC ¶ 61,068 (Oct. 20, 2005).
- **Web Package:**

<http://www.ferc.gov/legal/maj-ord-reg/land-docs/order2004/resources.asp>



Codification of Enforcement Rules

Order No. 670 -- # 1 (gas)

§ 1c.1 Prohibition of natural gas market manipulation.

- (a) It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission,
- (1) To use or employ any device, scheme, or artifice to defraud,
 - (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
 - (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.
- (b) Nothing in this section shall be construed to create a private right of action.



Codification of Enforcement Rules

Order No. 670 -- # 2 (electric)

§ 1c.2 Prohibition of electric energy market manipulation.

- (a) It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission,
- (1) To use or employ any device, scheme, or artifice to defraud,
 - (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
 - (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.
- (b) Nothing in this section shall be construed to create a private right of action.



Codification of Enforcement Rules

Order No. 670 -- # 3

Elements of a Part 1c Claim

The Commission may act in cases where:

- (1) Any entity,
- (2) (a) uses a fraudulent device, scheme or artifice; (b) makes a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule or regulation, or (c) engages in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity;
- (3) with the requisite scienter;
- (4) in connection with the purchase or sale of natural gas or electric energy or transportation of natural gas or transmission of electric energy subject to the jurisdiction of the Commission.



Codification of Enforcement Rules

Electric and Gas

Market Behavior Rules Orders

- **Order No. 673**: natural gas rule on manipulation (analog of rule 2) rescinded effective February 27, 2006; other gas rules (analog of 4 and 5) remain in 18 CFR Part 284.
- **Order No. 674**: electric MBR 1, 3, 4, and 5 codified in 18 CFR § 35.37, effective February 27, 2006.
- **“EL Docket”**: Rules 2 and 6 rescinded effective February 27, 2006.



Old Market Behavior Rules and new Anti-Manipulation Rule overlap January 26-February 27, 2006 only.

Comparison Between Former Market Behavior Rule 2 and New 18 C.F.R. Part 1c

| Former Market Behavior Rule 2 | Anti-Manipulation Rule Part 1c |
|---|---|
| Applied only to jurisdictional Market-Based Rate Sellers. | Applies to “any entity.” |
| Prohibited certain specifically defined activity (e.g., wash trades, sales on false information, artificial congestion, collusion for manipulation). | Prohibits all of the specifically defined activity in Market Behavior Rule 2, but as a “catch all” rule, rejects a “laundry list” approach to specific bad acts. |
| Required only that the conduct had a “foreseeable” effect on “market prices, conditions and rules.” | Requires a showing of scienter defined to include intentional <u>or</u> reckless conduct. |
| Prohibited conduct must have been directed at manipulating “market prices, conditions and rules.” | Manipulative or fraudulent conduct must be “in connection with” the jurisdictional transaction. |
| Included specifically defined affirmative defenses of actions at the direction of the Commission or a Commission-approved RTO/ISO. | Although not specifically noted in Part 1c, action taken at the direction of the Commission or a Commission-approved RTO/ISO can be asserted as a defense. |
| Included specifically defined affirmative defense of “legitimate business purpose.” | Rejects inclusion of “legitimate business purpose” as an affirmative defense, but the intent behind and rationale for actions taken by an entity will be examined and taken into consideration as part of determining whether the actions were manipulative behavior. |
| Required actions under the Market Behavior Rules be filed within 90 days after the end of the calendar quarter action occurred or, if later, 90 days after the complainant knew or should have known that the alleged violation occurred. | No statute of limitations except that the Commission is limited by the five-year statute of limitations in 28 U.S.C. § 2462 for actions in which civil penalties are sought. |



Access to Information

FERC-CFTC MOU

- Both agencies may request information in the possession of the other. E.g, FERC may request information regarding futures and options trading data, and the CFTC may request information on energy markets.
- Both agencies must treat information confidentially, unless it is furnished or derived from data in the aggregate.
- Requests must be in writing.
- Staffs of both agencies meet on a regular basis.



Access to Information

Record Retention

- Order No. 677, 71 Fed. Reg. 30,284 (May 26, 2006), FERC Stats. & Regs. ¶ 31,218
- Applies to holders of blanket certificates for unbundled natural gas sales services (pipelines and their affiliates) and to holders of market-based electric sales rate authorizations
- Extends from three to five years retention of data and information upon which these sellers billed the prices charged for jurisdictional natural gas sales or in transactions the prices of which were reported to price index publishers
- Intended to enable the reconstruction of prices



Parallels the five-year statute of limitations applicable to civil penalties for violations of Order No. 670.

Greater Due Process

No-Action Letters

- Interpretation of 18 CFR § 388.104 to allow industry to seek out staff advice on whether certain fact patterns or circumstances would trigger an enforcement action.
- Goal: to issue a response promptly to provide timely guidance to the requester.
- Difference from the Enforcement Hotline in three primary respects:
 - ✓ Limitation to the Standards of Conduct for Transmission Providers, Codes of Conduct, Market Behavior Rules (as now codified), and Anti-Manipulation Rule.
 - ✓ Statement whether staff would recommend that the Commission take enforcement action if a proposed transaction, practice, situation or other matter were implemented.
 - ✓ Publication of request and staff response to provide guidance to the regulated community, not just the persons who would be involved in the proposed matter.



Greater Due Process

Order No. 675

- Expands procedural rights of persons subject to operational audits under Federal Power Act, Natural Gas Act, Natural Gas Policy Act, and the Interstate Commerce Act.
- Applies rules applicable to subjects of financial audits since 1937.
- Audited persons may elect to file briefs with the Commission, or, in appropriate circumstances, participate in a trial-type hearing to challenge audit matters before the Commission makes its decision on the merits.



More Clarity

Enforcement Policy Statement

- Emphasized goal of firm but fair enforcement of its rules and regulations and its intention of placing entities subject to its jurisdiction on notice of the consequence of violating those rules and regulations
- Discussed the balancing FERC plans to conduct in determining the severity of penalties to be imposed on violations.
- Reserved the right to impose appropriate remedies and sanctions based on facts presented, including disgorgement of profits and penalties.



Statute mandates consideration of:

- Seriousness of the violation and
- Efforts to remedy the violation in a timely manner

Enforcement Policy (cont'd)

- Policy Statement identifies factors to consider regarding the seriousness:
 - What was the harm
 - Was the violation the result of manipulation, deceit, or artifice?
 - Was the action willful?
 - Is this a repeat offender?
 - Was senior management involved?
 - How did the wrong-doing come to light?
 - What effect would potential penalties have on the financial viability of the company?



Enforcement Policy (cont'd)

- Policy Statement identifies factors to consider for attempts to remedy the violation
 - Internal Compliance
 - Self-Reporting
 - Cooperation



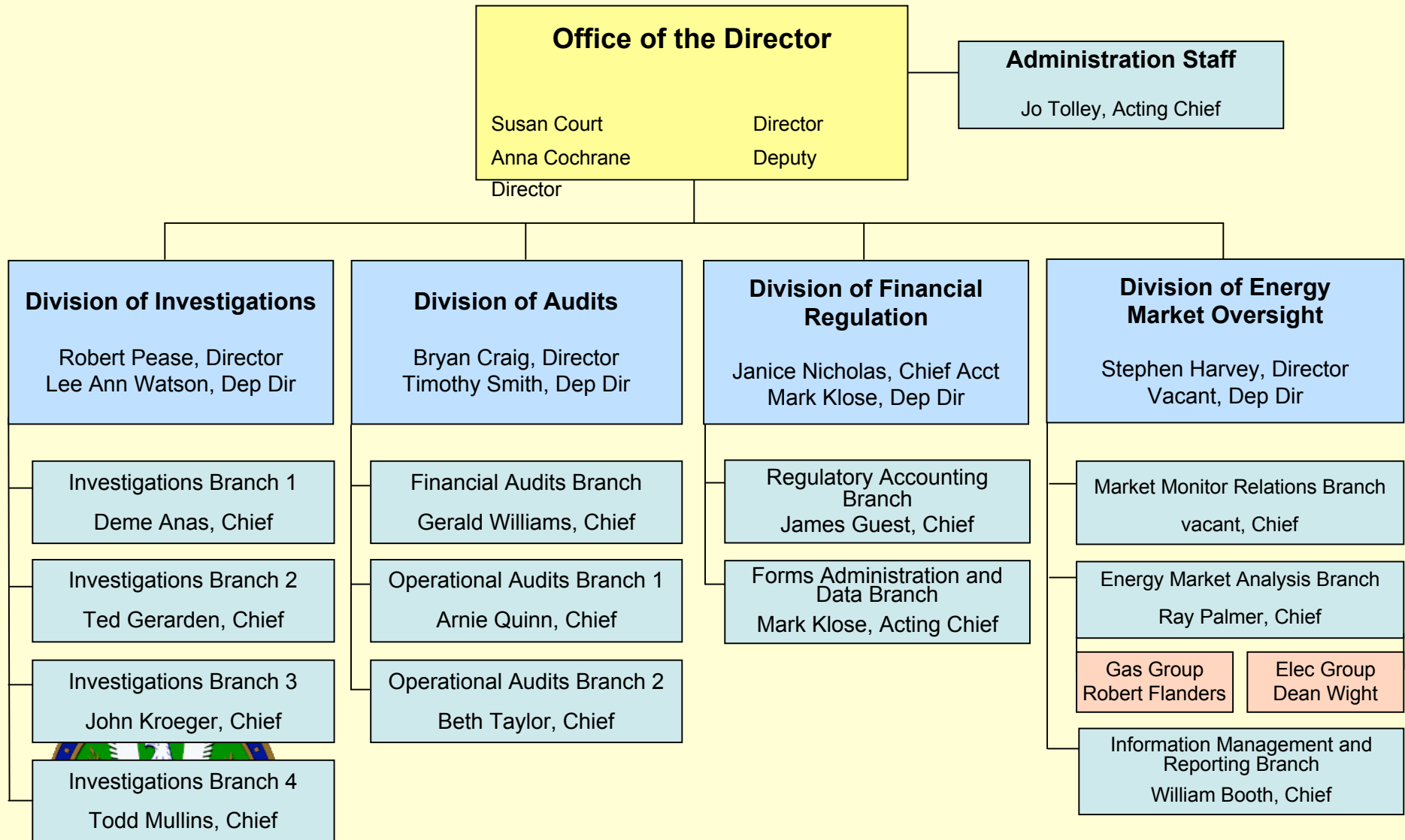
More Clarity

Web Package – www.ferc.gov

- Audit Process Memo
- Standards of Conduct FAQs
- Codes of Conduct (description and comparison to Standards of Conduct)
- Policy Statement on Enforcement
- No-Action Letters (Interpretive Order, How to File a Request for NAL, NAL Compared to Hotline, NALs)
- Overview of Order No. 670 and Comparison with Rescinded Market Behavior Rule 2



OFFICE OF ENFORCEMENT



Conclusion

**For the first time in its 70+ years,
FERC has an articulated
Enforcement Program
focused on
compliance and
fair but firm enforcement of its
statutes, rules,
regulations, and policies.**

