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FERC's 2017 Report on Enforcement Underscores Agency's Growing Surveillance and Importance of Robust Compliance Measures

By Charles R. Mills, Daniel A. Mullen, Shaun Boedicker, Natty Brower, and Karen Bruni*

The authors of this article review the Federal Energy Regulatory Commission Enforcement staff's 2017 Report on Enforcement, which highlights a number of statistics concerning the Office of Enforcement's activities over the past year, including 27 new investigations opened, 16 pending investigations closed, and 11 separate audits instituted that led to 301 recommendations for corrective action.

Federal Energy Regulatory Commission Enforcement staff released its 2017 Report on Enforcement[1] ("Enforcement Report"). The report highlights a number of statistics and case studies concerning the Office of Enforcement's activities over the past year: for instance, the Office of Enforcement opened 27 new investigations, closed 16 pending investigations, and instituted 11 separate audits that led to 301 recommendations for corrective action. The report shows an agency continuing to vigorously pursue its mission despite the uncertainty that attended the transition in administration and the lack of a FERC quorum for over half the year.

THE INCREASING ROLE OF THE DIVISION OF ANALYTICS AND SURVEILLANCE

The Enforcement Report highlights the Division of Analytics and Surveillance's ("DAS") important and growing role in the agency's enforcement program. DAS, which was created five years ago, conducts surveillance and analysis of the physical natural gas and electricity markets to detect potential manipulation, anti-competitive behavior, distorted financial incentives, and anomalous activity.[2] Concerning market activity generates an "alert" for further DAS analysis.

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[1] https://www.ferc.gov/legal/staff-reports/2017/11-16-17-enforcement.pdf.

[2] Report at 53.

In 2017, DAS evaluated nearly 320,000 surveillance "alerts," 4,744 in the natural gas markets and 314,824 in the electricity markets. In the natural gas markets, this led to 17 inquiries to market participants, and two referrals to the Division of Investigations ("DOI") for investigation. In the electricity markets, it led to 31 inquiries to market participants, and four referrals to DOI for investigation.

Members of the DAS team regularly work with attorneys from DOI in on-going investigations. In addition, "DAS develops, refines, and implements surveillance tools and algorithmic screens to perform continuous surveillance and analysis of market participant behavior, economic incentives, operations, and price formation."[3] To fulfill this mission, DAS receives, on average, "approximately six gigabytes of data in more than 1,000 tables each day from the six organized [electricity] markets combined."[4]

Market participants in both natural gas and electricity markets should have internal procedures for responding to DAS inquiries. Clear and accurate responses at the outset could save a market participant from a time consuming and costly investigation by DOI, or even a significant penalty. The Enforcement Report provides examples of the same:

- In one instance, DAS surveillance in the natural gas markets identified a market participant that was buying at elevated prices and with a high market concentration during bidweek. The market participant held benefitting positions tied to the index settlement. DAS inquired about the trades, both physical and financial, which the company was able to sufficiently explain thanks to internal documentation pertaining to why each of the trades was placed. After reviewing this information, the inquiry was closed without referral to DOI.[5]
- In the electric market, DAS surveillance screens identified fixed-price next day sales that were uneconomic when marked against the daily index. DAS inquired about the transactions, and the entity was able to provide sufficient documentation and explanation for the trades to demonstrate they were not made with manipulative intent. Only after reviewing the information provided was DAS able to close the inquiry without referral to DOI.[6]
- In a separate case in which DOI opened an investigation following a

[3] *Id.*

[4] *Id.*

[5] *See* Report at 56.

[6] *Id.*

> referral from DAS's surveillance group, the investigation was subsequently closed following interviews with the traders and review of relevant documentation and other evidence. As the report notes, the traders in the case "directed staff to documents and data that they believed would corroborate their legitimate explanations for their trading activity. Staff's review of the contemporaneous documents confirmed important aspects of the traders' testimony . . ."[7]

In contrast, haphazard or poorly thought-out responses to DAS inquiries can be highly detrimental. Establishing internal procedures for preparation of contemporaneous documentation explaining trading purposes and strategies can be an integral part of compliance plans for FERC-jurisdictional entities. These cases amplify the importance and potential value of such a program given the growing potential that a market participant will receive an inquiry from DAS.

SELF-REPORTING POTENTIAL VIOLATIONS

The Enforcement Report underscores that self-reporting of potential violations remains a significant feature of FERC Enforcement. During the past five fiscal years, Enforcement has received approximately 452 self-reports. "The vast majority" of those self-reports were concluded without further enforcement action. Reasons for closing the files on self-reports included that there was no material harm (or the reporting companies already had agreed to remedy any harms), and the companies had taken appropriate corrective measures (including appropriate curative filings), both to remedy the violation and to avoid future violations through enhancements to their compliance programs. In Fiscal 2017, FERC staff received 80 new self-reports and closed 121 self-reports without further action.

This agency history indicates the prudence of early evaluation of whether to self-report or not when compliance problems arise. Legal counsel should be consulted in making that assessment. It requires careful consideration of the need, the pros and cons, and the necessary follow up if a self-report is made.

The Enforcement Report described the following examples of self-reports that were closed without enforcement action:

- *Shipper Must Have Title and the Prohibition on Buy-Sell Transactions.* A large public utility self-reported, on behalf of certain recently-acquired retail natural gas marketing subsidiaries, violations of FERC's prohibition against Buy-Sell transactions and the Shipper Must Have Title Requirements. The violations were discovered by employees as a result

[7] *Id.* at 30.

of compliance training. Staff closed the matter with no further action because the violations: (1) were inadvertent; (2) involved modest volumes of gas; and (3) did not result in harm to other market participants.

- *Oil Tariff Violation*. A jurisdictional common carrier oil company self-reported that it owned and operated a crude oil pipeline for approximately two years prior to filing a tariff or obtaining a waiver of the relevant tariff filing provisions of the Interstate Commerce Act ("ICA") and FERC's related regulations. In addition to self-reporting, the company filed a request for a temporary waiver of the filing requirements and the ICA, which FERC subsequently granted. Enforcement closed the self-report without further action because there was no harm to the market, the company promptly self-reported and remedied the violation when it was discovered, and put measures in place, including training its employees, to prevent future similar violations.
- *Natural Gas Transportation*. A formerly intrastate pipeline made jurisdictional sales without first receiving a Blanket Certificate from FERC. The pipeline previously had operated entirely intrastate, but began transporting a small quantity of gas across state lines when the flow of the pipeline was reversed. The pipeline was unaware of the interstate sales and filed an application for a Blanket Certificate upon learning of them. Given the small volume of sales, the lack of intent to avoid Commission jurisdiction, and the pipeline's remedial steps (namely the filing of an application with FERC), staff closed the self-report without further action.
- *Violation of the Standards of Conduct.* A vertically-integrated utility with an affiliated power marketer self-reported a violation of the Standards of Conduct under Part 358 of FERC's regulations. A non-marketing function employee who had received information about an upcoming outage forwarded that information to a distribution list that included marketing function employees. Unbeknownst to the non-marketing function employee, the outage information was not publicly available at the time, and thus the disclosure to marketing function employees was prohibited by FERC's Standards of Conduct, which generally prohibits transmission function employees from conveying non-public information to marketing function employees. The error was promptly discovered, remedied, and self-reported. Because the violation was isolated, inadvertent, limited in scope and potential impact, and was promptly reported, Enforcement took no further action.

- *Electricity Trading Violation.* A company self-reported that due to manual error, it placed erroneous offers by entering Economic Minimum and Economic Maximum parameters with the same value (zero or one) for three hours on one day. Because of the erroneous parameters, the offers were not in the dispatchable range. The offers violated the RTO/ISO tariff and FERC regulations that provide sellers must provide accurate and factual information to ISOs. Staff closed the matter without further action because the company implemented procedures to prevent future occurrences, and the violation was limited in scope, inadvertent, promptly self-reported, and did not result in any discernable harm to the market.
- *RTO/ISO Violations.* Multiple RTO/ISOs reported relatively minor violations of their tariffs, resulting from either software errors or human errors. In all such instances, the harm from the self-reported violations was relatively small and inadvertent, and the RTO/ISO took appropriate steps to ameliorate any such harm and prevent future violations. Accordingly, staff closed those matters with no further action.
- *Violation of the Standards of Conduct.* A utility self-reported that when informing its employees of the removal of a high-voltage transmission line from service, the distribution list used erroneously included six marketing function employees, who consequently received the information before it was made public on the utility's Open Access Same-Time Information System. Part 358 of FERC's regulations prohibits transmission function employees from preferentially conveying non-public transmission function information to marketing function employees. The utility immediately conducted an internal review, requested that the marketing function employees delete the email, and submitted a self-report. Staff closed the matter without further action because the violation was limited to a single instance, was unintentional, and did not result in any identifiable harm.
- *Shipper Must Have Title Violation.* A natural gas pipeline self-reported a violation of the Shipper Must Have Title rule when it incorrectly transported gas owned by third parties using a shipping contract controlled by a different entity. An employee of the pipeline erroneously transported volumes not controlled by a third party on the third party's contract. Immediately upon realizing the error, the operator's employees notified compliance and senior management personnel, and reimbursed the third party for the incorrect use of its shipping contract. Because the violation lasted less than 24 hours, was not intentional, and was quickly identified through the pipeline's internal compliance

processes, staff closed the matter without further action.

CONCLUSION

FERC's Enforcement Report makes clear that market participants can expect continued inquiries from DAS and underscores the importance of responding to them timely and accurately. The Report also demonstrates the potential benefits from self-reporting violations and reinforces how a rigorous compliance program and prompt and thorough assessment of potential violations can minimize exposure to enforcement investigations and actions.