

CLIENT ALERT

Hidden Insights in the FERC 2017 Report of Enforcement

November 29, 2017

AUTHORS

Paul J. Pantano, Jr. | Thomas R. Millar

On November 16, 2017, the staff of the Federal Energy Regulatory Commission's Office of Enforcement ("OE" or "Staff") issued its 2017 Report on Enforcement (the "Report") for the fiscal year ending September 30, 2017.¹ The Commission requires OE to prepare the Report in order to inform the public of the activities of the Office of Enforcement and its four Divisions: the Division of Investigations ("DOI"); the Division of Analytics and Surveillance ("DAS"); the Division of Audits and Accounting ("DAA"); and the Division of Energy Market Oversight ("DEMO").²

OE Staff announced that its priorities remained unchanged in 2017. OE continues to focus on:

- fraud and market manipulation;
- serious violations of the Reliability Standards;
- anticompetitive conduct; and
- conduct that threatens the transparency of regulated markets.

OE also announced that it has no plans to change these priorities in the coming year. We offer below our view of the most noteworthy insights to be gleaned from the Report.

¹ Available [here](#).

² Enforcement of Statutes, Regulations and Orders, 123 FERC ¶ 61,156 at P 12 (2008) (Revised Policy Statement).

Hidden Insights in the FERC 2017 Report of Enforcement

Most FERC Enforcement Investigations Arise from Referrals by the Division of Analytics and Surveillance or RTO / ISO Market Monitors

OE stated that during 2017, DOI staff opened 27 investigations, as compared to 17 investigations opened in 2016. “The vast majority of these new investigations arose from referrals by DAS and/or RTO / ISO market monitors, with several others coming from the Commission or other program offices.”³ This statistic serves as a reminder that it is important to exercise caution when trading in RTOs / ISOs. It is also important to be careful when communicating with DAS and RTOs / ISOs, particularly RTO / ISO market monitors. Companies should always involve legal, compliance or both in their communications with DAS and market monitors.

Sloppy Natural Gas Transaction Reporting Can Lead to a Market Manipulation Investigation

OE announced in the Report that it had closed an investigation of a company that self-reported its multi-year failure to report natural gas transactions and erroneous reporting. The self-report triggered an investigation by DOI into whether the non-reports and incorrect reports were part of a manipulative scheme. DOI concluded that there was no manipulative scheme and that “the observed behavior was the result of sloppiness and a lack of internal controls, not an intent to manipulate.”⁴ Despite the fact that, in OE’s view, the conduct did cause a small amount of market harm, DOI closed the investigation without action because of the voluntary self-report and the implementation of changes that would prevent future recurrences.

When Is an Investigation Complete?

Anyone who has ever been involved in a FERC enforcement investigation knows that discovery is one way: only the Staff can demand documents and testimony, including from third-parties. When involved in OE’s investigatory process, most people logically would assume once OE tells the Commission that it believes that a violation has occurred and seeks settlement authority, the investigation has concluded. This is important because once an investigation is complete, the Staff’s authority to issue subpoenas and take testimony under a Commission Order of Investigation should expire. That, however, is not the view of OE or the Commission. OE stated in the Report, “[w]here settlement efforts fail, DOI may seek additional evidence, recommend that the Commission initiate a public show cause proceeding, or both.”⁵

The Commission advanced a similar position in the U.S. District Court for the Eastern District of California. There, an individual defendant and OE entered a tolling agreement that ended upon written notice from OE to the individual that the

³ Report at 23.

⁴ *Id.* at 30.

⁵ *Id.* at 6.

Hidden Insights in the FERC 2017 Report of Enforcement

investigation was complete.⁶ Citing to its own decision in the administrative proceeding, the Commission argued that the investigation does not end until penalties are assessed or the investigation is formally terminated.⁷

The court side-stepped the argument over whether the investigation actually terminated. It asked instead whether the Enforcement Staff Report and Recommendation attached to the Order to Show Cause gave the individual written notice within the meaning of the tolling agreement that the investigation had terminated irrespective of whether it actually had. On that point, the court decided that OE's many statements of conclusion in its report—e.g., “staff has concluded that”—provided notice of termination of the investigation for purposes of the tolling agreement.⁸ Although the court's decision avoided resolving when an investigation actually ends, consistent with the commonsense reasoning of the court, there may be good arguments that investigations end when the Order to Show Cause issues.

Inaccurate Advice of Counsel Can Provide an Effective Defense (Though We Have No Plans to Begin Offering this Service)

The Report recounted that a natural gas company filed a self-report explaining that it had failed to file FERC Form 552, Annual Report on Natural Gas Transactions, based upon “inaccurate advice of counsel.”⁹ OE explained that it closed the matter without action because once the company learned that the advice was incorrect, it quickly filed the report and explained the unintentional error, which did not result in market harm.

Self-Reporting at FERC, Unlike Self-Reporting at the Commodity Futures Trading Commission, can Successfully Avoid an Enforcement Proceeding and Sanctions

OE indicated that in 2017 it received 80 new self-reports and closed 121 self-reports without further action. During the last five years, OE received approximately 452 self-reports, “the vast majority” of which were concluded without further enforcement action.¹⁰ OE and the Commission deserve credit for overseeing an enforcement regime that provides a meaningful incentive to self-report and for exercising their discretion not to bring an enforcement action in response to every self-report. Unlike FERC's approach, the Commodity Futures Trading Commission (“**CFTC**”) moves forward with enforcement actions related to self-reports in all but “extraordinary circumstances.”¹¹

⁶ *FERC v. Smith, et al.*, No. 2:13-cv-02093 (Oct. 9, 2013).

⁷ *FERC v. Smith, et al.*, No. 2:13-cv-02093, Pl.'s Opp. to Def. Mot. For J. on the Pleadings at 11, 14-16 (ECF No. 234, Aug. 10, 2017) (citing 143 FERC ¶ 61,024 at P 33 (2013)).

⁸ *Id.* at 5.

⁹ Report at 22.

¹⁰ *Id.* at 16.

¹¹ See *CFTC Enforcement Division Dangles Self-Reporting Carrot: Is it Worth Taking a Bite?* (Willkie Client Alert dated Sept. 28, 2017), available [here](#).

Hidden Insights in the FERC 2017 Report of Enforcement

The Report Acknowledges Adverse Federal Court Decisions on De Novo Review, but also Omits Important Adverse Precedent

The Report stated that there are “five” ongoing United States District Court litigations to enforce civil penalty assessments under the Federal Power Act (“FPA”). However, the Report discussed only four FPA cases, and omitted two decisions from a case in the U.S. District Court for the Eastern District of California that are adverse to FERC’s positions on a number of important topics. The inconsistency may be a drafting error that resulted from confusion about how to handle the recently-settled case. OE acknowledged that other decisions on the scope of *de novo* review under the FPA have held that FPA penalty assessment actions must proceed as ordinary civil actions under the Federal Rules of Civil Procedure.

The Division of Analytics and Surveillance Offers New Information on Closed Investigations

For the first time, the Division of Analytics and Surveillance included a section describing matters that DAS investigated and closed without a referral to DOI. This section of the Report reveals that, as a matter of OE’s internal process, DAS may close a matter before sending it to DOI. DAS summarized two electricity and two natural gas matters closed without referral. The common thread in the summaries is that the subjects were able to convince DAS of a lawful reason for their trading behavior in each instance. This is an interesting contrast to two of the summaries of matters closed by DOI, which take a different tone. DOI closed those investigations only after DOI “concluded there was not sufficient evidence of scienter to find a violation.”¹² Every effort should be made to convince DAS of the legitimacy of the conduct that it is reviewing because it is generally the case that DOI is more difficult to convince if DAS refers the matter to them.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

Paul J. Pantano, Jr.
202 303 1211
ppantano@willkie.com

Thomas R. Millar
202 303 1144
tmillar@willkie.com

¹² Report at 30-31.

Hidden Insights in the FERC 2017 Report of Enforcement

Copyright © 2017 Willkie Farr & Gallagher LLP.

This alert is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This alert may be considered advertising under applicable state laws.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.