CLIENT ALERT

Hidden Insights in the FERC 2018 Report of Enforcement

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On November 15, 2018, the staff of the Federal Energy Regulatory Commission's Office of Enforcement ("**OE**" or "**Staff**") issued its 2018 Report on Enforcement (the "**Report**") for the Commission's fiscal year ending September 30, 2018.[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; and the Division of Energy Market Oversight.[2]

OE announced that its priorities remained unchanged in 2018. It continued to focus on:

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

As of the end of 2018, Staff is seeking to recover a total of approximately $317 million in civil penalties and $20 million in unjust profits in its pending federal court matters and two proceedings before the Commission. We highlight below the most noteworthy insights gleaned from the Report.

[1] *Available here.* All references to yearly totals in this document refer to FERC's fiscal year ending September 30, 2018.

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

New Investigation Numbers Belie the Apparent Relative Lack of Enforcement Activity

OE stated that in 2018, DOI staff opened 24 investigations, as compared to 27 in 2017 and 17 in 2016. Although the number of investigations opened in 2018 appears similar to the numbers opened in 2017 and 2016, the Commission issued only one new Order to Show Cause in 2018. Staff noted that it "awaits the Commission's decision on one FPA Order to Show Cause . . . and two NGA proceedings in which the respondent's motion for rehearing is under consideration." Report at 7.

New Investigations Continue to Be Originated Mainly by Market Monitors

DOI reported that of the 24 investigations opened in 2018, the "majority" resulted from referrals by ISO/RTO market monitors. This shows that it is very 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 OE, including DAS and market monitors.

Staff Very Rarely Closes an Investigation Where it Finds a Violation

If Staff believes serious wrongdoing has occurred and can prove it, it will generally not close an investigation without action. Of the 29 investigations that Staff closed in 2018 without action or through settlement, Staff closed only one where it determined that there was wrongdoing. Report at 7.

Staff described one instance in which it closed a matter without action where it found a violation. In the investigation, a hydropower facility had been operating without the proper license. When Staff learned of this and contacted the project owner, the owner said he would no longer generate without a license and sold the unit to a third party who committed not to generate before securing proper licensure. Meanwhile, the project was disconnected from the grid and the power purchase agreement with the local utility was terminated. In that unique circumstance and for those unique reasons, Staff closed the investigation without further action. Report at 32.

Staff will, however, close investigations where there is no evidence of improper intent or where contemporaneous evidence supports a determination that the action under investigation was lawful. For example, Staff summarized an electric demand response market manipulation investigation that it closed on the basis that the Curtailment Service Provider "credibly asserted that it had a good faith intention at the time of the [relevant] auction to procure the requisite demand response resources" and its "large buy-back appeared to have been legitimately motivated by a rapid change in its expectations for expanding its customer base." Report at 31.

Staff Closed a Tranche of Reactive Power Compensation Investigations

Staff closed, without further action, 10 investigations opened to determine whether the public utility owners of certain generators improperly received reactive power revenues in violation of the Federal Power Act, Commission regulations, or applicable tariffs. Staff found that the ISOs/RTOs were paying utilities based on their Commission-approved reactive power revenue requirement tariffs, many of which were established for fleets of generators. When the fleet-based rates were approved, the tariffs did not require the generator owners to update them if changes in the fleets occurred. Nor did the ISO/RTO tariffs require the utilities to update their reactive power revenue requirement tariffs.

Any time Staff closes a tranche of 10 investigations, it is significant. Some may wonder whether the closure of these investigations reflects changed priorities at the Commission. In prior matters, Staff has at times pursued enforcement action based upon allegations not that market participants violated any specific tariff rule, but that the participant traded in a manner inconsistent with the purpose of the product that they traded; e.g., trading Up-To-Congestion ("**UTC**") contracts for the purpose of collecting out-of-market rebates, rather than arbitraging locational price differences.[3]

The facts underlying the reactive power investigations appear, at least at face value, to be susceptible to an argument that the actions were not consistent with the purpose of reactive power compensation. The compensation paid was supposed to reflect the makeup of the generator or fleet. The generators or fleets changed, and units were retired, yet the parties receiving payments continued to benefit without saying anything. The Report does not indicate why Staff dropped the investigation, only that it "found no evidence of fraud, manipulation or tariff violations." Report at 33. Whether that was because Staff's priorities or legal views have changed or because the underlying facts were materially different from those in the UTC cases is not apparent from the Report. Market participants will have to continue to monitor Staff's and the Commission's activities for further hints of any potentially-developing enforcement trends.

Self-Reporting at FERC Continues to Be a Potential Way to Avoid an Enforcement Proceeding and Sanctions

OE indicated that in 2018 it received 80 new self-reports and closed 137 self-reports (including many from prior years) from a variety of market participants, including public utilities, natural gas companies, generators, and ISO/RTOs. Most involved "relatively minor" tariff violations. Report at 17. Staff closed 136 self-reports in 2018, only 14 of which carried over from 2017. In the examples of self-reports that were closed without action, Staff consistently found no evidence of improper intent and no harm to the market. In contrast to FERC's approach, the Commodity Futures Trading Commission generally moves forward with enforcement actions related to self-reports in all but "extraordinary circumstances."[4]

The Division of Analytics and Surveillance Continues to Offer New Information on Closed Investigations

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[3] *See, e.g.*, *FERC v. Powhatan Energy Fund, LLC*, No. 3:15-cv-00452-MHL; *FERC v. City Power Mktg.*, 196 F. Supp. 3d 218 (D.D.C. 2016).

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

Last year, for the first time, DAS 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. In fact, earlier this year, we convinced DAS to close its investigation without referral to enforcement.

District Court Actions

Staff represented the Commission in three cases, each of which remains pending. The status of each case is summarized below:

- ***FERC v. Silkman, et al.*, No. 1:13-cv-13054 (D. Me.).** On January 29, 2018, based upon an agreement between the parties, the court ordered summary judgment briefing on the applicability of the statute of limitations. The parties completed briefing on the cross-motions for summary judgment on April 20, 2018. Oral argument has not been scheduled, and the court has not decided the motions.

- ***FERC v. Powhatan Energy Fund LLC, et al., No. 3:15-cv-00452 (E.D. Va.).*** The Commission filed an amended complaint on January 29, 2018, and Defendants moved to dismiss, in part, based on statute of limitations grounds on February 28, 2018. On September 24, 2018, the Court found that the Commission had filed the case within the statute of limitations period but took the unusual step of authorizing Defendants to seek interlocutory appeal. On October 4, 2018, Defendants petitioned the United States Court of Appeals for the Fourth Circuit to review the order, and the Commission did not oppose the appeal. The district court case has been stayed pending resolution of the appeal.

- ***FERC v. Coaltrain Energy L.P., et al., No. 2:16-cv-00732 (S.D. Ohio).*** On July 27, 2016, Staff filed a petition in the United States District Court for the Southern District of Ohio to enforce the Commission's order. The Defendants filed motions to dismiss or transfer, which were denied by order of the court on March 30, 2018. Discovery commenced shortly thereafter and is currently scheduled to run through June 2019.

Administrative Hearings

Staff reported on three ongoing administrative hearings at the Commission:

- ***Footprint Power LLC, Footprint Power Salem Harbor Operations LLC, Docket No. IN18-7-000.*** Staff described the status of this matter as pending the Commission's review of the responses to the Order to Show Cause. In an unprecedented move, Staff filed a reply brief with the Commission in which it admitted fatal errors in its original recommendation that the Commission issue an Order to Show Cause and reversed its recommendation. If the Commission heeds Staff's advice, it will be a rare instance in which the Commission has issued an Order to Show Cause and not followed through with an Order Assessing Civil Penalties.

- ***BP America Inc., et al., Docket No. IN13-15-000.*** On December 11, 2017, BP filed a motion with the Commission for rehearing or to dismiss based upon *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) and other precedent. BP contends that a Commission Order to Show Cause does not initiate a "proceeding" under the applicable federal statute of limitations, 28 U.S.C. § 2462, and therefore, this case was not timely brought and should be dismissed. BP also argues that it cannot be ordered to repay its unjust profits because the same statute of limitations applies to actions for disgorgement under *Kokesh*. OE's response was filed on January 25, 2018. The Commission is reviewing the pleadings.

Settlements

In 2018, the Commission approved six settlement agreements. The settlements totaled approximately $83 million in civil penalties and disgorgement of more than $66 million. Most of the violations that settled in 2018 involved market manipulation and/or false statements. The others involved violations of reliability standards and tariff violations.

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