

FERC Enforcement Developments

March 13, 2015

During the past few months, there have been a number of important developments concerning FERC enforcement matters. FERC Enforcement staff is involved in four cases that are currently in litigation either before a FERC administrative law judge or in Federal district court. This is the easily the most cases that FERC Enforcement has had in court at any one time. In addition, FERC has three other cases in the order to show cause stage and it appears that all three may also end up in federal court. There are a number of consequences from this unprecedented amount of enforcement litigation. First, market participants should get some clarity from the courts on the reach of the FERC anti-manipulation rule. These are the first court challenges on the rule. Second, FERC enforcement investigations have slowed considerably. While FERC has significant resources devoted to enforcement, FERC did not staff that division expecting this many simultaneous court actions. Absent a considerable influx of staff, FERC investigations will take longer to resolve. Below is a summary of some of the recent key enforcement cases and developments. **BP America, Inc.**, Docket No. IN13-15 This matter, currently before a FERC administrative law judge, involves allegations of cross market manipulation. FERC Enforcement alleges that BP lost money on physical transactions to benefit financial positions. The critical piece of evidence in the case is a recording between two traders that, according to FERC, shows that the traders were manipulating the markets. BP is challenging FERC's assertions and claiming, among other things, that the transactions at issue were intrastate and thus FERC lacks jurisdiction. BP also maintains that the physical and financial data do not support a charge of manipulation. FERC is seeking \$28 million in civil penalties and an additional \$800,000 in disgorgement. An interesting note in this case is that despite over six years of investigation, including but not limited to data requests and depositions, FERC Enforcement is still actively engaged in discovery during this administrative phase of the case. Prior to the matter going to an ALJ, BP was not afforded an opportunity to conduct any discovery so it was not surprising that BP has been very active with discovery against FERC. FERC Enforcement, on the other hand, has been investigating BP since 2008. Nevertheless, it has sent numerous new data requests to third parties presumably to bolster its case that the transactions were indeed interstate in nature. FERC has also taken over a dozen depositions since the case was set for hearing before the ALJ. **Federal Energy Regulatory Commission v. Barclays Bank PLC**, Docket No. 2:13-cv-02093 U.S. District Court for the Eastern District of California This case is in Federal district court in California and also involves allegations of cross market manipulation. FERC is seeking \$435 million in civil penalties from the company and four individuals along with \$34.9 million in disgorgement. Barclays has moved to dismiss the case arguing, among other things, that it does not own or operate electric generating facilities and its transactions did not result in any electricity actually flowing. Barclays states that it operates as an intermediary and its

trading positions are flat at the end of each day. FERC, according to Barclays, only has jurisdiction over the actual flows of electricity and the trading here falls under the exclusive jurisdiction of the Commodity Futures Trading Commission. The individual defendants claim that FERC lacks the authority to impose a civil penalty against an individual person. Instead, the statute applies to "any entity" and "entity" does not cover individuals under the Federal Power Act. The court held oral arguments on Barclays' motion to dismiss on February 26, 2015 but has not yet issued a ruling on the motion. **Powhatan**, Docket No. IN15-3 On December 17, 2014, FERC issued an Order to Show Cause to Powhatan which Powhatan responded to on February 2, 2015. FERC accused Powhatan of manipulating the up to congestion market (UTC) by making the equivalent of riskless wash trades while capturing out of market payments. UTC trades are designed to capture the price spread between two points. FERC alleges that the Powhatan made virtual trades in opposite directions on the same paths, in the same volumes and during the same hours. Because the trades were from point A to point B and then the reverse B to A, the trades were almost riskless according to FERC. PJM treats UTC transactions as it does any other transmission transaction, thus Powhatan was eligible to collect marginal loss surplus allocations, or line loss payments, from PJM. By trading in large volumes, Powhatan was able to capture significant transmission line loss payments that made the transactions profitable. FERC is seeking over \$28 million from Powhatan and its affiliated companies as well as \$1 million from its chief trader. Powhatan has vigorously defended its actions throughout this proceeding and has taken the unusual step of making most of the investigative documents public through a web site it created for this purpose. See <http://ferclitigation.com>. Powhatan claims that it complied with all of PJM's rules and argues that if FERC and PJM think the rules are flawed, they should change the rules and not use enforcement as a substitute for correcting loopholes in the rules. The firm argues that the trades were not riskless and that indeed Powhatan had some significant losses trading in the UTC market. However, those losses occurred when Powhatan was trading at similar nodes instead of the same nodes in the opposite direction. FERC alleges that this change in bidding pattern supports its view that the transactions were manipulative. Pursuant to the Federal Power Act, "defendants" in FERC enforcement cases may seek *de novo* review in district court or have the case heard before a FERC administrative law judge. Powhatan has refused to pay the penalties and exercised its right to seek *de novo* review before a federal district court. FERC has yet to issue a final penalty determination. BP did not have a similar option to seek *de novo* review in federal district court pursuant to the Natural Gas Act and exercised the only option available to it " a hearing before a FERC administrative law judge. Also of note in the Powhatan matter is PJM's response to Powhatan. PJM, as well as the market monitor, maintain that market participants are held to "higher standard" when trading in wholesale markets compared to other financial markets. PJM stated that Powhatan's effort to defend its admitted exploitation of PJM's market illustrates only its failure to appreciate the unique legal and regulatory framework governing organized wholesale electricity markets. The electricity business, at its core, is still a public service in which Congress has mandated that consumers pay just and reasonable prices.

The FERC, and in particular its enforcement staff, are charged with ensuring just and reasonable outcomes even in competitive wholesale markets in which trading concerns like Powhatan participate. This statutory mandate and the FERC's regulatory mission differ significantly from

the regulation of traditional financial markets and the role played by the Securities and Exchange Commission. The exploitation of loopholes "“ although of questionable benefit to society "“ might be lawful behavior in financial and other commodity markets. In electricity markets, however, the Federal Power Act imposes a higher standard to protect consumers and other market participants from activities that increase prices without providing any accompanying benefits. This fundamental distinction is evidently lost on Powhatan.

Richard Silkman, Docket No. 1:13-cv-13054 and **Lincoln Paper**, Docket No. 1:13-cv-13056, U. S. District Court, District of Massachusetts The Silkman and Lincoln Paper cases involve allegations of manipulating the demand response market. FERC is seeking a \$1.25 million penalty against Silkman and a \$5 million civil penalty against Lincoln Paper along with \$379,000 in disgorgement. Both cases are in the same federal district court and are currently held in abeyance in light of the federal appellate court decision invalidating FERC's demand response program. **City Power Marketing**, Docket No. IN15-5 On March 6, 2015, FERC issued an Order to Show Cause against City Power and its chief trader. This is another UTC manipulation case where FERC is seeking a \$14 million civil penalties against City Power and an additional \$1 million against the chief trader. FERC Enforcement is also alleging that City Power made false statements to the market monitor. The facts are very similar to the Powhatan case discussed above. FERC is again arguing that the transactions were wash like trades with no risk designed solely to capture line loss payments. City Power has 30 days to respond to the Order to Show Cause. **Maxim Power**, Docket No.15-4 On February 2, 2015, FERC issued an Order to Show Cause for alleged violations of the anti-manipulation rule through a scheme to mislead the ISO-New England market monitor to collect make-whole payments for reliability dispatches based on the price of oil when Maxim's plant actually burned less expensive gas. FERC has proposed a \$5 million civil penalty and an additional penalty of \$50,000 against Maxim's executive. Maxim disputes FERC's charges arguing that it did not mislead the ISO and instead was engaged in a risk minimization strategy of bidding its dual fuel units on oil because of the risk of being dispatched on natural gas and not being able to procure it. Maxim states that it could lose up to \$300,000 on one day alone if it is dispatched on gas but forced to run on oil. Enforcement is wrong, according to Maxim, in claiming that because Maxim purchased some gas in advance of its bids, Maxim knew it would be dispatched and run on gas despite bidding on oil. Maxim states that it never knew when it would be dispatched. Should FERC proceed with this case, Maxim has invoked its right to have the matter heard before a Federal district court. **Tenaska Audit** FERC recently released its audit findings against Tenaska. This matter is significant from a precedent standpoint because FERC imposed enhanced compliance monitoring controls for the first time. FERC required Tenaska to monitor trading activities during particular market conditions. FERC did not specify under what conditions Tenaska should enhance its monitoring but it appears FERC was thinking of events such as the Polar Vortex. FERC also required Tenaska to increase its awareness of market conditions when traders transact and to monitor changes in trading strategies. Tenaska agreed to the enhanced monitoring requirements.