

## Insights

# BETWEEN THE LINES: DRAWING INSIGHTS FROM FERC OE'S ANNUAL REPORT ON ENFORCEMENT

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Pursuant to the Federal Energy Regulatory Commission's (FERC or Commission) Revised Policy Statement on Enforcement, the Commission's Office of Enforcement (OE) each year publishes "annual statistical reports" summarizing its enforcement activities during the preceding fiscal year (FY). Consistent with that directive, OE's Annual Report on Enforcement (Annual Report) contains statistical information about the activities of each of its components, the Division of Investigations (DOI), the Division of Audits and Accounting (DAA), and the Division of Analytics and Surveillance (DAS). These statistics convey important information about the year's activity and broader enforcement trends. Following OE's presentation of the FY 2022 report at the Commission's November 2022 open meeting, Chairman Glick summarized these broader trends quite succinctly: after a multi-year "lull," "it's like having the cop back on the street." That is, after several years of muted enforcement activity, OE has stepped up its intensity and will likely maintain this trajectory in the coming years.

But statistics and the broader trends they reveal are only the tip of the iceberg. The Annual Report also contains a great deal of background information about the nature of OE's divisions and the role they each play in fulfilling the Office's enforcement mission. The illustrative blurbs set forth in each section describing various matters handled, opened, or closed during the year can also be very instructive. These carefully curated selections reveal OE's priorities, its thought processes. They serve to flag specific types of activity for the regulated community to better evaluate their own compliance. DAA's accounting blurbs are especially useful for their volume and specificity. The DAA section of the Annual Report should be mandatory reading each year for employees involved in FERC jurisdictional accounting and rate design.

### Investigations: Insights from the 2022 Annual Report

Unlike DAA's periodic risk-based public audits (which typically do not result in civil penalties), the opening and closing of investigations are generally less transparent and more reactive. For these reasons, an entity seeking to enhance its compliance posture and minimize enforcement risk will want to scrutinize the Annual Report carefully for clues about OE's methods and priorities.

*DAS Surveillance – from Screen Trip to DOI Referral*

As detailed in the Annual Report, DAS performs many important functions. In this context, the most relevant ones are market surveillance and identification of potential investigative subjects. As a general proposition, DAS's surveillance apparatus is primarily designed to detect potential instances of market manipulation and anti-competitive behavior. The statistics tell an important story here: from 16,766 natural gas screen trips, only 26 instances warranted surveillance inquiries, with zero referrals to DOI for investigation; for the electric markets, 32 inquiries came from 525,865 (!) screen trips, with two matters being referred to DOI for further investigation. The Annual Report explains that the filter between each step of evaluation, from screen trip to referral, is whether there is a plausible non-manipulative explanation for the observed behavior sufficient to allay staff's concerns. Most of this analytical work occurs before the subject is contacted. This means that by the time staff contacts the Market Participant, DAS has reviewed a significant amount of data, is familiar with the market conditions relating to the inquiry, but remains unsatisfied as to the reason for or legitimacy of the identified activity. This highlights the importance of communications with DAS staff.

The FY 2022 illustrative surveillance inquiries closed with no referral are instructive regarding DAS's surveillance priorities. In the seven examples provided, we see two broad categories of behavior targeted: (1) "related position" market manipulation; and (2) "gaming" market manipulation.

Although five of the examples involved instances of potential related position market manipulation, this does not mean that potential gaming behavior is less of an enforcement risk or less of a DAS priority. The common thread in all of the examples: concern about a Market Participant potentially entering a transaction to profit from something else, whether that something else is a related physical or financial position or an out of market uplift payment. With this in mind, it is important for energy traders to understand what the Commission views as market manipulation and, in turn, what kinds of strategies and behaviors are likely to draw scrutiny. Likewise, trading managers and compliance professionals can explore best practices and compliance enhancements ahead of time to improve the chances that DAS staff will be satisfied before a screen trip evolves into a referral to DOI for further investigation.

#### *Investigations – observations from FY 2022*

DOI's illustrative investigations and self-reports closed with no action both provide valuable information for the regulated community.

Consistent with the recent issuance of the expanded Duty of Candor Notice of Proposed Rulemaking, several investigations closed in FY 2022 involved potentially inaccurate or misleading bids and offers. These were evaluated by enforcement staff as possible components of manipulative schemes or targeting of uplift payments. DOI works closely with the ISO independent market monitors, who play an important role in identifying and referring anomalous bid and offer behavior for potential investigation. This underscores both the importance of ensuring accurate and justified bid and offer parameters and the significance of contacts from a market monitor. Additionally, two of the five examples cited contemporaneous communications about the subject

activity with an ISO or market monitor as part of staff's justification for closing the investigation without further action. These kinds of communications can be strong evidence that a subject had good intentions and was taking reasonable steps to maintain compliance.

While the illustrative self-reports closed without action constitute a varied grab bag of generally minor regulatory violations, some could reasonably have been the subject of an investigation and/or given rise to civil penalties, depending on all the circumstances. Renewable project developers in particular should note the several self-report examples relating to Market Based Rate applications, Exempt Wholesale Generator filings, Qualifying Facility certifications, and timing of initial power sales. But the most important insight from the example self-reports closed with no action should be the value of self-reporting. Self-reporting a violation shows an entity's commitment to compliance, presents a well-tread path towards resolving a violation without sanctions, and – if staff opens an investigation and ends up proposing civil penalties – can yield a significant reduction to the civil penalties proposed under the Commission's penalty guidelines.

This section of the Annual Report also provides very useful information about considerations for remedial action and relevant information to collect when a potential violation is discovered.

### Conclusion

OE's Annual Report on Enforcement is packed with information. While each of the different sections will be more relevant for some than others, the Annual Report is worthwhile reading for legal counsel, trading managers, traders, compliance professionals, and accounting professionals, among others.

*Bryan Cave Leighton Paisner has deep experience in FERC enforcement matters and market manipulation. We represent regulated entities in all facets of the enforcement process, from initial contacts with DAS surveillance or market monitor staff through resolution of an investigation via settlement, litigation, or closure without enforcement action. We also provide tailored anti-market manipulation, anti-fraud, and market interactions training to energy traders and compliance professionals.*

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## MEET THE TEAM



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