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## Shots Across the Bow: A Change in Emphasis and Focus for FERC Enforcement

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The Federal Energy Regulatory Commission (“FERC”) recently sent several strong signals that it intends to ramp up anti-manipulation enforcement efforts in the energy trading markets, including potentially taking aim at trading practices that many in the energy industry may view as legitimate portfolio management strategy. As part of these increased enforcement efforts, Chairman Wellinghoff announced a reorganization of FERC’s Office of Enforcement aimed at the monitoring, detection, prevention, and prosecution of manipulation within the energy markets. FERC also issued a final rule on April 19, 2012, *Order No. 760*, requiring each regional transmission organization (“RTO”) and independent system operator (“ISO”) to deliver data related to the markets it administers electronically to the FERC on an ongoing basis.<sup>1</sup> Several recent high profile enforcement actions and Chairman statements have showcased FERC’s increased emphasis on anti-manipulation in organized energy markets. These developments in the enforcement sphere should alert energy sector entities that FERC is placing an increased emphasis on energy trading in organized markets and that actions taken in the course of historically acceptable trading activities may now be viewed in a different light. Market participants will need to educate their traders and compliance offices accordingly.

### *FERC Enhances Market Surveillance and Enforcement Capabilities*

Chairman Wellinghoff in February announced a reorganization of the Office of Enforcement. A new Division of Analytics and Surveillance will focus on developing surveillance tools and performing analysis to detect manipulation and anticompetitive behavior in the energy markets. The staff of approximately 35 is tasked with taking a detailed look at the operation of the markets and “looking for things in data that may indicate that there are people out there that are trying to utilize market processes and procedures in ways that are improper and in violation of statutory provisions.”<sup>2</sup>

With the issuance of *Order No. 760*, the new Enforcement Staff will have substantial amounts of new data to monitor the energy markets. In *Order No. 760*, FERC required each RTO and ISO to provide non-public market data on an ongoing basis to enable FERC to monitor activity in RTO and ISO markets and to evaluate existing market design and market rules. The data that the RTOs and ISOs must provide includes data on supply offers and demand bids for energy and ancillary services; virtual offers and bids; market awards for energy/ancillary services, capacity market offers, designations, and prices; resource output; marginal cost estimates; day-ahead shift factors; FTR transactions; internal bilateral contracts; pricing data for interchange transactions; and uplift charges and credits to market participants. Descriptive information, such as market participant names, unique identifiers, pricing points, and other “necessary and appropriate” information would be included. To implement *Order No. 760*, each RTO and ISO must amend its open access transmission tariff to reflect this data delivery requirement within 45 days of the effective date (July 6, 2012). Data subject to *Order No. 760* must be delivered electronically to FERC within seven days after each RTO or ISO creates the datasets in a daily market run or otherwise. Ongoing electronic delivery of the data must begin no later than 45 days after July 6, 2012, with full implementation to be completed within 210 days.

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The type of data sought by the Commission coupled with its bolstered enforcement ranks indicates a renewed emphasis on policing the energy trading activities taking place in the sophisticated energy markets operated and maintained by the RTOs and ISOs. The new staff and data access provide FERC with enhanced capability to monitor activity in these markets and reduce its reliance on RTOs and ISOs to identify participant behavior warranting investigation.

### *Recent Enforcement Activity: Taking Aim at Traditional Trading Activities in the Energy Markets*

FERC's recent enforcement actions also signal an emphasis on the organized energy markets and, specifically, the policing of energy trading practices that FERC views as influencing prices used to settle financial positions. FERC appears to be sending a signal that "uneconomic" trading, regardless of its purpose, will not be tolerated. As Chairman Wellinghoff explained at the March 15, 2012 FERC meeting, "[D]o not trade uneconomically on one position in order to benefit the value of another." Chairman Wellinghoff warned market participants that FERC "will be vigorous in using its anti-manipulation authority to protect consumers." Thus, elements of trading behavior that may once have been seen as acceptable behavior regardless of its economic outcome, may need to be revisited in light of FERC's single-minded pursuit.

For example, FERC's headline-grabbing \$245 million Constellation settlement that was approved in March 2012 concerned the alleged use of virtual trading and day-ahead physical schedules to move day-ahead prices in a direction that would benefit financial contract for differences positions.<sup>3</sup> FERC Enforcement Staff essentially inferred an intent to manipulate day-ahead prices solely from its determination that over a period of months the virtual trading and day-ahead physical schedules were "substantial," "routinely unprofitable" and had a "price impact" on day-ahead prices that benefited the contract for differences positions.<sup>4</sup> The Stipulation and Consent Agreement did not indicate that any of the trades were made away from prevailing market prices or address any other bases for such trading such as risk diversification and hedging. In this proceeding, FERC focused on Constellation's activities in the organized markets operated by the New York Independent System Operator, Inc. and ISO New England, Inc. It is noteworthy that FERC's order accepting the settlement did not contain any findings of the Commission; rather, the sanctions approved by the Commission were based solely on determinations and observations of the Enforcement Staff.

Enforcement Staff has recently issued several notices of alleged violation of the anti-market manipulation rule focusing on analogous trading behavior in western markets including markets operated by the California Independent System Operator, Inc. These notices set forth the Enforcement Staff's preliminary determinations that the anti-market manipulation rule was violated by the trading of physical energy to benefit financial transmission rights or financial swap positions. The notices and settlement also highlight the activity of individual traders, reinforcing FERC's willingness to charge individual traders for alleged violations.

### *Beginning of the Era of Enforcement*

Companies would be wise to implement a higher level of vigilance when trading in organized energy markets. As explained above, recently publicized enforcement actions address trading activities within these markets and FERC is clearly bolstering its ability to more closely monitor these markets in the future. FERC's recent activities also signal an expanding and less precise definition of manipulation as well as a more relaxed standard of proof for violations. As Chairman Wellinghoff indicates, if your trade is "uneconomic" (*i.e.*, unprofitable) and impacts prices to your benefit in other positions, FERC may well contend it is illegal. This could jeopardize common industry practices to

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hedge or diversify market risk, because individual trades used to pursue such strategies may appear unprofitable when viewed in isolation. With more enforcement staff at its disposal, FERC is better prepared to examine the discrete transactions of any trader. Companies will need to closely monitor FERC's actions in this area going forward and evaluate on a continuing basis whether their trading and hedging activity remains within the realm of practices that FERC considers acceptable.

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<sup>1</sup> Enhancement of Electricity Market Surveillance and Analysis through Ongoing Electronic Delivery of Data from Regional Transmission Organizations and Independent System Operators, 139 FERC ¶ 61,053 (2012) ("Order No. 760").

<sup>2</sup> Elec. Util. Week, 5 (Feb. 20, 2012) (quoting Chairman Wellinghoff).

<sup>3</sup> Constellation Energy Commodities Group, Inc., 138 FERC ¶ 61,168 (2012).

<sup>4</sup> Id.