

# REPORT OF THE ELECTRICITY REGULATION AND COMPLIANCE COMMITTEE

This report covers the enforcement activities of the Federal Energy Regulatory Commission's (FERC's) Office of Enforcement (OE) from January 1, 2008, to December 31, 2008.<sup>1</sup> Below is an index of major subjects covered:

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## I. OVERVIEW OF FERC ENFORCEMENT AND COMPLIANCE ACTIVITIES

The FERC's OE continued its active enforcement of electric statutes, orders, rules, and regulations. In 2008, the FERC issued orders in three cases involving electric utilities, approving consent and settlement agreements arising from electric enforcement matters. The orders, summarized below, resulted in civil penalties totaling nearly eight million dollars and mandated in two cases additional expenditures totaling three million dollars towards the development and implementation of comprehensive regulatory compliance plans. In addition, the FERC continued to clarify its enforcement programs and emphasize effective compliance programs.

## II. POLICY DEVELOPMENTS

### A. 2008 Report on Enforcement<sup>2</sup>

In its October Report, prepared pursuant to the FERC's Revised Policy Statement on Enforcement (Revised Policy Statement),<sup>3</sup> the OE provided further guidance regarding FERC compliance generally, noting trends in self-reporting and investigations, describing the types of investigations that were closed without payment of a civil penalty, providing an overview of the activities of the four divisions within the OE. The OE also noted that a July 2008 Workshop on

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1. This report was prepared primarily by Patrick Gerity.

2. FERC, OE, *2008 Report on Enforcement*, Docket No. AD07-13-001 (2008) (hereinafter 2008 Report on Enforcement).

3. 123 F.E.R.C. ¶ 61,156 at P 12 (2008). The Revised Policy Statement was summarized in the *Report of the Natural Gas Regulation Committee*, 29 ENERGY L.J. 730-31 (2008).

Regulatory Compliance assisted the OE in formulating recommendations to the FERC.<sup>4</sup>

*B. Enforcement Policy Statement (Docket No. PL09-1)*<sup>5</sup>

On October 16, 2008, the FERC supplemented its Revised Policy Statement, providing additional guidance on compliance. The FERC identified and described the following four key factors related to effective compliance: (i) the role of senior management in fostering compliance; (ii) effective preventive measures to ensure compliance; (iii) prompt detection, cessation, and reporting of violations; and (iv) remediation efforts.<sup>6</sup> The FERC noted that the factors would be applied in light of a company's commitment to compliance and the results of its compliance program, and could lead to the reduction or elimination of civil penalties for violations.<sup>7</sup> Highlighting the importance of compliance programs by companies engaged in jurisdictional activities, the FERC reaffirmed its commitment to provide updated guidance and information on its enforcement and compliance program policies.<sup>8</sup>

*C. Order on Standards of Conduct for Transmission Providers (Order No. 717)*<sup>9</sup>

The FERC adopted in Order No. 717 a series of reforms to the Standards of Conduct for transmission providers designed to encourage compliance, facilitate FERC enforcement, and conform the Standards of Conduct<sup>10</sup> to the decision of the U.S. Court of Appeals for the D.C. Circuit in the *National Fuel Gas Supply Corp. v. FERC*.<sup>11</sup> Notably, the FERC eliminated from the Standards the concept of energy affiliates and revised the category of employees who must function independently from transmission function employees to those who actively and personally engaged in marketing functions.<sup>12</sup>

*D. Ex Parte Contacts and Separation of Functions (Order No. 718)*<sup>13</sup>

In this order, the FERC adopted revisions to its regulations, first outlined in its May 2008 Notice of Proposed Rulemaking,<sup>14</sup> to clarify the application of rules governing off-the-record contacts (*ex parte* communications) and separation of functions in the context of non-public investigations. The revisions specify when the FERC litigation staff and persons outside the FERC may

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4. 2008 Report on Enforcement, *supra* note 2, at 7.

5. *Policy Statement on Enforcement*, 125 F.E.R.C. ¶ 61,058 (2008).

6. *Id.* at PP 2, 13-21.

7. *Id.* at PP 25-27.

8. *Id.* at PP 28.

9. F.E.R.C. STATS. & REGS. ¶ 31,280, 73 Fed. Reg. 63,796, *reh'g pending* (2008) (hereinafter Order No. 717).

10. *Id.* The Standards include three primary rules: (1) the "independent functioning rule," requiring transmission function and marketing function employees to operate independently of each other; (2) the "no-conduit rule" prohibiting passing transmission function information to marketing function employees; and (3) the "transparency rule," imposing posting requirements designed to detect instances of undue preference.

11. 468 F.3d 831 (D.C. Cir. 2006).

12. Order No. 717, *supra* note 9, at P 12.

13. F.E.R.C. STATS. & REGS. ¶ 31,279, 73 Fed. Reg. 62,881 (2008).

14. F.E.R.C. STATS. & REGS. ¶ 32,634, 73 Fed. Reg. 29,451 (2008).

contact decisional employees once the FERC has established proceedings on matters that had been investigated under Part 1b of the Federal Power Act.<sup>15</sup> In addition, the FERC revised its regulations to clarify that intervention is not permitted as a matter of right in proceedings arising from Part 1b investigations.<sup>16</sup>

### III. SETTLEMENTS OF FERC ENFORCEMENT PROCEEDINGS

#### A. *Duquesne Light Company*<sup>17</sup>

Duquesne, a public utility that purchases, transmits, and distributes electricity in its southwestern Pennsylvania service territory, was the subject of an audit conducted by the Division of Audits (DOA), which then referred Duquesne to the OE. Following an investigation, the OE found that Duquesne: (i) violated the FERC's cost allocation procedures by not charging affiliates for the actual time Duquesne employees spent working on affiliate tasks; (ii) violated the FERC's Electric Quarterly Reports (EQR) filing requirements by failing to file EQRs for a Duquesne marketing affiliate, from 2002 through 2006; (iii) violated FERC requirements with respect to OASIS various posting requirements; (iv) violated the independent functioning and information sharing requirements of the standards of conduct; and (vi) had submitted testimony to the Pennsylvania Public Utilities Commission (PAPUC) that mischaracterized the DOA's conclusions regarding Duquesne's cost allocation procedures.<sup>18</sup>

To resolve the OE's investigation, Duquesne and the OE entered into a stipulation and consent agreement whereby Duquesne was required to pay a \$250,000 civil penalty, develop and implement a comprehensive regulatory compliance program at a minimum cost of one million dollars, to rectify remaining identified violations, and clarify its PAPUC submission.<sup>19</sup> In approving the agreement, the FERC found: (i) Duquesne's acts caused no harm to the market or other market participants; (ii) Duquesne did not engage in any fraudulent or deceitful conduct; (iii) Duquesne had no history of violations; (iv) Duquesne's acts were discovered through an audit, and were not self-reported; and (iv) Duquesne's senior management failed to place sufficient emphasis on compliance.<sup>20</sup> Contrasting the Duquesne case to others where companies self-reported conduct and violations similar to some of Duquesne's violations and were closed without any sanction, the FERC noted that Duquesne did not self-report its conduct, engaged in a variety of violations for a longer period of time, and did not timely remedy all of the alleged violations.<sup>21</sup>

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15. 16 U.S.C. § 832(b).  
 16. 18 C.F.R. § 385.214 (2008).  
 17. 123 F.E.R.C. ¶ 61,221 (2008).  
 18. *Id.* at PP 4-9.  
 19. *Id.* at P 10.  
 20. *Id.* at P 11.  
 21. *Id.* at P 13.

*B. Otter Tail Power Company*<sup>22</sup>

Otter Tail, an investor-owned utility and transmission-owning member of the Midwest Independent Transmission System Operator, Inc. (MISO), was the subject of an OE investigation (originating from a 2005 DOA audit into Otter Tail's transmission scheduling practices and other matters) to determine whether Otter Tail's transmission scheduling practices were in compliance with the MISO's Open Access Transmission and Energy Markets Tariff (OATT) and applicable FERC rules and regulations. The OE identified two violations of MISO's OATT by Otter Tail: (i) the improper use of network service to import energy that was used to facilitate off-system sales, and (ii) the improper use over sixty-four days of a type of transmission service that provided a superior curtailment priority than appropriate in certain instances.<sup>23</sup>

Otter Tail and the OE entered into a stipulation and consent agreement to resolve the OE investigation whereby Otter Tail was required to disgorge \$546,832 in profits from the resultant off-system sales.<sup>24</sup> Reimbursement for point-to-point transmission revenues which Otter Tail's wholesale merchant function would have otherwise paid to the MISO was not sought because the bulk of those revenues would have been paid back to Otter Tail.<sup>25</sup> Similarly, the OE did not seek reimbursement for the curtailment priority violations because the advantage to Otter Tail in those circumstances was not readily quantifiable.<sup>26</sup> A compliance monitoring plan was not imposed on Otter Tail because, with changes in the MISO's market operation whereby transmission in the MISO footprint is no longer scheduled by member utilities, the subject violations were longer possible.<sup>27</sup>

*C. Edison Mission Energy*<sup>28</sup>

The bidding practices of Edison Mission Energy and its affiliates Edison Mission Marketing & Trading, Inc. and Midwest Generation, L.L.C. (collectively, Edison Mission) in the PJM Interconnection, LLC (PJM)<sup>29</sup> were the subject of a three and one-half year investigation by FERC staff. Over that period of time, however, the FERC found that FERC staff was misled, misdirected, and its analysis ultimately impeded by a series of communications by Edison Mission regarding its High Offer Strategy, as well as by failures in document production and preservation,<sup>30</sup> ultimately violations of the FERC's

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22. 123 F.E.R.C. ¶ 61,213 (2008).

23. *Id.* at P 4.

24. *Id.* at P 11.

25. *Id.* at P 7.

26. *Id.* at P 10.

27. *Id.* at P 12.

28. 123 F.E.R.C. ¶ 61,170 (2008), *reh'g denied*, 125 F.E.R.C. ¶ 61,020.

29. The Edison Mission bidding strategy examined was Edison Mission's offering, over a roughly two-year period, its capacity resource generation units at prices near the \$1,000/MWh PJM bid cap so that they would not be taken in the PJM day-ahead market and would instead be taken in the subsequent PJM real-time market (the High Offer Strategy). The High Offer Strategy was first identified by the PJM Market Monitor.

30. 123 F.E.R.C. ¶ 61,170 at PP 4-5.

Market Behavior Rules.<sup>31</sup> Those violations, the FERC noted, were “severe, and not the type of data errors or omissions that sometimes occur in investigations involving large data production. . . Edison Mission’s acts that misled staff were protracted, related to core issues under investigation, and caused extensive misallocation of resources.”<sup>32</sup>

The investigation into Edison Mission’s High Offer Strategy, and Edison Mission’s violations of the Market Behavior Rules in connection with its communications with the OE regarding that Strategy, Edison Mission and the OE entered into a stipulation and consent agreement that required Edison Mission to pay a civil penalty of seven million dollars, and to spend an estimated two million dollars to develop and implement a comprehensive regulatory compliance program.<sup>33</sup>

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31. 18 C.F.R. § 35.41(b) (2009) (“A Seller must provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the [FERC], [FERC]-approved market monitors, [FERC]-approved regional transmission organizations..., unless Seller exercises due diligence to prevent such occurrences”).

32. 123 F.E.R.C. ¶ 61,170 at P 9.

33. *Id.* at P 1.

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