REPORT OF THE COMPLIANCE & ENFORCEMENT COMMITTEE

This is the first report of the Energy Bar Association's Compliance & Enforcement Committee, and it summarizes key federal enforcement and compliance developments in 2010 of particular interest to energy law practitioners, including select decisions, orders, and rules of the Federal Energy Regulatory Commission (FERC), the Commodity Futures Trading Commission (CFTC), the Department of Justice (DOJ), the Department of Energy (DOE) and other relevant federal agencies. Certain decisions, orders, and rules from prior years are summarized to provide appropriate context.*

* The Compliance & Enforcement Committee acknowledges the support of the full Committee in producing this inaugural report, and, in addition, recognizes specific Committee members who made particular contributions. Those members are Michael Brooks, Andrea Chambers, Susan Court, Caroline Harmon, Sharon Jacobs, Andrew Jamieson, Andrea Kells, Shaun Ledgerwood, Todd Mullins, Julie Pradel, Andrew Soto, and Andrea Wolfman.

I. THE FEDERAL ENERGY REGULATORY COMMISSION

The Energy Policy Act of 2005[1] (EPAct 2005) expanded the enforcement powers of the Federal Energy Regulatory Commission (FERC). The Act amended both the Natural Gas Act (NGA) and the Federal Power Act (FPA) to provide the FERC with broad civil penalty authority.[2] The FERC has issued orders implementing this authority both in generic policy statements and rules as well as in individual investigation proceedings.[3]

A. Rules and Policy Statements

1. Market Manipulation

EPAct 2005 added a new section 4A to the NGA making it unlawful for any market participant to use or employ any manipulative or deceptive device (as those terms are used in section 10(b) of the Securities Exchange Act) in connection with a FERC-jurisdictional transaction for the sale or purchase or transportation of natural gas.[4] In 2006, the FERC promulgated rules prohibiting market manipulation closely tailored to rule 10b-5 of the Securities Exchange Commission.[5]

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1. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 574 (2005).

2. Energy Policy Act of 2005 § 314, 119 Stat. 691 (2005) (codified at 15 U.S.C. § 717t-1); Energy Policy Act of 2005 § 1284, 119 Stat. 980 (2005) (codified at 16 U.S.C. § 825o-1).

3. While many of these orders are described herein, they are more fully discussed in the prior reports of the Electricity Regulation and Compliance Committee, the Natural Gas Regulation and Compliance Committee, and the Competition and Antitrust Committee from 2007 through 2010.

4. Energy Policy Act 2005 § 314, 119 Stat. 691 (2005) (codified at Natural Gas Act § 4A, 15 U.S.C. § 717c-1) provides as follows:

> SEC. 4A. It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers. Nothing in this section shall be construed to create a private right of action.

Energy Policy Act 2005 § 1283, 119 Stat. 979-80 (2005) (codified at Federal Power Act § 222, 16 U.S.C. § 824v) amended the Federal Power Act in a similar manner.

5. Order No. 670, *Prohibition of Energy Market Manipulation*, F.E.R.C. STATS. & REGS. ¶ 31,202, 71 Fed. Reg. 4,244 (2006) (codified at 18 C.F.R. pts. 1c.1, 1c.2).

2. Enforcement Policy

In October 2005, the FERC issued its first policy statement on enforcement setting forth the factors it would take into account in determining remedies for violations, including applying its enhanced civil penalty authority under EPAct 2005.[6] In May 2008, the FERC revised its enforcement policies to give the industry a fuller picture as to how its investigative processes work.[7] It also issued an instant final rule amending its regulations to codify the right of an entity that is the subject to an investigation to be informed that staff intends to seek action against it and have an opportunity to provide Commissioners with a written non-public response to staff's allegations.[8]

3. Obtaining Guidance

In May 2008, the FERC issued an interpretive order discussing the mechanisms by which interested parties can obtain guidance regarding FERC's regulatory requirements.[9] The FERC stated that to the extent that formal guidance is needed, persons could: (1) petition for a declaratory order in order to terminate a controversy or remove uncertainty regarding a matter within the FERC's jurisdiction; (2) request a no-action letter on any issue that falls within the scope of FERC's jurisdiction, with certain exceptions; (3) request an opinion letter from the General Counsel to obtain legal guidance regarding the interpretation of any statute or implementing regulation under FERC jurisdiction; (4) seek an accounting interpretation from the FERC's Chief Accountant for guidance on the implementation of standards issued by the Financial Accounting Standards Board and existing or emerging industry-wide or entity specific accounting issues within the context of the Uniform System of Accounts; and (5) contact the Enforcement Hotline to obtain informal guidance on all areas within FERC jurisdiction, except matters before FERC in docketed proceedings.[10]

On April 15, 2010, the FERC issued an instant final rule transferring dispute-related calls regarding the construction of interstate pipelines from the Enforcement Hotline to the Dispute Resolution Service effective May 1.[11] The FERC explained that its Office of Enforcement, which operates the Enforcement Hotline, is focused on other matters, including fraud, market manipulation, violations of reliability standards, anticompetitive conduct, and conduct that threatens the transparency of regulated markets.[12] The FERC thought that by transferring landowner disputes related to pipeline construction to the Dispute Resolution Service, with its expertise in conflict resolution, it would ensure a more efficient allocation of resources that will better serve the public interest.

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6. *Enforcement of Statutes, Regulations, and Orders*, 113 F.E.R.C. ¶ 61,068 (2005).

7. *Enforcement of Statutes, Regulations, and Orders*, 123 F.E.R.C. ¶ 61,156 (2008).

8. Order No. 711, *Submission to the Commission upon Staff Intention to Seek an Order to Show Cause*, F.E.R.C. STATS. & REGS. ¶ 31,270 (2008), 73 Fed. Reg. 29,431 (2008) (codified at 18 C.F.R. pt. 1b.19).

9. *Obtaining Guidance on Regulatory Requirements*, 123 F.E.R.C. ¶ 61,157 (2008).

10. *Id.*

11. *Instant Final Rule Transferring Certain Enforcement Hotline Matters to the Dispute Resolution Service*, 131 F.E.R.C. ¶ 61,018 (2010).

12. *Id.*

4. Ex Parte Communications and Separation of Functions

In October 2008, the FERC issued Order No. 718 promulgating regulations governing ex parte communications and separation of functions as they relate to investigations.[13] Rule 2202 prohibits litigation staff from advising the Commissioners or other decisional employees in the outcome of any proceeding in which an adjudication is made after hearing.[14] In Order No. 718, the FERC stated that the separation of functions restriction begins to apply once the FERC issues a show cause order in an investigatory proceeding.[15] Rule 2201 regulates contacts between persons outside the agency and FERC's decisional employees. Order No. 718 made the ex parte restrictions applicable to investigatory proceedings beginning from the time the FERC issues an order to show cause.[16]

5. Compliance Programs

In October 2008, the FERC issued a policy statement on compliance encouraging regulated companies to develop rigorous compliance programs that will help minimize the potential for violations and providing that FERC will give significant weight to those programs when it determines whether to assess a civil penalty in the event of a violation.[17] The FERC expressed a policy that if a company acts aggressively to adopt, foster, and maintain an effective corporate culture of compliance and has in place rigorous procedures and processes that provide effective accountability for compliance, but a violation occurs, the FERC may provide a significant reduction or even elimination of the civil penalty based on certain factors.[18]

6. Disclosure of Exculpatory Information

In December 2009, the FERC issued a Policy Statement on the Disclosure of Exculpatory Information setting forth a policy that the FERC's Enforcement Staff would disclose to subjects of investigations any exculpatory evidence material to guilt or punishment during the course of investigations and administrative enforcement proceedings.[19] The FERC noted that the U.S. Supreme Court in *Brady v. Maryland*[20] held that the due process clause of the U.S. Constitution required the government to provide to criminal defendants exculpatory evidence that is material to guilt or punishment,[21] but that courts have held that *Brady* does not apply to administrative proceedings.[22] The FERC stated that while Staff's practice has been to disclose this information, the FERC believes that formalizing Staff's obligations in this regard will eliminate

13. Order No. 718, *Ex Parte Contact and Separation of Functions*, F.E.R.C. STATS. & REGS. ¶ 31,279 (2008), 73 Fed. Reg. 62,881 (2008) (codified at 18 C.F.R. pts. 385.214, 385.2201, 385.2202).

14. *Id*.

15. *Id*.

16. *Id*.

17. *Compliance with Statutes, Regulations, and Orders*, 125 F.E.R.C. ¶ 61,058 (2008).

18. *Id.* at PP 2, 4.

19. *Enforcement of Statutes, Regulations, and Orders*, 129 F.E.R.C. ¶ 61,248 (2009).

20. *Id.* (citing Brady v. Maryland, 373 U.S. 83 (1963)).

21. *Id.* at P 3.

22. *Id.* at P 6.

uncertainty and promote maximum fairness in investigations and administrative proceedings.[23] The order explained that since *Brady* only applies to evidentiary materials, the FERC's policy does not entitle a respondent to disclosure of the FERC Staff's strategies, legal theories, or evaluations of evidence.[24]

7. Preliminary Notices of Violation

In December 2009, the FERC issued an order authorizing the Secretary to issue a Preliminary Notice of Violation, upon the direction of the Director of the Office of Enforcement, after the enforcement staff has provided a letter to the subject of the investigation setting forth Staff's preliminary findings and conclusions regarding a matter under investigation and after the subject has had an opportunity to respond to Staff's letter.[25] The FERC stated that the notice would include: "(1) the identity of the entity or entities that are the subject of the investigation; (2) the time and place of the alleged conduct; (3) the rules, regulations, statutes or orders that staff alleges were violated; and (4) a concise description of the alleged wrongful conduct."[26] The FERC added that in the event Staff decides to terminate an investigation after the notice has been issued, the Secretary is authorized to issue a public notice of termination of the investigation upon direction of the Director of the Office of Enforcement.[27]

8. Civil Penalty Guidelines

In March 2010, the FERC issued a policy statement on penalty guidelines setting forth the manner in which it would calculate, and the factors it will consider in assessing, civil penalties for violations of FERC statutes, rules, or orders.[28] In developing a guidelines approach, the FERC stated that it was heavily influenced in this effort by the U.S. Sentencing Guidelines.[29] The FERC believed that using a guidelines approach would promote greater fairness, consistency, and transparency in its enforcement program.[30]

Generating a final penalty range under the guidelines was broken down into five discrete steps. Step one involves identifying the base violation level from an applicable guideline.[31] The FERC explained that there are three separate guidelines for various types of violations, each containing a unique base violation level: (a) violations of reliability standards; (b) violations involving fraud, manipulation, or anti-competitive conduct; and (c) violations involving misrepresentations and false statements to FERC.[32] Step two involves applying appropriate adjustments to the base violation level. For violations of reliability standards, the base violation level begins at 16 and is increased or decreased to

23. *Id.* at P 8.

24. *Id.* at P 14.

25. *Enforcement of Statutes, Regulations, and Orders*, 129 F.E.R.C. ¶ 61,247 (2009).

26. *Id.* at P 7.

27. *Id.*

28. *Enforcement of Statutes, Regulations, and Orders*, 130 F.E.R.C. ¶ 61,220 (2010).

29. *Id*. at P 10.

30. *Id.* at P 27.

31. *Id.*

32. *Id*. at P 38.

reflect the risk of harm.[33] For violations involving fraud, etc., the base violation level is 6 and is increased to reflect the amount of monetary harm, the quantity of natural gas or electricity involved in the transactions, and/or the length of time the violations continued.[34] For violations involving misrepresentations, the base violation level is 16 but may be increased if it substantially interfered with the administration of justice or involved the destruction of records, etc.[35]

> Step three involves calculating a 'base penalty' which is the greater of: (1) the dollar amount from the table in section 1C2.2(b) that corresponds to the applicable violation level, described above; (2) the pecuniary gain to the organization from the violation; or (c) the pecuniary loss from the violation caused by the organization.[36]

According to the specified dollar amounts, a base violation level of 6 would generate a civil penalty of $5,000, and a base violation level of 38 or more would generate a civil penalty of $72.5 million.

Step four involves calculating an organization's culpability score.[37] Each organization begins with a score of 5 which is adjusted up or down depending on six separate considerations, including: (1) whether high-level personnel in the organization were involved; (2) prior history of violations, in particular repeat violations close in time; (3) whether the violation involved an order directed at the organization; (4) whether the organization obstructed justice or encouraged obstruction during the investigation or resolution; (5) whether the organization had an effective compliance program; and (6) credit for self-reporting, cooperation, and acceptance of responsibility.[38] For each culpability score, there is a corresponding minimum and maximum multiplier. So, a score of 5 would carry a minimum multiplier of 1 and maximum multiplier of 2; a score of 10 would carry a minimum multiplier of 2 and a maximum multiplier of 4; and a score of 1 would carry a minimum multiplier of 0.2 and a maximum multiplier of 0.4. Step five involves multiplying the base penalty determined in step three by the minimum and maximum multipliers determined in step four to yield an applicable penalty range.[39]

The FERC added that these penalty guidelines do not affect FERC's practice of requiring the disgorgement of unjust profits.[40] In cases of identifiable pecuniary gain from a violation, the FERC will continue to require disgorgement of the full amount of the gain, plus interest, and the gain may also be relevant to determining the amount of the civil penalty as described in step three.[41] In addition, the FERC noted that it retained discretion to determine penalties in cases involving multiple types of violations.[42] The FERC stated that where the minimum guideline penalty was greater than the $1 million per day maximum

33. *Id*. at PP 39-41.
34. *Id.*
35. *Id*.
36. *Id*. at P 42.
37. *Id*. at PP 43-50.
38. *Id*.
39. *Id*. at P 51.
40. *Id.* at P 57.
41. *Id.*
42. *Id.* at P 60.

statutory penalty, the guideline penalty will be reduced to the maximum statutory penalty.[43] FERC added that it would reduce the penalty to the extent it would impair an organization's ability to disgorge profits or where the organization is not able to pay the minimum penalty.[44]

On April 15, 2010, the FERC suspended the penalty guidelines in order to afford interested entities a broader opportunity to comment on the guidelines before putting them into effect.[45]

On September 17, 2010, the FERC issued a revised policy statement on penalty guidelines setting forth the manner in which the FERC will calculate and the factors it will consider in assessing civil penalties for violations of FERC statutes, rules, or orders.[46] The Commission noted the following changes from its initial policy statement: first, the Commission clarified that the Penalty Guidelines will not affect Enforcement Staff's discretion to close investigations or self-reports without sanctions.[47] The Commission stated that it will apply the Penalty Guidelines to violations of the reliability standards only in formal investigations and enforcement actions and will not apply them to NERC Notices of Penalty.[48] The Commission reduced the base violation level for reliability violations from 16 to 6 and increased the risk of harm enhancements for reliability violations.[49] It also stated that it will use the quantity of load lost as one measure of the seriousness of the violation.[50] The Commission agreed to give partial credit to organizations that have effective yet imperfect compliance programs, and agreed to unbundle the mitigation credits for self-reports, cooperation, settling, and accepting responsibility.[51] Finally, the Commission included a scienter requirement for misrepresentations and false statements.[52] The FERC also stated that its decision to adopt a guidelines-based approach does not restrict its discretion to make an individualized assessment based on the facts presented in the case.[53]

With regard to reliability issues, the FERC decided that it would apply the penalty guidelines to enforce its regulations and requirements because enforcement of the reliability standards falls under FERC's direct enforcement authority.[54] The FERC revised the Penalty Guidelines to state explicitly that achieving compliance is the central goal of its enforcement efforts.[55] The FERC then listed four of the hallmarks of compliance as follows: (1) active engagement of senior leadership; (2) effective preventive measures; (3) prompt detection and

43. *Id.* at P 61.
44. *Id.*
45. *Enforcement of Statutes, Regulations, and Orders*, 131 F.E.R.C. ¶ 61,040 (2010).
46. *Revised Policy Statement on Penalty Guidelines*, 132 F.E.R.C. ¶ 61,216 (2010).
47. *Id.* at P 4.
48. *Id.*
49. *Id*.
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.* at P 19.
54. *Id.* at P 43.
55. *Id.* at P 110.

cessation of violations and voluntary reporting; and (4) remediation of misconduct.[56] FERC concluded that it would likely give some degree of compliance credit to an organization that achieves these four factors.[57]

Rather than eliminating any compliance credit where an organization's senior-level personnel participated in, condoned, or were willfully ignorant of the violation, the FERC decided that it would consider whether the senior-level employee acted on his or her own or at the direction or supervision or with tacit acquiescence of the organization's governing authority.[58] While the FERC did not eliminate the requirement that for compliance credit to be given a detected violation must be reported without unreasonable delay,[59] it did provide a list of factors it would consider, including: "(1) the time between when the violation was discovered, or reasonably should have been discovered, and the time of the report; (2) the steps the organization took before reporting the violation; and (3) the nature of the violation."[60] The FERC stated that it would continue to consider the size of an organization for purposes of determining whether an organization has met the requirements for an effective compliance program.[61] The FERC explained that size should be determined by looking at multiple factors including: "(1) the number of employees; (2) the annual revenue, profits, and budget of the organization; (3) the number of separate operating divisions or units within the organization; (4) the number of senior-level employees; and (5) the corporate structure of the organization."[62]

The FERC stated that organizations can now receive points for self-reports that are made prior to an imminent threat of disclosure or government investigation, for full cooperation, for affirmative acceptance of responsibility, and for resolving the matter without the need for a trial-type hearing.[63] The FERC determined that its obligation to consider an organization's remedy of a violation is built into the Penalty Guidelines in a number of places, including the section on effective compliance programs and the FERC, therefore, did not establish a specific, independent credit for remediation.[64]

B. Show Cause Proceedings

1. Amaranth

In July 2007, the FERC initiated show cause proceedings against Amaranth Advisors, L.L.C., several of its affiliates, and two of its former traders, Brian Hunter and Matthew Donohoe, to show cause why they should not be found to have violated the FERC's anti-market manipulation regulations over allegations that they manipulated the monthly NYMEX gas futures contract settlement price

56. *Id.* at P 116.
57. *Id.*
58. *Id.* at P 123.
59. *Id.* at P 127.
60. *Id.* at P 129.
61. *Id.* at P 134.
62. *Id.* at P 135.
63. *Id.* at P 145.
64. *Id.* at P 158.

to benefit swaps and other derivatives positions they held.[65] The FERC's enforcement staff settled with the Amaranth affiliates and Matthew Donohoe.[66] Following a hearing, an Administrative Law Judge found that Brian Hunter had engaged in market manipulation.[67]

2. Energy Transfer Partners

In July 2007, the FERC ordered Energy Transfer Partners, L.P. (ETP), and its affiliates, to show cause why it should not be found to have violated the FERC's anti-market manipulation regulations.[68] The FERC also ordered ETP affiliate, Oasis Pipeline, L.P., to show cause why it should not be found to have violated its tariff and engaged in undue discrimination.[69]

In November 2008, an Administrative Law Judge issued a partial initial decision granting summary disposition and dismissing undue discrimination claims against Oasis Pipeline, L.P., Oasis Pipe Line Company Texas, L.P., and ETC Texas Pipeline, Oasis Division – the pipeline subsidiaries of Energy Transfer Partners.[70] The judge concluded that in order to prove undue discrimination, it must be first demonstrated that there are at least two classes of shippers that were similarly situated.[71] The judge found that Staff failed to make that showing in part based on the cross examination and redirect of Staff's witness who stated that the shippers were not similarly situated but that there was disparate treatment.[72] The judge explained that absent similarly situated customers, one does not even reach the matter of whether there is disparate treatment or undue discrimination, preference, or advantage.[73] The judge thus granted summary disposition and dismissed the undue discrimination claim.[74] In February 2009, the FERC approved a settlement between the FERC's Enforcement Staff and the pipeline subsidiaries of ETP resolving all remaining issues arising out of the show cause proceedings.[75] In September 2009, the Commission issued an order approving a settlement between the FERC's Enforcement Staff and ETP, and its affiliates that resolved the allegations of market manipulation.[76] Under the settlement, ETP agreed to pay a total of $30 million comprised of $5 million in civil penalties to the U.S. Treasury and $25 million in disgorged profits to a designated fund from which eligible third parties may be compensated.[77] The FERC's Chief Administrative Law Judge was responsible for administering the fund.[78] ETP also agreed to have its compliance

65. *See generally Amaranth Advisors, L.L.C.*, 120 F.E.R.C. ¶ 61,085 (2007).
66. *See generally Amaranth Advisors, L.L.C.*, 128 F.E.R.C. ¶ 61,154 (2009).
67. *See generally Brian Hunter*, 130 F.E.R.C. ¶ 63,004 (2010).
68. *Energy Transfer Partners, L.P.*, 120 F.E.R.C. ¶ 61,086 (2007).
69. *Id.*
70. *Oasis Pipeline, LP*, 125 F.E.R.C. ¶ 63,019 (2008).
71. *Id*.
72. *Id*.
73. *Id*.
74. *Id*.
75. *Oasis Pipeline, L.P.*, 126 F.E.R.C. ¶ 61,188 (2009).
76. *Energy Transfer Partners L.P.*, 128 F.E.R.C. ¶ 61,269 (2009).
77. *Id.*
78. *Id.*

program audited by an independent auditor for two years.[79] In March 2010, a FERC Administrative Law Judge certified to the Commission an initial report allocating the $25 million in disgorged profits to specific entities that claimed to have been harmed by ETP's actions.[80] On August 9, 2010, the Administrative Law Judge issued a final report accounting for the distribution of funds.[81]

3. Seminole Energy Services and National Fuel Marketing Company

In January 2008, the FERC initiated enforcement proceedings against two groups of affiliates over allegations of market manipulation associated with bidding in Cheyenne Plains Natural Gas Company's March 2007 open season for new pipeline capacity. In March 2007, Cheyenne Plains posted an open season stating that if the bids exceeded the available capacity, the capacity would be allocated pro rata among all of the highest bidders. While forty-seven bidders were each awarded a pro rata share of the capacity, the FERC's Enforcement Staff found that five entities with multiple affiliates accounted for twenty-seven of the winning bids and 57% of the capacity. Staff believed that multiple affiliate bidding intended to game an open season in order to gain an unfair allocation of capacity is a fraud under the Commission's market manipulation rules. The FERC settled with several of the companies involved,[82] but issued show cause orders to two groups that did not agree to terms with the FERC's Enforcement Staff.[83]

Two Commissioners, however, dissented from the orders. Commissioner Moeller stated that the FERC "should not impose penalties in the range of millions of dollars for conduct that reasonably may be viewed as consistent with [FERC's] policy."[84] Commissioner Moeller also argued that the show cause orders violate fundamental fairness in not providing clear policies as to what conduct is prohibited.[85] Commissioner Spitzer agreed, stating that the FERC has been less than clear over a period of time, sending a "mixed message" with regard to multiple-affiliate bidding practices and, therefore, civil penalties are not warranted.[86]

C. *Other Litigation, Adjudications, or Resolutions Regarding Market Manipulation*

After the enactment of the EPAct 2005, through the end of 2010, the Commission adjudicated, litigated, or otherwise resolved five cases where electric companies were accused of manipulating the electric energy markets. These cases were either initiated by the Enforcement Staff or prompted by

79. *Id.*

80. *Energy Transfer Partners L.P.*, 130 F.E.R.C. ¶ 63,018 (2010).

81. Final Administrator's Post-Distribution Report and Accounting, *Energy Transfer Partners LP*, F.E.R.C. Docket No. IN06-3-010 (issued Aug. 9, 2010).

82. *See generally In re Tenaska Mktg. Ventures*, 126 F.E.R.C. ¶ 61,040 (2008).

83. *See generally Seminole Energy Servs., L.L.C.*, 126 F.E.R.C. ¶ 61,041 (2008); *Nat'l Fuel Mktg. Co.*, 126 F.E.R.C. ¶ 61,042 (2008).

84. *Seminole Energy Servs., L.L.C.*, 126 F.E.R.C. ¶ 61,041, at pp. 61,270-71 (2009).

85. *Id.*

86. *Tenaska Mktg. Ventures*, 126 F.E.R.C. ¶ 61,040, at p. 61,247 (2009).

formal complaints. Four of the five cases are final, and none of the final cases resulted in a finding of market manipulation. One case is pending before the Commission on briefs following a hearing before an administrative law judge. The agency's Enforcement Staff served as trial staff in that hearing. The five cases are summarized below.

1. Richard Blumenthal, Attorney General for the State of Connecticut v. ISO New England, Inc., et al.

In *Richard Blumenthal, Attorney General for the State of Connecticut v. ISO New England, Inc.*,[87] Administrative Law Judge Peter Young addressed the issue of whether any of respondents' energy supply offers at or near the $1000/Mwh price cap constituted: (1) a fraudulent device, scheme, or artifice; (2) a material misrepresentation or a material omission as to which there was a duty to speak under a commission-filed tariff, Commission order, rule, or regulation; or (3) any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.[88] Judge Young found that:

> [d]espite being afforded every possible opportunity to prove their case - by the Commission as well as the presiding judge - and despite being granted extraordinary latitude to secure the evidence they insisted would demonstrate that respondents manipulated the New England capacity markets in violation of [Federal Power Act] section 222(a) and section 1c.2 of the Commission's regulations, . . . [the] Connecticut Representatives have failed *in the extreme* to prove their allegations against any respondent here.[89]

The Enforcement trial staff in this case argued against the positions of the complainants.[90] The case is pending before the Commission.[91]

2. New York Independent System Operator, Inc. - Loop Flow

In *New York Independent System Operator, Inc.*,[92] the Commission authorized the public disclosure of, and otherwise adopted, the Enforcement Staff's findings regarding an investigation of alleged market manipulation in the placing of circuitous schedules in the Lake Erie region.

> The OE Report concludes that the uplift experienced by the NYISO's customers, as a result of Lake Erie region scheduling practices, between January 1, 2008 and July 22, 2008, was due, in substantial part, to: (i) the lack of seams coordination among the NYISO and neighboring [Regional Transmission Organizations], namely, between NYISO, PJM, the Midwest ISO, and Ontario's Independent Electricity System Operator; (ii) the incentives created by certain proxy bus pricing changes that the NYISO put into effect in 2007; and (iii) the NYISO's methodology for incorporating loop flow in NYISO's day-ahead modeling. The OE Report further concludes that, while the circuitous schedules examined in the investigation did appear to contribute to loop flow, they were openly placed as an economic response to price signals and did not constitute a fraudulent device, scheme or artifice. The

87. *Connecticut v. Brookfield Energy Mktg. Inc.*, 132 F.E.R.C. ¶ 63,017 (2010).

88. *Id.*

89. *Id.* at P 85 (citations omitted) (emphasis added).

90. *Id.*

91. *Id.*

92. *N.Y. Indep. Sys. Operator, Inc.*, 128 F.E.R.C. ¶ 61,049 (2009).

> OE Report also concludes that market participants are not well situated to predict or otherwise identify loop flow effects in real time. The OE Report concludes that the market participants responsible for these scheduling practices did not commit any tariff violations or violate the Commission's anti-manipulation rule.[93]

3. PJM Interconnection, L.L.C., v. Accord Energy, L.L.C. and BJ Energy, L.L.C. v. PJM Interconnection, L.L.C.

In *PJM Interconnection, L.L.C. v. Accord Energy, L.L.C.* and *BJ Energy, L.L.C. v. PJM Interconnection, L.L.C.*,[94] the Commission addressed two complaints involving Financial Transmission Rights (FTRs) in the PJM market, and at the same time published an Enforcement Staff report entitled "Non-Public Investigation into Possible Market Manipulation by Tower Research Capital Affiliates in the Financial Transmission Rights Markets Operated by PJM: Alleged Wrongful Coordination of FTR Strategies and Affiliate Risk Shifting." By way of background, on March 7, 2008, PJM filed a complaint contending that a group of companies (referred to as the "Tower Companies") manipulated PJM's Day-ahead energy and FTR markets.[95] In response to PJM's manipulation complaint, the Commission directed its Office of Enforcement (OE) to investigate the Tower Companies' conduct under 8 C.F.R. § 1b.5 (2008) and to report its findings to the Commission at the conclusion of its investigation.[96] On March 28, 2008, the Tower Companies filed a complaint against PJM contending that PJM was withholding collateral and revenues due several Tower Company affiliates in violation of its tariff.[97] The Tower Companies requested that the Commission direct PJM to distribute the funds.[98]

On April 2, 2009, the Commission partially dismissed PJM's complaint, and stated that:

> [a]lthough the OE investigation remains ongoing, OE has completed its investigation with respect to two of the allegations made by PJM in its complaint . . . . The first complaint allegation addressed in the report is that certain Tower Company affiliates perpetrated a fraud upon PJM by entering into coordinated, offsetting positions in the market for FTRs, concentrating high-risk or losing positions in one affiliate, Power Edge, and deliberately causing Power Edge to default on its obligations by saddling it with these positions, and hedging its risk in its more profitable affiliates . . . . The second complaint allegation addressed in the report is that Power Edge was deliberately under- or de-capitalized in order to trigger its collapse. Other allegations and issues raised by, or related to, the PJM Complaint remain under investigation and thus are not addressed in the attached report.
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> . . . .

93. *Id*. (citations omitted).

94. *PJM Interconnection, L.L.C. v. Accord Energy, L.L.C.*, 127 F.E.R.C. ¶ 61,007 (2009), *order on reh'g*, 129 F.E.R.C. ¶ 61,010 (2009); *BJ Energy, L.L.C. v. PJM Interconnection, L.L.C.*, 127 F.E.R.C. ¶ 61,006 (2009).

95. *Id*. ¶ 61,021.

96. *Id*.

97. *Id*.

98. *Id.*

> Regarding the two complaint allegations, OE reports that it found insufficient evidence of manipulation to support finding of a violation of the Commission's regulations . . . .
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> . . . .
>
> As a result we [the Commission] will take no further action regarding these instances of PJM's allegations of market manipulation.[99]

In *BJ Energy v. PJM*, issued concurrently with its order on PJM's complaint, the Commission held that since it was dismissing PJM's complaint, there was no basis for PJM to withhold the collateral and revenues due to the Tower Companies.[100] The Commission ordered PJM to return the excess collateral and revenues.[101]

4. DC Energy, L.L.C. v. H.Q. Energy Services (U.S.), Inc.

In *DC Energy, L.L.C. v. H.Q. Energy Services (U.S.), Inc.*,[102] the Commission denied a complaint filed by DC Energy, L.L.C. (DC Energy), against H.Q. Energy Services (U.S.), Inc. (H.Q. Energy), alleging that H.Q. Energy violated the Commission's prohibition of market manipulation[103] by exercising market power to unlawfully affect congestion and energy pricing in the New York Independent System Operator, Inc. (NYISO) energy and Transmission Congestion Credit (TCC) markets. To this end, the Commission relied on a report from OE entitled: "Non-Public Investigation into DC Energy's Allegations of Market Manipulation by HQ Energy in the New York Independent System Operator Energy and Transmission Congestion Contract Markets," which found no market manipulation.

5. New York Independent System Operator, Inc. - New York City Capacity Market

In *New York Independent System Operator, Inc*.,[104] the Commission accepted the Enforcement Staff's March 7, 2008 Report, entitled "Findings of a Non-Public Investigation of Potential Market Manipulation by Suppliers in the New York City Capacity Market," which found no manipulation. As a result, the Commission decided to take no further action on the parties' allegations of market manipulation in the New York City capacity market.[105]

By way of background, as described in the rehearing order, in 1998, Consolidated Edison of New York, Inc. (ConEd), divested most of its generators in three bundles – creating a high degree of market concentration for generation

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99. *Id*. at 61,019.

100. BJ Energy v. PJM, 127 F.E.R.C. ¶ 61,006 at P 23 (2009).

101. *Id.*

102. DC Energy, L.L.C. v. H.Q. Energy Servs. (U.S.), Inc., 124 F.E.R.C. ¶ 61,295 (2008).

103. 18 C.F.R. § 1c.2 (2008).

104. *N.Y. Indep. Sys. Operator, Inc.*, 122 F.E.R.C. ¶ 61,211 (2008), *order on reh'g*, 124 F.E.R.C. ¶ 61,301 (2008).

105. The United States Department of Justice continued to pursue its investigations into the same activities, and eventually entered into a settlement with KeySpan Corporation. *See generally* United States v. KeySpan Corp., No. 10-cv-1415(WHP), 2011 WL 338037 (S.D. N.Y. Feb. 2, 2011).

in New York City. To mitigate the market power of the owners of this divested generation, Con Ed proposed – and the Commission accepted – a $105/kW-year offer and revenue cap on sales of ICAP from these units.[106] The three companies that purchased ConEd's units were KeySpan-Ravenswood, L.L.C. (KeySpan), NRG,[107] and Astoria Generating Company, L.P. (collectively, the Divested Generation Owners, or DGOs).

On March 6, 2007, the Commission issued an order rejecting proposed tariff revisions filed by NYISO that would have reduced the DGOs' mitigation reference price to $82/kW-year.[108] In the March 6, 2007 Order, the Commission instituted a proceeding pursuant to section 206 of the Federal Power Act (FPA)[109] to investigate "the justness and reasonableness of the [in-City market], and whether and how market rules need to be revised to provide a level of compensation that will attract and retain needed infrastructure and thus promote long-term reliability while neither over-compensating nor under-compensating generators."[110] The Commission directed that the hearing be held in abeyance to provide time for settlement judge procedures.[111]

Following unsuccessful attempts at settlement, on May 4, 2007, the Independent Power Producers of New York, Inc. (IPPNY), filed a request to establish a paper hearing in the instant proceeding, augmented by a technical conference, if needed, to investigate the in-City market rules. On July 6, 2007, the Commission issued an order[112] instituting a paper hearing in Docket No. EL07-39-000, and in response to a suggestion by NYISO, directed NYISO to submit a proposal for a revised in-City ICAP market within ninety days. The Commission also set the issue of whether any entity has engaged in manipulation of the in-City ICAP market for investigation by the Commission's Office of Enforcement.[113] As noted above, the Enforcement Staff's finding of no manipulation was embodied in its report to the Commission, which then decided to take no further action with respect to market manipulation allegations.[114]

D. Settlements

After the enactment of the Energy Policy Act of 2005, through the end of 2010, the Commission issued thirteen orders that approved electric-related settlements, for a total of $58,475,000 in civil penalties, between its Enforcement Staff and companies subject to the Commission's jurisdiction. Only one of these settlements resolved allegations of market manipulation, specifically the misuse of PJM Interconnection's demand response tariff provisions.[115] Two of the

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106. *Consol. Edison Co. of N.Y., Inc.*, 84 F.E.R.C. ¶ 61,287 (1998) (1998 Divestiture Order).

107. NRG consists of NRG Power Marketing Inc., Arthur Kill Power L.L.C., Astoria Gas Turbine Power L.L.C., Dunkirk Power L.L.C., Huntley Power L.L.C., and Oswego Harbor Power L.L.C.

108. *N.Y. Indep. Sys. Operator, Inc.*, 118 F.E.R.C. ¶ 61,182 (2007).

109. Federal Power Act, 16 U.S.C. § 824e (2006).

110. 118 F.E.R.C. ¶ 61,182 at P 17.

111. *Id.*

112. *N.Y. Indep. Sys. Operator, Inc.*, 120 F.E.R.C. ¶ 61,024 (2007).

113. *Id.*

114. *Id.*

115. *N. Am. Power Partners*, 133 F.E.R.C. ¶ 61,089 (2010).

settlements, which involved the highest penalties imposed by the Commission since the passage of the EPAct 2005, concerned allegations of violations of mandatory reliability standards related to an outage in Dade County, Florida, in 2008.[116] Four of the settlements concerned violations of the utilities' Open Access Transmission Tariffs.[117] The others pertained variously to the company's violations cost allocation procedures, the electric quarterly report filing requirements and the Standards of Conduct,[118] the company's failure to comply with a prior settlement agreement by sharing nine employees and prohibited market information between different companies within the corporate family,[119] the company's violation of business practice standards for OASIS transactions,[120] the company's violations of its Independent System Operator's market rules and the Commission's Market Behavior Rules,[121] and the company's failure to adhere to the Commission's merger rules.[122]

The final settlement involved the allegation that the company engaged in conduct that misled Commission staff prior to, and during, an investigation of its bidding behavior in PJM Interconnection.[123] Specifically, the company allegedly violated 18 C.F.R. § 35.41(b), which imposes a duty to provide accurate, factual, and complete information in communications with the Commission upon electric power sellers authorized to engage in sales for resale of electric energy at market based rates.[124] The settlement here was unique in several respects. First, it was the first time section 35.41 of the Commission's regulations was the subject of a settlement. Second, it included the costliest compliance program ordered by the Commission - $ 2 million. Third, it prompted requests for rehearing of the order from third parties who sought to intervene. The Commission rejected their requests, and reiterated its general position that no entity has a right to participate in an investigative proceeding initiated under Part 1b of the Commission's regulations.[125]

Settlements of enforcement proceedings under the NGA have focused primarily on shipper misconduct. Nine settlements were the result of self-reported violations of the shipper-must-have-title rule.[126] As a result of a self-

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116. *Fla. Blackout*, 130 F.E.R.C. ¶ 61,163 (2010); *Fla. Blackout*, 129 F.E.R.C. ¶ 61,016 (2009). *See infra* Section I (F)(3) Investigations Involving Reliability Issues.

117. *In re Portland Gen. Elec. Co.*, 131 F.E.R.C. ¶ 61,224 (2010); *In re SCANA Corp.*, 118 F.E.R.C. ¶ 61,028 (2007); *In re Entergy Servs., Inc.*, 118 F.E.R.C. ¶ 61,027 (2007); *In re PacifiCorp*, 118 F.E.R.C. ¶ 61,026 (2007).

118. *Duquesne Light Co.*, 123 F.E.R.C. ¶ 61,221 (2008).

119. *In re Cleco Power, L.L.C.*, 119 F.E.R.C. ¶ 61,274 (2007).

120. *In re NorthWestern Corp.*, 118 F.E.R.C. ¶ 61,029 (2007).

121. *In re NRG Energy, Inc.*, 118 F.E.R.C. ¶ 61,025 (2007).

122. *Gexa Energy, L.L.C.*, 120 F.E.R.C. ¶ 61,175 (2007).

123. *In re Edison Mission*, 123 F.E.R.C. ¶ 61,170 (2008); *In re Edison Mission*, 125 F.E.R.C. ¶ 61,020 (2008); *Edison Mission*, 125 F.E.R.C. ¶ 61,278 (2008); Am. Pub. Power Ass'n v. FERC, No. 08-1382, 2009 WL 604333 (D.C. Cir. Feb. 26, 2009).

124. *Id.*

125. *In re Edison Mission*, 125 F.E.R.C. ¶ 61,020 at PP 28, 32.

126. *Sempra Energy Trading*, 125 F.E.R.C. ¶ 61,360 (2008); *DCP Midstream L.L.C.*, 125 F.E.R.C. ¶ 61,359 (2008); *Cornerstone Energy, Inc.*, 125 F.E.R.C. ¶ 61,234 (2008); *In re Northwestern Corp., L.L.C.*, 125 F.E.R.C. ¶ 61,233 (2008); *In re Enbridge Mktg. (U.S.) LP*, 125 F.E.R.C. ¶ 61,088 (2008); *In re Entergy New*

report by BP Energy, the FERC determined that "flipping," i.e., repeated short-term releases of discounted capacity to two or more affiliated replacement shippers on an alternating monthly basis to avoid the bidding requirement) was a violation of FERC's capacity release rules.[127] After an investigation by the FERC's enforcement staff and several self-reports, fourteen additional settlements were reached involving flipping.[128] In many of these cases, the settlements involved not only flipping transactions but additional violations such as prohibited buy-sell transactions and violations of the shipper-must-have-title rule. In another settlement, the FERC's enforcement staff had determined that a pipeline had failed to comply with the FERC's order requiring the pipeline to permit an interconnection.[129]

E. *Audits (Non-Reliability)*

During 2010, the FERC Enforcement's Division of Audits (DA) completed sixty-four directed audits of public utilities, natural gas pipeline and storage companies, and Regional Entities.[130] Fifty-seven of the sixty-four audits were non-financial (or operational) audits focused on ensuring compliance with requirements for: open access transmission tariffs and market-based rates, mergers and acquisitions, pipeline capacity releases, and independence of Regional Entities.[131] The remaining seven financial audits addressed affiliated transactions and the Public Holding Company Act of 2005, fuel cost recovery mechanisms, and Electric Quarterly Reports (EQR).[132] In total, these audits resulted in 210 recommendations for corrective action and included $4.1 million in monetary recoveries.[133] Below are summaries of several audit reports issued in 2010, which were uncontested and in which areas of non-compliance were identified.

Orleans, Inc., 122 F.E.R.C. ¶ 61,219 (2008); *In re MGTC, Inc.*, 121 F.E.R.C. ¶ 61,087 (2007); *In re Calpine Energy Servs., LP*, 119 F.E.R.C. ¶ 61,125 (2007); *In re Bangor Gas Co.*, 118 F.E.R.C. ¶ 61,186 (2007).

127. *See In re BP Energy Co.*, 121 F.E.R.C. ¶ 61,088 (2007).

128. *RRI Energy Inc. and RRI Energy Wholesale Generation, L.L.C.*, 132 F.E.R.C. ¶ 61,267 (2010); *S. Jersey Gas Co. and S. Jersey Res. Grp., L.L.C.*, 132 F.E.R.C. ¶ 61,266 (2010); *In re Noble Energy, Inc. and Noble Gas Pipeline, Inc.*, 130 F.E.R.C. ¶ 61,175 (2010); *In re Enserco Energy, Inc.*, 128 F.E.R.C. ¶ 61,173 (2009); *In re S. Co. Servs., Inc.*, 128 F.E.R.C. ¶ 61,013 (2009); *In re Wasatch Oil & Gas Corp, and Wasatch Energy, L.L.C.*, 127 F.E.R.C. ¶ 61,322 (2009); *In re ProLiance Energy, L.L.C.*, 127 F.E.R.C. ¶ 61,321 (2009); *In re Sequent Energy Mgmt., LP and Sequent Energy Mktg. LP*, 127 F.E.R.C. ¶ 61,320 (2009); *Piedmont Natural Gas Co.*, 127 F.E.R.C. ¶ 61,319 (2009); *In re Puget Sound Energy*, 127 F.E.R.C. ¶ 61,070 (2009); *In re Anadarko Petroleum Corp.*, 127 F.E.R.C. ¶ 61,069 (2009); *In re Louisville Gas and Elec. Co.*, 127 F.E.R.C. ¶ 61,068 (2009); *In re Integrys Energy Servs., Inc.*, 125 F.E.R.C. ¶ 61,089 (2008); *In re Constellation New Energy – Gas Div., L.L.C.*, 122 F.E.R.C. ¶ 61,220 (2008).

129. *See In re Columbia Gulf Transmission Co.*, 119 F.E.R.C. ¶ 61,174 (2007).

130. FERC OFFICE OF ENFORCEMENT, 2010 REPORT ON ENFORCEMENT, AD07-13-003, at 25 (Nov. 18, 2010), *available at* http://www.ferc.gov/legal/staff-reports/11-18-10-enforcement.pdf [hereinafter *2010 REPORT ON ENFORCEMENT*]. In addition to the twenty-five DA-directed audits, DA staff joined the FERC's Office of Electric Reliability staff to observe twenty-seven reliability audits conducted by the eight Regional Entities and two agreed-upon procedures audits conducted on behalf of the North American Electric Reliability Corporation. *Id*. at 26.

131. *Id.* at 25.

132. *Id.*

133. *Id.*

1. Financial Audits

a. Virginia Electric and Power Company

On January 12, 2010, the FERC issued a letter order accepting DA Staff's audit of Virginia Electric and Power Company's (VEPCO) compliance with FERC accounting and reporting regulations concerning calculation of the wholesale fuel adjustment clause (FAC) charges under 18 C.F.R. § 35.14 and VEPCO's wholesale contracts' FACs.[134] The audit covered January 1, 2005, to October 31, 2009.[135] DA Staff determined that, under the terms of VEPCO's FAC, it had improperly included wood chip costs and interim oil storage in calculating fuel costs for FAC billings to wholesale customers as well as certain accounting entry errors.[136] The FERC approved DA Staff's recommendations that VEPCO, among other things, recalculate its FAC billings to wholesale customers to eliminate the wood chip and interim oil storage costs.[137]

b. American Electric Power Company, Inc.

On April 23, 2010, the FERC issued a letter order accepting DA Staff's audit of American Electric Power Company, Inc.'s (AEP) compliance with the FERC's cross-subsidization restrictions on affiliate transactions, 18 C.F.R. Part 35, the accounting, reporting, and record keeping requirements, 18 C.F.R. Part 366, the Uniform System of Accounts, 18 C.F.R. Part 367, and the preservation of records requirements for holding and service companies, 18 C.F.R. Part 368.[138] The audit period covered was January 1, 2006, through December 31, 2008.[139] DA Staff's findings concerned deficiencies in reporting in FERC Form 60, the allocation of costs between affiliates, and the use of the wrong Uniform System of Accounts account number for a number of expenses.[140] The FERC adopted the fourteen DA Staff recommendations including that AEP record corrected accounting entries and strengthen certain of its processes and procedures.[141]

c. Duke Energy Corporation/FirstEnergy Service Company/Ameren Services Company

During 2010, the FERC issued letter orders accepting DA Staff's audit of Duke Energy Corporation (Duke), FirstEnergy Service Company (FirstEnergy), and Ameren Services Company (Ameren).[142] Similar to AEP, DA reviewed

134. *Va. Elec. and Power Co.*, Letter Order, Docket No. FA08-17-000 (Jan. 12, 2010) (unpublished Letter Order).

135. *Id.*

136. *Id.*

137. *Id.*

138. *Am. Elec. Power Co., Inc.*, Letter Order, Docket No. FA09-7-000 (Apr. 23, 2010) (unpublished Letter Order).

139. *Id.*

140. *Id.*

141. *Id.*

142. *Duke Energy Corp.*, Letter Order, Docket No. FA09-8-000 (Mar. 3, 2010) (unpublished Letter Order).

their compliance with the FERC's cross-subsidization restrictions on affiliate transactions, accounting, reporting and record keeping requirements, the Uniform System of Accounts, and the preservation of records requirements for holding and service companies.[143] Duke's audit period was from January 1, 2006, through December 31, 2008, while FirstEnergy and Ameren's audits covered January 1, 2008, through December 31, 2009.[144] DA Staff determined that Duke failed to report certain wholesale sale transactions and incorrectly reported contract information in its Electric Quarterly Reports (EQR), did not provide timely notice to the FERC of its premature loss of records, used four cost-allocation methods that were not reported in the FERC Form No. 60, did not file FERC-61 descriptions for its special purpose companies, and improperly classified certain expenses in Account 920.[145] The FERC adopted sixteen DA Staff recommendations including that Duke re-file certain of its 2008 EQRs and strengthen its processes and procedures applicable to the audit areas.[146]

In FirstEnergy's audit, DA Staff determined that FirstEnergy had failed to submit its FERC-61 filings for thirteen affiliates in 2008.[147] The FERC approved the DA Staff recommendations that FirstEnergy submit the FERC-61 filings and strengthen its processes and procedures applicable to the FERC-61 filings.[148]

DA Staff identified areas of noncompliance for Ameren, including incorrect accounting entries for lobbying costs, contributions, salaries, payroll and pension costs, service company insurance, construction or service contracts, memberships, and the capitalization of interest expense, and reporting deficiencies in FERC Form 60 and Form 1.[149] The FERC approved the DA Staff recommendations including that Ameren must correct the accounting entries, revise certain procedures, and re-submit certain FERC reports.[150]

2. Non-financial Audits

a. PJM Interconnection, L.L.C.

DA Staff audited PJM Interconnection, L.L.C.'s (PJM) compliance with its Operating Agreement, its Open Access Transmission Tariff, and FERC accounting regulations from January 1, 2007, through December 31, 2009.[151] On August 26, 2010, the FERC issued an order approving the audit report.[152] The audit report contained nine findings, including that PJM had inadequate controls to ensure it consistently applied procedures for identifying potential price errors

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *FirstEnergy Corp.*, Letter Order, Docket No. FA10-2-000 (Dec. 6, 2010) (unpublished Letter Order).

148. *Id.* In a parallel audit of FirstEnergy subsidiary Toledo Edison Company in Docket No. FA10-5-000, the Audit Report accepted by the FERC letter order, issued on December 6, 2010, found that Toledo Edison Company had failed to report in its 2009 Form 1 affiliate transactions with FirstEnergy Service Corp.

149. *Ameren Corp.*, Letter Order, Docket No. FA10-3-000 (Oct. 21, 2010) (unpublished Letter Order).

150. *Id.*

151. *PJM Interconnection, L.L.C.*, 132 F.E.R.C. ¶ 61,173 at P 1 (2010).

152. *Id.*

in real time Locational Marginal Prices.[153] The report concluded that PJM did not always charge time for services performed on behalf of subsidiaries or for subsidiaries' use of PJM data; PJM had inadequate procedures to monitor and enforce employees' acceptance of gifts and entertainment from vendors; PJM did not always follow its procurement policies for competitive bidding; PJM did not use actual or a time study as the basis for employee labor charges; PJM did not correctly classify certain pension and post-retirement liabilities; and, PJM provided generators zonal dispatch rate data through dispatch instructions about five seconds prior to making this information available to the public.[154] The FERC approved the audit report including the twenty-five recommended corrective actions.[155]

b. Questar Pipeline Company

On March 18, 2010, the FERC issued a letter order accepting DA Staff's audit of Questar Pipeline Company's (Questar) compliance with 18 C.F.R. 154.1(d), certain information in FERC Form No. 2 filed under 18 C.F.R. Part 260, NAESB Standards under 18 C.F.R. § 284.12 and selected portions of Questar's FERC Gas Tariff. [156] The audit period covered was January 1, 2006, through September 11, 2009.[157] DA Staff found twelve areas of noncompliance in the areas reviewed, including that at least twenty-eight contracts with material deviations were not filed with FERC. The FERC approved the twenty-three DA Staff recommendations including that Questar file contracts containing material deviations and negotiated rates with FERC, establish policies and procedures to ensure compliance with FERC requirements, and file certain revised reports.[158]

c. Equitrans L.P.

On November 12, 2010, the FERC issued a letter order accepting DA Staff's audit of Equitrans L.P.'s **(**Equitrans) compliance with 18 C.F.R. § 154.1(d), certain information in FERC Form No. 2 filed under 18 C.F.R. Part 260, NAESB Standards under 18 C.F.R. § 284.12, and selected portions of Equitrans' FERC Gas Tariff.[159] The audit covered the period January 1, 2007, through May 26, 2010. DA Staff identified ten areas of noncompliance including record keeping issues, compliance with certain NAESB standards, and the failure to follow instructions applicable to certain FERC reporting requirements. The FERC approved the DA Staff recommendations including that Equitrans perform an independent audit of its accounting processes and procedures within a year, modify certain of its policies and procedures, provide

153. *Id.*

154. *Id*. at P 5.

155. *Id.*

156. *Questar Pipeline Co.*, Letter Order, Docket No. PA09-4-000 (Mar. 18, 2010) (unpublished Letter Order).

157. *Id.*

158. *Id.*

159. *Equitrans LP*, Letter Order, Docket No. PA09-14-000 (Nov. 12, 2010) (unpublished Letter Order).

training to relevant employees about appropriate accounting for certain transactions, and re-file certain FERC reports.[160]

F. Reliability Issues

Perhaps one of the more sweeping substantive provisions of EPAct 2005 for the work of the Commission was the electric reliability provision engrafted into the Federal Power Act.[161] It called for the development and implementation of an entirely new and, in many ways, unique regulatory scheme. The Commission and industry stakeholders devoted significant regulatory effort in 2006 and 2007 to establishing the Electric Reliability Organization (ERO) in the form of the North American Electric Reliability Corporation (NERC), NERC's system of delegation of authority to the "Regional Entities" who would carry out day-to-day standards development and enforcement, and the approval of the first round of electric reliability "standards."[162] Additionally, the framework of electric reliability enforcement was established in the form of the NERC "Compliance Monitoring and Enforcement Plan" as well as Commission regulations pertaining to the Commission's review of the NERC enforcement program and the Commission's own reliability enforcement activities.

Since the completion of those formative activities, the Commission and NERC's reliability enforcement program has significantly developed. Specifically, NERC and regional enforcement programs began to produce cases and policy matters that ripened for Commission review in 2009 and 2010. The Commission fine-tuned its audit activities (directed largely at the Regional Entities), developed and refined its process for reviewing NERC penalty cases, exercised its own independent investigative and enforcement authority, and grappled with a number of policy issues pertaining to reliability enforcement. Due to the timing of this inaugural report by the Enforcement Committee and the timing of the evolving Commission program, some developments from 2009 are discussed here, as well as those from 2010.

1. Notices of Penalty

Section 215(e) of the FPA[163] and section 39.7(c) of the Commission regulations[164] mandate that NERC, as the ERO, file Notices of Penalty (NOP) via the Compliance Monitoring and Enforcement Program. NOPs are filed with the Commission and reflect that either NERC or one of the eight Regional Entities has found a violation of one or more reliability standards by a registered entity.[165] Each NOP proposes resolution of a violation, or alleged violation, through a penalty and mitigation plan, which is the result of either settlement negotiations with the registered entity or an assessment by the Regional Entity or

160. *Id*.

161. Federal Power Act, 16 U.S.C. §§ 791a–823D (2006).

162. *Id.*

163. 16 U.S.C. § 824o(e).

164. 18 C.F.R. § 39.7(c) (2009).

165. Registered entity refers to an entity that has been registered through a NERC registry process for one or more functional areas thereby placing it on notice that it is responsible for complying with one or more reliability standards. 18 C.F.R. § 39.7(c) (2009);16 U.S.C. § 824o(e)(1).

NERC.[166] An NOP becomes effective thirty days after filing with the Commission if the Commission does not act within that time to either request more information or to open the matter for review. Since 2009, NOP review by the Commission has become a significant and ongoing activity. The discussion that follows provides a summary of the highlights of this program as it has developed.

a. The 2009 "Omnibus" NOP

To deal with the initial round of proposed penalties that had accumulated since enforcement began, NERC filed an "Omnibus" NOP (Omnibus Filing) on October 14, 2009, requesting Commission approval of 564 proposed penalties for non-compliance with mandatory Reliability Standards.[167] NERC assessed the proposed penalties against 140 entities nationwide.[168] NERC stated that no significant reliability benefit would be gained by developing the record in each of these matters separately and fully.[169] NERC also noted that those possible violations included in the Omnibus Filing posed at least a substantial risk to the Bulk-Power System.[170]

Included in the Omnibus NOP were twenty-three non-zero-dollar penalties against eight different entities, totaling $91,000.[171] The largest number of penalties involved violations of Requirements R1 through R4 of Reliability Standard CIP-001-1, which requires procedures for sabotage reporting, and the second largest number of penalties involved violations of the requirements of Reliability Standard PRC-005-1, which requires protection system maintenance and testing programs.[172] Other frequent violations included violations of the requirements of FAC-008-1 and FAC-009-1, which mandate a facility's rating methodology and a number of TOP-002-2 requirements, which require coordination and communication of certain operating information.[173]

The Commission found the penalties to be within the range of reasonableness, and stated that it would not review them further.[174] Examples included the $6,500 penalty assessed to the City of Lansing Board of Water and Light for failing to test 15% of its transmission relays within the relevant maintenance and testing intervals,[175] and the $6,000 penalty assessed to LSP-

166. FERC OFFICE OF ENFORCEMENT, 2009 REPORT ON ENFORCEMENT, AD07-13-002, at 17 (Dec. 17, 2009), *available at* http://www.ferc.gov/legal/staff-reports/12-17-09-enforcement.pdf [hereinafter *2009 REPORT ON ENFORCEMENT*].

167. *Order on Omnibus Notice of Penalty Filing*, 129 F.E.R.C. ¶ 61,119 (2009).

168. *Id.* at P 1 (2009). The following Regional Entities had found violations: Florida Reliability Coordinating Council, Inc. (FRCC), Midwest Reliability Organization (MRO), Reliability*First* Corporation (RFC), SERC Reliability Corporation (SERC), Southwest Power Pool Regional Entity (SPP), and the Western Electricity Coordinating Council (WECC). *Id.*

169. *Id.* at P 5.

170. *Id.* at P 6.

171. *Id.* at P 7.

172. *Id.* at P 9.

173. *Id.*

174. *Id.*

175. *Id.* at P 22.

Whitewater, LP, for failing to establish a testing interval in protection system maintenance and testing programs.[176]

The Commission noted that the Omnibus Filing helped to reduce the NOP backlog faced by NERC.[177] It also noted that it does not anticipate reviewing every future NOP; rather it expects NERC to provide appropriately detailed information about each violation to allow the Commission to determine whether further review of a NOP would be necessary.[178] Further, the Commission stated it looked forward to receiving "streamlined" NOPs in the future, which should follow a short form or *pro forma* NOP recently developed via consultation between Commission staff, NERC, Regional Entities, and stakeholders.[179]

b. Rule on Zero Dollar Penalty Cases

Of the 564 non-compliance penalties comprising the Omnibus NOP, 541 penalties include the assessment of a zero-dollar ($0) penalty.[180] Since the issuance of the Omnibus NOP, many other cases turned out to be zero penalty cases, which would have ordinarily called for Commission review. In Order No. 728, the Commission delegated its authority in an approach that will now apply to all zero-dollar penalties.[181]

The Order stated that instead of full Commission review and voting, the Director of the Office of Enforcement is permitted to process "routine, non-controversial [NOPs] that propose zero dollar penalties."[182] Further, the Commission will not be required to issue public notices setting forth that this process is taking place.[183] The Commission stated that the Director would also be allowed to issue requests for information to NERC or other entities without further action by the Commission.[184]

c. 2009 NOPs

In 2009, all of the violations in the additional forty-six NOPs (besides the Omnibus) submitted by NERC became effective without further review by the Commission.[185] These cases involved twenty-four zero-dollar penalties and twenty-two penalties with fines assessed; these fines totaled $1,336,000. 2009's largest single penalty of $250,000 originated from a settlement between FPL Energy, L.L.C., and the SERC, and was the result of violations involving protections system maintenance and testing and sabotage reporting.[186]

176. *Id.* at P 29.
177. *Id.* at P 38.
178. *Id.* at P 39.
179. *Id.* at P 40.
180. *Id.* at P 1.
181. *Delegations for Notices of Penalty*, 129 F.E.R.C. ¶ 61,094 (2009).
182. *Id.*
183. *Id.*
184. *Id.*
185. *2009 REPORT ON ENFORCEMENT*, *supra* note 166, at 18.
186. *Id*.

d. 2010 NOPs and Information Requests

In 2010, the Commission reviewed 190 NOPs filed by NERC.[187] The Commission, through its Director of Enforcement, issued requests for more information on ten NOPs and declined to review 154 NOPs.[188] The Commission also reviewed an Omnibus II Filing,[189] which comprised sixty-two violations.[190]

Of the pending NOPs for which the Commission requested information, the first involved a $5,600 proposed penalty assessed to an entity (whose identity is non-public) for violations of Reliability Standard CIP-004-1 R3.2 and R4, which involved failure to complete personnel risk assessments and failure to maintain and enforce required access lists for personnel.[191] The second NOP for which the Commission requested information involved a $100,000 penalty assessed to Duke Energy Corporation for violation of NERC Reliability Standard FAC-003-1, relating to a 2007 vegetation grow-in contact with a transmission line that produced a sustained outage on the line.[192] At the end of 2010, just one NOP remained under review; this NOP also represented the third NOP in which the Commission requested information.[193] In that case, NERC proposed an $80,000 penalty against Turlock Irrigation District (Turlock), which addressed several alleged violations of Reliability Standards. The FERC then initiated its own review of one of the violations, which related to vegetation-caused outage of transmission facilities in 2007.[194] The Commission stayed NERC's proposed penalty pending further Commission review.[195]

2. Reliability Audits

In the electric reliability sphere, there are a number of different activities that fall under an "audit" rubric. Discussed below are those developments that may have the broadest industry impact.

a. Commission Audits of Regional Entities

During 2010, the Commission conducted audits of three Regional Entities: the Florida Reliability Coordinating Council (FRCC), the Texas Regional Entity (TRE), and the Western Electric Coordinating Council (WECC). One purpose of these audits was to evaluate each Regional Entity's compliance with its Bylaws and Regional Entity Delegation Agreement with NERC, and with conditions contained in relevant Commission Orders.[196] In addition, the audits were designed to ensure that the Regional Entity functions of these entities, which are successors to earlier organizations pre-dating Order No. 672, are

187. *2010 REPORT ON ENFORCEMENT*, *supra* note 130, at 3. These cases involved approximately 1,300 violations.

188. *Id.* at 6.

189. *N. Am. Electric Reliability Corp.*, 133 F.E.R.C. ¶ 61,037 (2010).

190. *2010 REPORT ON ENFORCEMENT*, *supra* note 130, at 6.

191. *N. Am. Electric Reliability Corp.*, 132 F.E.R.C. ¶ 62,097 (2010) (Letter Order).

192. *N. Am. Electric Reliability Corp.*, 132 F.E.R.C. ¶ 62,021 (2010) (Letter Order).

193. *2010 REPORT ON ENFORCEMENT*, *supra* note 130, at 6.

194. *N. Am. Electric Reliability Corp.*, 130 F.E.R.C. ¶ 61,151 at P 1 (2010).

195. *Id*. at P 20.

196. *2010 REPORT ON ENFORCEMENT*, *supra* note 130, at 22.

sufficiently independent from their non-Regional Entity functions, such as member services.[197]

i. Florida Reliability Coordinating Council

The FRCC audit (Docket No. PA09-7-000) (FRCC Audit Order) focused on the relationship between the FRCC Regional Entity and FRCC's Member Services Division.[198] The audit report concluded that FRCC had taken steps to improve the separation between these entities' functions, but that the following concerns remained: (1) interference of the FRCC Compliance Committee in the FRCC Regional Entity's performance of compliance activities pursuant to the CMEP; (2) oversight of the reporting of misoperations; (3) lack of an agreement with a third party to perform the CMEP activities for all reliability functions for which the FRCC has registered; (4) review of reliability assessments; (5) cost allocation between activities subject to the Commission's reliability jurisdiction pursuant to section 215 of the FPA ("statutory" activities) and other ("non-statutory") activities; and (6) absence of adequate periodic evaluations of FRCC RE staffing needs.[199]

In order to address these concerns, the Commission directed FRCC to implement eighteen actions to maintain separation between its Regional Entity and Member Services functions, including revising the bylaws to reflect the appropriate roles of certain entities, entering into and filing with the Commission an agreement with NERC or a NERC-approved entity to perform CMEP duties under the Regional Delegation Agreement for Reliability Coordinator and Planning Authority functions, designating specific Regional Entity staff to perform reliability assessments of the FRCC region, studying the allocation of costs between Regional Entity and non-statutory activities, and evaluating staffing needs related to statutory activities and procedures for working with outside experts in addressing CIP spot checks and audits.[200] While the Audit Report made several recommendations regarding FRCC's handling of misoperations, the Commission accepted FRCC's response that its Members Services Division is charged with collecting and reporting information regarding misoperations, with the caveat that should this function be transferred to the Regional Entity, FRCC would be required to implement the misoperations-related recommendations made by the Audit Report.[201] The Commission noted, however, its concern with this arrangement as it could affect the Regional Entity's ability to monitor compliance by registered entities with their obligation to report and correct misoperations.[202] To mitigate this possibility, the Commission directed FRCC to provide to its Regional Entity function "full

197. *See, e.g.*, Order Approving Audit Report, Determining Issue of Separation of Functions, and Directing Compliance and Other Corrective Actions, *Fla. Reliability Coordinating Council, Inc.*, 131 F.E.R.C. ¶ 61,262 at P 1 (2010).

198. Order Approving Audit Report, *Audit of Regional Entity Independence of the Florida Reliability Coordinating Council*, 131 F.E.R.C. ¶ 61,262 (2010).

199. *Id* at PP 8, 10.

200. *Id*. at P B.

201. *Id*. at P 19.

202. *Id*. at P 20.

information" from its Member Services division on each misoperations report received and the response of Member Services to that event.[203]

Finally, in addition to the Audit Report's recommendation that the FRCC design and submit for Commission staff approval a plan to implement the recommendations and make quarterly non-public reports on its progress in implementing those recommendations, the Commission directed its staff to make a post-audit site visit to FRCC, once FRCC reports that the implementation is complete, to ensure that the recommendations and associated corrective actions have been fully implemented.[204]

ii. Texas Regional Entity

The audit of the Texas Regional Entity (TRE) (Docket No. PA09-6-000), which at the time was a division of ERCOT, addressed TRE's independence from ERCOT and its capability to access compliance with Reliability Standards by the ERCOT ISO in an unbiased manner.[205] The Commission's order accepting the audit report noted that while TRE had taken "significant measures" to ensure a sufficient separation between itself and the ERCOT ISO, several concerns regarding independence remained, including the operations of the TRE and ERCOT occurring under a shared Board of Directors, the TRE's role in monitoring compliance by the ERCOT ISO and in preparing reliability assessments for the ERCOT region, and the TRE's control over access to confidential information by the ERCOT ISO.[206] The Commission directed the TRE to implement the recommendations made by OE staff to address these concerns.[207]

With the TRE's legal separation from ERCOT, as a result of which it is now an independent entity known as Texas Reliability Entity, Inc., many of the concerns raised in this audit report have been addressed.[208]

iii. Western Electric Coordinating Council

The audit of the WECC (Docket No. PA09-5-000) examined whether WECC demonstrated a strong separation between its CMEP and the reliability functions for which it is registered with NERC (Reliability Coordinator and Interchange Authority), and whether it was sufficiently independent from users, owners, and operations within the Western Interconnection through its Member Services Division.[209] While the audit report acknowledged WECC's contractual arrangement with NERC to provide CMEP oversight of WECC's Reliability Coordinator and Interchange Authority functions, it also noted additional

203. *Id*.

204. *Id*. at P 21.

205. *Tex. Reg'l Entity*, 130 F.E.R.C. ¶ 61,025 at PP 1-2 (2010).

206. *Id*. at PP 3, 11.

207. *Id*. at P B.

208. *N. Am. Electric Reliability Corp.*, 131 F.E.R.C. ¶ 61,112 (2010) (approving NERC petition to delegate authority to TRE as successor to Texas Regional Entity).

209. Order Approving Audit Report, Determining Issue of Separation of Functions, and Directing Compliance and Other Corrective Actions, *W. Electric Coordinating Council*, 132 F.E.R.C. ¶ 61,149 at P 2 (2010).

concerns: accounting practices; failure to obtain Commission authorization to perform certain activities; lack of proper safeguards for ensuring independence and data confidentiality when establishing a Board-level Compliance Committee; efforts at reducing backlogs in its CMEP; and protocols for dealing with inappropriate communications involving CMEP staff.[210] The Commission's order accepting the audit report directed WECC to comply with the recommendations made there, which addressed each of these concerns.[211] As with FRCC, the Commission directed Commission staff to make a post-audit site visit once WECC reports it has completed all of the recommendations to ensure complete implementation of them.[212] In addition, the Commission directed its staff to conduct another audit of WECC during the 2012 fiscal year.[213]

b. NERC and Region Audit Program Developments

In addition to responding to the foregoing orders and activities, NERC and the Regions have been refining their audit programs. For example, NERC has been working to implement "Risk-Based Reliability Compliance," which would emphasize utilizing NERC audit resources for high-risk reliability concerns and increasing the use of spot-checks and Regional Entities to address lower-level incidents. A White Paper presented at the December 2010 meeting of the NERC's Compliance and Certification Committee provided an update on NERC's developing approach to this effort, and identified several goals currently being pursued with intent to correlate efforts to monitor and enforce reliability standards to the level of risk involved with each standard and requirement. For instance, the paper advised that NERC "employ a risk-based approach to reliability compliance where monitoring and enforcement efforts on a particular reliability requirement are made directly proportional to that requirement's stated risk to the reliability of the bulk power system."[214] This goal would include, for instance, NERC and Regional Entities limiting their enforcement actions regarding low-level, low-risk issues to entities that demonstrate a persistent pattern of failure to address those issues.[215] The paper also advised that NERC and Regional Entities "explicitly incorporate a risk-based approach in carrying out the Compliance Monitoring and Enforcement Program," and that NERC should "identify sets of requirements designed to achieve a specific defense-in-depth strategy when assessing risks to the reliability of the bulk power system and when devising its risk-based approach to reliability compliance."[216]

As of December 23, 2010, NERC and the independent auditing firm Crowe Horwath, LLP (Crowe) had conducted, pursuant to NERC's obligations under Order No. 672, audits of five of the Regional Entities for compliance with

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210. *Id*. at P 3.

211. *Id*. at P B.

212. *Id*. at P 23.

213. *Id*.

214. NERC COMPLIANCE AND CERTIFICATION COMMITTEE, RISK-BASED RELIABILITY COMPLIANCE WHITE PAPER (DRAFT) 3 (Sept. 13, 2010) (presented at the December 2, 2010, Compliance and Certification Committee meeting).

215. *Id*.

216. *Id*. at 3, 4.

NERC's Rules of Procedure, Compliance Monitoring and Enforcement Program (CMEP), and the Regional Entity delegation agreements: MRO, NPCC, RFC, SERC, and SPP.[217] NERC plans to have fulfilled its audit obligations with regard to the remaining Regional Entities — FRCC, TRE, and WECC — by the end of 2011.[218] The remaining audits, however, will be conducted under a restructured Regional Entity Audit Program. As NERC explained in a December 23, 2010, filing the initial phase of audits "focused on defined, process-based requirements set forth in the NERC Rules of Procedure and the CMEP on a three year cycle."[219] Based on its experience with the first five audits, NERC has concluded that that approach did not permit it to appropriately evaluate the effectiveness of Regional Entities' programs.[220] As a result, NERC has proposed to refocus its Regional Entity Audit Program to be "an on-going and simultaneous evaluation of performance-based objectives to gauge the effectiveness of the Regional Entities."[221] Under this new approach, NERC has concluded that full audits of the remaining three Regional Entities are not needed, and it will instead perform Spot Checks of these entities' compliance with the relevant obligations.[222] NERC will, however, apply findings, exceptions, and lessons learned from the first five audits to these Spot Checks to ensure that all Regional Entities are developing with similar guidance in place.[223] In November 2010, NERC requested that each of these three remaining Regional Entities self-certify compliance with the applicable obligations by January 31, 2011.[224]

3. Investigations Involving Reliability Issues

Though most of the Commission's reliability activities involve oversight and appeals, it does have its own independent enforcement authority which it exercised in 2009 and 2010.

a. Florida Blackout – Florida Power and Light

On February 26, 2008, portions of the lower two-thirds of the bulk electric system in Florida experienced an event that involved voltage and frequency swings that resulted in losses of customer load. In response to the event, the Commission opened a formal investigation into the cause and events

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217. Informational Filing of the North American Electric Reliability Corporation in Response to Paragraph 773 of Order No. 672 Regarding the Initial Three Year Regional Entity Audits and Plan for Future Audits, *N. Am. Electric Reliability Corp.*, Nos. RR09-7-000, RR10-11-000, at 1 (filed Dec. 23, 2010).

218. *Id*.

219. *Id*. at 8.

220. *Id*.

221. *Id*.

222. *Id*. at 7. NERC's plan for completing the remaining Spot Checks includes: (1) performing ongoing oversight of compliance and enforcement activities over the last three years; (2) reviewing its findings from the first five Regional Entity audits with these remaining entities to confirm their compliance with NERC Rules of Procedure and the Regional Entity delegation agreements; and (3) analyzing the Regional Entity Business Plan and Budgets to assess staffing and other capabilities for conducting delegated functions under the delegation agreements.

223. *Id*. at 8.

224. *Id*. at 6.

surrounding the outages. The matter was the first Commission investigation of a reliability event and the Commission took the somewhat unusual step of announcing the existence of the investigation at the outset, though the substance of the investigation remained non-public.[225] Contemporaneously, NERC also opened a parallel Compliance Violation Investigation.[226] On October 8, 2009, the Commission approved a settlement between Commission staff, NERC, and Florida Power & Light (FPL) for a $25 million civil penalty.[227] The settlement had several unique features including that $5 million of that figure was allowed to be used for reliability improvements to FPL's system. Of the $20 million cash component, half went to the U.S Treasury and half went to NERC, which amount was available under NERC rules to offset future NERC budget allocations to NERC members.[228]

FPL denied admission of any wrongdoing but did agree to a mitigation plan as part of the settlement (apart from its financial terms), including: enhancements to its general compliance program; training and certification enhancements for operating employees; and measures regarding frequency response, emergency operating procedures, Bulk Electric System analysis pertaining to planning and real time scenarios, and equipment maintenance. Although Commission Staff agreed that FPL's actions were neither intentional nor fraudulent, the settlement represented the largest civil penalty yet assessed by the Commission.

The settlement came under some implicit criticism in concurrences issued by two Commissioners, expressing concerns that the settlement and resulting order did not "identify with specificity the Reliability Standards alleged to have been violated in this matter and how the facts of this case apply to those Reliability Standards."[229]

b. Florida Blackout – FRCC

As a separate part of the same *Florida Blackout* investigation, on March 15, 2010, the Commission approved a settlement between Commission staff, NERC, and the FRCC.[230] FRCC serves as the Reliability Coordinator (RC) meaning that it has responsibility and authority for reliable operations for the footprint in which the February 26, 2008, event occurred.[231] The case was notable in that FRCC also serves as a "Regional Entity" with delegated authority from NERC for standard setting and enforcement responsibility.[232] This Commission-approved "dual role" also arises in other Regions outside of Florida where the same entity can serve both as a Regional Entity and fulfill reliability compliance

225. Order Approving Stipulation and Consent Agreement, *Fla. Blackout*, 122 F.E.R.C. ¶ 61,244 (2008). In most cases, Commission investigations under 18 C.F.R. pt. 1b (2009) are non-public, meaning that even the fact of the investigation is itself non-public.

226. *Fla. Blackout*, 130 F.E.R.C. ¶ 61,163 at P 27 (2010).

227. *Fla. Blackout*, 129 F.E.R.C. ¶ 61,016 (2009).

228. *Id.*

229. *Id.* (Spitzer, Comm'r concurring; Moeller, Comm'r concurring).

230. *Fla. Blackout*, 130 F.E.R.C. ¶ 61,163 (2010).

231. *Id.*

232. *Id.* at P 3.

responsibilities as a "Registered Entity" under NERC functional model.[233] Perhaps heeding the Spitzer and Moeller concurrences from the FPL settlement order, the FRCC settlement and order contained a specific list of standards Commission staff alleged to have been violated,[234] and a discussion of RC staffing, communication, and system awareness issues, though FRCC neither admitted nor denied these matters involved violations.[235] The FRCC settlement totaled $350,000. As with FPL, this settlement payment was split in light of the dual investigation by both the Commission and NERC. The settlement also observed that FRCC had taken several steps since the February 26, 2008, event to improve and ensure compliance with the Reliability Standards and committed FRCC to additional mitigation measures in the areas of communications, staffing and oversight of the RC function, system stability analysis, and planning assessment.[236]

4. Reliability Enforcement Policy and Process Developments

a. Violation Risk Factor and Severity Level Developments

In the event of a violation of a Reliability Standard, NERC is to establish a base penalty amount. To do so, NERC has generally assigned a "violation risk factor" (VRF) for each requirement of a Reliability Standard that relates to the expected or potential impact of a violation on the reliability of the Bulk-Power System. In addition, NERC has generally defined up to four "violation severity levels" (VSL) – Lower, Moderate, High, and Severe – as measurements for the degree to which the requirement was violated in a specific circumstance. The Commission had approved the use of these VRFs and VSLs in 2008[237] and in subsequent orders has provided additional policy guidance on their use.

On May 21, 2009, the Commission issued a NOPR proposing to approve Reliability Standard PRC-023-1 as proposed by NERC.[238] In its March 18, 2010, Order No. 733, the Commission approved the Standard but also directed NERC to establish VRFs and VSLs.[239]

On March 18, 2010, the Commission issued an Order approving the proposed VSLs for eight CIP reliability standards, as well as issuing additional guidelines that apply specifically to VSLs and VRFs in the cyber security

233. *About Standards: Functional Model*, NERC (Mar. 2, 2011), http://www.nerc.com/page.php?cid=2| |108. NERC's website provides the foundation and framework upon which NERC develops and maintains reliability standards. The Functional Model defines the set of functions that must be performed to ensure Bulk-Power System reliability and explains the relationship between and among entities for performing tasks within each function.

234. *Fla. Blackout*, 130 F.E.R.C. ¶ 61,163 (2010) (attached settlement at PP 13-14) (PER-004-1 (R1), IRO-002-1 (R1), IRO-001-1 (R9), COM-002-2 (R2), IRO-003-2 (R1), IRO-003-2 (R2), IRO-005-2 (R5), IRO-005-2 (R13) & TOP-006-1 (R5)).

235. *Id.* at P 12.

236. *Id.*

237. *Order on Violation Severity Levels Proposed by the Electric Reliability Organization*, 123 F.E.R.C. ¶ 61,284 (2008).

238. *Transmission Relay Loadability Reliability Standard*, 127 F.E.R.C. ¶ 61,175 (2009), *order on reh'g and clarification*, 134 F.E.R.C. ¶61,127 (2011).

239. *Id.* at PP 285-312.

context.[240] The Commission also directed NERC to revise fifty-seven sets of VSLs associated with the eight CIP Reliability Standards as well as some of the proposed VRFs.[241] On December 16, 2010, the FERC denied a request for rehearing of the Commission's order addressing VSLs for the CIP Reliability Standards.[242] The entities further asked the Commission to recognize that, "contrary to CIP Violation Severity Level Guideline 2, the successful electronic implementation of electronic-access controls does not necessarily depend on the documentation of such controls."[243] The Commission rejected arguments, reinforcing the appropriateness of a "binary" rather than a "gradated" approach to VSLs.[244] Further, the Commission rejected arguments concerning electronic implementation of electronic-access controls, asserting that the:

> programs, policies, and procedures are necessary to ensure that an organization applies the technical and physical controls in a reliable and repeatable manner . . . . [and] that sufficiency in the documentation . . . prevent[s] some violations, reduce[s] the incidence of others, and promote[s] early detection of human error, all of which enhance cyber security protections and the reliability of the Bulk-Power System.[245]

Finally, the Commission reasserted that its ordering of modifications to the VSLs without first permitting NERC to modify those assignments through its Reliability Standards Development Procedures was sound policy.[246]

On November 18, 2010, the FERC issued a NOPR seeking comments regarding three new Reliability Standards proposed by NERC, designated as IRO-008-1 (Reliability Coordinator Operational Analyses and Real-time Assessments), IRO-009-1 (Reliability Coordinator Actions to Operate Within IROLs), and IRO-010-1a3 (Reliability Coordinator Data Specification and Collection).[247] NERC stated that because it developed the VSLs for these new standards before the Commission issued its June 19, 2008, order on VSLs, some of the proposed VSLs do not comport with the Commission's guidelines on VSLs, and some do not comport with NERC's revised guidelines.[248] Through this NOPR, the Commission proposed to accept the VRFs and VSLs.[249] Comments are due January 24, 2011. The Commission also issued an order on

240. Order Addressing Violation Severity Level Assignments for Critical Infrastructure Protection Reliability Standards, *Mandatory Reliability Standards for Critical Infrastructure Protection*, 130 F.E.R.C. ¶ 61,211 (2010).

241. *Id.* at P 37.

242. *Mandatory Reliability Standards for Critical Infrastructure Protection*, *order on reh'g*, 133 F.E.R.C. ¶ 61,237 at P 1 (2010). The entities requesting rehearing were the American Public Power Association, Edison Electric Institute, and the National Rural Electric Cooperative Association. Those entities asserted that though they generally support the principles reflected in the CIP VSL Guidelines, they were concerned that aspects of the ordered modifications to the VSLs were inappropriate, and that the Commission should reinstate the gradation approach for certain VSLs.

243. *Id.* at P 7.

244. *Id.* at PP 16-31.

245. *Id.* at P 25.

246. *Id.* at P 32.

247. *Mandatory Reliability Standards for Interconnection Reliability Operating Limits*, 133 F.E.R.C. ¶ 61,151 (2010).

248. *Id.* at PP 73-74.

249. *Id.* at PP 75-76.

the same day deferring ruling on VSLs and VRFs for a number of EOP Standards.[250]

On December 7, 2010, the Commission issued a Letter Order accepting NERC's May 29, 2009, and July 6, 2009, filings revising VSLs for approved Reliability Standards in response to the FERC's Order No. 722, subject to a compliance filing.[251]

b. Technical Feasibility Exception Procedures

The Commission issued several orders during 2010 addressing NERC's proposed procedures for evaluating requests for Technical Feasibility Exceptions (TFEs) from Reliability Standard requirements (TFE Procedure). In the order initially approving the CIP Reliability Standards, Order No. 706,[252] the Commission directed NERC to develop a set of criteria that a [Responsible Entity] would have to meet to obtain a TFE to specific requirements of the CIP Standards.[253] In October 2009, NERC made a filing in response to this directive, containing NERC's proposed section 412 to its Rules of Procedure, which would incorporate the TFE procedure contained in proposed Appendix 4D to the Rules of Procedure. On January 21, 2010, the Commission largely approved NERC's proposal to add the "new section 412, 'Requests for Technical Feasibility Exceptions to NERC Critical Infrastructure Protection Reliability Standards;' and [a] new Appendix 4D, 'Procedure for Requesting and Receiving Technical Feasibility Exceptions to NERC Critical Infrastructure Protection Standards,'" to its Rules of Procedure.[254] The January 21 Order also, however, directed NERC to submit a compliance filing with certain revisions to the TFE Procedure, and asked for further information on certain issues. The Commission has not yet issued its final ruling on the required compliance filing.[255]

c. Guidance Order on Repeat Violations

In a "guidance order" issued with respect to a NOP/settlement agreement between ComEd and RFC to resolve a violation of PRC-005-1 R2.1, the Commission stated its position on how it expects NERC and the Regions to evaluate "repeat violation" issues in determining penalties.[256] In reviewing the NOP, the Commission noted that it will evaluate whether a violation is a repeat offense or if the company has a history of violations.

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250. *Sys. Restoration Reliability Standards*, 133 F.E.R.C. ¶ 61,161 (2010).

251. *In Reply Refer to: Version Two Facilities Design, Connections and Maintenance Reliability Standards*, 133 F.E.R.C. ¶ 61,204 at P 1 (2010).

252. Order No. 706, *Mandatory Reliability Standards for Critical Infrastructure Protection*, 122 F.E.R.C. ¶ 61,040, *order on reh'g*, Order No. 706-A, 123 F.E.R.C. ¶ 61,174 (2008), *order on clarification*, Order No. 706-B, 126 F.E.R.C. ¶ 61,229 (2009).

253. Order No. 706, *supra* note 252 at P 192.

254. Order Approving Technical Feasibility Exception Procedures and Ordering Compliance Filing, *N. Am. Electric Reliability Corp.*, 130 F.E.R.C. ¶ 61,050 (2010).

255. *See* Order Granting Rehearing, *N. Am. Electric Reliability Corp.*, 133 F.E.R.C. ¶ 61,209 (2010).

256. Notice of No Further Review and Guidance Order, *N. Am. Electric Reliability Corp.*, 132 F.E.R.C. ¶ 61,182 (2010).

> Similarly, the NERC Sanction Guidelines state that, "[i]f a violator has had repetitive infractions of the same or a closely-related reliability standard requirement, particularly within a time frame defined within the standard(s) or deemed appropriate by NERC or the regional entity in the absence of the standard(s) defining the time frame, NERC or the regional entity shall consider some increase to the penalty.[257]

On the facts of the case, the Commission viewed ComEd's two violations of PRC-005-1 R2.1 as "repetitive infractions" because they were two violations of the identical Reliability Standard and Requirement by the same registered entity that in the Commission's words "embod[ied] that entity's repeated failure to meet the performance obligation the Requirement specifies."[258]

The Commission stated more broadly that it "believe[d] that there are situations in which NERC or a Regional Entity could consider a registered entity's violation as a prior violation with respect to an affiliate's later-in-time violation."[259] The Commission then stated that future Notices of Penalty should:

> explain how NERC and the Regional Entities assessed whether the instant violations may reflect recurring conduct by the same registered entity or by an affiliate or department that is operated by the same corporate entity or whose compliance activities may be conducted by that entity. Likewise, prior violations by the same or affiliated entity should not be disregarded for the reason that a different Regional Entity made the prior finding.[260]

The Commission observed that this dictate "should not be read to suggest that NERC and the Regional Entities lack the discretion to determine, based on the particular facts of each violation, whether a prior violation of the same or a closely-related Reliability Standard should be considered an aggravating factor."[261]

d. Enforcement Aspects of the FERC's Three-Year Assessment of NERC

On September 16, 2010, the Commission issued its Order containing its "Three Year Assessment" designed to evaluate NERC's effectiveness as the ERO, including its enforcement program.[262] The Commission determined "that NERC has demonstrated that it has the ability to . . . enforce Reliability Standards"[263] and that "each of the Regional Entities continues to meet the relevant statutory and regulatory criteria."[264] The Commission then further addressed certain specifics of NERC and regional enforcement programs.

As to NERC's auditing program, the Commission encouraged NERC to continue making improvements in consistency, especially with respect to comments regarding audit techniques and practices. The Commission agreed

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257. *Id.* at P 5.

258. *Id.* at P 6.

259. *Id.* at P 7.

260. *Id.*

261. *Id* at P 8.

262. *North American Electric Reliability Corporation Reliability Standards Development and NERC and Regional Entity Enforcement*, 132 F.E.R.C. ¶ 61,217 (2010).

263. *Id.* at P 54.

264. *Id.* at P 55.

with numerous comments about auditors who arrived at on-site audits without apparently having reviewed the voluminous responses already provided in writing. The Commission "note[d] that while it is understandable that compliance auditors sometimes seek additional information during compliance audits, compliance auditors should prepare prior to on-site visits by reviewing fully information prepared by registered entities in response to pre-audit requests for information."[265] The Commission further suggested that NERC and Regional Entities consider providing ongoing training for their compliance auditors on effective auditing techniques.[266]

In response to comments about the practice of auditors adhering to "Reliability Standard Audit worksheets" (RSAWs) rather than the Requirements themselves, the Commission noted "providing the types of evidence listed in [RSAWs] is not the exclusive way for registered entities to show compliance; rather, Reliability Standard Audit Worksheets are a tool for evaluating compliance."[267] The Commission directed NERC to continue its oversight of Regional Entity audits with NERC staff that are technically proficient.[268]

The Commission commented, and NERC had acknowledged, that the bases for NERC and Regional Entity penalty determinations for Reliability Standards violations should be more transparent to stakeholders, and more consistent and efficient in their application.[269] The Commission observed "that there always will be some tension between the transparency of specific NERC Sanction Guidelines and flexibility to negotiate penalties in specific cases."[270] The Commission declined to order any specific remedy for this tension, but seemed to signal openness to NERC reevaluating its sanctions guidelines approach.

e. Most Violated Standards - Survey of the Public Reports

As the reliability enforcement programs at the Regions and NERC have evolved, public reports tending to highlight the most violated standards have begun to emanate from NERC and may shed light on where industry faces the most compliance challenges, where regulators may be focusing their attention, or both.[271] The table below provides data published by NERC as to the ten most violated standards in 2009.

Table 1.

No.	Standard	No. of Violations
1	PRC-005- Transmission and Generation Protection System Maintenance and Testing	214
2	CIP-004- Personnel & Training	119

265. *Id.* at P 118.
266. *Id.*
267. *Id.* at P 121.
268. *Id.* at P 126.
269. *Id.* at P 129.
270. *Id.* at P 133.
271. *NERC 2010 Violation Statistics* & *NERC 2009 Violation Statistics*, NERC, *available at* http://www.nerc.com/page.php?cid=3/304.

3	CIP-001- Sabatoge Reporting	71
4	EOP-005- System Restoration Plans	62
5	FAC-008- Facility Ratings Methodology	50
6	TOP-002- Normal Operations Planning	48
7	CIP-007- Systems Security Management	48
8	PER-002- Operating Personnel Training	40
9	VAR-002- Generator Operation for Maintaining Network Voltage Schedules	39
10	EOP-001- Emergency Operations Planning	37
Total		728

The table below presents data for both 2010 and 2009. Five of the ten most violated electric reliability standards from 2009 remained in the top ten in 2010. Nine remained in the top twenty. In 2009, the top ten most violated standards accounted for 728 total violations. In 2010, the top ten most violated standards accounted for 1,301, nearly a 50% increase. Violations of CIP-007 experienced the greatest jump in the number of violations, increasing some 400%.

Table 2.

No.	Standard	No. of Violations	
		2010	2009
1	CIP-007- Systems Security Management	256	48
2	CIP-004- Personnel & Training	203	119
3	PRC-005- Transmission and Generation Protection System Maintenance and Testing	201	214
4	CIP-006- Cyber Security – Physical Security	131	n/a
5	CIP-005- Cyber Security – Electronic Security Perimeter	109	n/a
6	CIP-003- Cyber Security – Security Management Controls	105	n/a
7	CIP-002- Cyber Security – Critical Cyber Asset Identification	93	n/a
8	CIP-001- Sabotage Reporting	69	71
9	VAR-002- Generator Operation for Maintaining Network Voltage Schedules	68	39
10	CIP-009- Cyber Security – Recovery Plans for Critical Cyber Assets	66	n/a
		1301	

In general, Critical Infrastructure Protection violations increased significantly, likely in part because many of them became effective on a phased-in basis in 2009 and 2010.

G. *Annual Enforcement Report*

On November 18, the FERC's Enforcement Staff issued a report detailing the activities of the office for fiscal year 2010.[272] According to the report, Enforcement's priorities remained the same with staff focusing on matters involving fraud and market manipulation, serious violations of the reliability standards, anticompetitive conduct, and conduct that threatens the transparency of regulated markets.[273] The report detailed significant matters involving each of the major divisions within the Office of Enforcement. The Division of Investigations noted its work on major policy initiatives regarding penalty guidelines, preliminary notices of violations, and disclosure of exculpatory materials.[274] Investigations also reported on the market manipulation trial of Brian Hunter before an administrative law judge.[275] Settlements were down as compared to years past with six settlement agreements entered into during FY2010, half of which involved self-reports of flipping and shipper-must-have-title violations.[276] Staff received ninety-three self-reports in FY2010, fifty-four of which were closed without an investigation, and thirty-nine are still pending.[277] Staff also opened fifteen non-self-reported investigations – eight involved tariff violations, five involved market manipulation, three involved reliability standards, three involved market-based rates, and one involved capacity release.[278] The Division of Audits conducted fifty-two financial and non-financial audits, including audits of LDCs regarding compliance with capacity release regulations.[279] The report noted that all of the audits regarding capacity release were completed with no findings of non-compliance.[280] The Division of Energy Market Oversight reported on its State of the Markets reports and seasonal assessments as well as the work they have begun to assess the effects of removing the price cap on and changing the asset management rules for released pipeline capacity, which is due to the Commission by January 30, 2011.[281] The division also noted its support in providing clarifications regarding the annual transactions reporting requirements (Order No. 704), and the pipeline posting requirements (Order No. 720).[282]

II. THE COMMODITY FUTURES TRADING COMMISSION

The Commodity Futures Trading Commission (CFTC) has been continually increasing its focus on energy markets. Between December 2002 and the end of fiscal year 2008 the CFTC charged forty-two companies and thirty-one individuals in the energy sector with manipulation, attempted manipulation, false

272. *2010 REPORT ON ENFORCEMENT*, *supra* note 130.
273. *Id.*
274. *Id.*
275. *Id.*
276. *Id.*
277. *Id.*
278. *Id.*
279. *Id.*
280. *Id.*
281. *Id.*
282. *Id.*

reporting, and wash trading violations.[283] Although the CFTC historically pursues non-public investigations, in May of 2008 it took the unusual step of publicly disclosing an ongoing nationwide investigation into practices concerning the purchase, transportation, storage, and trading of crude oil and related derivative contracts.[284] The first complaint resulting from that nationwide investigation was filed on July 24, 2008, charging a trading firm and several of its personnel with manipulation and attempted manipulation of crude oil, heating oil, and gasoline futures traded on the NYMEX.[285] In fiscal year 2009 the CFTC reported that it had filed only one energy related complaint,[286] but in fiscal year 2010, the CFTC reported that it had filed six complaints charging manipulation, attempted manipulation or false reporting, and eleven trade practice violation complaints.[287] The notable recent energy-related cases are described below.

A. Energy-Related Enforcement Cases

1. Manipulation and Attempted Manipulation

In *CFTC v. Amaranth Advisors, L.L.C.*, the CFTC charged two related hedge funds and the head trader, Brian Hunter, with attempted manipulation of the natural gas futures contract traded on the NYMEX on two days in 2006.[288] The complaint alleged that the defendants acquired a large position in NYMEX natural gas futures contracts for sale near the close on two specific expiry days in order to lower the NYMEX price to benefit large short swap positions primarily held on the IntercontinentalExchange (ICE).[289] The settlement price of the ICE swaps is based on the NYMEX natural gas futures settlement price during the closing on expiry days.[290] Evidence obtained from instant messages formed an important basis for the CFTC's allegation that the trading had been with an intent to affect the NYMEX closing price. In August 2009, the hedge funds consented to an order to pay a $7.5 million civil penalty.[291]

CFTC v. Energy Transfer Partners, L.P., also concerned CFTC charges of attempted manipulation to lower the price in one market with the intent of

283. Press Release, CFTC, CFTC's 2008 Fiscal Year Enforcement Roundup: Agency Files 40 Actions, Obtains Record Amount in Penalties and Fines, Discloses Crude Oil Investigation, Forms Forex Task Force (Oct. 2, 2008) (PR5562-08).

284. Press Release, CFTC, CFTC Announces Multiple Energy Market Initiatives (May 29, 2008) (PR5503-08).

285. U.S. Commodity Futures Trading Comm'n v. Optiver US, L.L.C., No. 1:08cv6560 (S.D. N.Y. filed July 24, 2008).

286. Press Release, Commodity Futures Trading Commission, CFTC Enforcement Program Files 25% More Cases During Fiscal Year 2009 than in the Prior Fiscal Year (Oct. 16, 2009) (PR5733A-09).

287. Press Release, Commodity Futures Trading Commission, CFTC Enforcement Program Filings Increase 14 Percent in Fiscal Year 2010 (Oct. 5, 2010) (PR5918-10).

288. U.S. Commodity Futures Trading Comm'n v. Amaranth Advisors, L.L.C., No. 07 Civ. 6682, 2009 U.S. Dist. LEXIS 37094 (S.D. N.Y. Apr. 29, 2009).

289. *Id.*

290. *Id.*

291. *Id.*

benefitting short swap positions.[292] In this instance, the allegation was that the defendants attempted to manipulate the physical natural gas price at the Houston Ship Channel (HSC), during the period following Hurricane Rita in September and November 2005, and the *Inside FERC* reported HSC index price, to benefit their swap positions.[293] The CFTC maintained that the defendants acquired a large physical position prior to the hurricane and then when there was little demand after the hurricane they sold large quantities, with the intent to push down the price.[294] The sales were made on ICE where the defendants represented 96% of the trading volume that day for the HSC.[295] The defendants reported the depressed prices to *Inside FERC*, the CFTC alleged, with the intent and belief they would be used to calculate a lower monthly HSC index price, which benefitted their financial basis swap positions tied to that index.[296] The defendants agreed to a consent order under which they were required to pay a $10 million civil penalty.[297]

In October 2009, the U.S. Court of Appeals for the Second Circuit affirmed the CFTC's orders in *In re DiPlacido*.[298] The CFTC had found Anthony J. DiPlacido liable for manipulating and attempting to manipulate the NYMEX settlement prices for the PV electricity futures contract for four months in 1998, and the COB futures settlement prices for one month in 1998, as well as other violations, and had assessed a $1 million civil penalty.[299] The court of appeals reduced the civil penalty by $320,000, finding that the CFTC had erred in penalizing DiPlacido both for the substantive offense of manipulation and for aiding and abetting when the underlying conduct was the same.[300]

2. False Reporting or Concealing Material Facts

In *Morgan Stanley Capital Group, Inc*., the CFTC maintained that section 9(a)(4) of the Commodity Exchange Act[301] was violated when a trader requested a third party broker defer the reporting of a mid-day block trade of crude oil futures contracts until after the close of trading on February 6, 2009. NYMEX rules require trades to be reported within five minutes of their execution. Morgan Stanley Capital Group, Inc., agreed to pay a civil penalty of $14 million.[302]

In a related order, UBS Securities L.L.C. agreed to pay a $200,000 civil penalty for its liability for its broker who, the CFTC maintained, aided and

292. U.S. Commodity Futures Trading Comm'n v. Energy Transfer Partners, L.P., No. 3-07CV1301-K (N.D. Tex. July 26, 2007).

293. *Id.*

294. *Id.*

295. *Id.*

296. *Id.*

297. *Id.*

298. DiPlacido v. Commodity Futures Trading Comm'n, 364 Fed. Appx. 657 (2d Cir. 2009) (affirming *In re Anthony J. DiPlacido*, CFTC Docket No. 01-23, ¶ 30,970 (CFTC Nov. 5, 2008)).

299. *Id.*

300. *Id.*

301. *Morgan Stanley Capital Group, Inc.*, CFTC Docket No. 10-10 (CFTC Apr. 29, 2010); Commodity Exchange Act, 7 U.S.C. § 13(a)(4) (2006).

302. *Id.*

abetted a customer's February 6, 2009, concealment of a trade in violation of the NYMEX rule to report trades within five minutes of execution.[303] The CFTC's order notes that UBS Securities promptly reported the incident to the CFTC's Division of Enforcement, was proactive and forthcoming in providing information, and that UBS Securities took disciplinary action against its employee. These factors were probably influential in justifying the lower civil penalty paid by UBS Securities.

3. Causing Non-Bona Fide Prices

In *ConAgra Trade Group, Inc.*, the CFTC accepted an offer of settlement from ConAgra Trade Group, Inc. (CTG), to pay a $12 million civil penalty to settle allegations that it caused a price to be reported that was not a bona fide price, in violation of section 4c(a)(2)(B) of the Commodity Exchange Act.[304] On January 2, 2008, a CTG trader sought to be the first to trade crude oil futures on the NYMEX at $100.[305] The CTG trader instructed its floor broker to accept a $100 offer for the NYMEX February crude oil futures contract.[306] However, there were better price offers at $99.90 outstanding. Based on complaints from another NYMEX floor trader, the NYMEX Floor Committee took down the $100 price "print" from the NYMEX price change register.[307] The CTG trader then instructed its floor broker to buy all of the contracts then being offered at $99.90 to enable CTG to purchase one February crude oil contract at $100.[308] As it happens, the $100 trade did not occur during the settlement period so it was not included in NYMEX's determination of the settlement price on that day. The order indicates that the CTG trader bragged to others that he had instructed the floor broker that CTG wanted the $100 print and that "[s]ome people collect art prints, we collect price prints."[309]

Two CFTC commissioners dissented. Commissioner Sommers dissented because the statutory penalty for a trade practice violation applicable at that time was significantly lower.[310] Commissioner O'Malia's dissent emphasized that the high penalty might have been justified as an attempted manipulation violation but was excessive as compared to other disruptive trading practice settlements.[311]

4. Fraud/Control Person Liability

In 2008, the CFTC filed a complaint against a former natural gas trader for the Bank of Montreal's Commodity Derivatives Group, his direct supervisor, and two voice brokers and their brokerage services firm, for their involvement in the mis-marking of the trader's natural gas options book to exaggerate its

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303. *UBS Securities L.L.C.*, CFTC Docket No. 10-11 (CFTC Apr. 29, 2010).

304. *ConAgra Trade Group, Inc.*, CFTC Docket No. 10-14 (CFTC Aug. 16, 2010); 7 U.S.C. § 6c(a)(2)(B).

305. *ConAgra Trade Group, Inc.*, CFTC Docket No. 10-14.

306. *Id.*

307. *Id.*

308. *Id.*

309. *Id.* (internal quotation marks omitted).

310. *Id.* (Sommers, Comm'r dissent).

311. *Id.* (O'Malia, Comm'r dissent).

profitability.[312] The case arose from a public announcement by the bank in April 2007 that it anticipated losses in connection with its natural gas book in the range of C$350 million to C$450 million. The CFTC alleged that the trader had mis-marked his natural gas options book between 2003 and 2007 and mis-valued other natural gas options for a shorter period to deceive the bank in violation of section 4c(b) of the Commodity Exchange Act,[313] and the CFTC's Regulation 33.10,[314] which makes it unlawful, in connection with option transactions, to make any false report or statement or to deceive or attempt to deceive another person. The voice brokers were alleged to have participated with the trader in deceiving the bank by fabricating purported independent broker quotes used to test the value of the book. The direct supervisor was alleged to be liable as a controlling person under section 13(b) of the Act.[315] The trader, David Lee, settled in November 2009, agreeing to a $500,000 civil penalty and a permanent ban on commodity trading,[316] and the supervisor, Robert Moore, agreed to a $150,000 civil penalty in a consent order entered in March 2010.[317]

5. Trade Practice (Wash Sales & Fictitious Trades)

In the first half of 2010 the CFTC settled four wash sale cases. The first two, approved on the same date, concern two Canadian limited partnerships, Pinemore, L.P., and Birchmore, L.P., controlled by the same general partner,[318] and a Canadian investment dealer.[319] The general partner arranged for the two limited partnerships to take opposite positions of the same quantity of NYMEX natural gas futures contracts, with one position long and the other short, for tax management purposes.[320] Once the positions were liquidated, the trading losses from the partnership with the losing position were to be funded by the general partner to offset taxable capital gains.[321] The trading gains from the partnership that realized gains were to be allocated to all the limited partners, one of which was a retirement trust resulting in the deferral of taxes on the trading gain allocated to that limited partner.[322] The trading strategy was discussed with a broker and an instruction was given to minimize the "slippage" or price difference between the transactions. The matching pairs of orders were executed either at the same price or prices that differed by a maximum of half a cent.[323] The CFTC charged a violation of section 4c(a) of the Act, 7 U.S.C. § 6c(a)

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312. Securities and Exchange Comm'n v. Cassidy, 720 F. Supp. 2d 305 (S.D. N.Y. June 18, 2010).

313. 7 U.S.C. § 6c(b) (2006).

314. 17 C.F.R. § 33.10.

315. 7 U.S.C. § 13c(b).

316. *Cassidy*, 720 F. Supp. 2d at 305. The consent order provides that Lee's payment of criminal restitution, as part of the criminal sentence he receives arising from the same facts, has priority over payment of the civil penalty.

317. Commodity Futures Trading Comm'n v. Cassidy, No. 08-CIV 9962 (S.D. N.Y. Mar. 8, 2010).

318. *Pinemore, L.P. and Birchmore, L.P.*, CFTC Docket No. 10-04 (CFTC Jan. 28, 2010).

319. *Scotia Capital, Inc.*, CFTC Docket No. 10-05 (CFTC Jan. 28, 2010).

320. *Id.*

321. *Id.*

322. *Id.*

323. *Id.*

(2006), and Regulation 1.38 (a), 17 C.F.R. § 1.38(a)(2009).[324] Pinemore and Birchmore were each assessed a $250,000 civil penalty.

In *Scotia Capital, Inc.*, the investment dealer was assessed a civil penalty of $250,000 for the conduct of its employees in prearranging the purchase and sale of the same quantity of natural gas futures trades on the NYMEX, with a fact pattern matching that described in the Pinemore and Birchmore settlement.

In *San Diego Gas & Electric Co.* (SDG&E),[325] the company had established a long position in NYMEX futures contracts for delivery months August through October 2006 as a price hedge. Between January 26, 2006, and February 2, 2006, a SDG&E employee instructed an introducing broker to place orders that would have the effect of liquidating and then reestablishing the same NYMEX contracts with a minimum price difference.[326] The instructions to sell and to buy were given in the same phone call and the employee was aware that the introducing broker placed the orders with the NYMEX floor brokers together with a request for the prices to be at or near the same price. SDG&E asserted that the transactions were solely for the purpose of managing its internal liquidity and risk management limits. In a footnote to the order the CFTC noted that the fact that there may be a legitimate economic purpose for a wash sale is not a defense under the Act.[327] SDG&E agreed to pay an $80,000 civil penalty.

In *Noble Americas Corp.*,[328] the traders entered into commodity futures contracts trades and exchanges for physical trades in heating oil and gasoline on the NYMEX and Globex with Noble Americas on each side of the trades for the same contract, quantity, and a same or similar price. The CFTC order notes that in some instances Noble Americas prearranged the execution of the NYMEX trades through a Futures Commission Merchant, in other instances exchange for physical trades were used to transfer positions from one Noble Americas trader to another, and in one instance a Noble Americas trader effectuated the trades directly by using instant messages to submit simultaneous buy and sell orders on Globex after the Futures Commission Merchant provided notice that the wash trades violated the NYMEX rules and refused to execute them.[329] Noble Americas agreed to pay a $130,000 civil penalty.

B. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or Act), signed into law on July 21, 2010, established a comprehensive framework for the regulation of the over-the-counter derivatives market.[330] Title VII of the Act, the Wall Street Transparency and Accountability Act grants the CFTC and the Securities and Exchange Commission (SEC) expansive new authority to regulate swaps and security-based swaps,

324. *Id.*

325. *San Diego Gas & Electric Co.*, CFTC Docket No. 10-08 (CFTC Apr. 22, 2010).

326. *Id.*

327. *Id.*, slip op. at n.2.

328. *Noble Americas Corp.*, CFTC Docket No. 10-12 (CFTC May 3, 2010).

329. *Id.*, slip op. at 2-3.

330. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act).

respectively. Swaps are broadly defined in the Act to include, among other things, currency, equity, interest rate, foreign exchange, and commodity swaps, including energy swaps. Security-based swaps are defined as swaps on a single security, a narrow-based security index or certain events related to a single issuer or narrow-based security index. The Act contains parallel provisions for swaps and security-based swaps and mandates coordination between the CFTC and the SEC.

Title VII of the Act generally provides that the new regulatory framework will be effective on July 15, 2011 (360 days after enactment), or 60 days after publication of any final rules (where rulemaking is required).[331] The rulemaking process is expected to continue at least through 2011 as the Commission considers final rules under the Act. Key Dodd-Frank Act derivatives reform provisions relevant to enforcement and energy market participants are summarized below.[332]

1. Anti-Manipulation

The Dodd-Frank Act provides the CFTC with several new tools to pursue fraud and manipulation in the futures, swaps, and commodities markets.[333] The Act expands the CEA's manipulation authority by establishing a new fraud-based standard for market manipulation in the futures and derivatives markets. This new manipulation standard is similar to those currently utilized by several other federal enforcement agencies (the SEC, the FERC, and the Federal Trade Commission). The Act also prohibits market manipulation and the reporting of false information with respect to swap transactions. Among other things, section 753 of the Dodd-Frank Act amends CEA section 6(c) to include a new subsection 6(c)(1), which is fraud-based and modeled after the provisions of section 10(b) of the Securities Exchange Act of 1934, and a new subsection 6(c)(3), which prohibits manipulation and attempted manipulation of the price for swaps, commodities, and futures contracts. The Commission's existing manipulation authority under CEA section 9(a)(2) is not impacted by the Act.

On October 26, 2010, the CFTC approved proposed anti-manipulation rules to implement its new anti-manipulation authority under section 753 of the Dodd-Frank Act.[334] These proposed rules would significantly expand the CFTC's enforcement authority over futures, swaps, and physical commodities.[335] In the proposing release, the Commission described new CEA section 6(c)(1) as a "broad, catch-all provision" addressing all forms of fraud, including "intentional or reckless conduct that deceives or defrauds market participants."[336] The

331. *See* Dodd-Frank Act § 754. The Act also provides different effective dates for certain specific provisions. For example, the Act requires that the CFTC establish position limits for exempt commodities (including energy commodities) within 180 days after enactment and for agricultural commodities within 270 days after enactment. *See* Dodd-Frank Act § 737(a).

332. The Finance and Transactions Committee Report in this volume of the *Journal* describes in detail various other provisions of the Act.

333. *See* Dodd-Frank Act § 753.

334. Prohibition of Market Manipulation, 75 Fed. Reg. 67,657 (Nov. 3, 2010) (codified at 17 C.F.R. pt. 180).

335. *Id.*

336. *Id.* at 67,658.

proposed rule under CEA section 6(c)(1) is based on SEC Rule 10b-5 and makes it unlawful to: (i) "employ . . . any manipulative device, scheme, or artifice to defraud;"[337] (ii) "[m]ake . . . any untrue or misleading statement of a material fact or to omit to state a material fact;"[338] (iii) "[e]ngage . . . in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person;"[339] or (iv) knowingly or recklessly deliver a "false or misleading or inaccurate report concerning crop or market information."[340]

The Commission also proposed a rule under CEA section 6(c)(3) that mirrors the statutory language and makes it: "unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity."[341] In discussing the proposed rule under CEA section 6(c)(3), the Commission specifically reaffirmed the four-part test for manipulation that has developed through case law, which requires that the Commission establish: "[i] [t]hat the accused had the ability to influence market prices; [ii] that they specifically intended to [influence market prices]; [iii] that artificial prices existed; and [iv] that the accused caused the artificial prices."[342] The Commission also reaffirmed a broad reading of the term "manipulation" and proposed to "continue interpreting the prohibition on price manipulation and attempted price manipulation to encompass every effort to influence the price of a swap, commodity, or commodity futures contract that is intended to interfere with the legitimate forces of supply and demand in the marketplace."[343] The proposed anti-manipulation rules were published in the Federal Register on November 3, 2010; the comment period closed January 3, 2011.[344]

2. Disruptive Trading Practices

Section 747 of the Dodd-Frank Act provides the CFTC with new authority to pursue trading misconduct by making it unlawful to engage in three specific disruptive trading practices on a registered entity. The prohibited "disruptive practices" include: (i) violating bids or offers; (ii) demonstrating intentional or reckless disregard for the orderly execution of transactions during the closing period; and (iii) spoofing (bidding or offering with the intent to cancel the bid or offer before execution). The Act also grants the CFTC broad authority to adopt rules as reasonably necessary to prohibit the enumerated practices and any other trading practice that is "disruptive of fair and equitable trading."[345]

On October 26, 2010, the CFTC approved an Advanced Notice of Proposed Rulemaking addressing its new authority to prohibit disruptive trading practices

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337. *Id.*
338. *Id.*
339. *Id.*
340. *Id.*
341. *Id.* at 67,662.
342. *Id.* 67,660.
343. *Id.* at 67,660.
344. *Id.*
345. Dodd-Frank § 747, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

under the Act.[346] The Advanced Notice of Proposed Rulemaking posed a list of nineteen questions which, among other things, asked: (i) how the Commission should distinguish between orderly and disorderly trading during the closing period; (ii) how "orderly execution" should be defined; (iii) whether executing brokers should have an obligation to ensure customer trades are not disruptive; (iv) how to distinguish between "spoofing" and other legitimate trading activity; (v) whether other specified practices should be classified as disruptive; and (vi) whether there should be specific duties of supervision to prevent disruptive trading practices.[347] The Commission also invited comment on whether rules should be adopted regulating the design, use, or supervision of algorithmic trading methodologies and whether algorithmic traders should be held accountable if they disrupt trading. The Advanced Notice of Proposed Rulemaking was published in the Federal Register on November 2, 2010; the comment period closed January 3, 2011.[348] After considering public comments, the CFTC issued a proposed interpretive order intended to provide market participants with additional guidance concerning the types of trading, conduct, and practices prohibited by its new disruptive trading practices authority.[349] The comment period for the proposed interpretive order closes May 17, 2011.

3. Whistleblower Provisions

The Dodd-Frank Act requires the CFTC to establish a new whistleblower program to provide incentives and protections to eligible individuals with knowledge of alleged wrongdoing who provide tips to the CFTC.[350] Under section 748 of the Dodd-Frank Act, those who provide the CFTC with "original information" that leads to the successful prosecution of certain enforcement actions can be entitled to a bounty of 10-30% of the value of any penalty or settlement over $1 million.[351] To qualify, the whistleblower must provide information that is developed from "independent knowledge or analysis" and not otherwise known by the CFTC. The Act provides discretion to the CFTC in determining the exact amount of the award within the prescribed range and identifies a number of factors for the CFTC to consider, including the "significance of the information" and the CFTC's interest in encouraging whistleblowers in particular regulatory areas.[352] The Act permits whistleblowers to proceed through an attorney and remain anonymous until an award is due. The whistleblower rewards also can apply to violations that occurred prior to the passage of the Act. The Act also creates several whistleblower protections and

346. Advanced Notice of Proposed Rulemaking; Request for Comments, Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301 (2010) (codified at 17 C.F.R. ch. 1).

347. *Id.*

348. The CFTC staff also hosted a roundtable on December 2, 2010 to address issues regarding the implementation of the Act's disruptive trading practices provisions.

349. Proposed Interpretive Order, Antidisruptive Practices Authority, 76 Fed. Reg. 14,943 (2011).

350. *See* Dodd-Frank Act § 748.

351. *Id.*

352. *Id.*

establishes a private right of action for whistleblowers who are subject to retaliation by an employer.[353] In addition, the Act contains a number of specific provisions addressing whistleblower eligibility, exclusions for persons with particular responsibilities, and the operation of a new CFTC customer protection fund.[354]

On November 10, 2010, the CFTC approved proposed rules to implement the whistleblower provisions of section 748 of the Dodd-Frank Act.[355] The proposed whistleblower rules address the operation of the whistleblower program by, among other things, defining certain key terms, outlining the Commission's claim procedures, and further explaining the whistleblower protections from employer retaliation. The proposed whistleblower rules were published in the Federal Register on December 6, 2010; the comment period is set to close February 4, 2011.[356]

III. THE FEDERAL TRADE COMMISSION

The Federal Trade Commission (FTC) generally is responsible for preventing unfair methods of competition and unfair acts or practices in or affecting commerce.[357] In 2007, Congress passed the Energy Independence and Security Act of 2007 (EISA), which increased the power of the FTC with regard to petroleum products.[358] Specifically, Subtitle B of Title VIII of EISA empowers the FTC to prohibit fraud and manipulation in connection with petroleum wholesale markets and expressly prohibits reporting false information related to such markets to the federal government.[359] In August 2009, the FTC promulgated a final rule prohibiting manipulative and deceptive practices.[360] The Final Rule took effect on November 4, 2009.

Responsibility for implementing and enforcing Subtitle B of EISA has been assigned to the Mergers III Division of the FTC's Bureau of Competition, which has primary responsibility for overseeing mergers in the energy industry. To date, there have been no public investigations or cases brought under the FTC's new authority. However, the FTC has also been engaged in proactive efforts to educate market participants regarding compliance with the anti-fraud provisions of EISA, including industry outreach and issuing written guidance.[361]

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353. *Id.*

354. *Id.*

355. Notice of Proposed Rulemaking, Implementing the Whistleblower Provisions of Section 23 of the Commodity Exchange Act, 75 Fed. Reg. 75,728 (2010) (codified at 17 C.F.R. pt. 165).

356. *Id.*

357. *See, e.g.*, Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (2010) (FTC Act).

358. Energy Independence and Security Act of 2007 (EISA), Pub. L. No. 110-140, 121 Stat. 1492 (Dec. 19, 2007), Title VIII, Subtitle B (codified at 42 U.S.C. §§ 17301-05).

359. For further analysis of EISA, *see* Theodore A. Gebhard & James F. Mongoven, *Prohibiting Fraud and Deception in Wholesale Petroleum Markets: The New Federal Trade Commission Market Manipulation Rule*, 31 ENERGY L.J 125 (2010).

360. Final Rulemaking, Prohibitions on Market Manipulation, 74 Fed. Reg. 40,686 (2009) (codified at 16 C.F.R. pt. 317) [hereinafter *Final Rule*].

361. FTC, GUIDE TO COMPLYING WITH PETROLEUM MARKET MANIPULATION REGULATIONS (Nov. 2009), *available at* (http://www.ftc.gov/os/2009/11/091113mmrguide.pdf.

IV. THE DEPARTMENT OF JUSTICE [362]

Below are described certain settlements between the Department of Justice and market participants with regard to energy enforcement matters.

A. United States v. KeySpan Corporation

On February 22, 2010, in *United States v. KeySpan Corp.*, CA No. 10-cv-1415, the Department of Justice filed a complaint and stipulated judgment against the KeySpan Corporation for violations of section 1 of the Sherman Act, 15 U.S.C. § 1, arising from facts that the FERC Office of Enforcement had concluded did not constitute market manipulation under the Federal Power Act.[363] KeySpan agreed to pay $12 million for violating the antitrust laws by acquiring a financial interest in substantially all the output of a major competitor's generation through a financial swap with a financial services company that had the effect of restraining competition in the New York City electricity capacity market.[364]

The complaint alleged that during the relevant period the New York City Installed Capacity Market "was highly concentrated, with three firms . . . controlling a substantial portion of the generating capacity," one of which was KeySpan.[365] Because it was a highly concentrated market, capacity sellers were required to sell through a New York Independent System Operator (NYISO) auction subject to price and bid caps.[366] KeySpan had the highest cap and consistently bid at its cap, which set the market price.[367] In 2006, the complaint alleges, with the entry of 1000 MW of new generation owned by Astoria Generating Company (Astoria), KeySpan anticipated that it would not be able to continue its bidding strategy without losing revenue.[368] In order to preserve its revenue stream, the complaint alleges, KeySpan sought a financial services company to enter into a swap under which if the market price for "capacity was above $7.57 per kW-month the financial services company would pay KeySpan the difference between the market price and $7.57 times 1800 MWs. If the market price was below $7.57, KeySpan would pay the financial services company the difference times 1800 MW."[369] The swap was contingent on the financial services company entering into an offsetting agreement with Astoria because it was the only other supplier with sufficient capacity to offset the KeySpan swap.[370] The complaint alleges that the financial services company entered into an offsetting swap with Astoria under which "if the market price for capacity was above $7.07 per kW-month, Astoria would pay the financial

362. This report does not address any enforcement or regulatory developments involving the BP oil spill.

363. United States v. KeySpan Corp., No. 10-cv-1415 (S.D. N.Y. Feb 22, 2010); *N.Y. Indep. Sys. Operator, Inc.*, 122 F.E.R.C. ¶ 61,211 (2008), *order on reh'g*, 124 F.E.R.C. ¶ 61,301 (2008).

364. United States v. KeySpan Corp., No. 10-cv-1415, 2011 U.S. Dist. LEXIS 12889, at *6 (S.D. N.Y. Feb. 2, 2011).

365. Complaint at P 17, United States v. KeySpan Corp., No. 10-cv-1415 (S.D. N.Y. Feb. 22, 2010).

366. *Id.*

367. *Id.* at PP 17, 20.

368. *Id.* at PP 21-22.

369. *Id.* at P 26.

370. *Id.* at P 25.

services company the difference times 1800 MW [and] if the market price was below $7.07 Astoria would be paid the difference times 1800 MW."[371] The offsetting swaps were executed two days apart for matching durations.[372]

The Department of Justice charged that the swap removed KeySpan's incentive to compete for sales by giving KeySpan a financial interest in Astoria's capacity.[373] "After the [swaps] went into effect in May 2006," the complaint alleges, "KeySpan consistently [continued] to bid its capacity at its cap even though a significant portion of its capacity went unsold."[374] Even though the Astoria generation increased the amount of capacity in the capacity market, "the market price of capacity did not decline."[375] In August 2007, the complaint alleges, as a condition of the sale of KeySpan, the New York Public Service Commission required the divestiture of KeySpan's New York City generation and, beginning in March 2008 until the divestiture, the New York City capacity was to be bid at zero. The complaint alleges that after March 2008, the market price for capacity declined.[376]

B. *United States ex rel. Wright v. Chevron U.S.A., Inc.*

DOJ entered into settlements in 2010 with several producers of natural gas as a result of an ongoing lawsuit filed by Harold Wright on behalf of the United States under the whistleblower provisions of the False Claims Act.[377] Mr. Wright, who is now deceased, filed his original suit in 1998 and alleged that numerous producers systematically underpaid royalties due for natural gas produced on federal and Indian lands.[378] The qui tam or whistleblower provisions of the False Claims Act allow private citizens to file actions on behalf of the United States and to share in any recovery.[379]

In April 2010, Mobil Natural Gas Inc., Mobil Exploration & Producing U.S. Inc. and their affiliates agreed to pay $32.2 million to resolve claims that they used affiliate transactions to reduce the reported value of gas, claimed excessive deductions, and otherwise understated the value of the gas reported. The Mobil companies are alleged to have systematically under reported the value of natural gas taken from the leases from March 1, 1988, to Nov. 30, 1999.[380]

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371. *Id.* at P 28.
372. *Id.* at P 29.
373. *Id.* at P 31.
374. *Id.* at P 32.
375. *Id.*
376. *Id.* at P 33.
377. United States ex rel. Wright v. Chevron U.S.A., Inc., No. 5:03-CV-264 (E.D. Tex. 2008); Press Release, U.S. Dep't of Justice, Chevron to Pay U.S. More than $45 Million to Resolve Allegations of False Claims for Royalties Underpayment (Dec. 23, 2009), *available at* http://www.justice.gov/opa/pr/2009/December/09-civ-1379.html.
378. *Id.*
379. False Claims Act, 31 U.S.C. §§ 3729-3733 (2006).
380. United States ex rel. Wright v. Chevron U.S.A., Inc., 5:03-CV-264 (E.D. Tex. 2008).

C. Dominion Oklahoma Texas Exploration & Production Co. and Marathon Oil Co.

In August 2010, Dominion Oklahoma Texas Exploration & Production Co. and Marathon Oil Co. agreed to pay the United States $2.2 million and $4.7 million, respectively, to resolve claims that the two companies improperly deducted from royalty values the cost of boosting gas up to pipeline pressures, and that Dominion improperly reported processed gas as unprocessed gas to reduce royalty payments.[381]

V. THE DEPARTMENT OF ENERGY

A. Minimum Energy Efficiency Standards

The Department of Energy (DOE) is tasked with monitoring and enforcing compliance with the energy and water conservation standards for covered consumer products authorized in the Energy Policy and Conservation Act of 1975 (EPCA) and set forth in 10 C.F.R. § 430, Subpart C. The EPCA and its accompanying regulations give the DOE authority to assess civil monetary penalties for violations of the Act.[382] Under 10 CFR § 430.73, the DOE also has authority to seek a judicial order restraining further distribution of a non-compliant product. According to the DOE General Counsel Scott Harris, however, the DOE had never systematically enforced these conservation standards prior to his tenure.[383]

B. ENERGY STAR Program

The DOE and the EPA have also renewed their focus on compliance with ENERGY STAR program requirements.[384] A 2009 DOE-EPA Memorandum of Understanding clarified the division of responsibility between the two agencies, assigning the DOE the lead role in monitoring compliance with ENERGY STAR criteria while designating the EPA the program "brand manager" responsible for setting performance criteria, conducting marketing and outreach, and maintaining the master list of eligible products.[385] Both agencies have taken steps to strengthen the ENERGY STAR program in the wake of a media event involving noncompliant refrigerators that bore the ENERGY STAR label and the

381. *Id.* Previous settlements in this litigation include Shell Oil Corp. for $56 million in 2000; the Dominion Exploration and Production Co. for $2 million in 2003; Burlington Resources, a subsidiary of ConocoPhillips Inc., for $105 million in 2007; and Chevron Corp., Texaco, Unocal Inc. and affiliates for $45 million in 2009. *Id.*

382. Energy Policy and Conservation Act of 1975, 42 U.S.C. §§ 6302-03 (2006); 10 C.F.R. § 430.61 (1989).

383. Scott Harris, DOE General Counsel, Enforcing Energy-Efficiency Standards, ENERGYBLOG, http://blog.energy.gov/blog/2010/09/13/enforcing-energy-efficiency-standards.

384. Press Release, U.S. Dep't of Energy, EPA, DOE Announce New Steps to Strengthen ENERGY STAR (Mar. 19, 2010), *available at* http://yosemite.epa.gov/opa/admpress.nsf/bd4379a92ceceeac8525735900400c27/f721f69419064539852576eb0065e109!OpenDocument [hereinafter *New Steps to Strengthen ENERGY STAR*].

385. SUMMARY OF EPA-DOE PARTNERSHIP (Sept. 30, 2009), *available at* http://www.energystar.gov/ia/partners/downloads/mou/Summary_of_EPA-DOE_Partnership.pdf.

release of several government reports criticizing the program as vulnerable to fraud.[386]

1. LG Refrigerators

In 2008, DOE learned that LG had misapplied energy efficiency testing procedures for its french-door refrigerators and that as a result some LG refrigerators carrying the ENERGY STAR logo did not in fact meet program standards. The parties signed an agreement in November 2008 that set forth a timeline for LG to move away from the disputed testing procedures.[387] However, DOE terminated the agreement in 2009 when testing revealed that some refrigerators remained out of compliance. DOE banned non-compliant LG refrigerators from using the ENERGY STAR label after January 2, 2010.[388] LG filed a lawsuit over DOE's energy efficiency testing procedures and the agency's decision to remove ENERGY STAR labels from its refrigerators,[389] but voluntarily dismissed the suit in May 28, 2010.[390]

2. GAO Investigation and Inspector General Reports

In March 2010, the GAO issued a report criticizing the ENERGY STAR program as vulnerable to fraud and abuse. As part of its investigation, the GAO obtained ENERGY STAR certification for ten of fifteen fake products. The report's conclusions focused on the program's self-certification process, which it found left ENERGY STAR vulnerable to manipulation.[391] A series of reports from the EPA and DOE Offices of the Inspector General also criticized the program.[392]

The DOE and the EPA have taken a number of steps since 2009 to strengthen enforcement of EPCA's conservation standards and the requirements of the ENERGY STAR program.

C. Enforcement of Certification Requirements

By regulation, manufacturers of covered consumer products must "certify by means of a compliance statement and a certification report that each basic

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386. Elisabeth Leamy, *Undercover Investigation Faults Energy Star Program*, ABCNEWS.COM (Mar. 26, 2010).

387. AGREEMENT BETWEEN THE U.S. DEPARTMENT OF ENERGY AND LG ELECTRONICS, USA, INC. (Nov. 14, 2008), *available at* http://www.energy.gov/media/DOE_LG_Signed_Settlement_Agreement.pdf [hereineafter *LG Agreement*].

388. Press Release, U.S. Dep't of Energy, Department of Energy to Take Steps to Remove ENERGY STAR Label on Certain LG Refrigerator-Freezer Models (Dec. 7, 2009), *available at* http://www.energy.gov/news/8367.htm.

389. *LG Electronics USA Files Complaint Against U.S. Department of Energy in Federal Court*, PR NEWSWIRE (Dec. 4, 2009), *available at* http://www.prnewswire.com/news-releases/lg-electronics-usa-files-complaint-against-us-department-of-energy-in-federal-court-78546672.html.

390. Press Release, U.S. Dep't of Energy, LG Dismisses Lawsuit Against DOE Over ENERGY STAR Enforcement (May 28, 2010), http://www.gc.energy.gov/1580.htm.

391. GAO, COVERT TESTING SHOWS THE ENERGY STAR PROGRAM CERTIFICATION PROCESS IS VULNERABLE TO FRAUD AND ABUSE (Mar. 2010), *available at* http://www.gao.gov/new.items/d10470.pdf.

392. *See, e.g.*, EPA OIG, *ENERGY STAR Program Integrity Can Be Enhanced Through Expanded Product Testing* (Nov. 30, 2009), *available at* http://www.epa.gov/oig/reports/2010/20091130-10-P-0040.pdf.

model[s] meets the applicable energy conservation standard," before those products may enter the market.[393] DOE published guidance on October 14, 2009, clarifying that manufacturers must properly certify products covered by energy conservation regulations and that manufacturers who fail to do so may be subject to enforcement action, including the assessment of civil penalties.[394] These enforcement actions, DOE noted, are separate and distinct from any determination of compliance or noncompliance with the energy conservation standards themselves. DOE also announced that it intended to take a more rigorous approach to enforcement of the standards and planned to undertake a random review of manufacturer compliance with certification requirements.[395]

D. Strengthening ENERGY STAR

On March 19, 2010, the EPA and the DOE announced new steps to strengthen the ENERGY STAR program, including expanded government verification of product energy usage and a requirement that products be tested in accredited labs before certification. The DOE also announced the formation of a new enforcement team within its General Counsel's office that would monitor compliance with ENERGY STAR criteria and enforce the Department's energy conservation standards. The press release stated that, "[w]hen a violation is found, the right to use the Energy Star label is revoked, corrective measures are required and the Energy Star partnership may be terminated."[396] It was unclear whether "corrective measures" for ENERGY STAR violations could include civil penalties, and none have been assessed to date,[397] although some manufacturers have agreed to make voluntary payments to owners of affected products.[398]

E. New Civil Penalty Guidelines

On May 7, 2010, the DOE issued final guidance on penalty guidelines for violations of EPCA conservation standards and certification requirements.[399] First, the DOE outlined its approach to calculating civil penalties for violations of energy conservation standards pursuant to its authority under EPCA. According to the guidance, the DOE intends to seek the maximum allowable penalty of $200 for each unit of a noncompliant model that had been distributed in commerce (including units made available for sale as well as those sold).[400] In determining the total penalty, the DOE will consider "the size of the violator, the

393. 10 C.F.R. § 431.327 (2010).

394. Notice, Guidance on Energy Efficiency Enforcement Regulations, 74 Fed. Reg. 52,793, 52,794 (2009).

395. *Id.* at 52,795.

396. *New Steps to Strengthen ENERGY STAR*, *supra* note 384.

397. Penalties have, however, been assessed for violations of EPCA's conservation standards (*see infra* Section III).

398. *See, e.g.*, *LG Agreement*, *supra* note 387, at 4.

399. U.S. DEP'T OF ENERGY, GUIDANCE ON THE IMPOSITION OF CIVIL PENALTIES FOR VIOLATIONS OF EPCA CONSERVATION STANDARDS AND CERTIFICATION OBLIGATIONS (May 7, 2010), *available at* http://www.gc.energy.gov/documents/Penalty_Guidance_5_7_2010__final_.pdf.

400. *Id.* at 3.

extent of deviation from the EPCA requirements, the technical reason, if any, for the noncompliance, a violator's history of compliance or non-compliance, a violator's ability to pay, self-reporting of violations and corrective actions taken."[401] The DOE also reserved the right to adjust penalties where appropriate "to encourage the prompt and comprehensive resolution of cases."[402]

Next, for violations of EPCA's certification requirements, the DOE stated that it will calculate any civil penalty "based on each day a manufacturer distributes each basic model in commerce in the U.S. without having submitted a certification report and will calculate an additional penalty calculated per day for failure to submit a compliance statement" according to the following formula:

> for the first thirty models, [the DOE] will assess the basic penalty; for the next twenty models, [the DOE] will assess one half the basic penalty; and for the remaining models [the DOE] will assess one third the basic penalty up to a cap of $500,000 (which may be exceeded in aggravating circumstances).[403]

The DOE will adopt a rebuttable presumption that the products in question have been in circulation for one year without proper certification.[404] This presumption yields a penalty of $7,300 per model, which translates to $20 per day, or 10% of the $200 maximum penalty.[405] In setting the penalty, the DOE will also take into account "the size of the violator, demonstrated inability to pay, the extent of deviation from the EPCA requirements, self-reporting of a violation and a violator's history of compliance or non-compliance."[406]

F. *Enforcement of Conservation Standards*

On September 2, 2010, the DOE issued a Notice of Proposed Rulemaking (NOPR) in which it described several proposed changes to its energy efficiency certification and enforcement regulations.[407] In the NOPR, the DOE proposed to clarify that, under the EPCA, the DOE may request information by letter or subpoena from manufacturers concerning a model's compliance with the applicable conservation standard, may test or examine units for compliance, and may take appropriate enforcement action as warranted.[408] The DOE also proposed to clarify its authority to require independent, third-party testing of covered products where the DOE has discovered noncompliance with conservation standards or certification requirements.[409]

The NOPR proposes the establishment of "a standardized process for seeking injunctive relief, civil penalties, or other remedies for violations of conservation standards and/or certification requirements" as well as a

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401. *Id.* at 4.

402. *Id.*

403. *Id.* at 6.

404. *Id.* at 5.

405. *Id.* at 6.

406. *Id.*

407. Notice of Proposed Rulemaking and Public Meeting, Energy Conservation Program: Certification, Compliance, and Enforcement for Consumer Products and Commercial and Industrial Equipment, 75 Fed. Reg. 56,796, 56,798 (2010) (to be codified at 10 C.F.R. pts. 429, 430, 431).

408. *Id.* at 56,803.

409. *Id.* at 56,805.

standardized process for responding to complaints, notifying the product manufacturer, collecting data, and settling enforcement actions.[410] As part of this standardization, the revised regulations would include a framework for civil penalty assessments based on the guidance described above.[411]

Between January 1, 2010 and September 13, 2010, the DOE's enforcement efforts led to the removal of sixty-six products from the market for failure to meet federal energy efficiency standards. During that same period, the DOE initiated seventy-five enforcement investigations and actions leading to the certification of more than 600,000 products with the DOE.[412] In September 2010, the DOE brought thirty certification enforcement actions, resolving twenty-six of them by October 19, 2010. Civil penalties from these cases totaled nearly $100,000.[413] Significant DOE and EPA actions from the past year to enforce conservation standards, certification requirements, and compliance with the ENERGY STAR program include the following:

- On December 13, 2010, the DOE announced that it had resolved an enforcement case against Westinghouse Lighting Corporation for failure to certify fluorescent light bulbs as compliant with federal energy efficiency standards and for its sale of nearly 30,000 bulbs that did not meet these standards. As part of the settlement, Westinghouse agreed to pay a civil penalty of $50,000.[414]

- On November 15, 2010, the DOE announced a $27,200 settlement with Mackle Company for its failure to certify that its Avanti-brand refrigerators and refrigerator-freezers complied with federal efficiency standards.[415]

- On November 9, 2010, the DOE announced that the testing of Viking Refrigerators in response to allegations that they exceeded federal standards for maximum energy use showed that the allegations were without merit. Other products under investigation in the 2009-10 time frame that were cleared after testing include Arcelik's Blomberg refrigerators, ASKO dishwashers, and Whirlpool's Maytag refrigerators.[416]

- On October 6, 2010, the DOE determined that an Electrolux Gibson air conditioner and an Equator clothes washer failed to meet ENERGY STAR

410. *Id.* at 56,798, 56,805.

411. *Id.*

412. Press Release, U.S. Dep't of Energy, DOE Continues Aggressive Energy Efficiency Enforcement Effort with Nearly 30 New Proposed Penalties (Sept. 13, 2010), http://www.energy.gov/news/9483.htm.

413. General Counsel News, *DOE Resolves Nearly All of Its September 2010 Certification Enforcement Actions*, U.S. Dep't of Energy (Oct. 19, 2010), http://www.gc.energy.gov/1627.htm.

414. General Counsel News, *Westinghouse Pays $50,000 Civil Penalty to Resolve Light Bulb Efficiency Violations* U.S. Dep't of Energy (Dec. 13, 2010), http://www.gc.energy.gov/1655.htm.

415. General Counsel News, *DOE Resolves Avanti Refrigerator and Freezer Civil Penalty Case*, U.S. Dep't of Energy (Nov. 15, 2010), http://www.gc.energy.gov/1632.htm.

416. General Counsel News, *DOE Closes Investigation into Energy Efficiency of Viking Refrigerator*, U.S. Dep't of Energy (Nov. 15, 2010), http://www.gc.energy.gov/1631.htm.

requirements. The manufacturers elected to discontinue these products. DOE referred both products to the EPA for appropriate action.[417]

- On June 1, 2010, testing showed that an ASKO dishwasher was not ENERGY STAR compliant. The matter was referred to the EPA for enforcement. The DOE also opened an investigation into whether the dishwasher met federal energy efficiency standards (which, as discussed above, was eventually resolved with a determination of compliance).[418]

- On May 7, 2010, the Air-Conditioning, Heating and Refrigeration Institute (AHRI) agreed to make a $5000 voluntary contribution to the U.S. Treasury on Mitsubishi's behalf as part of a consent decree resolving an action against Mitsubishi for failure to submit certification reports from some air conditioners and heat pumps. In its press release, the DOE reminded manufacturers that they are ultimately responsible for ensuring that reports reach the DOE.[419]

- On March 30, 2010, the DOE testing showed that certain AeroSys air conditioners and heat pumps used energy in excess of the level specified in the relevant conservation standards. In response to test results, the DOE for the first time issued a Notice of Noncompliance requiring the company to respond within fifteen days with a description of steps taken to remove the affected models from the market. The company was also required to provide written notice to all businesses where the models were distributed.[420]

- On March 3, 2010, EPA terminated US Inc/US Refrigeration's partnership with ENERGY STAR due to what EPA described as a history of logo misuse, unresponsiveness, and pattern of failure to comply with ENERGY STAR program guidelines.[421]

- On January 7, 2010, the DOE entered into a consent decree with Haier America resolving an investigation into whether certain Haier freezers violated the DOE energy efficiency standards and ENERGY STAR program requirements. Haier agreed to notify affected customers, repair defective units, and pay a voluntary contribution of $150,000 to the U.S. Treasury.[422]

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417. General Counsel News, *Electrolux Gibson Air Conditioner and Equator Clothes Washer Fail DOE Energy Star Testing*, U.S. Dep't of Energy (Oct. 6, 2010), http://www.gc.energy.gov/1621.htm.

418. General Counsel News, *DOE Energy Star Testing Reveals Inefficient ASKO Dishwasher*, U.S. Dep't of Energy (June 1, 2010), http://www.gc.energy.gov/1581.htm.

419. General Counsel News, *DOE/Mitsubishi Enter Consent Decree Dismissing Claims of Certification Violations*, U.S. Dep't of Energy (May 7, 2010), http://www.gc.energy.gov/1573.htm.

420. General Counsel News, *DOE Orders AeroSys to Halt Distribution of Inefficient Air Conditioner and Heat Pump Models*, U.S. Dep't of Energy (Mar. 30, 2010), http://www.gc.energy.gov/1579.htm.

421. *New Steps to Strengthen ENERGY STAR* , *supra* note 384.

422. Press Release, U.S. Dep't of Energy, DOE Announces Additional Energy Efficiency Enforcement Action to Protect Consumers (Jan. 7, 2010), http://www.energy.gov/news/8497.htm.

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