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Congress, FERC issue warning to marketers in energy industry

ENERGY MARKETING

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Congress introduced a broad range of initiatives in the most fundamental legislative change to the energy industry in over a decade in the Energy Policy Act of 2005. EPAct 2005 significantly changed the federal government's oversight and investigation powers over businesses that are engaged in natural gas and electricity marketing and trading.

EPAct 2005 substantially enhanced the Federal Energy Regulatory Commission's oversight of the energy marketing and trading business, and significantly increased FERC's civil penalty authority for violations of the Natural Gas Act, the Natural Gas Policy Act of 1978 and Part II of the Federal Power Act. EPAct 2005 provided the framework for FERC to deter (and penalize) market manipulation.

FERC seized this initiative when it issued its final rule on the Prohibition of Energy Market Manipulation on Jan. 19. Under this rule, it is unlawful for any entity, directly or indirectly, in connection with the purchase or sale of electric energy, natural gas, electric transmission services subject to FERC's jurisdiction or natural gas transportation services subject to FERC's jurisdiction:

- To use or employ any device, scheme, or artifice to defraud.
- To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
- To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.

ANTI-MANIPULATION RULE

EPAct 2005 and FERC's anti-manipulation rule expressly state that there is no private right of action created.

This anti-manipulation rule applies to any entity, including governmental utilities and other market participants otherwise beyond FERC's jurisdiction.

FERC stated that its anti-manipulation rule "is not intended to regulate negligent practices or corporate mismanagement, but rather to deter or punish fraud in wholesale energy markets."

The rule is not intended to turn every covered fraud into a violation — broadly defining "fraud" as "any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market: Instead, the anti-manipulation rule requires an intent to deceive, to manipulate, or to act recklessly.

CIVIL PENALTY AUTHORITY

FERC's increased ability to oversee energy markets takes on special importance when combined with the greatly expanded civil penalty authority that EPAct 2005 granted to FERC.

EPAct 2005 enhanced FERC's civil penalty authority in two ways:

- FERC's maximum civil penalty authority was increased from $5,000 (for gas matters) and $10,000 (for electric matters) to $1 million per day per violation for both.
- FERC's jurisdiction was expanded to cover any violation of the Natural Gas Act, Part II of the Federal Power Act or rules, regulations, or orders issued under the authority of the Natural Gas Act or Part II of the Federal PowerAct.

FERC may assess civil penalties for an assortment of violations, not just market manipulation.

In addition, EPAct 2005 increased the applicable criminal penalties for violations of the Natural Gas Act, Natural Gas Policy Act, and Part II of the Federal Power Act. Under these new provisions, violators of these statutes are now subject to criminal fines of up to $1 million (increased from $5,000) and imprisonment for up to five years (increased from two years).

Through its Oct. 20, 2005, Policy Statement on Enforcement, FERC explained how it will apply its increased civil penalty and remedial authority. While emphasizing that each case is different, the Policy Statement outlines some factors that FERC will consider when developing remedies. FERC's approach is consistent with the approach other federal agencies have applied in similar situations.

To determine the appropriate penalty, FERC will first look to the "seriousness of the violation." FERC will consider:

- The extent of the harm resulting from the violation.
- Whether the violation included fraud or deceit.
- The violating parties intent.

Next, FERC will consider efforts (if any) that the violating company made to remedy the violation in a timely manner. FERC may give a company credit for its internal compliance programs, self-reporting, and "exemplary cooperation" with FERC's investigation.

In deciding whether to give a company credit for its commitment to compliance, FERC will consider whether the company has a formal, documented, independently run and sufficiently resourced compliance program and the extent of the entity's compliance training.

When considering the violating companies self-reporting efforts, FERC will consider how the market participant uncovered the misconduct, how quickly it notified FERC, whether any remedial steps were taken and the extent of the entity's meetings with, and disclosures to, FERC. Any self-reporting credit would impact only the level of the penalty imposed.

FERC will also require an entity to return all profits received from the inappropriate activity. Self-reporting will not change the disgorgement amount.

MARKET CONCERNS

FERC wanted the new anti-manipulation rules to provide certainty. Some market participants, however, expressed concerns about the potential application of these rules to unique business transactions and activities.

To alleviate these concerns, FERC initiated a "no action letter" process where a market participant can solicit the opinion of FERC's legal and enforcement staff as to whether a proposed transaction is consistent with the anti-manipulation rule. FERC also hopes to encourage compliance with the new rule by posting on its Web site both information regarding its audit procedures and frequently asked questions.

EPAct 2005 solidified FERC's role as a guardian and watchdog of energy markets and the energy industry generally. While this authority does not reach all transactions and all segments of the industry (leaving, for example, oil and petroleum products markets unaffected), the broad authority extended to FERC to levy substantial civil fines should put all industry participants on notice that failure to ensure internal compliance with all applicable FERC regulations can lead to the accumulation of significant penalties quickly.

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