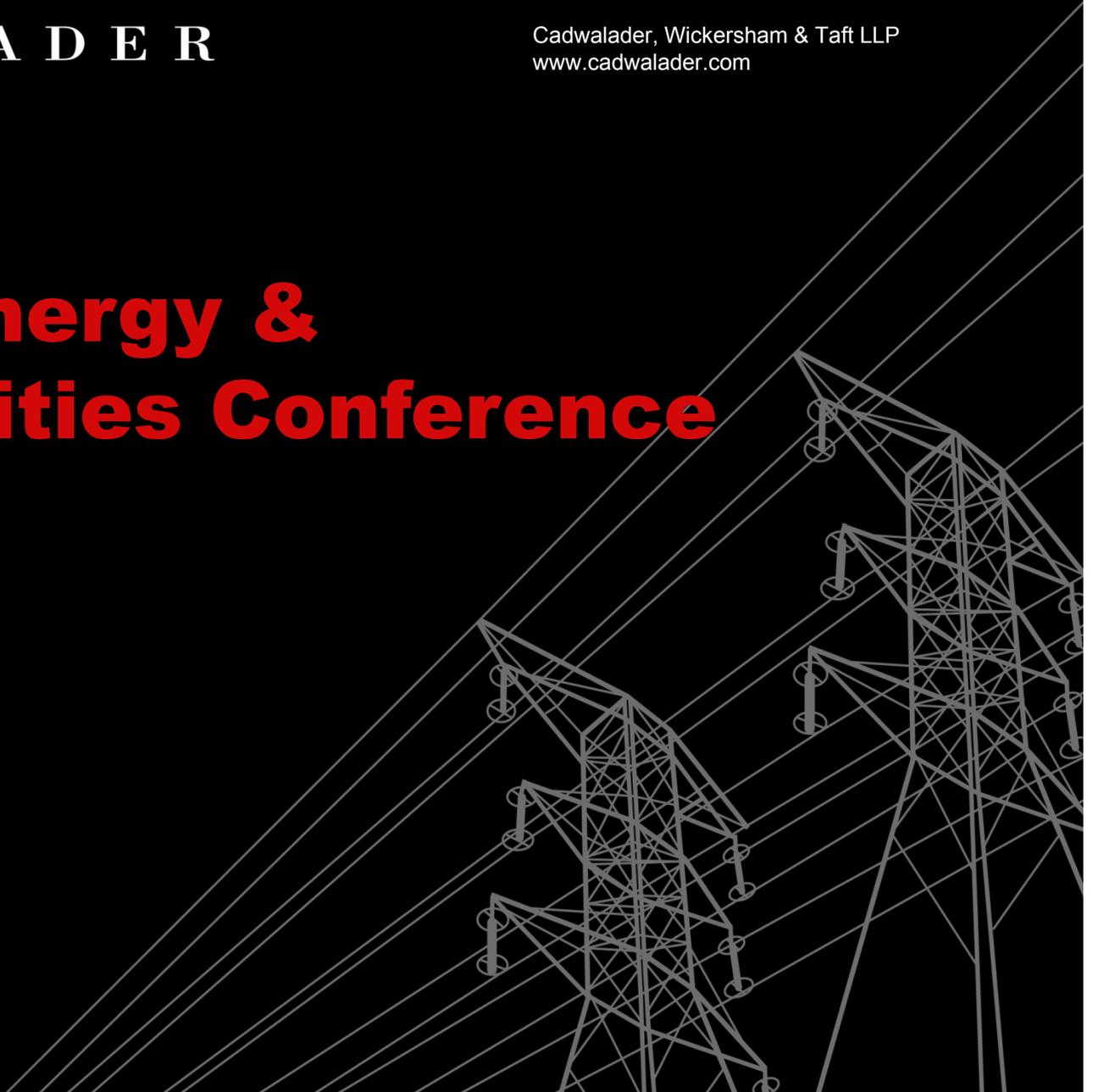


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Spring Energy & Commodities Conference

April 6, 2016





C A D W A L A D E R

Panel One:
**FERC, RTO and ISO Regulatory and
Enforcement Update**

Panelists

- Moderator: Mark Haskell, Cadwalader
- George Billinson, Cadwalader
- Vincenzo Franco, Assistant General Counsel – Wholesale Trading Compliance, Exelon Corporation
- Brett Snyder, Cadwalader

Recent Developments in FERC Enforcement Actions and the CFTC Ruling on RTO/ISO Exemptions

April 6, 2016

Vincenzo Franco

Recent Developments in Electric Enforcement – Berkshire Power Co. LLC & Power Plant Management Services LLC

- Berkshire owns a generation plant and hired PPMS to provide management and administration services.
- Violations Admitted in Settlement:
 - Berkshire and PPMS violated FPA Section 222 and FERC's Anti-Manipulation Rule by concealing maintenance work and related outages from ISO-NE; and
 - Berkshire separately violated ISO-NE's tariff, FERC's Market Behavior Rules (18 C.F.R. § 35.41) and FERC-approved Reliability Standards by: (a) failing to schedule and disclose plant maintenance; (b) failing to report accurately on plant availability; and (c) making false and misleading representations to ISO-NE.
- Penalties:
 - Both companies admitted their violations and agreed to a civil penalty of \$2 million.
 - Berkshire also agreed to an additional \$30,000 penalty for violations of the Reliability Standards and \$1,012,563 plus interest in disgorgement.

Recent Developments in Electric Enforcement – Berkshire & PPMS – *Cont'd*

- The Massachusetts U.S. Attorney and Attorney General subsequently announced that Berkshire, PPMS, and another management company agreed to resolve a separate criminal investigation of the conduct through plea agreements and payment of a total of \$8.5 million.
 - Berkshire and PPMS agreed to plead guilty to felony charges of violating the Clean Air Act for tampering with emissions monitoring equipment at the plant.
 - PPMS agreed to plead guilty to felony charges of violating the FPA by making false statements to ISO-NE regarding the plant's flexibility.

Recent Developments in Electric Enforcement – ETRACOM LLC and Michael Rosenberg

- FERC in 2015 issued an OSC and NAV against ETRACOM LLC and its principal member and primary trader, Michael Rosenberg.
 - **FERC Allegations:**
 - ETRACOM and Rosenberg violated FPA Section 222 and FERC’s Anti-Manipulation Rule through uneconomic virtual supply transactions to affect power prices and benefit ETRACOM’s Congestion Revenue Rights in CAISO.
 - **FERC’s Proposed Penalties:**
 - ETRACOM:
 - \$2.4 million penalty
 - \$315,072 plus interest in disgorgement
 - Rosenberg: \$100,000 penalty

Recent Developments in Electric Enforcement – Coaltrain Energy, LP

- On Jan. 6, 2016, FERC issued an OSC against Coaltrain Energy, LP, its co-owners, three of its traders, and an analyst.
 - **FERC Allegations**: Coaltrain and the named individuals violated FPA Section 222 and FERC's Anti-Manipulation Rule by allegedly engaging in fraudulent Up To Congestion transactions in PJM designed to capture Marginal Loss Surplus Allocations. Defendants also allegedly violated FERC's Market Behavior Rules by making false and misleading statements and material omissions in response to Enforcement data requests.
 - **FERC's Proposed Penalties**: \$26 million penalty against Coaltrain, \$5 million penalty against each owner, \$1 million penalty against one of the traders and \$500,000 penalty against the other two, and \$250,000 penalty against the analyst. FERC also seeks disgorgement of \$4,121,894 jointly and severally against Coaltrain and its two co-owners.
 - **Procedural Developments**: Coaltrain elected *de novo* review in federal district court under FPA Section 31(d)(3) and, on Mar. 4, 2016, filed an Answer to FERC's OSC that included supplemental material not cited by Enforcement.

FERC Federal Litigation Update – *De Novo* Review under FPA 31(d)(3) of FERC Penalty Assessments

- **Eastern District of Virginia: Powhatan & Houlian Chen**

- **Basic Alleged Scheme:** Sham UTC transactions done in high volumes to collect Marginal Loss Surplus Allocation Payments in PJM.
- Court denied Defendants' Motion to Dismiss, stayed discovery, and ordered briefing by the parties – now complete – regarding the procedure mandated by FPA 31(d)(3).
- Oral argument scheduled for April 18, 2016.
- Settlement conference scheduled for May 19, 2016.

- **Mass. District Court: Maxim Power & Kyle Mitton:**

- **Basic Alleged Scheme:** Offer-oil, burn gas scheme to wrongfully collect inflated fuel cost payments from ISO-NE.
- Court is currently considering defendants' motion to dismiss.

FERC Federal Litigation Update- *De Novo* Review under FPA 31(d)(3) of FERC Penalty Assessments – *Cont'd*

- **Mass. District Court: Lincoln Paper & Tissue:**
 - **Basic alleged scheme:** Demand response manipulation whereby Lincoln artificially inflated Day-Ahead Load Response Program payments without intending to provide the service or actually having to reduce load.
 - Defendants moved to dismiss, in part, based upon a D.C. Circuit holding that FERC lacked jurisdiction over demand response and district court sat on motion to dismiss pending review of D.C. Circuit decision by Supreme Court.
 - Supreme Court reversed D.C. Circuit and the District Court cancelled a scheduled hearing on the motion to dismiss and stated that it will notify the parties if any further hearing is required, in the Court's words, to "dispose of the motion."
- **D.C. District Court: City Power Marketing et al.:**
 - **Basic alleged scheme:** Similar to Powhatan, involves sham UTC transactions done in high volumes to collect Marginal Loss Surplus Allocation Payments in PJM.
 - Defendants' Motion to Dismiss is pending. In jointly requesting a modified briefing schedule on the motion to dismiss, the parties previewed their dispute over the nature of "de novo" review under the FPA and what properly constitutes "the record" below.

CFTC Ruling on ISO/RTO Exemptions & Private Rights of Action

- On May 21, 2015, the CFTC published a proposed order that would exempt Southwest Power Pool (SPP) transactions, SPP members, and SPP from all but the anti-fraud and anti-manipulation provisions of the CEA.
- SPP's proposed exemption order was largely the same as the final exemption order that the other ISOs and RTOs received in 2013.
- **But** the CFTC stated in the preamble its intent to preserve private rights of action under Section 22 of the CEA in connection with both the SPP order and the ISO-RTO final exemption order:
 - “It would be highly unusual for the [CFTC] to reserve to itself the power to pursue claims for fraud and manipulation . . . while at the same time denying private rights of action and damages remedies for the same violations.”
- Notably, neither the text of the Proposed SPP Order nor that of the ISO-RTO Final Order preserves a private right of action under CEA Section 22, however.

CFTC Ruling on ISO/RTO Exemptions & Private Rights of Action – *Cont'd*

- The CFTC's stated intent to preserve private claims raises a number of troubling issues.
 - If the CFTC allows private CEA claims related to ISO-RTO transactions, it:
 - could lead to inconsistent rulings among the nation's hundreds of federal district court judges, the CFTC, and FERC concerning the scope of the CEA and the FPA;
 - will enable plaintiffs to collaterally attack rules approved by FERC or permitted to take effect by the PUCT by claiming that transactions made pursuant to, and in compliance with, those rules are unlawful.
- Many interested persons filed comments on the proposed SPP exemption order and the CFTC has not yet issued a Final Order.
- Unless the CFTC withdraws or modifies its statement of intent, expect plaintiffs lawyers to file private CEA claims as soon as FERC issues an NAV alleging that a market participant has manipulated the price of an ISO-RTO transaction.

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Natural Gas Compliance and Enforcement Developments

April 6, 2016

George Billinson

Overview of Topics

- Recent Natural Gas Enforcement Cases
- FERC Audit Process

Natural Gas Enforcement Cases

BP America Inc., et al. (2013)

- FERC issued an Order to Show Cause and Notice of Proposed Penalty requiring BP America, Inc. to show cause why it should not be required to pay a \$28 million civil penalty and disgorge \$800 thousand in alleged unjust profits for alleged manipulation at Houston Ship Channel.
 - The Order alleged that BP traded fixed-price natural gas uneconomically to increase the value of its financial position.
- The case was tried before an Administrative Law Judge, who issued an Initial Decision upholding Enforcement Staff's allegations. BP filed exceptions to the Initial Decision and the matter is currently pending before the FERC.

Direct Energy Services (2014)

- Direct Energy trades both physical natural gas and financial products that settle based on the price of physical natural gas.
 - Several traders engaged in “unusual trading” at Transco Zone 6 by buying next-day physical index gas and selling comparable volumes of fixed-price gas. The physical fixed price sales were approximately 23% of the fixed-price volume transacted on ICE on those days.
 - Most of the trading was conducted very early in the day when there were very few market participants and sold at prices lower than prices others bought at later in the day. Direct Energy lost money on these transactions and, in the process, lowered the Gas Daily index and Direct Energy’s financial positions benefited from the lower index price.
- Direct Energy stipulated to the facts but did not admit or deny violating the market manipulation prohibition. The company agreed to pay a \$20,000 civil penalty, disgorge almost \$32,000, as well as continuing existing compliance measures, and compliance monitoring.

Total Gas & Power North America, Inc., et al. (2015)

- FERC Enforcement Staff issued a Notice of Alleged Violation alleging that Total and two of its traders violated the anti-manipulation rule by “making largely uneconomic trades for physical natural gas during bidweek designed to move indexed market prices in a way that benefited the company’s related positions.”
- Staff further alleges that Total’s West Trading Desk “implemented the bidweek scheme on at least 38 occasions” during the period reviewed and that the two traders each implemented the scheme and supervised and directed other traders in implementing the scheme.

Total Gas & Power North America, Inc., et al. (2015)

- The CFTC issued a Consent Order alleging that Total and one of its traders had engaged in attempted market manipulation through fixed-price bid-week trades during four bid-weeks primarily to benefit the company's related financial positions, "whose value was derived from the published index price at each of the relevant locations."
- The Consent Order required the respondents to pay a \$3.6 million civil penalty and agree to certain trading limitations and reporting obligations.

Key Takeaways

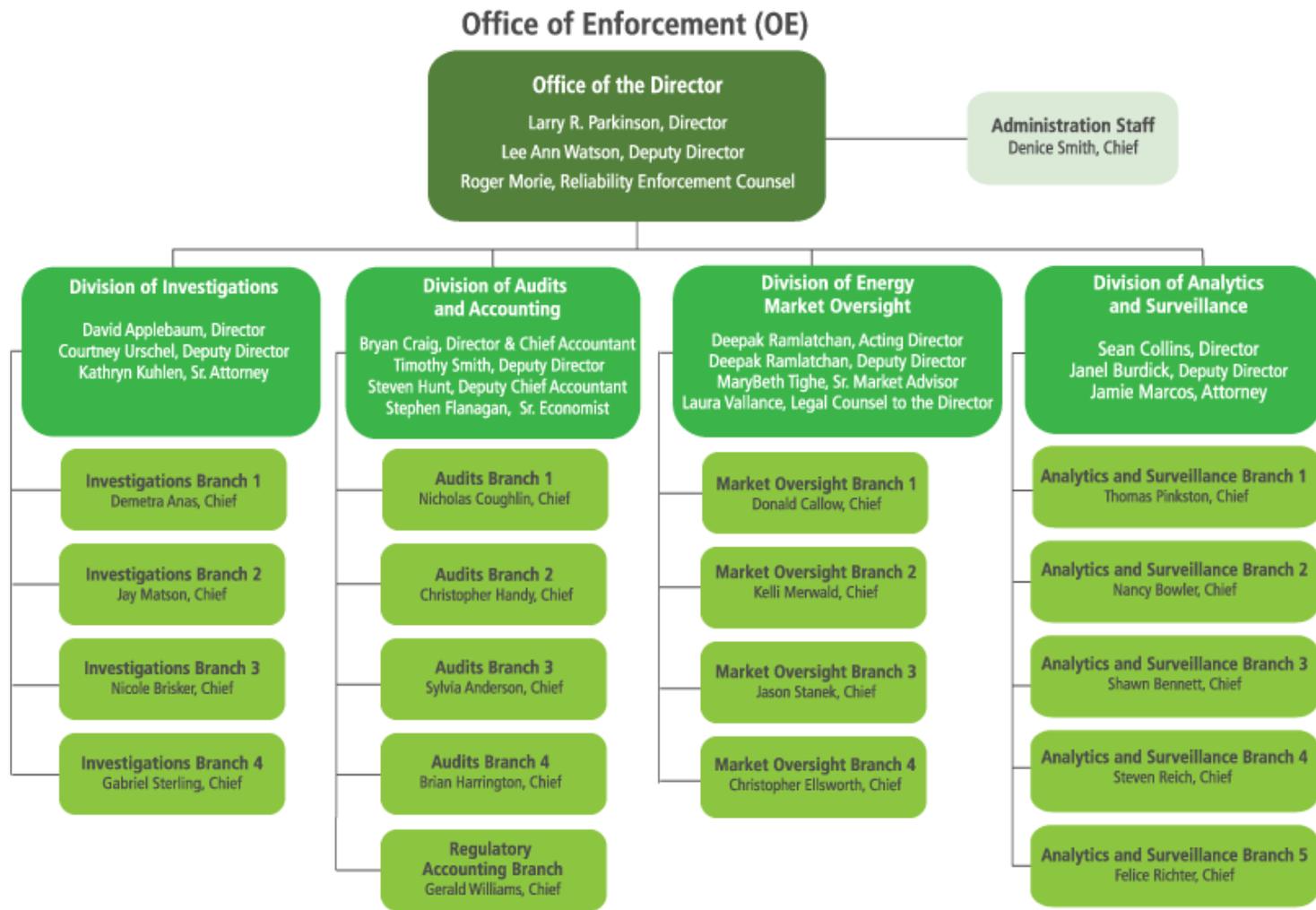
- FERC and Enforcement Staff view FERC's jurisdiction very broadly.
- Companies that have offsetting physical and financial positions can expect scrutiny from regulators.
- FERC Enforcement Staff looks closely at “early trading.”
- Be on the lookout for “unusual trading.”

FERC Audits

Why This Is Important

- Audit subjects are not limited to traditional utilities.
- An audit may result in onerous and expensive corrective actions.
- Audit Staff may refer a matter to Investigations Staff for investigation, which may result in civil penalties.
- Your company may be involved in a transaction being reviewed by Audit Staff in another audit.

FERC Office of Enforcement (OE)



Division of Audit Activities

- FY 2010: 52 audits completed; 210 corrective action recommendations and \$4.1 million in monetary recoveries.
- FY 2011: 72 audits completed; 300 corrective action recommendations, \$290,000 in refunds and write-off of \$95.8 million in regulatory assets.
- FY 2012: 44 audits completed; 399 corrective action recommendations, \$5.8 million in refunds, and accounting adjustments of \$3.5 million not recoverable in future rate proceedings.
- FY 2013: 29 audits completed; 360 corrective action recommendations, \$15.4 million in refunds, and \$200,000 in accounting adjustments.
- FY 2014: 19 audits completed; 62 corrective action recommendations and \$11.7 million in refunds and recoveries.
- FY 2015: 22 audits completed; 360 corrective action recommendations, more than \$16.8 million in refunds, and more than \$9.5 million excluded from transmission plant or wholesale formula rates.

Substantive Areas Audited In FY 2015

- MBR and EQRs
- Formula Rates
- Transmission Incentives
- Natural Gas Tariff & Accounting
- Mergers and Acquisitions
- Oil Tariff and Accounting
- Form No. 552
- Nuclear Decommission Trust Funds
- Capacity Markets and Demand Response

Auditing Compliance

- Most FERC audits include a review of companies' compliance programs.
 - Several purposes:
 - Collect data on industry compliance efforts.
 - Provide informal feedback and recommendations to company being audited.
 - If Audit Staff finds significant noncompliance with substantive requirements, the Final Audit Report may include a discussion of the adequacy of the subject's compliance program.

Questions?

George D. Billinson
Cadwalader, Wickersham & Taft
202.862.2411
George.Billinson@cwt.com

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Brett A. Snyder

April 6, 2016

Cost Recovery Mechanisms (CRMs)

- *Cost Recovery Mechanisms for Modernization of Natural Gas Facilities*, 151 FERC ¶ 61,047 (2015) (“Modernization Cost Recovery Policy Statement”).
 - Review of Existing Base Rates
 - Defined Eligible Costs
 - Avoidance of Cost Shifting
 - Periodic Review of the Surcharge and Base Rates
 - Shipper Support

Cost Recovery Mechanisms (CRMs) *(cont'd)*

- Tallgrass Rate Case, Docket No. RP16-137 (Oct. 2015)
 - Included CRM
 - Scope protested by shippers
- ANR Rate Case, Docket No. RP16-440 (Jan. 2016)
 - May file in Summer 2016
- Issues to watch:
 - Pipelines proposing expansive definition of CRMs
 - Negotiated rate agreements

Algonquin Gas Transmission LLC, Docket No. RP16-618

Reliability concerns in electric market affecting operation of natural gas market.

Algonquin's proposal:

- Algonquin proposed to exempt electric distribution companies (“EDCs”) participating in state-regulated electric reliability programs from the capacity release bidding requirements when they directly or indirectly release capacity to electric generators.
- No incentives for some generators to obtain long-term, firm capacity on natural gas pipelines.
 - These generators operate in spot market, which results in higher prices.
- EDCs would release capacity to asset managers who would release capacity to generators.
- Algonquin analogizes its proposal to the current bidding exemption for state natural gas retail choice programs.

Algonquin Gas Transmission LLC, Docket No. RP16-618 (cont'd)

Arguments in Protests:

- Commission's policy is that the party who most values the capacity should receive the capacity.
- Elimination of the price ceiling on short-term capacity releases and imposing a requirement for bidding on released capacity
- Proposal is preferential and discriminatory; would keep prices low for one segment of the capacity market.
- Interferes with price signals in the market, which would affect both the decision to build new capacity and the price market participants would be willing to bid for such capacity.

Algonquin Gas Transmission LLC, Docket No. RP16-618 ***(cont'd)***

Arguments in Protests *(cont'd)*:

- Algonquin's proposal operates as a subsidy to gas-fired electric generation.
- Unlike natural gas retail access programs, there is no retail consumer choice that would increase competition in the retail market or any other market and there is no stranded capacity due to decreased retail customer demand.
- May broaden the definition of asset management arrangement.

FERC set the case for technical conference.

Jordan Cove Energy Project L.P & Pacific Connector Gas Pipeline, LP

- On March 11, 2016, FERC denied the applications of Jordan Cove Energy Project, L.P. and Pacific Connector Gas Pipeline, LP for a new LNG export terminal in Coos County, Oregon and an associated interstate supply gas pipeline.
- Certificate Policy Statement for section 7 pipeline application:
 - FERC determined that Pacific Connector was prepared to financially support the project and, as a new natural gas company, would not be reliant on subsidization from existing customers.
 - FERC then considered Pacific Connector’s potential effect on the interests of (i) existing customers, (ii) competing existing facilities and their captive customers, and (iii) landowners and surrounding communities.

Jordan Cove Energy Project L.P & Pacific Connector Gas Pipeline, LP *(cont'd)*

- Under its Certificate Policy Statement, FERC first determined that Pacific Connector failed to show demand for the proposed pipeline and, therefore, could not overcome the negative effects on private landowners. It concluded that the pipeline's application must be denied.
- FERC then determined that, absent the Pacific Connector's pipeline, the LNG terminal proposed by Jordan Cove "can provide no benefit to the public" that would outweigh its environmental and other costs. FERC denied Jordan Cove's LNG terminal application as well.
- FERC considered the LNG terminal and the pipeline as essentially one project and denied Jordan Cove's LNG terminal application on the grounds that the Pacific Connector project would not be built.
- Increased preference for precedent agreements to show demand when a pipeline project is challenged by landowners?