

FERC Compliance:

New Procedures and Latest Audit Issues

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Topics

-  **NEW** Procedures

- No action letter process
- Contested audit procedures

-  **LATEST** Issues

- FERC audit reports – year in review
- FERC “Frequently Asked Questions” (FAQs) on Standards of Conduct

No Action Letter Process

- FERC adopts a no action letter process to help clarify its rules (November 2005).
- The process is an outgrowth of the May 2005 FERC technical conference on Standards of Conduct/Market Behavior Rule compliance – where the industry emphasized the lack of/need for clear rules.
- Under the no action letter process, **FERC Staff will provide informal advice** as to whether a proposed transaction, practice or situation may raise compliance issues under FERC regulations and could lead to enforcement action.

No Action Letter Process

- Part of FERC Chairman Kelliher's "firm, but fair" enforcement stance - "This no-action letter process will help clear up ambiguities in our rules," Kelliher said.
- **Letter does not bind FERC** – not subject to rehearing or judicial review.
- But, it is understood that FERC Staff involved in the no action letter process is well-acquainted with the statutes, regulations, rules and orders that FERC administers.

No Action Letter Process

- Initially, no action letters will be limited to questions about Standards of Conduct and Market Behavior Rules/anti-market manipulation rules.
- Company submits questions on a non-public basis to the FERC General Counsel, with the understanding that requests will be reviewed by Staff experts in relevant FERC offices.
- Company may seek guidance about its **existing practices or anticipated future practices or transactions.**

No Action Letter Process

- **When the no action letter is issued, FERC letter and company's submission to FERC is made public.**
- FERC will consider requests to keep the no action letter non-public for a short period of time to protect confidential information, or until transaction is implemented.
- The no action letter response will be:
 - (1) no enforcement action recommended;
 - (2) no enforcement action recommended if matter is implemented with certain conditions; or
 - (3) enforcement action would be recommended.

No Action Letter v. Petition for Declaratory Order

- No Action Letter
 - Not binding; no FERC analysis; no required time frame for FERC action; free - no fee
- Petition for Declaratory Order
 - Binding; FERC analysis; no required time frame for FERC action; \$19,410.00 fee

1 No Action Letter Issued to Date

- Cinergy transfer of generating facilities between affiliates.
- Code of Conduct questions – sharing of support employees that manage and operate plants (no merchant employees); sharing of information; pricing and information sharing requirements with respect to sales of non-power goods and services between the affiliates.
- No enforcement action was recommended under the facts.

Contested Audit Procedures

- Final Rule issued February 2006.
- Rule applies the contested audit procedures for financial audits to all operational audits, e.g., Standards of Conduct, Code of Conduct and so on (but does not apply to ERO audits).
- Rule provides **greater due process for audited persons who dispute findings or proposed remedies** of FERC audit staff in draft operational audit reports.

Contested Audit Procedures

- At the end of the audit process, FERC audit staff provides the audited person with a draft audit report for review and comment.
- FERC audit staff considers the audited person's comments and discusses them with the audited person. FERC audit staff and the audited person have a final "wrap-up" conference.
- The audited person provides **in writing** to the FERC audit staff a response indicating any findings and/or remedies it disagrees with in the draft audit report.

Contested Audit Procedures

- When the audit process concludes, FERC will issue an order on the merits of **non-disputed** audit matters in an audit report and will notice, without making any findings on the merits, any **disputed** audit matters. The audit report will include the audited person's response on disputed matters.
- Audited person may elect a **shortened proceeding** (i.e., paper hearing when no material issues of fact are in dispute) **or a trial-type proceeding** to challenge disputed audit matters.
- The audit is non-public whereas the shortened or trial-type proceeding is public.

Contested Audit Procedures

- FERC will allow interested parties (intervenors) to participate in the shortened procedures.
 - There will be no discovery.
 - The interested party will have access only to publicly available filings and not non-public audit information and communications between the audited person and the FERC audit staff.

Contested Audit Procedures

- In the Final Rule, FERC addressed other audit issues to clarify its enforcement program:
 - Audit reports and FERC orders on uncontested audit reports **are not binding** on entities other than the audited party.
 - But, FERC views them as providing guidance as to what the Commission and FERC Staff considers compliant.
 - A FERC order on a contested matter **has precedential effect for all** – audited party and non-parties.
 - Non-parties must pay close attention to contested matters – rules of general applicability may be imposed on all on a case-by-case basis.

Contested Audit Procedures

- In the Final Rule, FERC addressed other audit issues to clarify its enforcement program (*continued*):
 - Information that the audited person gives to the FERC audit staff during an audit must be kept confidential.
 - FERC audit staff and investigations staff may freely share information throughout the audit process – FERC will not separate these functions.
 - The audited person's employees may have counsel present at any time, during any part of the audit.

Audit Reports – Year in Review

- Audit reports issued in 2005:
 - Mid-American
 - Dayton Power & Light
 - Westar Energy
 - Progress Energy
 - Duke Energy
 - Public Service of Colorado
 - Nevada Power Company
 - Sierra Pacific Power Company

Audit Reports – Year in Review

- Audit reports have trailed off in late 2005/2006.
 - Is FERC spending more time on review and issuance of audit reports to make sure that it has got it right?
- However, FERC is still full steam ahead on audits, especially Standards of Conduct audits.
 - In December 2005, FERC announced that the new FERC OMOI Director Susan J. Court will make compliance with the Standards of Conduct “a top priority”.

Audit Reports – Year in Review

- Audits pending:
 - Duquesne Light Company, Consolidated Edison, Louisville Gas & Electric, Montana – Dakota Utilities Co., Public Service of New Mexico, UBS AG, DTE Energy, Edison Mission Marketing & Trading, Sempra Energy Trading and Otter Tail Power Company.

Latest Issues – Audit Reports and FERC FAQs

- Joint meetings of transmission/marketing employees:
 - *Gas* case – FERC objected to transmission employee's silent attendance at a daily meeting.
 - *Duke* – Joint meetings were permitted with compliance protections.
 - *Progress* – Joint meetings with recorded calls were prohibited.

Latest Issues – Audit Reports and FERC FAQs

- Joint meetings of transmission/marketing employees:
 - FERC FAQ #28 – Joint meetings are permitted so long as:
 - (1) there are no disclosures of non-public transmission information by transmission employees;
 - (2) the meetings do not convey an undue preference to marketing and energy affiliates; and
 - (3) the subject of the meeting is a topic that is specifically allowed for a shared discussion (e.g., specific transactions discussion).

Latest Issues – Audit Reports and FERC FAQs

- Joint meetings and written minutes:
 - *Duke* – FERC Staff says that written minutes for joint meetings are a “best practice.”
 - Final Rule on Contested Audit Matters Procedures – Commission says that written minutes are not a requirement.
- **Utilities should evaluate their joint meetings and implement compliance measures commensurate with the risk of violations.**

Latest Issues - Audit Reports and FERC FAQs

- Senior officers and directors – meetings and information flows:
 - FERC FAQ #27 – Shared officers and directors may receive all the information that they need, provided that (i) they do not direct, organize or execute transmission, marketing or Energy Affiliate functions, and (ii) they do not act as a conduit.
 - Senior level meetings attended by operating personnel:
 - Cycling operating employees in and out of the meeting.
 - Written record of operating employees' attendance and excusal from the meeting.
 - Do any of your senior managers direct, organize or execute?

Latest Issues - Audit Reports and FERC FAQs

- Physical separation measures - key cards:
 - *Duke* – all transmission employees including transmission engineers, planners and contract administration must be physically separated with effective measures.
 - *Duke* – FERC Staff considers key card access a “best practice”.
 - FERC FAQ #19 – Key card access is not a requirement. However, FERC will impose stricter physical separation measures when transmission and marketing employees are in close proximity to each other, e.g., employees that share the same building.

Latest Issues - Audit Reports and FERC FAQs

- FERC FAQ #29 – Disclosures of non-public transmission information to marketing/energy affiliates when non-affiliated customers are present at a meeting:
 - OK when a public invitation is extended to all transmission customers and potential customers, affiliated and non-affiliated.
 - Not OK when transmission provider invites some, but not all, customers and potential customers to a meeting.