drums along the potomac

We've come to realize that this policy and compliance tea leaves column could easily fill this entire publication (if we weren't careful). Never before have we seen so much policy, rule, legislative and regulatory stuff swirling around at the same time that can have a potentially huge impact on the sector. We ran this up the flagpole in the newsroom the other day: what to do about it? Should we pare some bits back a bit? Should we organize it differently? Should we blow off certain agencies and elevate others? This week we will be asking many of you this very question; we will be sending out a bunch of emails asking your thoughts on the matter, since, at the end of the day, you're the boss when it comes to content. If you have any thoughts on the matter now, send them directly to the editor at johns@scudderpublishing.com.

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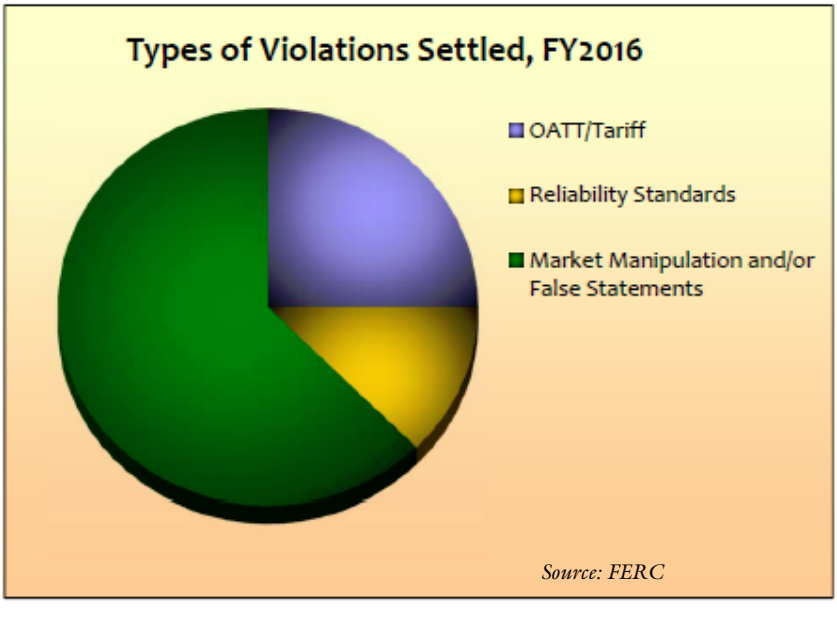
It's been a busy couple weeks at FERC. Hearings, new white papers and reports, new leadership vying for position on the new administration and lots of other frothy stuff. The agency released a white paper that thankfully the good folks at Cadwalader reviewed for your analytic pleasure. The white paper detailed the commission's experience investigating potentially manipulative conduct under the Anti-Manipulation Rule. Over 10 years, FERC staff investigated more than 100 matters, settled 24 proceedings resulting from those investigations and pursued two cases in administrative proceedings. Currently, FERC is also litigating six penalty assessment orders in federal district courts. In the report, FERC staff asserts that the commission and the courts have "developed a body of law that, while still in its early stages and continuing to evolve, identifies and provides notice on specific types of conduct that can constitute market manipulation in the energy markets and factors that are indicative of such conduct."

In its "Manipulation" white paper, FERC staff largely restates its litigation positions – many of which currently are being challenged – and seeks to provide notice of: (1) factors that typically indicate manipulative conduct; (2) specific types of conduct that often constitute manipulation; (3) mitigating and aggravating factors affecting penalty amounts for manipulation violations; and (4) the types of investigations that it has closed without further action.

FERC staff first provides the following list of key elements emerging from FERC's developing manipulation law:

- Fraud is a question of fact;
- Fraud includes open-market transactions (transactions executed with manipulative intent on exchanges or public trading platforms);
- Fraud is not limited to violations of a tariff or other express rule;
- A manipulation violation does not require a showing that the manipulative conduct resulted in artificial prices;
- The Anti-Manipulation Rule includes attempted fraud;
- Manipulative intent, even where it is combined with a legitimate purpose, establishes the scienter element of the Anti-Manipulation Rule;
- Pursuant to its "in connection with" jurisdiction, the commission has jurisdiction over conduct that affects jurisdictional transactions, including the "rates, terms and conditions of service in a market"; and
- Individuals constitute "entities" and, as such, are subject to the Anti-Manipulation Rule.



Source: FERC

FERC staff also provides guidance on three types of conduct that it says constitute manipulation, but notes that companies can "consult" with FERC staff before engaging in conduct that could be construed as manipulative. Staff acknowledges that it cannot provide formal, binding decisions, but it does state that it can informally express its views, including with regard to analysis of potentially relevant factors. It is unclear whether nonbinding guidance from FERC staff has much practical value. First, staff did not indicate how quickly it would provide guidance. The timeline within which trading decisions must be made before they are moot typically is very brief. Second, the informal opinion of one or two staff members is not binding on the Office of Enforcement or the commission. Third, it may be difficult to ensure in tight time constraints that you have provided staff with all the material facts, many of which are not available to market participants, *e.g.*, ISO dispatch algorithms) related to a proposed strategy. Nevertheless, one potential benefit to seeking guidance from staff is that disclosure makes it difficult for staff to claim later that a market participant was acting with fraudulent intent.

For the full Cadwalader write-up, go to *http://www.cadwalader.com/resources/clients-friends-memos/ferc-staffs-*

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white-paper-on-manipulation-provides-insights-on-commissions-developing-manipulation-law.

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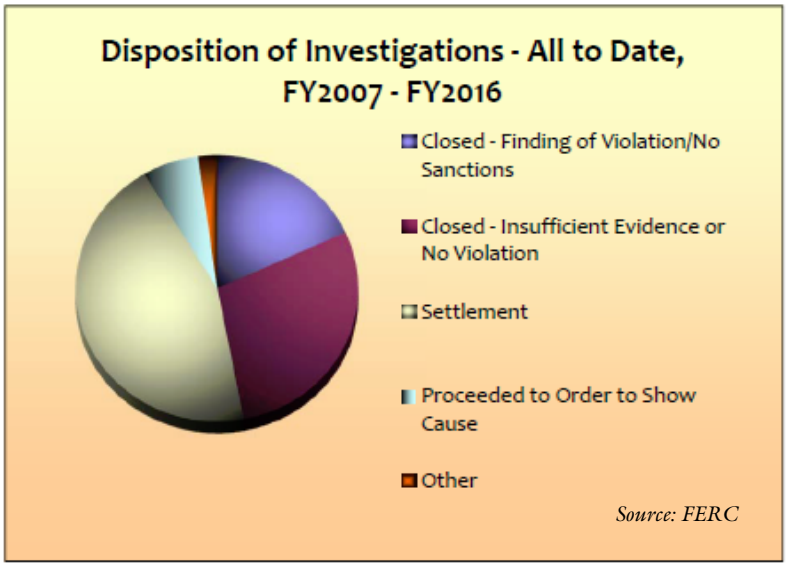
It's baaaaack. Position limits that is. Bloomberg first ran a piece two weeks ago that has CFTC chief Timothy Massad pushing ahead with the position limits final rule before the "Chimes at Midnight "(great film by the way). Of course, if you've been paying attention, you'd already know that Massad never actually stopped the internal administrative process on position limits – why would he? His boss is named Obama, and last time we checked, Massad's marching orders have not changed a lick for this final stretch. To quote the prophet Steven Tyler, "the train kept a-rollin' all night long … " We wonder if Massad is an Aerosmith fan. Whatever the final rule looks like, the market and the current GOP opposition won't like it anyway, so why stop now? We're told that the other two commissioners have had final drafts of a position limits rule for over a week, and at least one red pencil is getting a workout. Last week it was reported that Michael Conaway, chairman of the House Agriculture Committee fired off a letter to Chairman Massad imploring him to refrain from "midnight rulemaking." Chairman Conaway didn't mix terms or metaphors. He specifically named Reg AT, position limits and cross-border rules to be removed from the agency's to-do list immediately. It's the type of letter that would send your average commission chairman scrambling home, drinking early. Not Massad. Full steam ahead is the word internally. One professional inside-the-Beltway cynic we spoke to said that Massad is bluffing, that he won't really press the vote on limits before the end of the year and that he's only playing hardball now to "leverage a future role" someplace else. Nuts, we say. Not Massad's style. Technically, Conaway has no real recourse on this one anyway. Does anybody think that Massad will pursue the public sector after 2016? Unlikely. And the Obama camp is no fan of Conaway and vice versa. Seems Massad is simply being a good soldier. We don't like the position limits rule, never have, and believe it will be torched by the next chairman. But we give the current chairman points for standing firm. Before the chimes at midnight on Dec. 31, we think the chairman call a vote on position limits, and draw a 2-1 majority.



Two compliance officers we spoke to earlier said they certainly would "go through the motions," on whatever the new rule might direct then to do, but both expected any new limits rule to be first blocked and then yanked, early in 2017. "The current limits work pretty well," said one source… Reg AT is expected to see a similar fate; this latter rule's comment period ends mere days before the new team takes its oath of office in January. Fast-tracked or back-burnered? Guess we'll see just how independent an independent agency really is, come January.

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On Nov. 15, House Majority Leader Kevin McCarthy fired off a letter to all "Secretaries, Administrators, Directors and Commissioners," asking them to "refrain from acting with undue haste," on "finalizing pending rules or regulations in the administration's last days." He said that by finalizing stuff at the 11th hour could be costly to Americans for some vague reason. And, what if they ignore this warning? "Should you ignore this counsel, please be aware that we will work with our colleagues to ensure that Congress scrutinizes your actions and, if appropriate, overturns them pursuant to the Congressional Review Act." Ooooooooh. That should have everybody shaking in their shoes.

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Want some solid tea leaves? A source suggested we download a document from 2015. CFTC Commissioner Chris Giancarlo drafted a lengthy white paper on regulatory reform. It's as though he saw all of this coming. Most folks believe he will be the next agency chief. We do too. As such, we have your weekend reading assignment ready for download at: h*ttp://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf*.

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FERC also recently issued a white paper called, "Staff White Paper on Effective Energy Trading Compliance Practices" The Compliance white paper provides electric energy and natural gas market participants with "concrete examples of compliance practices, procedures, training and review" that will help in the design, implementation and maintenance of strong compliance programs that "may" prevent or detect market manipulation.

Cadwalader attorneys outlined FERC staff's recommendations on: (1) designing an effective compliance program, (2) establishing, implementing and enforcing effective practices to deter and detect market manipulation and other misconduct; and (3) assessing the performance of the compliance program on a regular basis. The attorneys stated that while many of the recommended measures make sense considering recent enforcement actions, others may be impractical or expensive to implement. On the implications of implementing these "exhaustive, costly, and time-consuming (compliance) practices," Cadwalader attorneys state:

Some of FERC Staff's examples, such as rotating business unit personnel

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into compliance units, may be unworkable in practice and seemingly reflect a fundamental difference between FERC staff and market participants about a company's overall business objectives and resources. Other examples, such as recording, retaining (for a minimum of five years) and reviewing all oral and written trader communications, could be costly and time-consuming to implement. In some cases, the costs associated with this facet of the Compliance white paper could outweigh the potential benefits associated with obtaining a compliance credit in an investigation.

Here are a few highlights of the measures that FERC staff considers as examples of effective compliance practices:

- Tailoring the compliance program to a company's specific business;
- Providing training that reflects a variety of training styles, ranging from one-on-one meetings to compliance newsletters and annual, large group trainings;
- Hiring compliance personnel with various professional and educational backgrounds (legal, operations, trading, and risk management);
- Devoting sufficient resources, including experienced personnel and technology, to implementing and enforcing an effective compliance program;
- Regularly performing background investigations on traders and, prior to hiring traders, identifying candidates' compliance track records;
- Integrating compliance and operational professionals, management, and internal counsel in all aspects of the compliance program;
- Documenting the business and compliance basis for undertaking new trading strategies, particularly when they involve related physical and financial positions;
- Conducting frequent, topic-specific training using a variety of techniques;
- Recording, retaining, and regularly reviewing all written *and oral* trader communications for at least five years;
- Monitoring employee communications for potential misconduct, such as through algorithmic-based software programs;
- Monitoring trading activity, including tracking and reviewing profit and loss calculations by product and location combinations instead of aggregate portfolios;
- Enforcing – and documenting enforcement – of compliance rules and restrictions, including appropriate discipline of traders who fail to comply with Commission and ISO rules and the company's compliance policies and procedures; and
- Regularly auditing compliance programs through, for example, full audits every other year or smaller audits every six months.

For the full FERC report, go to *https://www.ferc.gov/legal/staff-reports/2016/tradecompliancewhitepaper.pdf*.

energy transitions and risk

It is officially peak season for market analysis reports. Every bank research desk, major (or minor) consulting firm, pol, pundit or policy wonk is issuing insights before the holiday rush completely monopolizes everybody's attention. We found one particular report that was gisted nicely by the good folks at NGI. The report, courtesy of WoodMac, noted that the next global energy transition may pose big risks for Big Oil as world consumption continues to trend toward natural gas and renewables. The WoodMac analysis follows recent and all-too-similar analysis by the IEA. "In the shift to lower-carbon fuels, natural gas and zero-carbon fuels are forecast to satisfy at least 60 percent of the rise in global energy demand to 2035, with some scenarios forecasting renewable demand will grow nearly 500 percent over the next 20 years. Meanwhile, coal and oil demand may peak well before 2035," according to the report, "Fossil Fuels to Low-Carbon: The Majors' Energy Transition."

"As carbon policy intensifies, the oil and gas majors will face more regulatory burden and are likely to face increasing costs," said Wood Mackenzie's Paul McConnell, research director of global trends. "Green financing could also mean higher cost of capital for more carbon-intensive oil assets such as oil sands, as investors shift to alternative fuels and lower-carbon technologies."

WoodMac researchers investigated how the major producers are responding to the pressure to move to a low carbon-energy environment. Only 13 percent of global emissions currently are covered by a price on carbon. And most of the majors' upstream operations "are not yet directly impacted, with most policies primarily focused on the power and industrial sectors."

Up to half of the oil and gas produced by Big Oil companies over the next decade could be hit by carbon costs, if countries and regions that currently price carbon extend policies to the extractives sectors, Wood Mackenzie found. Carbon pricing now is usually beyond the scope of emissions-limiting schemes.

"While all the major oil companies put a price on carbon in their long-term planning, the big question is how much risk each has taken into account," McConnell said.

Wood Mackenzie's study found the global oil majors are under pressure to reduce risk in their existing business models and diversify into low-carbon energies. However, diversifying into renewables may be challenging, as it could be difficult to both justify allocating scarce capital to low-returning projects and transform existing business models.

"The timing of a transition to low-carbon energy will be critical," McConnell said. "Diversifying to renewable energy will be a balancing act. Moving too quickly could leave money on the table from the majors' fossil fuels business. But too slowly, and they could miss their window of opportunity. The biggest risk for oil and gas companies is to do nothing, and be left exposed to investors making their own minds up."

For free trials to NGI's many excellent publications, go to *http://www.naturalgasintel.com/trials*. For a copy of the WoodMac report, go to *https://www.woodmac.com/*.