ENFORCEMENT AT THE FEDERAL ENERGY REGULATORY COMMISSION: CONSIDERATIONS FOR THE PRACTITIONER

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Although the Federal Energy Regulatory Commission established a separate, formal enforcement function in 1978, the first tangible results of the program have begun to appear only during the last year and a half.[1] Recruitment and training of personnel, development of enforcement policies and procedures and completion of the first investigations commenced by the Commission pursuant to its Rules Relating to Investigations[2] have taken considerable time.

This article provides an overview of some of the more important aspects of the Commission's enforcement program, with emphasis upon observations and considerations which may be helpful to the practitioner. The article begins with a discussion of the legal bases for and due process requirements of the Commission's investigations. It then describes the kinds of investigations conducted by the Enforcement Division and a number of matters which may arise during the course of investigations, including subpoena enforcement, assertion of the attorney-client privilege and assertion of reliance upon the advice of counsel. There follow discussions of the manner in which settlement negotiations are conducted and significant aspects of several settlements recently approved by the Commission.

I. The Commission's Investigations

A. The Commission's Authority to Conduct Investigations

All investigations conducted by the Enforcement Division are conducted pursuant to the Commission's Rules Relating to Investigations.[3] In Commission investigations, there are no "parties", as that term is used in the adjudicatory context,[4] witnesses are sequestered,[5] there is no right to cross-examination,[6] an attorney must represent the witness in the witness' individual capacity to be present,[7] and an attorney is limited in questioning the witness he represents to clarification of the witness' answers and offering other evidence.[8]

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[1] *E.g.*, Texaco Inc., 16 FERC ¶ 61,068; Texas Sea Rim Pipeline, Inc., 17 FERC ¶ 61,302; Conoco Inc., 20 FERC ¶ 61,306; Tenneco Inc. *et al.*, 21 FERC ¶ 61,011; Sun Exploration and Production Company, 21 FERC ¶ 61,009; Atlantic Richfield Company, 21 FERC ¶ 61,010; Paul E. Cameron, Jr., Inc., 21 FERC ¶ 61,003; Amoco Production Company *et al.*, 21 FERC ¶ 61,012; Gas Producing Enterprises, Inc., 21 FERC ¶ 61,014; Various Producer-Owned Natural Gas Processing Plants, 21 FERC ¶ 61,015.

[2] 18 C.F.R. Part 1b.

[3] *Id.*

[4] 18 C.F.R. § 1b.11 (1982).

[5] 18 C.F.R. § 1b.16 (1982).

[6] 18 C.F.R. § 1b.16(c) (1982); *cf.* § 1b.16(d).

[7] 18 C.F.R. § 1b.16(b) (1982).

[8] 18 C.F.R. § 1b.16(c)(3) (1982).

The constitutional bases upon which objections to agency investigations typically have been made are the fourth amendment's proscription of unreasonable searches and seizures and the fifth amendment's guarantee of due process of law. *Oklahoma Press Publishing Co. v. Walling*[9] and *U.S. v. Morton Salt Co.*[10] are the seminal cases establishing that, properly conducted, investigations do not violate the fourth or fifth amendments. The cases also establish that public entities are not entitled to the same fourth and fifth amendment protections as private individuals.[11]

Morton Salt and *Oklahoma Press* and their progeny[12] hold that agency investigations are more in the nature of grand jury proceedings and suggest that agencies may properly conduct what has been characterized as "fishing expeditions".[13]

The Supreme Court concluded in *Oklahoma Press* (decided in 1946) and thereafter in *Morton Salt* (decided in 1950) that an agency's investigation does not contravene the fourth amendment's proscription against unreasonable searches

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[9]327 U.S. 186 (1946).

[10]338 U.S. 632 (1950).

[11]In discussing the fourth and fifth amendment protections, the Court in its decision in *Oklahoma Press* reviewed numerous cases on the matter and concluded that:

> Historically private corporations have been subject to broad visitorial power, both in England and in this country. And it long has been established that Congress may exercise wide investigative power over them, analogous to the visitorial power of the incorporating state, [footnote omitted] when their activities take place within or affect interstate commerce. [footnote omitted] Correspondingly it has been settled that corporations are not entitled to all of the constitutional protections which private individuals have in these and related matters.

327 U.S. at 204-205. Similarly in *Morton Salt,* the Court cited a number of cases upholding Congress' right to exercise broad investigative authority over persons and entities engaged in activities which are in the public sphere and concluded that it is well settled that such entities are *not* entitled to all of the constitutional protections afforded private persons, stating:

> [N]either incorporated nor unincorporated associations can plead an unqualified right to conduct their affairs in secret. [citations omitted]
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> While they may have and should have protection from unlawful demands made in the name of public investigation, corporations can claim no equality with individuals in the enjoyment of a right to privacy. They are endowed with public attributes. They have a collective impact upon society, from which they derive the privilege of acting as artificial entities. [citations omitted] 338 U.S. at 652.

[12]Hannah v. Larche, 363 U.S. 420 (1960); SEC v. Brigadoon Scotch Distributing Co., 480 F.2d 1047 (2d Cir. 1973), *cert. denied sub nom* Brigadoon Scotch Distributors, Ltd. v. SEC, 415 U.S. 915 (1974); SEC v. Arthur Young and Co., 584 F.2d 1018 (D.C. Cir. 1978), *cert. denied,* 439 U.S. 1071 (1979); U.S. v. Powell, 379 U.S. 48 (1964); See v. City of Seattle, 387 U.S. 541 (1967); Federal Maritime Commission v. Port of Seattle, 521 F.2d 431 (9th Cir. 1975).

[13]For example, referring to the investigations conducted by the Federal Trade Commission, the Court in *Morton Salt* stated:

> The only power that is involved here is the power to get information from those who best can give it and who are most interested in not doing so. Because judicial power is reluctant if not unable to summon evidence until it is shown to be relevant to issues in litigation, it does not follow that an administrative agency charged with seeing that the laws are enforced may not have and exercise powers of original inquiry. It has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties are delegated by statute to an administrative body, it, too, may take steps to inform itself as to whether there is probable violation of the law. 338 U.S. at 642-43.

See Morton Salt, 338 U.S. at 641-42; *Oklahoma Press,* 327 U.S. at 195. *See also SEC v. Howatt,* 525 F.2d 226, 229 (1st Cir. 1975) (SEC not required by statute or the Constitution to limit its investigations to those against whom "probable cause" or even "reasonable cause" to suspect a violation has been established.)

and seizures or the fifth amendment's due process protections so long as its inquiry is "for a lawfully authorized purpose, within the power of Congress to command",[14] the demand is not too indefinite,[15] and the information sought is reasonably relevant.[16] Finally, *Oklahoma Press* established that an agency need not have probable cause in order to initiate an investigation[17] and that it may do so without a prior adjudication that the industry or activity being investigated is covered by its statutes.[18]

Hannah v. Larche,[19] *Morton Salt*, and *Withrow v. Larkin*[20] were relied upon by the Commission in Opinion 41,[21] in the preamble to Order 8 implementing the Commission's Rules Relating to Investigations,[22] and in the Preamble to the Commission's Proposed Rules Relating to Investigations[23] as the bases for the Commission's authority to conduct investigations. A number of comments to the proposed rulemaking to amend Order 8[24] set forth the position that neither the proposed rules nor the existing rules provide sufficient due process, and that the Commission's reliance on the cases mentioned above is misplaced and inappropriate.

It has been argued that *Hannah* provides no basis for the Commission's investigations because *Hannah* involved investigations by the Civil Rights Commission, which was not empowered to adjudicate, but rather was limited to fact finding and reporting the results of its findings to the President and Congress.[25] It was argued that since the Commission has the authority to adjudicate, reliance on *Hannah* by the Commission is "weak justification for severe limitations on the procedural rights of respondents and witnesses in [Commission] investigations."[26]

This argument ignores the Court's analysis in *Hannah*. The Court's analysis was not dependent upon whether the agency involved could statutorily adjudicate legal rights but rather turned upon whether, in the context of exercising its investigative function, the agency was adjudicating legal rights. The Court held that an investigation is not unlawful so long as legal rights are not adjudicated during the investigation.[27]

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[14]327 U.S. at 208.

[15]*Id.*

[16]338 U.S. at 652.

[17]327 U.S. at 215.

[18]*Id.* at 209, 214.

[19]363 U.S. 420 (1960).

[20]421 U.S. 35 (1975).

[21]7 FERC ¶ 61,258 at pp. 61,540-61,542. Opinion 41 was the Commission's response to a challenge by Tenneco Inc. to the suspension of a public investigation and the initiation by the Commission of a private investigation under the Commission's Rules Relating to Investigations. In Opinion 41, the Commission stated that its decision to do so was influenced by its review of the Commission's history of investigating potential violations of law in public adjudicatory proceedings. That review convinced the Commission that setting such matters for hearing before administrative law judges prior to full investigation was inappropriate. The Commission stated:

> The Federal Power Commission's adherence to such procedures in cases of this character made for inadequate adjudicative records. There is some reason to believe that these led at times to improvident settlements accepted on insufficient knowledge. Moreover, the methodology did not make for the effective discharge of the Commission's responsibility to enforce the statutes that the Congress had entrusted to its care. 7 FERC ¶ 61,258 at p. 61,537.

[22]FERC Statutes and Regulations, ¶ 30,013.

[23]FERC Statutes and Regulations, ¶ 32,013.

[24]*Id.*

[25]Van Tine, *Enforcement Issues Under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978*, 16 Hous. L. Rev. 1025 (1979).

[26]*Id.* at 1051.

[27]363 U.S. at 440-442.

The crux of the Court's analysis is its observation that:

> 'Due Process' is an elusive concept. Its exact boundaries are undefinable, and its content varies according to specific factual contexts. Thus, when governmental agencies adjudicate or make binding determinations which directly affect the legal rights of individuals, it is imperative that those agencies use the procedures which have traditionally been associated with the judicial process. On the other hand, when governmental action does not partake of an adjudication, as for example, when a general fact-finding investigation is being conducted, it is not necessary that the full panoply of judicial procedures be used.[28]

The Court discussed the rules of procedure adopted by the "vast majority of governmental investigating agencies" as follows:

> The history of investigations conducted by the executive branch of the Government is also marked by a decided absence of those procedures here in issue. [footnotes omitted] The best example is provided by the administrative regulatory agencies. Although these agencies normally make determinations of a quasi-judicial nature, they also frequently conduct purely fact-finding investigations. When doing the former, they are governed by the Administrative Procedure Act [citation omitted], and the parties to the adjudication are accorded the traditional safeguards of a trial. However, when these agencies are conducting non-adjudicative, fact-finding investigations, rights such as apprisal, confrontation, and cross-examination generally do not obtain.[29]

That the Court's holding is not limited to agencies having the authority only to investigate and not adjudicate is made clear by the Court's discussion of the investigative procedures of several agencies which both investigate and adjudicate. In discussing the Securities and Exchange Commission, the Court stated:

> Although the [Securities and Exchange] Commission's Rules provide that parties to adjudicative proceedings shall be given detailed notice of the matters to be determined, [citation omitted] and a right to cross-examine witnesses appearing at the hearing, [citation omitted] those provisions of the Rules are made specifically inapplicable to investigations, [citation omitted] even though the Commission is required to initiate civil and criminal proceedings if an investigation discloses violations of law. [citation omitted] Undoubtedly, the reason for this distinction is to prevent the sterilization of investigations by burdening them with trial-like procedures.[30]

In sum, it is now well-settled that since the purpose of an agency investigation is "to discover and procure evidence, [and] not to prove a pending charge",[31] the traditional due process protections afforded by the Constitution do not apply.

B. Due Process Requirements in Investigations

The Commission's commencement of investigations under its present Rules Relating to Investigations began in 1978, and followed many years during which investigations of alleged violations of Commission statutes, regulations, rules and orders had been conducted in trial-type proceedings in which the full panoply of due process rights were afforded the participants.[32] During that period, there were a number of decisions issued by the Commission's administrative law judges[33] and by

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[28] *Id.* at 442.

[29] *Id.* at 445-446.

[30] *Id.* at 446-448.

[31] 327 U.S. at 201.

[32] These proceedings were initiated by the issuance of an order to show cause pursuant to 18 C.F.R. § 1.6(d) and were governed by the Commission's Rules of Practice and Procedure for on-the-record hearings. *See* 18 C.F.R. § 1.20 *et seq.*

[33] Between the years 1973 and 1977, more than 30 proceedings were commenced by the issuance of an order to show cause. A number of decisions issued by administrative law judges in those proceedings discussed the difficulties encountered. *See, e.g., El Paso Natural Gas Company*, 53 FPC 163-164; *Certain Producer and Pipeline Respondents*, 4 FERC ¶ 63,017.

the Commission[34] criticizing that approach, primarily because of the difficulties in developing a full evidentiary record inherent in such proceedings.

Due process rights which are afforded witnesses in Enforcement investigations include the right to counsel, the Fifth Amendment's privilege against self-incrimination (which may be asserted only by individuals)[35] and the attorney-client privilege.

The case law recognizes the principle that there is nothing inherently unconstitutional in a procedure pursuant to which an administrative agency first conducts an investigation and thereafter adjudicates the legality of the conduct or transaction investigated.[36] The reason for the principle is that agencies must perform the two very different functions of prosecuting and adjudicating; consequently, the mere participation by the agency in an investigation does not of itself result in bias or prejudice if the agency subsequently adjudicates the legality of the conduct or transaction investigated.

The decision by the United States Supreme Court in *Withrow v. Larkin* contains perhaps the most well-articulated explanation of why due process is not denied merely because an investigator/prosecutor thereafter adjudicates the legality of the conduct or transaction investigated. In that case a physician commenced an action against the Wisconsin State Examining Board arguing that its procedures, pursuant to which it first investigated and thereafter adjudicated, constituted an unconstitutional denial of due process.[37]

The Supreme Court's analysis began with the recognition that a fair trial is a basic requirement of due process and that the requirement applies to administrative agencies which perform an adjudicatory function.[38] However, the Court held that the Board's performing both the investigative and adjudicatory functions was not in itself a denial of due process. The Court stated:

> The contention that the combination of investigative and adjudicative functions necessarily creates an unconstitutional risk of bias in administrative adjudication has a much more difficult burden of persuasion to carry. It must overcome a presumption of honesty and integrity in those serving as adjudicators; and it must convince that, under a realistic appraisal of psychological tendencies and human weakness, conferring investigative and adjudicative powers on the same individuals poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented.[39]

The Court described a number of other analogous factual situations where similar denials of due process were rejected. For example, the Court pointed out that judges are not prohibited from trying the same case more than once, nor are they prohibited from first issuing arrest warrants or presiding over preliminary hearings to decide whether there is sufficient evidence to hold a defendant for trial and then presiding over the trial itself.[40] Similarly, the Court noted that judges are not

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[34]*See supra* note 21.

[35]The fifth amendment privilege, like the attorney-client privilege, is personal and must be invoked by the witness. Hale v. Henkel, 201 U.S. 43 (1906). Further, a corporate officer may not withhold testimony or documents solely on the ground that the corporation would be incriminated and, as discussed earlier, the corporate records must be produced even if they may tend to incriminate its officers. U.S. v. Fago, 319 F.2d 791 (2d Cir. 1963).

[36]Withrow v. Larkin, 421 U.S. 35; Hannah v. Larche, 363 U.S. 420.

[37]It should be noted that the Board's procedures, although permitting the physician and his counsel to attend the closed investigative hearing, did not permit them to cross-examine witnesses brought before the Board. 421 U.S. at 39.

[38]*Id.* at 46.

[39]*Id.* at 47.

[40]*Id.* at 56.

Subpoena enforcement proceedings are consequently summary in nature[69] and may be treated by the court as a motion for an order pursuant to Rule 7(b) of the Federal Rules of Civil Procedure rather than a complaint pursuant to Rule 7(a). As previously stated, the agency has the burden of showing that the matters being investigated are within the scope of its legislative mandate, which is to say that the inquiry is being conducted for a legitimate purpose. Allegations of an improper purpose may entitle the person under subpoena to an evidentiary hearing and to limited discovery.[70]

In addition to showing that the investigation has a legitimate purpose, the agency must demonstrate that the information sought is generally relevant to that purpose. Here, too, the courts have given agencies broad authority, holding that an agency need only determine that the information sought is not clearly immaterial or irrelevant.[71] Again, the policy reason given by the courts for the broad latitude afforded an agency is the need to determine the facts. Thus, in *FTC v. Texaco, Inc.*,[72] the court stated:

> [I]n the pre-complaint stage, an investigating agency is under no obligation to propound a narrowly focused theory of a *possible* future case. Accordingly, the relevance of the agency's subpoena requests may be measured only against the general purposes of its investigation. The district court is not free to speculate about the possible charges that might be included in a future complaint, and then to determine the relevance of subpoena requests by references to these hypothetical charges. The court must not lose sight of the fact that the agency is merely exercising its legitimate right to determine the facts, and that a complaint may not, and need not, ever issue. (footnote omitted) (emphasis in original)[73]

Agency subpoenas may be attacked upon the ground of burdensomeness. However, the courts have required only that the cost of compliance not be unreasonably burdensome and have stated that this burden is "not easily met".[74] Generally, the courts consider the cost of subpoena compliance to be a cost of conducting a regulated business.[75]

Indefiniteness and vagueness are also grounds upon which agency subpoenas may be attacked. In determining whether a subpoena is sufficiently specific, courts have applied the standard of reasonableness.[76]

Other judicially recognized defenses to subpoena enforcement include the attorney-client privilege, discussed in Part III *infra*, and bad faith on the part of the agency resulting in an abuse of process.[77] Some of the abuse of process cases have

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[69]U.S. v. Kis, 658 F.2d 526 (7th Cir. 1981) (because IRS' summons enforcement proceedings occur only at the investigative stage when guilt or liability is not at issue, proceedings are summary in nature). *See Port of Seattle*, 521 F.2d at 431, where the court, citing *Endicott Johnson Corp.*, 317 U.S. 501, stated: "[T]he Supreme Court has held that a district court's function in enforcing an administrative subpoena extends no further than to ascertain whether the information sought is 'not plainly incompetent or irrelevant to any lawful purpose' of the administrative authority . . . ." *See also* Donaldson v. U.S., 400 U.S. 517 (1971).

[70]*See U.S. v. Fensterwald*, 553 F.2d 231, 232 (D.C. Cir. 1977); *U.S. v. McCarthy*, 514 F.2d 368, 373-76 (3d Cir. 1975).

[71]*See Endicott Johnson Corp.*, 317 U.S. 501; *SEC v. Arthur Young & Co.*, 584 F.2d 1018; *Moore Business Forms v. FTC*, 307 F.2d 188, 189 (D.C. Cir. 1962).

[72]555 F.2d 862, 874 (D.C. Cir.), *cert. denied*, 431 U.S. 974 (1977).

[73]*Id.* at 874.

[74]*See Brigadoon Scotch Distributing Co.*, 480 F.2d at 1055; *Arthur Young & Co.*, 584 F.2d at 1031; *U.S. v. Continental Bank*, 503 F.2d at 45 (10th Cir. 1974).

[75]*Arthur Young & Co.*, 584 F.2d at 1033.

[76]*E.g.*, *Oklahoma Press*, 327 U.S. at 209; *SEC v. Savage*, 513 F.2d 188, 189 (7th Cir. 1975).

[77]*See* U.S. v. Powell, 379 U.S. 48 (1964) for a discussion of abuse of process in enforcing agency subpoenas. In U.S. v. LaSalle Bank, 437 U.S. 298, 316 (1978), the Supreme Court stated that the burden of proving bad faith "is a heavy one."

involved allegations of bad faith resulting from improper political interference with the agency investigation.[78] Abuse of process also has been relied upon in cases where an agency has issued a civil summons after it has referred a matter to the Department of Justice for criminal prosecution or while the person was the subject of a parallel criminal proceeding. *U.S. v. Kordel*[79], *SEC v. Dresser Industries, Inc.*[80].

In the context of an Internal Revenue Service investigation, it has been held that the IRS acted improperly by issuing a civil subpoena *solely* for the purpose of obtaining criminal discovery. *U.S. v. LaSalle Nat'l Bank*,[81]; *Donaldson v. U.S.*,[82].

The *Dresser* decision, which is an SEC case, is a striking departure from *LaSalle* and other abuse of process cases which preceded *LaSalle* and which were also IRS cases. In *Dresser*, the court enforced the SEC's civil subpoena even though the SEC had already transmitted its file regarding the company being investigated to the Department of Justice. The court distinguished *LaSalle* on the basis of the difference in the statutory schemes: under the Internal Revenue Code, once a referral is made to the Department of Justice, the IRS' civil authority ceases; the SEC's civil authority, on the other hand, continues even after the referral.[83] Noting the overlap in the securities laws between the civil and criminal statutes and the need for prompt and possibly simultaneous action by both the Department of Justice and the SEC, the court in *Dresser* held that parallel proceedings were not objectionable *per se* absent substantial prejudice to the rights of the parties involved.[84]

Finally, there are a number of cases concerning allegations of wrong-doing or impropriety on the part of the agency or its staff.[85]

In sum, in subpoena enforcement actions, courts have recognized that investigations are not nor do they result in adjudications and have, as a consequence, limited their inquiry to a determination that the investigation has a legitimate

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[78]For example, FTC v. Standard Oil Co., 449 U.S. 232 (1980) and SEC v. Wheeling-Pittsburgh Steel Corp., 482 F.Supp. 555 (W.D.Pa. 1979), *aff'd* 648 F.2d 118 (3d Cir. 1981) (en banc), involved claims that the investigation (and, in *Standard Oil*, the complaint) was initiated in bad faith for political reasons. Although the specific issue addressed by the Supreme Court in *Standard Oil* was whether the issuance of a complaint by the FTC was "final agency action" and therefore subject to judicial review (the court decided that it was not), the issue of improper political influence of the agency's decision to initiate the complaint was raised by Standard Oil and discussed by the Court.

In the Wheeling-Pittsburgh case, the SEC initiated an investigation after it had received a request from a United States Senator for an investigation of Wheeling-Pittsburgh. Although finding that Wheeling-Pittsburgh had not shown bad faith on the part of the SEC, the district court nevertheless declined to enforce the subpoena on the ground that the SEC had permitted its investigatory function to be abused. That decision was reversed by the Court of Appeals for the Third Circuit on a finding that the SEC had itself acted in good faith regardless of the motives of third persons. Thereafter, the Third Circuit vacated the opinion of the panel and issued a decision *en banc*. In its decision, the court determined that acquiescence by an agency in the abuse of its process could result in an abuse of the court's process, 648 F.2d at 125, and remanded for evidence that the agency had in fact failed to consciously and objectively evaluate the allegations of wrong-doing. *Id.* at 127-128.

[79]397 U.S. 1 (1970).

[80]453 F. Supp. 573 (D.D.C. 1978), *aff'd.*, 628 F.2d 1368 (D.C. Cir.) (en banc).

[81]437 U.S. 298, 316, 318 (1978).

[82]400 U.S. 517, 526 (1971).

[83]*Dresser*, 628 F.2d at 1374. The statutes administered by the Commission are similar in this regard to those administered by the SEC. *E.g.*, § 20(a) of the NGA, 15 U.S.C. § 717s(a) (1982); § 504(b)(1) and (5) of the NGPA, 15 U.S.C. § 3414(b)(1) and (5) (1982); § 314(a) of the FPA, 16 U.S.C. § 825m(a) (1982).

[84]*Dresser*, 628 F.2d at 1374.

[85]*See, e.g.*, SEC v. Gulf & Western Industries, Inc., C.A. No. 79-3201 (D.D.C.) (Parker, J.) (defendants alleged, *inter alia*, a violation of attorney-client privilege and leaks of confidential information to the press); *McCarthy*, 514 F.2d 368 (defendants alleged that the agency summons was issued for purposes of harrassment); U.S. v. Tweel, 550 F.2d 297 (5th Cir. 1977) (defendant alleged that an IRS agent had intentionally misled a taxpayer); SEC v. ESM Gov't. Securities, Inc., 645 F.2d 310 (5th Cir. 1981) (ESM alleged that SEC staff had obtained ESM's consent to be searched based on fraud, trickery or deceit).

may be very difficult to establish the required element of confidentiality.[96] One court of appeals has stated that "[i]t is not asking too much to insist that if a client wishes to preserve the privilege . . . he must take some affirmative action to preserve confidentiality."[97] The court held that the element of confidentiality had not been established where assertedly privileged documents were treated in the same manner as all other corporate records, and were accessible to, but not viewed by, independent auditors.[98]

One court, however, has taken a more pragmatic view in a recent decision addressing this issue.[99] The District Court for the District of Delaware held that, although the failure to segregate assertedly privileged documents from general corporate records made it more likely that "unauthorized corporate personnel" might purposely or inadvertently read the assertedly privileged documents, that likelihood would not render the documents non-confidential.[100] The court stated that a contrary holding would be to require corporations to maintain two sets of files and to maintain procedures for the review of every document generated for the purpose of determining in which set of files the document should be placed. The court stated that "[s]uch a system is neither practical nor in . . . [its] opinion required by case law."[101]

The court's analysis is subject to criticism because the suggestion that the viewing of assertedly privileged documents by "unauthorized corporate personnel" would not render the documents non-confidential is misplaced. The failure to segregate the assertedly privileged documents would seem to make it equally likely that unauthorized *non*-corporate personnel (such as independent accountants and auditors) might view the documents, which would clearly render the documents non-confidential.

2. *The Scope of the Privilege – What Communications Are Protected?*

The purpose of the attorney-client privilege is to promote the uninhibited and unfettered communication by a client to his or her atorney so as to enable the attorney to provide informed legal advice.[102] However, whether communications from the attorney to the client are protected by the privilege is an issue upon which the courts differ.

Some courts have taken a more restricted view of the privilege as it applies to communications from attorneys to clients, and have held that the privilege applies

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[96]*See In re Grand Jury Proceedings Involving Berkley & Co.*, 466 F.Supp. 863; U.S. v. Kelsey-Hayes Wheel Co., 15 F.R.D. 461, 465 (E.D. Mich. 1954), where the court stated that "[i]t is difficult to be persuaded that these documents were intended to remain confidential in the light of the fact that they were indiscriminately mingled with the other routine documents of the corporation and that no special effort to preserve them in segregated files with special protections was made. One measure of their continuing confidentiality is the degree of care exhibited in their keeping, and the risk of insufficient precautions must rest with the party claiming the privilege." *Cf.* Dunn Chem. Co. v. Sybron Corp., 1975-2 Trade Cases (CCH) ¶ 60,561 at 67,461 (S.D.N.Y. 1975) (confidentiality preserved for correspondence between corporate vice president and house counsel where the letters, while "not completely segregated," were kept in the "personal dictate files" of the vice-president and "apparently were not openly available to just anyone, either within or without the corporation.")

[97]*In re Horowitz*, 482 F.2d 72, 81-82 (2d Cir.), *cert. denied*, 414 U.S. 867 (1973).

[98]*Id. See also* Advisory Committee's Note to Proposed Federal Rule 503(a)(4) ("taking or failing to take precautions may be considered as bearing on intent" to preserve confidentiality).

[99]James Julian Inc. v. Raytheon Co., 1982-1 Trade Cases (CCH) ¶ 64,599 (D. Del. 1982).

[100]*Id.* at pp. 73,250-73,251.

[101]*Id.* at p. 73,251.

[102]*See, e.g.*, Fisher v. U.S., 425 U.S. 391, 403 (1976); *cf.* Upjohn Co. v. U.S., 449 U.S. 383 (1981).

only to communications which disclose client confidences;[103] other courts have taken a broader view. The Court of Appeals for the District of Columbia Circuit, for example, has stated that "[a]s applied in the federal courts . . . the privilege has consistently included communications of the attorney to the client as well as *vice versa*."[104] In another case, the same court offered the following explanation for its rationale for adopting the broader view:

> While [the purpose of the attorney-client privilege] is to protect a *client's* disclosures to an attorney, the federal courts extend the privilege also to an attorney's written communications to a client, to ensure against inadvertent disclosure, either directly or by implication, of information which the client has previously confided to the attorney's trust. (footnote omitted) (emphasis in original).[105]

Because the effect of the privilege is to withhold information from the fact finder, the privilege should be construed as narrowly as possible,[106] and should be applied only where necessary to achieve its purpose.[107] At least one court has analyzed the issue in the context of these limiting principles and concluded that the privilege should not extend to communications from attorney to client which are ". . . demonstrably based upon facts which did not come from the client in confidence."[108]

The impact of *Upjohn Co. v. U.S.*[109] upon the extent to which the privilege attaches to communications from attorneys to clients is unclear. In *Upjohn*, the Court rejected a limitation upon those corporate employees who may be "clients" for purposes of the privilege because the limitation would threaten ". . . the valuable efforts of corporate counsel to ensure their clients' compliance with the law."[110] On the one hand, it could be argued that attorneys would be better able to insure clients' compliance with the law if the privilege extended to all communications from attorneys to clients. On the other hand, it could be argued that, so long as client confidences are protected, any such benefit is outweighed by the limiting principles described above.

3. *Waiver*

Of significant interest to persons and entities subject to the jurisdiction of the Commission are two recent court of appeals decisions addressing the issue of waiver of the attorney-client privilege. One decision dealt with the issue of waiver where privileged information was voluntarily made available by a corporation to an auditor and underwriter in an effort to facilitate approval of a public securities offering, and allegedly to comply with the corporation's legal duty to exercise due diligence in connection with the offering. Another recent decision dealt with the issue of waiver where privileged information was voluntarily made available by a corporation to the

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[103] *In re Fischel*, 557 F.2d 209 (9th Cir. 1977); *Colton v. U.S.*, 306 F.2d 633, 639 (2d Cir. 1962), *cert. denied*, 371 U.S. 951 (1963; *In re Ampicillin Antitrust Litigation*, 81 F.R.D. 377, 387-90 (D.D.C. 1978); *see also* FTC v. TRW, Inc., 628 F.2d 207 (D.C. Cir. 1980).

[104] Mead Data Central, Inc. v. U.S. Department of Air Force, 566 F.2d 242, 254 n.25 (D.C. Cir. 1977); *accord*, U.S. v. Amerada Hess Corp., 619 F.2d 980, 986 (3d Cir. 1980).

[105] Coastal States Gas Corp. v. Department of Energy, 617 F.2d 854, 862 (D.C. Cir. 1980); *accord* Attorney General of the U.S. v. Covington & Burling, 430 F.Supp. 1117, 1121 n.1 (D.D.C. 1977).

[106] u J. Wigmore, Evidence § 2291 (McNaughton rev. 1961); *In re Grand Jury Investigation*, 599 F.2d 1224, 1235 (3d Cir. 1979); Diversified Industries, Inc. v. Meredith, 572 F.2d 596.

[107] Fisher v. U.S., 425 U.S. at 403; Cohen v. Uniroyal, Inc., 80 F.R.D. at 483.

[108] SCM Corp. v. Xerox Corp., 70 F.R.D. 508, 523 (D. Conn. 1976), *appeal dismissed*, 534 F.2d 1031 (2d Cir. 1976).

[109] 449 U.S. 383 (1981).

[110] *Id.* at 392.

Securities and Exchange Commission, to expedite SEC approval of a proposed exchange offer, pursuant to an agreement which afforded the corporation the opportunity to raise claims of privilege prior to disclosure of the information by the SEC to third parties. In both cases, the privilege was held to have been waived.

The first case, *In re John Doe Corp.*[111], involved a grand jury investigation of a corporate payment purporting to be a payment of a legal fee, but which was suspected of being a payment of a bribe. In connection with a proposed public offering of the corporation's securities, a report of questionable corporate payments (which did not specifically mention the suspected bribe), prepared by in-house and outside counsel, was disclosed to the underwriter. In addition, specific disclosures regarding the suspected bribe were made by the corporation's general counsel to the corporation's independent auditors. When the corporation did not produce, in response to a grand jury subpoena, early drafts of the report (which had specifically mentioned the suspected bribe) and the general counsel's memoranda of interviews with employees concerning the suspected bribe, a judgment of civil contempt was entered against the corporation.

On appeal, the United States Court of Appeals for the Second Circuit held that the privilege had been waived as a result of the disclosures to the independent auditors and the underwriter.[112] The Court rejected the arguments that disclosure had been made to the auditors for the purpose of securing legal advice[113] and that disclosure to the underwriter was required by the legal duty of due diligence.[114] In this regard, of particular importance to business entities, including those subject to the jurisdiction of the Commission, is the court's reasoning that if privileged information is disclosed for a commercial purpose, no matter what the legal requirements may be, the privilege is lost.[115]

The second case, *Permian Corp. v. U.S.*[116], involved privileged documents which had been disclosed by a corporation to the SEC to expedite approval of a proposed exchange offer. The documents were disclosed pursuant to an agreement which afforded the corporation the opportunity to raise claims of privilege prior to disclosure of the documents by the SEC to third parties. Subsequently, the corporation attempted to prevent dissemination of the documents by the SEC to the United States Department of Energy.

The United States Court of Appeals for the District of Columbia held that the privilege had been waived by the disclosure of the documents by the corporation to the SEC,[117] and specifically rejected the argument that disclosure of the documents to the SEC constituted only a "limited waiver".[118] It has been the policy of

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[111]675 F.2d 482 (2d Cir. 1982).

[112]*Id.* at 489.

[113]Where the disclosure of confidential information is made to an accountant as a necessary aid to the rendering of effective legal advice, the attorney-client privilege is not waived. *See* United States v. Cote, 456 F.2d 142, 144 (8th Cir. 1972); United States v. Kovel, 296 F.2d 918, 921, (2d Cir. 1961). However, statements to accountants unrelated to the seeking of legal advice are not privileged. *See In re Horowitz,* 482 F.2d at 72.

[114]*John Doe Corp.*, 675 F.2d at 489. With respect to the report of questionable payments, the court also held that the privilege did not apply because the report was part of an ongoing scheme to cover up the suspected bribe. 675 F.2d at 491-492.

[115]*Id.* at 489.

[116]665 F.2d 1214 (D.C. Cir. 1981).

[117]*Id.* at 1219-1220.

[118]*Id.* at 1220-1221. It is important to note that the court, by way of *dicta,* quoted with approval from its earlier decision in U.S. v. AT&T, 642 F.2d 1285 (D.C. Cir. 1980) for the proposition that, although a voluntary disclosure of privileged information to a third person will generally suffice to waive the attorney'client privilege, it should not in itself suffice to waive the work-product immunity.

Enforcement that it will not accept documents assertedly covered by the attorney-client privilege pursuant to any agreement which purports to preserve the privilege.

B. *Reliance Upon Advice of Counsel*

Although reliance upon the advice of counsel is often referred to as a "defense", that term is inaccurate because proof of such reliance is not a complete defense.[119] Rather, proof of reliance upon the advice of counsel is permitted to establish that a defendant acted in good faith[120] or with due care[121], where proof of a breach of either standard is an element of the claim.[122] Simply stated, proof of reliance is relevant to establishing the defenses of good faith and due care, although reliance in and of itself is not a defense to a claim. For example, proof of good faith would be relevant to the issue of whether a violation is a "knowing" violation of the Natural Gas Policy Act of 1978.[123] Proof of reliance is also relevant to the question of appropriate relief where liability has been established.[124]

The assertion of reliance upon the advice of counsel is important in the investigative setting in several respects. First, it may prevent the attorney who rendered the advice from representing the client in any subsequent action or proceeding.[125] Second, it results in a waiver of the attorney-client privilege.[126] Third, it follows, that the privilege is waived with respect to every element which must be proved to establish the reliance, and each element is therefore properly within the scope of the investigation. The elements which must be proved are: (1) the selection by the client of a competent and disinterested attorney; (2) a complete disclosure of all relevant facts by the client to the attorney; (3) a request by the client for the attorney's advice on the legality of the proposed conduct; (4) receipt by the client of the attorney's erroneous advice that the proposed conduct was lawful; and (5) action by the client in accordance with the advice after it was received.[127]

The following questions, which are by no means exhaustive of the subject, would clearly be appropriate areas for investigative inquiry where reliance upon the advice of counsel has been asserted.

(1) Competency and Disinterest.

Was the attorney a member of the bar?

In what jurisdiction(s) was the attorney admitted to practice?

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[119]U.S. v. Finance Comm. to Re-Elect the President, 507 F.2d 1194, 1198 (D.C. Cir. 1974).

[120]*E.g.*, Linden v. U.S., 254 F.2d 560, 568 (4th Cir. 1958).

[121]*E.g.*, Gilbert v. Burnside, 216 N.Y.S. 2d 430, 432 (Sup. Ct. 1961), *aff'd* 229 N.Y.S. 2d 10 (1962), *appeal dismissed*, 281 N.Y.S. 2d 108 (1967).

[122]It follows that, where a statute imposes strict liability, and proof of good faith or standard of care is irrelevant, so is proof of reliance upon the advice of counsel. *E.g.*, Haynes v. Logan Furniture Mart, Inc., 503 F.2d 1161, 1167 (7th Cir. 1974).

[123]Section 504(b) of the NGPA, 15 U.S.C. § 3414(b)(6)(A) (1982), provides for the notice and assessment of civil penalties for, among other things, "knowing" violations of the statute.

[124]*E.g.*, SEC v. Harwyn Industries Corp., 326 F.Supp. 943 (S.D.N.Y. 1971).

[125]DR 5-102 of the Disciplinary Rules of the Code of Professional Responsibility; *cf.*, Rule 3.y of the Model Rules of Professional Conduct (Final Draft), Supplement to 68 A.B.A.J. (Nov. 1982).

[126]*E.g.*, Panter v. Marshall Freed & Co., 80 F.R.D. 718, 721, (N.D. Ill. 1978); Handguards, Inc. v. Johnson & Johnson, 413 F.Supp. 926, 932-3 (N.D. Cal. 1976); International Telephone & Telegraph Corp. v. United Telephone Co. of Florida, 60 F.R.D. 177 (M.D. Fla. 1973).

[127]*Hawes & Sherrard, Reliance on Advice of Counsel As A Defense in Corporate and Securities Cases*, 62 Va. L. Rev. 1 (1976), and numerous cases cited therein.

The nature of the attorney's practice.

The attorney's area of specialization, if any.

Did the attorney have any personal stake or interest in the subject matter of the advice?[128]

Was the attorney an in-house or an outside counsel?[129]

(2) Full Disclosure.

Was the disclosure made orally or in writing?

What was disclosed?

Did the attorney seek additional information or clarification of information provided? If so, what additional information was provided?

(3) Request for Advice.

Was the request made orally or in writing?

What was the nature of the request?

(4) The Advice.

Was the advice given orally or in writing?[130]

Was the advice clear and unambiguous?

Was the advice substantiated?[131]

Was the advice preliminary or final?[132]

Was the advice qualified or unequivocal?[133]

Did the client understand the advice?

Were there any subsequent communications between the attorney and the client concerning the advice?

(5) Reliance.

Did the client engage in the proposed conduct upon which he sought advice?

Did the client follow or deviate from the advice?

IV. SETTLEMENTS

A. Negotiations

Upon the completion of a preliminary or formal investigation and where Enforcement has concluded that a civil violation of law has occurred, Enforcement

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[128]*E.g.*, U.S. v. Finance Comm. to Re-Elect the President, 507 F.2d at 1198; U.S. V. Piepgrass, 425 F.2d 194 (9th Cir. 1970).

[129]Arthur Lipper Corp. v. SEC, 547 F.2d 171, 181-182 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).

[130]It has been suggested that because oral advice is less formal than written advice, it is entitled to less reliance. *Hawes & Sherrard*, 62 Va. L. Rev. at 33.

[131]*E.g.*, SEC v. M.A. Lundy Associates, 362 F.Supp. 226, 233 (D.R.I. 1973).

[132]*Id.* at 233.

[133]*See, e.g.*, Mead Johnson & Co. v. Baby's Formula Service, Inc., 402 F.2d 19, 22 (5th Cir. 1968).

will inquire whether the person or company under investigation desires to enter into settlement negotiations.[134]

If settlement negotiations are commenced, the negotiations are usually conducted pursuant to a written confidentiality agreement between Enforcement and the person or company under investigation. The agreement serves, among others, two important purposes. First, it governs the admissibility in evidence in any subsequent proceeding or action of documents disclosed and statements made during the course of the negotiations.[135] Second, in appropriate situations, the agreement governs the dissemination by the person or entity under investigation to third parties of documents disclosed and statements made during the course of the negotiations.[136] In appropriate circumstances, Enforcement may also require the written agreement of the person or company under investigation that all applicable statutes of limitations are tolled during the pendency of the negotiations.[137]

Enforcement has a number of "ground rules" which apply to all settlement negotiations. First, Enforcement will not negotiate any aspect of any potential criminal liability on the part of the person or company under investigation.[138] Second, Enforcement will negotiate and enter into only a settlement agreement which it will recommend that the Commission approve. The recommendation, however, is not binding upon the Commission, which may approve or reject the settlement agreement, or request that it be modified.[139]

With regard to substantive provisions of settlement agreements which it will recommend that the Commission approve, Enforcement has a number of policies from which it will not deviate. Most importantly, such agreements must contain:

a. An admission by the person or company under investigation of all relevant facts; and
b. A provision that the agreement in no way limits the Commission's ability to provide information secured during the course of the investigation to other governmental departments and agencies.

Enforcement will neither enter into nor recommend that the Commission approve any proposed settlement agreement which contains a statement by which the person or company under investigation either "denies" civil violations of law or

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[134]Enforcement is not required to secure Commission authorization to enter into settlement negotiations.

[135]Enforcement's confidentiality agreements typically provide that the issue of the admissibility in evidence in any subsequent proceeding or action of documents disclosed and statements made during settlement negotiations is governed by Rule 408 of the Federal Rules of Evidence.

[136]Enforcement may deem it necessary, where more than one person or company is under investigation, that the agreement provide that documents disclosed and statements made during settlement negotiations will not be disclosed to third persons.

[137]Such agreements generally provide for termination only upon written notice to Enforcement.

[138]The Commission's jurisdiction with respect to potential crimes is limited to transmitting evidence of possible crimes to the Attorney General of the United States. *E.g.*, § 20(a) of the NGA, 15 U.S.C. § 717s(a) (1982); § 504(b)(5) of the NGPA, 15 U.S.C. § 3414(b)(5) (1982); § 314(a) of the FPA, 16 U.S.C. § 825m(a) (1982).

[139]In this regard, settlement agreements between Enforcement and the person or company under investigation generally contain a provision that makes the agreement null and void unless approved without modification by the Commission.

"does not admit" civil violations of law.[140] In appropriate circumstances, Enforcement may recommend approval of a settlement agreement containing the statement that the person or company under investigation "neither admits nor denies" all violations of law.[141] In other circumstances, Enforcement may insist that the person or company under investigation admit civil violations of law.

B. Recent Settlements

A number of settlements recently approved by the Commission reflect the policies described above and provide examples of methods by which the Commission has sought to accomplish its enforcement objectives.

Recent settlements have included the entry of judgments in federal district courts permanently enjoining certain violations of law,[142] and enjoining violations of law for a limited period of time.[143] The Commission also has recently approved settlements including Commission orders prohibiting certain conduct for a limited period of time.[144] Recent settlements have included the payment of substantial amounts of civil penalties.[145]

Approved by the Commission recently was a comprehensive settlement with Conoco Inc.[146] Among other things, Conoco agreed to the entry of a federal district court injunction enjoining Conoco from failing to comply with certain Commission orders under the Natural Gas Act.[147] In order to assure future compliance, Conoco acknowledged that it had established and agreed to maintain procedures for compliance with the Commission orders.[148] As part of its procedures, Conoco acknowledged that it had designated and agreed to retain personnel with sufficient training and available work hours to be responsible for discharging Conoco's obligations under the Commission orders.[149]

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[140]An explanation of the policy underlying Enforcement's position is the same as that set forth in § 202.5(e) of the SEC's rules relating to Informal and Other Procedures, 17 C.F.R. § 202.5(e) (1982), which provides as follows:

> The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur. Accordingly, it hereby announces its policy not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.

Section 1a.12(c) of the Commission's Proposed Rules Relating to Investigations, FERC Statutes and Regulations, ¶ 32,013, provides as follows:

> In connection with any decree or sanction to be entered or imposed in any civil lawsuit or administrative proceeding of an accusatory nature brought by the Commission, the Commission will not accept a defendant or respondent to consent to a judgment or order that imposes a sanction while denying allegations contained in the complaint for injunctive relief or the order for administrative proceedings.

[141]*Id.*

[142]Tenneco Inc., 21 FERC ¶ 61,011.

[143]Conoco Inc., 20 FERC ¶ 61,306.

[144]Sun Exploration and Production Company, 21 FERC ¶ 61,009; Atlantic Richfield Company, 21 FERC ¶ 61,010.

[145]*Id.*

[146]20 FERC ¶ 61,306.

[147]*Id.*

[148]*Id.*

[149]*Id.*

A recent Commission order approving a settlement with Paul E. Cameron, Jr., Inc.[150] marked the first occasion upon which civil penalties under the NGPA have been paid for the filing of an application for well category determination containing an untrue statement of material fact.[151] Although the NGPA does not expressly make the filing of such an application a violation of the statute, the Commission relied upon the well-settled principle that the filing of a document containing an untrue statement of material fact constitutes a violation of the statutory provision pursuant to which the document was filed.[152] Pursuant to that settlement, and in order to insure future compliance, Cameron also acknowledged that it had employed additional qualified persons to assist in complying with certain requirements of the NGPA, including legal counsel to review and monitor certain of its future filings.[153]

V. Conclusion

It has now been a little more than five years since the Commission first established a separate, formal enforcement function. The Commission and its predecessor had at that time been in existence for more than forty years. There were many who thought that the Commission and the industry had functioned quite well without, and that the public interest did not require the establishment of, a separate, formal enforcement function.

The Commission thought otherwise. In Opinion 41, it set forth some of its reasons:

> [T]he practice of referring administrative questions of prosecutorial discretion to administrative law judges for resolution on the basis of evidence, that the Commission's staff was constrained to gather in public was not conducive to effective enforcement.
>
> The entire modus operandi was marked by what some students of the administrative process have called 'overjudicialization'. What should have been, and what the Congress doubtless meant to be, an effective law enforcement agency and an aggressive guardian of the public interest became a kind of utility court that devoted itself to the passive decision of cases.[154]

In 1979 the first director of the then Office of Enforcement looking back at the first few years of the office's existence, wrote that "while the foundation of change has been laid, substantial work remains."[155] That was, and in some respects is, still true. It could not realistically have been otherwise. Yet in significant ways Enforcement at the Commission has come of age and has demonstrated its effectiveness.[156]

Self-implementing regulations are becoming the rule rather than the exception at the Commission. In adopting this approach to regulation, the Commission must insist more than ever upon the integrity of its processes. A strong and effective enforcement program is the most meaningful method by which the Commission may encourage self-policing by the entities it regulates.

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[150]21 FERC ¶ 61,003.

[151]Section 503(d) of the NGPA, 15 U.S.C. § 3413(d) (1982).

[152]*See, e.g.*, SEC v. Savoy Industries, Inc., 587 F.2d 1149 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979); GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972).

[153]21 FERC ¶ 61,003, Stipulation and Consent Agreement, Section II, paragraph O.

[154]7 FERC ¶ 61,258 at p. 61,538.

[155]Marston and Hollis, *A Review and Assessment of the FERC Natural Gas Enforcement Program*, 16 Hous. L. Rev. 1105, 1126-1127 (1979).

[156]*See supra* note 1.