

THE FERC ENFORCEMENT PROCESS

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Synopsis: It has been nearly a decade since Congress passed the Energy Policy Act of 2005 (EPAcT 2005), which established new authorities and tools for the Federal Energy Regulatory Commission (FERC) to police energy market manipulation. Over the ensuing years, FERC has issued policies and procedures to implement that new authority, developed a robust Office of Enforcement, and standardized its enforcement process to ensure fairness and transparency for all investigative subjects.

A few practitioners who have represented investigative subjects have, in an article recently published in this *Journal*, proposed changes to FERC's enforcement process and its market manipulation authority. Particularly in agencies like FERC, which are charged with investigating complex markets, constructive suggestions for improvement are welcome. But this review shows why the proposed reforms are unnecessary. The context for this discussion includes the history behind EPAcT 2005 to understand Congress' direction to the Commission on both process and market manipulation matters, a complete review of the steps in our process, and an analysis of FERC's process compared to its counterpart at other independent agencies.

The Commission's goal is to carry out a fair, effective enforcement program. This comprehensive review of FERC's recent history and process will show how the Enforcement program is designed and implemented to fulfill those goals of fairness and effectiveness.

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In the wake of the Western Energy Crisis and the 2003 Northeast Blackout, Congress gave the Federal Energy Regulatory Commission (FERC) significant new authority to police the energy markets and enforce mandatory reliability standards. Congress also enhanced penalty authorities to ensure that adequate sanctions can be levied for unlawful conduct. FERC has implemented this new authority by, among other things, strengthening its Office of Enforcement, developing enhanced procedures to govern enforcement investigations, and increasing its capability to monitor market behavior and grid operations. Those efforts are succeeding—the Commission has uncovered numerous manipulative schemes in the past few years, returned ill-gotten funds to consumers and market participants harmed by unlawful conduct, assessed appropriate penalties to deter such conduct, and improved compliance throughout the industry.

Some FERC practitioners who have represented investigative subjects, however, have challenged the Commission's enforcement efforts and proposed significant changes. The Commission has shown consistently since 2005 that it is open to considering improvements to its enforcement processes. However, the recently-proposed changes are unnecessary in light of Enforcement staff's actual practice, would be inconsistent with practices at other regulatory agencies, and if implemented, would undermine the Commission's continuing effort to protect consumers.

One such set of changes was proposed in an article (the Article) published by the *Energy Law Journal* earlier this year.¹ This response offers some context for the Commission's current approach to enforcement and responds to the most substantial criticisms and proposed changes in the Article. As attorneys in the Commission's Office of Enforcement, we know the Office welcomes feedback and believes that the Commission should always consider constructive suggestions for reform. But many of the particular changes suggested by the Article are misguided, and the analyses offered in support of them rely on fundamental mischaracterizations of the investigation process in general and the specific policies and practices of the Commission and other regulatory agencies. This response begins by providing background regarding FERC's enforcement mission and its investigative process. Using that background, it then identifies two fundamental errors in the Article and shows how those errors undermine the Article's criticisms and proposals for reshaping FERC's enforcement program. Finally, it responds to the Article's substantive discussion of FERC's prohibition of energy market manipulation.

* * * * *

I. INTRODUCTION

When the Commission created its enforcement office in 1978, it vested that office with broad investigatory powers, deliberately rejecting the more limited approach that had been taken by its predecessor agency, the Federal Power Commission (FPC). The FPC conducted all of its investigations through formal adjudicatory hearings before administrative law judges with the full set of procedures associated with trials.² The Commission determined that this formal approach made it unduly difficult to develop an effective investigatory record, and criticized the FPC's approach for failing to "redress the gross informational imbalance between counsel for the public interest, on the one hand, and their private sector adversaries on the other."³ Accordingly, FERC rejected the suggestion by some in industry that it should adopt the FPC model or otherwise cabin the powers of the new Office of Enforcement (Enforcement).⁴ In support of this decision, the Commission noted that its investigatory rules "are similar to rules . . . used by other Federal agencies with regulatory mandates similar to those of the Commission," and that "[r]egulations used by those agencies have been in

1. William Scherman, Brandon Johnson & Jason Fleischer, *The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms*, 35 ENERGY L.J. 101 (2014) [hereinafter Article].

2. Marilyn L. Doria & Gary Lloyd, *Enforcement at the Federal Energy Regulatory Commission: Considerations for the Practitioner*, 4 ENERGY L.J. 39, 42 (1983); Philip M. Marston & Sheila S. Hollis, *A Review and Assessment of the FERC Natural Gas Enforcement Program*, 16 HOUS. L. REV. 1105, 1115-16 (1979).

3. Opinion and Order Clarifying and Reaffirming Prior Orders Directing a Private Investigation and Suspending a Related Adjudicatory Proceeding at 10, FERC Docket Nos. CI77-298, IN79-3 (June 13, 1979). See also *id.* at 11 ("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 [the FPC] became a kind of utility court that devoted itself to the passive decision of cases.").

4. See *id.*; see also Notice of Proposed Rulemaking, Rules Relating to Investigations, 44 Fed. Reg. 21,586, 21,586-87 (Apr. 10, 1979) (codified at 18 C.F.R. pt. 1b).

use for a number of years, and are promulgated under statutory authority similar to that provided by the statutes administered by the Commission.”⁵

A. *Early Enforcement by the Commission*

The Commission carried out its enforcement mission using those same basic investigatory rules over the next two decades, and it did so with relatively little controversy. However, that mission became much more complicated after the wholesale electric power industry and natural gas industry were restructured and their services were unbundled in the 1990s and 2000s.⁶ Enforcement staff had to address a new set of enforcement challenges coming from new market players (including sophisticated energy traders), electronic trading tools and platforms, and new markets involving both physical and novel financial products related to the power and natural gas industries. Enforcement staff, and the Commission as a whole, had to adjust to those new challenges.

The Commission lacked the regulatory tools and resources necessary to keep up with the changes in the industries it regulated,⁷ and traders at Enron and other companies developed manipulation schemes that took advantage of the Commission’s limited capabilities.⁸ In addition, some companies did not make the investments in safety and reliability that were necessary to ensure proper functioning of the power grid.⁹ These dynamics led to serious economic losses and rolling blackouts during the Western Energy Crisis of 2000-2001 and the massive Northeast Blackout in August 2003. Those two events led the

5. Rules Relating to Investigations, 43 Fed. Reg. 27,174, 27,175 (June 23, 1978) (codified at 18 C.F.R. pt. 1b).

6. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation under Part 282 of the Commission’s Regulations and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 59 F.E.R.C. Stats. & Regs. ¶ 61,030, *order on reh’g*, Order No. 636-A, 60 F.E.R.C. Stats. & Regs. ¶ 61,102, *order on reh’g*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272 (1992), *order on reh’g*, 62 F.E.R.C. ¶ 61,007 (1993), *aff’d in part and remanded in part sub nom.* United Distribution Cos. v. FERC, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 F.E.R.C. ¶ 61,186 (1997); Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, F.E.R.C. Stats. & Regs. ¶ 31,036 (1996), *order on reh’g*, Order No. 888-A, F.E.R.C. Stats. & Regs. ¶ 31,048, *order on reh’g*, Order No. 888-B, 81 F.E.R.C. ¶ 61,248 (1997), *order on reh’g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046 (1998), *aff’d in relevant part sub nom.* Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom.* New York v. FERC, 535 U.S. 1 (2002).

7. See, e.g., Jeff Gerth & Richard A. Oppel, Jr., *Regulators Struggle With a Marketplace Created by Enron*, N.Y. TIMES (Nov. 10, 2001), <http://www.nytimes.com/2001/11/10/business/regulators-struggle-with-a-marketplace-created-by-enron.html?pagewanted=print> (quoting then-Chairman Wood as acknowledging that “the agency had ‘a long way to go’ in matching the sophistication of the companies it regulate[d].”); *id.* (quoting then-Representative Edward Markey as describing the regulatory situation at that time as “a supersonic-speed era of electronic trading with a horse-and-buggy-era regulatory system to protect consumers”).

8. See generally FERC STAFF, FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS: FACT-FINDING INVESTIGATION OF POTENTIAL MANIPULATION OF ELECTRIC AND NATURAL GAS PRICES, FERC Docket No. PA02-2-000 (Mar. 26, 2003), available at <http://www.ferc.gov/legal/maj-ord-reg/land-docs/PART-I-3-26-03.pdf>.

9. See, e.g., U.S.-CANADA POWER SYSTEM OUTAGE TASK FORCE, FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT IN THE UNITED STATES AND CANADA: CAUSES AND RECOMMENDATIONS 17-22 (2004), available at <http://energy.gov/sites/prod/files/oeprod/DocumentsandMedia/BlackoutFinal-Web.pdf>.

Commission¹⁰—and ultimately Congress—to rethink its approach to enforcement and to obtain the tools necessary to protect consumers in the rapidly-changing electricity and natural gas industries.

B. *Post-Enron Congressional Push for Robust Enforcement*

In the immediate aftermath of Enron’s manipulative schemes, Congress demanded that the Commission take its enforcement responsibilities in a “far bolder” direction.¹¹ The Senate Governmental Affairs Committee undertook an investigation of FERC’s oversight role of Enron, telling then-Chairman Patrick Wood III at a hearing that, “Members of both parties on the Committee [share the interest] that FERC learn . . . from the Enron scandal and . . . [be] as aggressive and sophisticated as the players out in the deregulated energy market”¹² The Committee’s lead witness summarized its report that, “most importantly, FERC must reorient itself to a changed and increasingly complex regulatory environment”¹³ At another one of the many Enron-related hearings, another Senate Committee told the Commission’s Chairman:

I hope that we are able to look back at your tenure, Mr. Wood, and say that you dramatically changed it, you had an emergency [brake], you had aggressive overseers, you were an aggressive regulator, you saw wrongdoing, and that you took action immediately. I hope that is the legacy you will leave at that agency.¹⁴

The Commission received the same message from committees in the House of Representatives, with the Chairman of the Subcommittee on Energy Policy challenging the Commission to send a “clear and unequivocal message about this kind of behavior not being tolerated.”¹⁵ About the same time, President Bush’s nominee to serve as a Commissioner, Joseph Kelliher, faced questions about the Commission’s enforcement role, especially about market manipulation, to which he responded, “The Federal Energy Regulatory Commission only has the tools

10. See, e.g., Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L. J. 1, 29-33 (2005). (The then-Commissioner of the Federal Energy Regulatory Commission, who became Chairman later that year, called for Congress to “strengthen the Commission’s penalty and [enforcement] authority”). *Id.* at 25.

11. *Examining Enron: Developments Regarding Electricity Price Manipulation in California: Hearing Before the Subcomm. on Consumer Affairs, Foreign Commerce & Tourism of the S. Comm. on Commerce, Science, and Transportation*, 107th Cong. 140 (2002) (statement of Sen. Wyden to Patrick Wood III, Chairman, Federal Energy Regulatory Commission) [hereinafter *Examining Enron*]; see also *id.* at 144 (statement of Sen. Byron Dorgan to Patrick Wood III, Chairman, Federal Energy Regulatory Commission, “[B]e a tiger . . .”).

12. *Asleep at the Switch: FERC’s Oversight of the Enron Corporation: Hearing Before the S. Comm. on Gov’t Affairs*, 107th Cong. 59 (2003) (statement of Joseph Lieberman, Chairman, Senate Committee on Governmental Affairs).

13. *Id.* at 18 (statement of David Berick, Professional Staff Member, Senate Committee on Government Affairs, “Had FERC proven more aggressive on any one of the fronts I have described in my testimony today, it might have unearthed Enron’s abuses sooner, perhaps mitigating the company’s collapse, protecting consumers from hardships, and competitors from Enron’s alleged market manipulations.”).

14. *Examining Enron*, *supra* note 11, at 135 (statement of Sen. Byron Dorgan, Chairman, Subcommittee on Consumer Affairs, Foreign Commerce and Tourism).

15. *California Energy Markets: Refunds and Reform: Hearing Before the Subcomm. on Energy Policy, Natural Resources and Regulatory Affairs of the H. Comm. on Gov’t Reform*, 108th Cong. 38 (2003) (statement of Rep. Doug Ose, Chairman, Subcommittee on Energy Policy, Natural Resources and Government Affairs).

that Congress chooses to give it, and Congress has never given the Commission express authority to prohibit market manipulation. I believe the time has come for Congress to take that step.”¹⁶

Also, the Bush Administration requested amendments to a pending energy bill to increase the Commission’s statutory authority to include meaningful *criminal* penalties under the Federal Power Act—heightened monetary fines and longer potential prison terms—as stronger deterrents to market manipulation and other violations.¹⁷

In 2005, Congress passed the Energy Policy Act (EPAAct 2005), which included some of those tougher penalties.¹⁸ Pushed by the Northeast Blackout of 2003 and market manipulation schemes in the west coast electricity market,¹⁹ EPAAct 2005 was not only an “overhaul [of] energy regulation” but it “dramatically changed the Federal Energy Regulatory Commission’s ability to enforce laws related to reliability and market manipulation.”²⁰ Specifically, EPAAct 2005 amended section 316A of the Federal Power Act (FPA), adding civil penalty authority of \$1 million per day per violation. Similarly, it revised the Natural Gas Act (NGA) to include the same civil penalty authority under section 22. Under

16. 149 CONG. REC. S13997 (daily ed. Nov. 5, 2003) (quoting Letter from Joseph Kelliher to Sen. Maria Cantwell, Nov. 5, 2003).

17. *Examining Enron*, *supra* note 11, at 118 (statement of Patrick Wood III, Chairman, Federal Energy Regulatory Commission):

The White House has requested that Congress, as part of the energy bill, increase criminal penalties under the Federal Power Act. Specifically, the White House proposes that the penalty for a willful and knowing violation of the FPA be increased from the current \$5,000 level to \$1 million and that the potential prison term be increased from two years to five years. For a violation of the Commission’s regulations under the FPA, the White House proposes to increase the penalty from \$500 per day to \$25,000 per day. These changes will provide stronger deterrents to anti-competitive behavior, market manipulation, and other violations of the FPA and Commission regulations.

18. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) [hereinafter EPAAct 2005].

19. *See, e.g.*, Tony Clark & Robin Z. Meidhof, *Ensuring Reliability and a Fair Energy Marketplace*, 25 COLO. NAT. RESOURCES, ENERGY & ENVTL L. REV. 339, 341 (2014).

That year [2013] marked the ten-year anniversary of the Northeast Blackout, in which fifty million people were impacted from the northeast United States through the Midwest and into Canada. This historic blackout took place only about two years after the meltdown of Enron and revelations of its extensive manipulation of energy markets in the western U.S.

These two events created the legislative impetus and political will to overhaul energy regulation. These events, more than any others, were *the* watershed events that changed how we oversee the energy industry in the United States. The legislation was the Energy Policy Act of 2005

Id. *See also* 151 CONG. REC. H6942, 6944 (daily ed. July 28, 2005) (statement of Rep. Hastings regarding the conference report for EPAAct):

[T]his legislation includes consensus language providing for mandatory reliability standards for electric transmission to help prevent blackouts like we saw in the Northeast in 2003 There are also important provisions for enhanced consumer protection against the kind of market manipulation we experienced in the west coast electricity market 4 years ago.

See also 149 CONG. REC. S13998 (statement of Sen. Maria Cantwell, Nov. 5, 2003):

The Senate knows and understands that Enron has admitted market manipulation. They have executives who have said, yes, these contracts were manipulated and prices were faulty. We have a report by the Federal Energy Regulatory Commission so thick it is hard for me to hold in one hand that goes through a variety of issues in relation to market manipulation in which FERC found there was not only manipulation, but a demonstration for the need of explicit prohibitions on this kind of harmful and fraudulent market behavior.

20. Clark & Meidhof, *supra* note 19, at 341.

both laws, and the Natural Gas Policy Act, Congress expanded the scope of the criminal penalties by increasing the maximum fines and imprisonment time for cases prosecuted by the United States Department of Justice.²¹ Finally, the statute amended both the FPA and NGA to explicitly prohibit market manipulation.²² With those changes, Congress filled in “[t]he main deficiencies of [FERC’s enforcement] program” from its prior state as a “hodgepodge” of tools.²³

C. The Commission’s Enforcement Approach after Enron

The Commission responded to Congressional direction to develop its enforcement program into a more sophisticated operation, to expand its substantive reach, including acting against market manipulation schemes like the ones committed by Enron, and to strengthen enforcement of the rules. In 2002, the Commission elevated its oversight role by establishing the Office of Market Oversight and Investigation,²⁴ the immediate predecessor to the current Office of Enforcement.

After Congress passed EAct in 2005, the Commission immediately began the process of carrying out its new statutory authority. Within three months of EAct 2005’s passage, the Commission issued its first Policy Statement on Enforcement, “to place entities subject to [its] jurisdiction on notice of the consequences of violating the statutes, orders, rules, and regulations [it] enforce[s].”²⁵ The Commission subsequently crafted, with the input of public commenters, more detailed policy statements, rules, and orders to describe the Office of Enforcement’s policies and procedures. Among these rulemakings, the Commission implemented Order No. 670 to shape the bounds of its new prohibition of energy market manipulation,²⁶ defining it broadly “to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market.”²⁷ Since EAct 2005, the Commission also

21. EAct 2005 §§ 314(a), 1284(d) (increasing criminal sanctions under the Natural Gas Act and Natural Gas Policy Act, and Federal Power Act, respectively).

22. 16 U.S.C. § 824v (2000), amended by EAct 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 594, 979; 15 U.S.C. § 717c-1 (1938), amended by EAct 2005 § 315.

23. JAMES H. MCGREW, FERC: FEDERAL ENERGY REGULATORY COMMISSION 241 (2d ed. 2009).

24. *Examining Enron*, *supra* note 11, at 107.

[B]y the end of the year the full Commission agreed that market oversight is one of the three principal functions of what we do: infrastructure; balanced rules; and protection of customers through oversight. That third goal again was elevated to priority with the other two and we created the Office of Market Oversight and Investigation in January of this year . . .

Id. (statement of Patrick Wood III, Chairman, Federal Energy Regulatory Commission).

25. Policy Statement on Enforcement, *Enforcement of Statutes, Orders, Rules, and Regulations*, 113 F.E.R.C. ¶ 61,068 at P 1 (2005) [hereinafter Policy Statement on Enforcement].

26. Order No. 670, *Prohibition of Energy Market Manipulation*, F.E.R.C. STATS. & REGS. ¶ 31,202 at P 49 (codified at 18 C.F.R. pt. 1c), *reh’g denied*, 114 F.E.R.C. ¶ 61,047 (2006) [hereinafter Order No. 670]. The Commission patterned its anti-manipulation rule on the SEC’s Rule 10b-5, codified at 17 C.F.R. § 240.10b-5 (2014) (as Congress directed the Commission to do in EAct 2005).

27. Order No. 670, *supra* note 26, P 50 (rejecting commenters’ suggestions for *per se* limits on the elements of market manipulation, and stating that “[f]raud is a question of fact that is to be determined by all the circumstances of a case”). Some enforcement practitioners and commenters argue that the Commission, through this language, penalizes any conduct that, in effect, interferes with market functions, but that is not what Order No. 670 says. Order 670 prohibits conduct undertaken “for the purpose” of interfering with, obstructing, or

held conferences,²⁸ compliance workshops,²⁹ and a technical conference;³⁰ created a new website regarding FERC's enforcement policies and activities;³¹ initiated annual reports on Enforcement's activities; and issued many settlement orders and orders in show-cause proceedings that further explain and define its approach to enforcing the anti-manipulation rule.³² In addition to providing substantive guidance, these efforts have clearly described the Commission's procedures in market manipulation and other investigations.

After holding a widely-attended Conference on Enforcement Policy in 2007 to provide guidance on its post-EPA Act 2005 enforcement practices, the Commission issued a Revised Policy Statement on Enforcement in May 2008.³³ The Revised Policy Statement explained Enforcement's internal procedures, considerations when opening or closing an investigation, and factors relevant to remedies, including civil penalties.³⁴ Also that year, the Commission reiterated that "the central goal of our enforcement efforts" is compliance, and provided guidance on elements of internal control programs in the Policy Statement on Compliance.³⁵ In 2010, the Commission issued its Policy Statement on Penalty Guidelines, took public comment, and issued a revised version.³⁶ It followed in 2011 with a Technical Conference to address how the Penalty Guidelines were working.³⁷ Like other efforts at the time, the Commission issued the Penalty Guidelines as part of its effort to provide "fairness, consistency, and transparency to [its] enforcement program."³⁸ It also published an interpretive order revising its No-Action Letter process,³⁹ one of multiple options for regulated entities to seek Commission and staff guidance on compliance issues. Other options include

defeating FERC-jurisdictional markets. *Id.* This language underscores the core element of scienter, i.e., intent, in determining whether a subject violated the Anti-Manipulation Rule. *Id.* at PP 52-3.

28. *See, e.g.*, OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, REPORT ON ENFORCEMENT, Docket No. AD07-13-000 (2007) [hereinafter 2007 ENFORCEMENT CONFERENCE].

29. *See, e.g.*, OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, 2008 REPORT ON ENFORCEMENT, Docket No. AD07-13-001, at 7 (2008) [hereinafter 2008 REPORT ON ENFORCEMENT].

30. *See, e.g.*, Technical Conference on Penalty Guidance, *Second Notice of Technical Conference on Penalty Guidelines*, FERC Docket No. PL10-4-000 (Oct. 27, 2011).

31. *Enforcement*, FED. ENERGY REGULATORY COMM'N, <http://www.ferc.gov/enforcement/enforcement.asp> (last updated Aug. 6, 2014); *see also* 2008 REPORT ON ENFORCEMENT, *supra* note 29, at 6 (describing webpage updates).

32. *See, e.g.*, 2007 ENFORCEMENT CONFERENCE, *supra* note 28.

33. Revised Policy Statement on Enforcement, *Enforcement of Statutes, Regulations, and Orders*, 123 F.E.R.C. ¶ 61,156 (2008) [hereinafter 2008 Revised Policy Statement on Enforcement].

34. *Id.* at PP 5, 20.

35. Policy Statement on Compliance, *Compliance with Statutes, Regulation's, and Orders*, 125 F.E.R.C. ¶ 61,058 at P 1 (2008).

36. Revised Policy Statement on Penalty Guidelines, *Enforcement of Statutes, Orders, Rules, and Regulations*, 132 F.E.R.C. ¶ 61,216 (2010) [hereinafter 2010 Revised Policy Statement on Penalty Guidelines]; *see also* Policy Statement on Penalty Guidelines, *Enforcement of Statutes, Orders, Rules, and Regulations*, 130 F.E.R.C. ¶ 61,220 (2010).

37. Second Notice of Technical Conference on Penalty Guidelines, *Technical Conference on Penalty Guidelines*, Docket No. PL10-4-000 (2011).

38. 2010 Revised Policy Statement on Penalty Guidelines, *supra* note 36, at P 2.

39. Interpretive Order Regarding No-Action Letter Process, *Informal Staff Advice on Regulatory Requirements*, 113 F.E.R.C. ¶ 61,174 (2005); Interpretive Order Modifying No-Action Letter Process, *Informal Staff Advice on Regulatory Requirements*, 117 F.E.R.C. ¶ 61,069 (2006).

seeking declaratory orders, general counsel opinion letters, or accounting interpretations; calling the enforcement hotline; and meeting with staff.

The Commission also announced additional procedures, such as providing the written response of a subject to the Commission when staff requests settlement authority⁴⁰ or seeks a show cause order from the Commission.⁴¹ And the Commission issued a Notice of Proposed Rulemaking, and then a Final Order regarding *Ex Parte* Contacts and Separation of Functions. This rulemaking designates certain Enforcement staff as non-decisional when the Commission issues an Order to Show Cause, which limits Enforcement staff contact with the Commission once the Commission itself has concluded that a subject should be required to show cause why it should not pay disgorgement and a civil penalty for violating FERC-jurisdictional statutes, rules, regulations, and orders.⁴²

To provide further guidance to the regulated community regarding compliance with the law, in 2007, Enforcement staff began publishing annual reports with statistics regarding ongoing investigations and other matters, summaries of enforcement priorities, and details regarding the conduct at issue in the Commission's investigations.⁴³ Enforcement's annual reports show that roughly half of investigations were resolved through settlement from 2007 through 2013. Enforcement staff closed nearly a quarter based on a finding that the violation did not warrant sanctions, and closed nearly another quarter because there was no violation or insufficient evidence.⁴⁴ From 2011 through 2013, Enforcement staff closed more market manipulation investigations without Commission action than any other type of investigation,⁴⁵ and the annual reports provide illustrative examples of such closed investigations to give notice to market participants.⁴⁶

D. Balancing Fairness and Effectiveness in the Investigation Process

As the Commission developed its enforcement program, it also standardized the investigative process through its rules and policy statements. It carefully designed and developed this process to ensure both fairness and effectiveness. Although the Article singles out the Commission's enforcement program for its purportedly insufficient process, the irony is that comparisons between our enforcement process, and enforcement processes of other administrative agencies, show that our process has more procedural steps and more opportunities for subjects to make their views known to investigative staff and the Commission. While the Article advocates for even more procedures in enforcement, it is important to consider that additional procedures would have a cost. Unnecessary procedures can impede, delay, and frustrate the Commission's duty—mandated

40. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 32.

41. 18 C.F.R. § 1b.19 (2014).

42. Order No. 718, *Ex Parte Contacts and Separation of Functions*, 125 F.E.R.C. ¶ 61,063 (2008).

43. For the Office of Enforcement's Annual Reports see *Enforcement Resources*, FED. ENERGY REGULATORY COMM'N, <http://www.ferc.gov/enforcement/enforce-res.asp>.

44. STAFF OF THE OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, 2013 REPORT ON ENFORCEMENT, Docket No. AD07-13-006, at 21-24 (2013) [hereinafter 2013 Report].

45. *Id.* at 24-25.

46. *Id.* at 26.

by Congress—to effectively police the energy markets. Additional, unnecessary process will add greater delays, costs, and harm to consumers—a reality that should be at the forefront in any discussion about “reforming” the Commission’s policies and practices.

Consistent with the Commission’s efforts to be transparent and provide accurate guidance to practitioners, the following is a summary of the investigative process. To further describe the process at the end of this section, we summarize the procedural steps taken in an ongoing public case, *Barclays Bank PLC*, cited by the Article,⁴⁷ as an example.

1. The Initial Investigative Process

In order to provide guidance to the regulated community, the Commission has publicly described the process of enforcement investigations in its Revised Policy Statement on Enforcement.⁴⁸ That policy statement elaborates on the Commission’s Rules Relating to Investigations⁴⁹ by providing additional detail and insight into internal staff considerations, including the opportunities that subjects have to communicate with staff or the Commission about their investigation. The Commission “emphasize[s] that we are committed to ensuring the fairness of our investigatory process from the commencement of an investigation until the time it is completed.”⁵⁰

Staff initiates an investigation based on “reason to suspect violations,” which could be based on information obtained from an office within the Commission itself, an ISO/RTO market monitor referral, a hotline tip, information from another government agency, or various other sources.⁵¹ Preliminary research, review, and analysis informs the decision to open an investigation, and when staff decides to investigate, it notifies the subject.⁵² Staff then gathers facts through common methods, such as data requests, interrogatories, testimony, contact with third parties, presentations from the subject itself, and informal communications with the subject’s counsel.⁵³

During the investigative process, “staff is in frequent contact with the subject being investigated, and will meet or otherwise converse with company representatives to discuss relevant facts, data and legal theories.”⁵⁴ Under Rule 1b.18, subjects may “at any time during the course of an investigation” submit information that the subject “considers relevant.”⁵⁵ In addition to contacting

47. Article, *supra* note 1, at 2.

48. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at PP 1, 20-71.

49. 18 C.F.R. §§ 1b.1 - 1b.21 (2014).

50. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 21.

51. *Id.* at PP 23-26.

52. *Id.* at P 26.

53. *Id.* at P 28.

54. *Id.*

55. 18 C.F.R. § 1b.18 (2014).

staff,⁵⁶ subjects may also communicate with the Commission, so long as it is in writing.⁵⁷

In the experience of Enforcement staff, subjects are uniformly aware of their opportunities to make their views known to staff and the Commissioners at all stages of the investigation, and many subjects (through counsel) take advantage of their right to pick up the phone, send an email, or otherwise communicate their position directly to staff. These communications—as well as formal and informal presentations from subjects, their counsel, or experts—are very helpful to staff’s understanding of the facts. They often result in Enforcement staff’s decision to modify their views of the case—everything from deciding to close the investigation outright, to refining the scope of the investigation (including the extent of the alleged violations, the individuals involved in the alleged violations, and the harm to the market caused by the alleged violations), or reaching the conclusion that the subject does not have persuasive defenses to an alleged violation. Each investigation is different, and each counsel to an investigative subject is different in terms of counsel’s willingness to engage openly and truthfully with staff, but Enforcement staff has found that frequent, robust back-and-forth between staff and the subject is useful to everyone involved in the investigation. We are unaware of any enforcement-related agency or department of the federal government that has more of these candid exchanges between the government investigators and the subjects of the investigation.

2. Preliminary Conclusions

At some point during the course of an investigation, staff reaches preliminary conclusions. Staff determines either to close the investigation, or, preliminarily concludes that a violation occurred. If the latter, “staff shares with the subject of the investigation its views, including both the relevant facts and legal theories. This may be done either orally or in writing.”⁵⁸ Staff often sends the investigative subject a preliminary findings letter, which provides a detailed description of staff’s factual and legal conclusions. These letters are often dozens of pages long, and on occasion have exceeded sixty pages. We are unaware of any other federal government enforcement agency or department that has anything like this process, where investigative staff presents detailed findings about their conclusions at this stage of the investigative process.

In addition to the ongoing ability of subjects to communicate with staff throughout an investigation, at the preliminary conclusions stage, subjects have “an opportunity to respond and to furnish any additional information [they] may

56. See, e.g., 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 28 (“We note that subjects of an investigation are always free to contact Enforcement staff to provide additional information or explanations of their conduct.”).

57. *Id.* at 27 (“[N]othing in our regulations prohibits the submission of such written information directly to the Commission. Such a submission may be made at any time during an investigation, up to the point at which our procedures regarding Orders to Show Cause come into play, which follow specific rules . . .”).

58. *Id.* at P 32. In some cases, investigative subjects express an interest in resolving a matter through a negotiated settlement and prefer to expedite the process through oral preliminary findings (with either an oral or written response). In those instances, staff frequently meet at length with the subject to explain its findings, often using a power point presentation.

deem to be helpful.”⁵⁹ Subjects rightfully take full advantage of this opportunity, routinely submitting voluminous materials to staff.⁶⁰ Staff carefully analyzes the subject’s response to the preliminary findings letter, and may revise its conclusions or close the investigation (both which have happened during the investigative process). Or, if the facts continue to support staff’s conclusion that there is a violation that warrants sanctions, the next step is for staff to seek the Commission’s authority to try to resolve the investigation through settlement.

3. Seeking Settlement Authority

To resolve Enforcement investigations, the Commission’s preferred course is to reach a settlement with the subject.⁶¹ “Staff requests settlement authority from the Commission and, in that request, seeks authority to negotiate within a range of potential civil penalties and/or disgorgement.”⁶² To ensure that “the Commission has both the views of its staff and the subject before it determines whether to authorize settlement negotiations,” staff provides to the Commission any materials submitted by the subject in response to the preliminary findings letter.⁶³

If the Commission grants settlement authority,⁶⁴ staff then engages in settlement discussions with the subject. If the subject is interested in exploring settlement, this process often involves multiple discussions, including in-person meetings.

If staff reaches a settlement agreement with the subject, it seeks Commission approval of that joint agreement, called the Stipulation and Consent Agreement.⁶⁵ It is ultimately the Commission’s decision—not staff’s decision—whether a matter should be resolved through settlement and, if so, the appropriate terms of such settlement. If the Commission concludes that a settlement reached by staff and a subject is in the public interest, it issues an order approving the settlement and expressing its views about the conduct at issue.

59. *Id.*

60. For example, in the *Barclays* case, the company submitted an 86-page response with numerous attachments and the individual respondents submitted their own lengthy responses (Connelly, 48 pages plus attachments; Brin, 36 pages plus attachments, Levine, 34 pages; Smith 35 pages). In another case, a subject submitted six responses totaling nearly 200 pages to staff’s preliminary findings letter.

61. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 33 (“[T]he public interest is often better served through settlements because we are able to ensure that compliance problems are remedied faster and that disgorged profits may be returned to customers faster, and we are able to reallocate to other enforcement matters the resources that would have been spent in lengthy litigation.”).

62. *Id.* at P 34.

63. *Id.* Before Enforcement staff’s request for settlement authority goes to the Commission, the request is also reviewed by senior staff from other FERC offices, including the Office of General Counsel, the Office of Energy Market Regulation, and the Office of Energy Policy and Innovation. In matters involving potential reliability violations, Enforcement staff also works closely with FERC’s Office of Electric Reliability and the North American Electric Reliability Corporation (NERC). For matters involving gas pipeline certificates or hydropower, Enforcement staff consults the Office of Energy Projects.

64. *Id.* Also, if the staff receives settlement authority, the Director of the Office of Enforcement directs the Secretary to issue a public Notice of Alleged Violations. The Notice is brief, commonly one-page in length, and identifies the identity of a subject, the statute or rule that staff alleges was violated, and the alleged wrongful conduct.

65. *Id.* Enforcement staff and counsel for the subject negotiate the specific language of the stipulations, and those negotiations often take substantial time and energy to complete.

4. 1b.19 Process

If settlement discussions do not lead to an agreement, staff advises the subject that it will recommend enforcement action to the Commission.⁶⁶ Staff also informs the subject of its right under Rule 1b.19, to submit its own statement to the Commission, which “may consist of a statement of fact, argument, and/or memorandum of law, with such supporting documentation as the entity chooses”⁶⁷ Staff then submits to the Commission its report and recommendation as well as the subject’s 1b.19 response.⁶⁸ The Commission then decides whether or not to issue an Order to Show Cause.⁶⁹

5. Order to Show Cause

After considering the subject’s submission in response to the 1b.19 process and staff’s report and recommendation, the Commission may choose to issue an Order to Show Cause. An Order to Show Cause is not a finding of a violation but the start of a process in which the Commission identifies potential violations and notifies the subject of a potential civil penalty and/or disgorgement amount. At that stage, the subject is provided a third opportunity to submit—without limitation—any statement of facts or arguments that it chooses. The subject is also provided staff’s report and recommendation, which is a lengthy document setting forth staff’s conclusions.⁷⁰ We are unaware of any other federal enforcement agency or department that has anything like this lengthy, detailed process, in which there is a full (and public) airing of staff’s and the subjects’ views about the factual and legal issues underlying the alleged violation *before* the government ever issues a decision resulting in an adjudicative hearing or federal court review. By the standards of other federal government enforcement processes of which we are aware (whether the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the Federal Trade Commission (FTC), the Department of Justice (DOJ), or any other agency), it is possible that the Commission’s Enforcement process does indeed stand out—but, if anything, that is only because there is so much detailed, thorough process before the matter ever goes to court.

6. The *Barclays* Example

There are not many investigations that have proceeded all the way through the Order to Show Cause process, but the *Barclays* matter is one of them, and so

66. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 35.

67. *See, e.g.*, 18 C.F.R. § 1b.19 (2014); 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 35.

68. 2008 Revised Policy Statement on Enforcement, *supra* note 33, at P 35. As with requests for settlement authority and other significant decisions in the investigative process, Enforcement staff’s report and recommendation in support of an Order to Show Cause are also reviewed by senior staff from other FERC offices.

69. *Id.* at 36. Even if a matter proceeds to an Order to Show Cause, or eventually to an Order Assessing Penalties, a subject always has the opportunity to pursue settlement. *See also infra*, note 85 (noting that issuance of an Order to Show Cause does not terminate an investigation).

70. Under Commission regulations, once an Order to Show Cause is issued, Enforcement staff working on the investigation is “walled off” from communicating with the Commission except through publicly filed briefs. 18 C.F.R. §§ 385.2201-.2202; Order No. 718, *Ex Parte Contacts and Separation of Functions*, 125 F.E.R.C. ¶ 61,063 (2008).

we use this investigation as an example to show how the process works. In the *Barclays* matter, the steps in this process took several years. Enforcement staff commenced an investigation in 2007 after multiple market participants reported potentially manipulative trading to the Commission.⁷¹ On June 10, 2011, staff provided a sixty-three page preliminary findings letter to the subject, Barclays Bank and four of its former traders.⁷² After receiving extra time to respond, Barclays and the four traders filed over 200 pages, along with hundreds of pages of exhibits. Staff carefully considered the extensive response, but still concluded that the subjects had engaged in market manipulation. Staff sought settlement authority from the Commission and provided the subjects' responses to the Commission.

After the Commission granted settlement authority, staff filed a Notice of Alleged Violation,⁷³ and engaged in settlement discussions with the subjects but no agreement was reached. On May 3, 2012, staff informed the subjects of its intent to recommend enforcement action to the Commission, consistent with Rule 1b.19.⁷⁴ One month later, on June 11, 2012, Barclays and the traders submitted a second set of voluminous submissions. After considering the submissions, staff wrote a sixty-seven page Enforcement Staff Report and Recommendation for the Commission, which it submitted to the Commission along with the subjects' prior submissions.

On October 31, 2012, the Commission unanimously issued an Order to Show Cause and Notice of Proposed Penalty.⁷⁵ Pursuant to its ordinary practice, the Commission attached the Enforcement Staff Report to the Order to Show Cause, so that the subjects would have another (third) opportunity to respond to staff's factual findings and legal conclusions.⁷⁶ Again, the subjects received an extension of time to file a response, which they did in over 500 pages of argument, with additional pages of exhibits on December 14, 2012.⁷⁷ Staff replied in a filing on January 28, 2013, finalizing the briefing process for the Commission's decision.⁷⁸ The Commission unanimously issued an Order Assessing Penalties on July 16, 2013.⁷⁹

From June 2011, when staff conveyed its preliminary findings to the subjects to the July 2013 Order Assessing Penalties, the steps in FERC's process took more than two years. FERC's process gave the Barclays subjects three opportunities to respond to staff's conclusions and they took full advantage of all three opportunities. With no limits on topics or pages, and multiple extensions of time upon request, Barclays and its traders submitted *over 850 pages* of argument and factual representations to the Commission. Under these circumstances, the Article's contention that FERC's investigative process "hinders the subject's

71. Order Assessing Civil Penalties, *Barclays Bank PLC*, 144 F.E.R.C. ¶ 61,041 at P 9 (2013).

72. *Id.*

73. *Barclays Bank PLC*, Staff Notice of Alleged Violation (Apr. 5, 2012).

74. 144 F.E.R.C. ¶ 61,041 at P 9 (2013).

75. Order to Show Cause and Notice of Proposed Penalty, *Barclays Bank PLC*, 141 F.E.R.C. ¶ 61,084 (2012).

76. *Id.* at 2 & App'x A – Staff Report.

77. 144 F.E.R.C. ¶ 61,041 at PP 12-13 & n.45.

78. *Id.* at P 13.

79. *Id.*

ability to get a fair and meaningful review of the merits” rings hollow.⁸⁰ And the Article’s various suggestions that other government agencies (whether the SEC or any other agency) provide more process to subjects are at odds with a fair and accurate examination of their rules and practices.

II. RESPONSE TO THE ARTICLE’S CRITIQUES AND PROPOSED REFORMS CONCERNING FERC’S ENFORCEMENT PROGRAM

Despite many actions by the Commission to establish a fair process, enhance transparency, and provide guidance to market participants, the Article claims that the “enforcement process has become lop-sided and unfair” and that there are “fundamental due process . . . concerns” about the way in which the Commission conducts investigations.⁸¹ This description bears no resemblance to the enforcement program that we know, and the antagonism between investigators and subjects portrayed in the Article misapprehends the role of each—and is descriptive of a very small number of subjects and an even smaller number of counsel. The Article ignores the value in efficient and rigorous fact-finding by Enforcement staff (such as the benefit that innocent parties receive from the expeditious resolution of investigations) and the important public interest served by an effective enforcement program. It also ignores substantial legal precedent and administrative practice that contravene its due process arguments.

While the main arguments in the Article are framed in terms of “due process,” the nature of those arguments suggests that the authors are more concerned with changing the fundamental nature of the investigative process. The Article seems to envision the process as one that effectively places Enforcement staff and the subject in a trial-like setting before staff has even had the opportunity to ascertain what happened and why. But an investigation by FERC, or any other agency with enforcement responsibilities, is not a piece of litigation. It is an initial *fact-finding* process in which Enforcement staff are obligated to find out what happened in a particular matter and the subjects are obligated to provide requested data and answer questions truthfully and completely.⁸²

There are many points in the Article concerning procedural aspects of FERC practice with which we disagree, but rather than providing a line-by-line critique, this response will focus on two fundamental themes: (1) the Article’s conflation of the investigatory stage with the adjudicatory stage in administrative law, and (2) the incorrect characterizations of practices and procedures of the Commission and other regulatory agencies that create the misimpression that FERC practice is some kind of outlier among federal agencies. After briefly introducing each theme, we will provide examples addressing the Article’s critiques and proposed “reforms.”

80. Article, *supra* note 1, at 112.

81. *Id.* at 101.

82. The Article’s criticism that the FERC enforcement process has become “lop-sided” reveals a fundamental misunderstanding of how an investigative process works. *Id.*

A. Investigations are Distinct from Adjudication and are Governed by Different Rules

Regulatory agencies like FERC have to perform “legislative, executive, and quasi-judicial functions simultaneously.”⁸³ One of the executive functions is *investigating* potential violations of law to determine whether the Commission should begin an *adjudication* (a quasi-judicial function) aimed at determining whether civil penalties or other remedies are warranted. Those two stages, investigation and adjudication, are distinct, and they are designed to serve different purposes and are subject to different sets of rules.⁸⁴ Investigations at FERC start with a suspicion of wrongdoing, are governed by Rule 1b and its subparts, and generally involve Enforcement staff taking testimony, reviewing documents and data, and developing preliminary conclusions as to whether subsequent adjudicatory proceedings are warranted. Enforcement staff, acting in the public interest, tries to determine the relevant facts in an investigation as effectively and expeditiously as possible. Adjudications, on the other hand, are governed by Part 385, which starts with an order to show cause.⁸⁵ Subjects and Enforcement staff are deeply engaged in briefing, argument, and (when necessary) discovery at this stage, and the adjudication ends with a fact-finder determining whether imposition of civil penalties or other remedies is warranted.⁸⁶

The due process concerns associated with each stage also are distinct. The key difference between an agency investigation and adjudication is that one’s legal rights are not implicated in the former, only the latter, when the agency makes its penalty determination. While the facts developed during the investigation certainly become part of the adjudication, factual development does not affect the subject’s legal rights. Accordingly, the due process requirements that apply

83. See generally Marshall J. Breger & Gary J. Edles, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 ADMIN. L. REV. 1111, 1188 (2000).

84. See, e.g., *Genuine Parts Co. v. FTC*, 445 F.2d 1382, 1387 (5th Cir. 1971) (“Although it is quite possible to view investigative proceedings and adjudicative proceedings as merely constituent parts of the administrative enforcement process, they have long been recognized as separate and distinct proceedings serving different functions and entitling parties to different rights under the due process clause of the Fifth Amendment.”).

85. 18 C.F.R. § 385.209 (2014). In the *Barclays* case, the subject of the investigation argued that Enforcement staff could not seek discovery after issuance of a Notice of Alleged Violations or after an Order to Show Cause. *Barclays Bank PLC*, 143 F.E.R.C. ¶ 61,024 at P 3 (2013) (Order Denying Motion) (citations omitted). The Commission rejected that argument stating:

Notably, the statute does not indicate that the Commission’s authority to issue or enforce subpoenas expires upon the issuance of either a notice of alleged violations or an order to show cause, as Barclays suggests. Here, consistent with precedent and with the statutory language’s imposing no such limitation, we hold that the Commission’s investigative authority does not terminate upon the issuance of either a notice of alleged violations or an order to show cause [W]e find that Barclays’ interpretation of the Commission’s orders is incorrect, and that the issuance of a notice of alleged violations or order to show cause does not signal the end of the authority to conduct investigations.

Id. at PP 24-26. A federal magistrate judge agreed with and adopted the Commission’s position. Report-Recommendation & Order, *FERC v. Smith*, No. 12-MC-00074, 10-14 (N.D.N.Y. Jan. 25, 2013), *vacated as moot*.

86. Note, however, that a FERC adjudication after an Order to Show Cause does not fall under the Administrative Procedure Act’s definition of an adjudication, i.e., a hearing “on the record.”

during the investigative stage are much less exacting than those that apply during the adjudicative stage.⁸⁷

The Article ignores this fundamental distinction, which undermines the premise for many of its recommendations. This is also true of the Article's comparisons of FERC's procedures to those of other agencies; most of them relate to agency rules that are applicable only during the adjudication phase.⁸⁸

1. Administrative Agency *Ex Parte* and Separation of Function Rules Apply to Adjudications, Not Investigations

The authors seek to extend the prohibition on confidential communications between the Commission and its Enforcement staff from the adjudicatory stage (during which the Commission sits as neutral decision-maker) to the investigative stage (during which the Commission carries out its own enforcement responsibilities and supervises staff). They argue that from the very "start of an investigation," the Commission should apply separation of functions rules and have no *ex parte* contacts with its own Enforcement staff.⁸⁹ That suggestion is unprecedented among federal agencies and unsupported by the case law.⁹⁰ It also would undermine the Commission's ability to discharge one of its fundamental responsibilities: to carry out effective enforcement investigations.

The Article contends that expanded separation of function and *ex parte* rules are necessary to "protect due process rights and ensure the integrity of proceedings,"⁹¹ and argues that Commission investigations are "tainted" by the ability of Commissioners to confer with their own staff during investigations. These assertions ignore both the applicable statutory framework (the Administrative Procedure Act) and many decades of contrary precedent. As the

87. See, e.g., *SEC v. Jerry T. O'Brien, Inc.*, 467 U.S. 735, 742 (1984) ("The Due Process Clause is not implicated [by Respondent's claim] because an administrative investigation adjudicates no legal rights."); *Hannah v. Larche*, 363 U.S. 420, 442 (1960) (distinguishing between due process rights that apply during investigations and those that apply during adjudications); *Aponte v. Calderón*, 284 F.3d 184, 193 (1st Cir. 2002) ("[I]t is clear that investigations conducted by administrative agencies, even when they may lead to criminal prosecutions, do not trigger due process rights."); *Stockman v. Fed. Election Comm'n*, 138 F.3d 144, 155 (5th Cir. 1998) (rejecting claim, because "the [Federal Election Commission's] investigation does not determine any rights of the person under review"); *Genuine Parts*, 445 F.2d at 1388 ("The purpose of an investigative proceeding conducted by an administrative agency 'is to discover and produce evidence not to prove a pending charge or complaint, but upon which to make one if, in the (agency's) judgment, the facts thus discovered should justify doing so.'" (quoting *Okla. Press Publ'g Co. v. Walling*, 327 U.S. 186, 201 (1946))).

88. The Article also improperly cites case law concerning criminal procedure to justify proposed changes in FERC's civil investigation procedures. For example, it cites cases concerning grand jury testimony to support its proposed expansion of subjects' rights to review their transcripts in FERC civil investigations. Article, *supra* note 1, at 127. Due process requirements are more exacting in the criminal context, and, unlike witnesses in FERC proceedings, grand jury witnesses are not entitled to have counsel present to take notes, raise objections, or ask clarifying questions. But even in the grand jury context, the right to access transcripts in many jurisdictions is not as broad as the article suggests. See, e.g., *In re Grand Jury*, 566 F.3d 12, 14 (1st Cir. 2009) (requiring showing of particularized need to inspect transcript); *In re Grand Jury Subpoena*, 72 F.3d 271, 276 (2d Cir. 1995) (affirming district court's denial of witness's request to review prior grand jury testimony).

89. Article, *supra* note 1, at 115.

90. See, e.g., *infra* note 105 (addressing portion of SEC Enforcement Manual that discusses analytical reports that SEC staff provide to SEC commissioners during investigations and noting that those reports may be followed up with in-person meetings); 17 C.F.R. § 12.8(b) (2014) (expressly exempting CFTC commissioners from that agency's separation of function rule).

91. Article, *supra* note 1, at 114.

case law makes clear, it is entirely permissible for agencies to supervise and communicate with Enforcement staff during the investigative stage and apply separation of functions and *ex parte* rules only after commencement of a formal adjudication.⁹²

The Fifth Circuit long ago rejected the types of arguments made in the Article in response to a challenge to the Commission's "practice of reviewing the recommendations of the investigatory staff . . . and then ordering a formal investigation."⁹³ It specifically stated that the APA does not prohibit the Commission from serving these multiple roles and that "courts have . . . uniformly held that this feature does not make out an infringement of the due process clause of the Fifth Amendment."⁹⁴

Indeed, it has been settled for decades that an agency can both investigate potential violations and later adjudicate alleged violations. In *Withrow v. Larkin*, the definitive case addressing this issue, state law authorized a board to both investigate alleged wrongdoing by doctors and later to suspend a doctor's license if the board found, based on evidence at a hearing, that the doctor committed a violation.⁹⁵ This same type of arrangement is commonplace throughout the government, including at FERC.⁹⁶

In *Withrow*, the Supreme Court rejected a doctor's claim that this combination of functions violates Due Process, explaining that "[t]he case law, both federal and state, generally rejects the idea that the combination [of] judging [and] investigating functions is a denial of due process . . ."⁹⁷ The Court pointed out that it is "very typical for the members of administrative agencies to receive the results of investigations, to approve the filing of charges or formal complaints instituting enforcement proceedings, and then to participate in the ensuing hearings."⁹⁸ A due process challenge to such a system:

[M]ust 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 prejudice that the practice must be forbidden if the guarantee of due process is to be adequately implemented.⁹⁹

92. See, e.g., *Porter Cnty. Chapter of Izaak Walton League of Am., Inc. v. Nuclear Regulatory Comm'n*, 606 F.2d 1363, 1370-71 (D.C. Cir. 1979) (concluding that the APA's strictures against combination of decision making and prosecutorial or investigative functions [apply] *only to formal adjudications*). An investigation is not a formal adjudication, and thus the APA does not require separation of functions before a formal adjudication has begun.

93. *Air Products & Chemicals, Inc. v. FERC*, 650 F.2d 687, 709 (5th Cir. 1981). The Commission cited *Air Products* when it considered, and soundly rejected, the exact arguments regarding separation of function and *ex parte* communications raised in the Article. See, e.g., *Energy Transfer Partners, L.P.*, 121 F.E.R.C. ¶ 61,282 at PP 80-81 (2007).

94. *Air Products*, 650 F.2d at 710.

95. *Withrow v. Larkin*, 421 U.S. 35 (1975).

96. *Air Products*, 650 F.2d at 709.

97. *Withrow*, 421 U.S. at 52 (quoting 2 K. Davis, *Admin. Law Treatise* § 13.02, at 175 (1958)).

98. *Id.* at 56.

99. *Id.* at 47. "Without a showing to the contrary, state administrators 'are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances.'" *Id.* at 55 (quoting *U.S. v. Morgan*, 313 U.S. 409, 421 (1941)).

After considering the relevant facts and a line of precedent rejecting similar challenges, the Court concluded that “[t]his mode of procedure does not violate the Administrative Procedure Act, and it does not violate due process of law.”¹⁰⁰

Similarly, the APA’s prohibitions on *ex parte* communications apply (at most) only to certain types of formal adjudications and formal rulemaking, not to investigations.¹⁰¹ As the Commission expressly recognized when it proposed its Separation of Function rules, the Commission’s rule is consistent with that of other agencies.¹⁰²

There are powerful practical reasons why agency heads need to be able to direct and supervise investigations and then later be able to decide an adversarial proceeding arising out of the investigation. One of the central duties of the Commission (and of similar agencies, such as the SEC, the CFTC, and the FTC) is to enforce the laws entrusted to it. In some cases, federal agencies are the *only* ones who can enforce these laws; the anti-manipulation authority granted to FERC in EAct 2005, for example, provides no private right of action for victims of market manipulation.¹⁰³

At FERC, until the beginning of an adjudication (i.e., issuance of an Order to Show Cause), the Commission’s Enforcement staff acts for and at the direction of the Commission. Like any supervisor, the Commission needs to be able to consult confidentially with its staff to give direction both about particular decisions in a given matter (such as, whether to pursue particular charges or to settle for a particular amount) and about broader questions regarding policy that may arise during investigations.

The “reform” proposed by the Article would interfere with the Commissioners’ ability to manage FERC investigations by rendering them unable to communicate confidentially with their own enforcement staff, even during the period when, by law, they are expected *to investigate* whether “any person . . . has violated or is about to violate any provision of this Act or any rule, regulation, or order thereunder.”¹⁰⁴ Such a rule would interfere with the Commission’s ability to obtain candid advice from, or to give confidential direction to, its own staff for months or years while an investigation is ongoing, and months or years before any adjudication.¹⁰⁵ Commissioners would be unable to have confidential discussions with agency staff about pre-adjudication settlement, subpoena enforcement, staff’s assessments of subjects’ defenses, staff’s views of witness credibility, confidential

100. *Id.* at 56.

101. Richard J. Pierce, Jr., *Federal Energy Regulatory Commission Ex Parte Regulations and Practices*, at 2, 7 (FERC issued Nov. 27, 2006), available at <http://www.ferc.gov/legal/maj-ord-reg/land-docs/exparte.asp>.

102. Order No. 718, *Ex Parte Contacts and Separation of Functions*, 125 F.E.R.C. ¶ 61,063 (2008) (to be codified at 18 C.F.R. pt. 385) (recognizing that the separation of function rules at the SEC and FTC do not take effect until a proceeding has commenced).

103. 16 U.S.C. § 824v(b) (2012).

104. 16 U.S.C. § 825f(a) (2012) (emphasis added); accord 15 U.S.C. § 717m(a) (2012).

105. The SEC’s Enforcement Manual calls for SEC staff to provide a confidential memorandum (i.e., an *ex parte* briefing) to that agency’s commissioners, providing recommendations and analysis with subsequent in-person meetings, in response to any Wells submission filed by the subject of the investigation. DIV. OF ENFORCEMENT, SEC. & EXCH. COMM’N, ENFORCEMENT MANUAL, § 2.5.1, at 25-27 (2013) [hereinafter SEC ENFORCEMENT MANUAL].

whistle-blowers, or whether and how to start an adjudication (e.g., which allegations should be included in the report attached to an Order to Show Cause).

In sum, we think the argument that the Commission should have *less* responsibility and involvement in overseeing its investigation and enforcement function than it had before EAct 2005—or than it has now—is wholly without merit.

2. The Proposed Limitations on Fact-Gathering

The authors urge the Commission to cap Enforcement staff's fact-finding ability during investigations by imposing numeric limitations on the number of data requests it can issue and the amount of testimony it can take, absent approval from some third party like an ALJ.¹⁰⁶ Though the Article's basis for this proposal is the Federal Rules of Civil Procedure, which include some discovery limits, that example is inapplicable here. The Federal Rules of Civil Procedure are the rules for court adjudications, and again, FERC investigations are neither adjudications nor civil litigation.

The Article's proposal to cap Enforcement staff's fact-finding ability is unprecedented.¹⁰⁷ As far as we can determine, no other federal department or agency (whether DOJ, the SEC, the CFTC, the FTC, the Equal Employment Opportunity Commission, the National Labor Relations Board, the Consumer Financial Protection Bureau, the Department of Labor, the Federal Deposit Insurance Corporation, or any federal inspector general) has ever imposed numerical limits on its investigators.¹⁰⁸

There are sound policy reasons why neither the Commission nor any other federal agency has imposed such limits. Most importantly, there is simply no way to determine in advance how much fact-finding will be necessary to effectively investigate a matter, particularly in a field as complicated as energy market manipulation.¹⁰⁹

Imposing arbitrary limits on Enforcement staff would not only impede staff's ability to uncover relevant facts, but also would empower those who want to obstruct and delay FERC investigations. For example, some witnesses who have appeared before Enforcement staff have repeatedly refused to answer relevant questions, falsely denied the existence of highly relevant documents, claimed not to understand basic facts, or engaged in other stonewalling tactics to avoid

106. Article, *supra* note 1, at 116, 120.

107. See, e.g., 17 C.F.R. pt. 203.2 (there are no such caps in the SEC's Rules Relating to Investigations); 17 C.F.R. pt. 11(a) (nor in the CFTC's Rules Relating to Investigations).

108. Nor is there any limit on the number of witnesses who can be called to a grand jury, the number of questions that a prosecutor can ask a witness, or the number of documents a prosecutor can subpoena or obtain by search warrant.

109. The Commission has already directed Enforcement staff to target its investigative requests to the specific demands of the investigation, to "refrain[] from seeking information unnecessary to the resolution of the issues and conduct examined," and to "work[] with the subject of an investigation to accommodate reasonable requests regarding the production of data." 123 F.E.R.C. ¶ 61,156 at P 29. Enforcement staff routinely invite subjects to raise concerns regarding breadth of requests and regularly agrees to narrow data requests, and to extend production deadlines, when subjects provide legitimate reasons for doing so.

providing the information requested.¹¹⁰ Imposing new limits on fact-gathering would provide incentives to some investigative subjects and their counsel to run out the clock by engaging in obstructive behavior aimed at impeding Enforcement staff's ability to get key information before they hit those limits.

Because there are other means (including good faith negotiation) to address any issue of excessive burdens without hamstringing legitimate factual development, there is no reason for the Commission to adopt such restrictions on investigations.¹¹¹ The SEC is not hobbled by arbitrary restrictions on its fact-finding capabilities as it investigates potential fraud in the securities markets.¹¹² Nor is the CFTC so hobbled in its efforts to investigate fraud in the commodities markets.¹¹³ Nor is the FTC in its efforts to investigate antitrust or consumer protection violations or potential manipulation of the wholesale crude markets.¹¹⁴ Nor is the Department of Justice in its efforts to investigate banking fraud, health care fraud, or fraud in the many other areas within its jurisdiction. It is difficult to understand why FERC should have *less* ability to investigate fraud in the nation's energy markets than these other agencies have in investigating fraud in the markets subject to their jurisdiction.

3. Enforcement Staff Provides Detailed Responses to Subjects' Arguments Once the Adjudication Stage Begins

The Article misleadingly claims that “the Commission [has] state[d] that the staff of the Office of Enforcement . . . is ‘under no obligation to provide any response’ to the ‘legal and factual arguments’ raised by [Commission] subjects.”¹¹⁵ The statement is, at best, misleading because the selective quote is solely about what happens *during an investigation*.¹¹⁶ In fact, as discussed above

110. As one example (of many), in a review of non-public investigative testimony, staff counted 255 separate times *in one day* in which the witness claimed either to “not recall” facts or not understand a word or the question. During that same testimony, staff counted 386 times (in one day) in which counsel improperly interrupted Enforcement staff's questions and instructed the witness to “answer if you can.” Enforcement Staff's Mot. to Strike the Prepared Answering Testimony of Energy Transfer Partners L.P.'s Fact Witnesses, Energy Transfer Partners L.P., et al., No. IN06-3-003 at 51-53 (June 1, 2009). *See generally id.* at 5-53 (discussing stonewalling at FERC depositions).

111. The Article's proposal to litigate fact-finding disputes during the investigative stage before ALJs further illustrates the authors' apparent misunderstanding of the investigatory process. Investigations are not “any other type of litigation,” and, unlike in adjudications, there are no applicable rules of evidence or civil procedure pursuant to which subjects may raise discovery objections. Article, *supra* note 1, at 122. Again, an investigation is a fact-gathering process and the Article's proposal to engraft a civil litigation model on that process is misguided.

112. *See, e.g.*, 17 C.F.R. pt. 203 (2014) (SEC's Rules Relating to Investigations).

113. *See, e.g.*, 17 C.F.R. pt. 11 (2014) (CFTC's Rules Relating to Investigations).

114. *See, e.g.*, 16 C.F.R. §§ 2.1-2.17 (2014) (FTC's rules regarding investigations).

115. Article, *supra* note 1, at 102-3.

116. In full, the paragraph from the *Barclays* Order reads as follows:

Barclays argues that its ability to respond to the Order to Show Cause has been prejudiced by OE Staff's refusal to respond to certain arguments raised by Respondents in their prior submissions to OE Staff. This reflects a misunderstanding of the purpose of the Commission's investigative procedures. **The preliminary findings letter and Rule 1b.19 process** are intended to provide the subject of an investigation with both general notice of the nature of the violations alleged by OE Staff, and the opportunity to adduce arguments and evidence that could change OE Staff's views on whether a violation occurred. The process is also intended to ensure that OE Staff's views are as informed as

in section I.D, subjects have the opportunity to reach out to Enforcement staff at any time to provide their views and facts of the challenged conduct, and staff typically engages in iterative discussions on those issues, including staff's views on the subjects' factual and legal arguments. Enforcement staff has no obligation, however, to make a formal response before any adjudication begins. The authors claim that "[f]ixing this part of the process is essential,"¹¹⁷ but they do not identify any government agency that has "fixed" its procedures to require investigators to provide a point-by-point response to defense arguments before any adjudication begins.

If an investigation advances to an *adjudication*, Enforcement staff does, of course, respond to the arguments raised by defense counsel. At the Order to Show Cause phase in the *Barclays* case, for example, Enforcement staff filed a 102-page Reply brief responding to arguments made by the subjects.¹¹⁸ Before the Commission makes any determination in a proceeding about a subject, the subject will have had three separate opportunities to present its side of the story and staff will have provided a brief setting forth its responses to the arguments raised by the subject. The authors' suggestion that "this approach hinders the subject's ability to get a fair and meaningful review of the merits"¹¹⁹ is just plain wrong.

B. Practice and Policy at FERC and Other Regulatory Agencies

The Article pursues many criticisms based on its flawed contention that FERC's Enforcement practice violates Commission rules and is inconsistent with practices at other regulatory agencies. To the contrary, following the Article's so-called "reforms" would push FERC's Enforcement program well beyond the boundaries of enforcement practices at other agencies. The Commission developed its enforcement program after many other enforcement divisions at other agencies had long been in operation, and modeled the current Enforcement program after those examples. Particularly in recent years, the Commission has adopted a number of additional policies and procedures to increase the openness, fairness, and transparency of that program.

possible before an investigation matures to the point that OE Staff recommends that the Commission issue an order to show cause. In short, **while OE Staff shall give consideration to the legal and factual arguments put forward by the subject of an investigation, it is under no obligation to provide any response.** Thus, Barclays was not prejudiced merely because OE Staff declined to share in detail its views on each argument that Respondents raised in their prior submissions. Instead, under the procedures of section 31(d)(3) of the FPA, which have been invoked by Respondents here, in their answers to the Order to Show Cause Respondents have had the opportunity to respond to the allegations included in the Staff Report and those arguments have been considered in this proceeding. They are, in fact, addressed below.

Barclays Bank PLC, 144 F.E.R.C. ¶ 61,041 at P 18 (2013) (emphasis added).

117. Article, *supra* note 1, at 112.

118. Barclays was not the only matter with a lengthy staff reply in support of a Commission Order to Show Cause. For example, in December 2013, Enforcement staff filed an 84-page reply in support of the Order to Show Cause concerning BP America, Inc. and others. Reply of Enforcement Staff to Answer to Order to Show Cause, *BP America, Inc.*, Docket No. IN13-15 (Dec. 4, 2013).

119. Article, *supra* note 1, at 112.

1. FERC Provides Comparatively More Disclosure than do Other Agencies

The authors claim that FERC's "Wells process" should be reformed to be more "similar to that used by the SEC."¹²⁰ They suggest that such reform is necessary to "get a fair and meaningful review of the merits" and to enable the Commission to "fully evaluate and understand both sides of the case."¹²¹ But they fail to acknowledge that, unlike the SEC, FERC has established a three-phase process of providing notice to investigative subjects.¹²² While some have referred to the letters that Enforcement staff has sent under rule 1b.19 as "Wells notices," that is an inaccurate and incomplete characterization. A 1b.19 notice is the last stage of a lengthy process of back-and-forth between Enforcement staff and an investigative subject. Accordingly, subjects of a Commission investigation already receive far more information than they would during the corresponding stage of an SEC investigation.

As discussed in section I.D above, Enforcement staff provides a substantial amount of information to the subjects (and to the Commission) long before it reaches the point of sending a 1b.19 notice. First, as noted above, there is often back-and-forth between the subject and Enforcement staff throughout the investigation regarding staff's contentions and the subject's defenses.¹²³ Second, if Enforcement staff reaches a preliminary conclusion that a suspect has committed a violation, it notifies the subject and provides it with detailed initial findings, usually written and sometimes orally. Staff considers the subject's response to these findings, which often leads to further discussion, particularly if the subject has offered new factual or legal arguments. Third, if Enforcement staff continues to believe the case is worth pursuing after analyzing the subject's response to the preliminary findings letter, it seeks settlement authority from the Commission. At this stage, staff sends its preliminary findings and the subject's response to the Commission and notes any changes in its analysis that it believes are warranted based on its review of the subject's response to the preliminary findings letter. If the Commission grants authority for staff to engage in settlement

120. *Id.* at 111. The term "Wells notice" refers to communications sent by the SEC, not FERC, to subjects of investigations. That type of notice is named after John A. Wells, the chairman of an SEC committee that issued an influential 1972 report recommending reforms to the SEC's enforcement program. *See generally* U.S. SEC. & EXCH. COMM'N, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES (1972).

121. Article, *supra* note 1, at 112.

122. Nor do they acknowledge that the Commission has expressly rejected an earlier proposal for it to "adopt a 'Wells submission' process like that of the SEC." Order No. 670, *Prohibition of Energy Market Manipulation*, F.E.R.C. STATS. & REGS. ¶ 31,202 at P 69, 71 Fed. Reg. 4244, 4255 (2006) (codified at 18 C.F.R. pt. 1c). In rejecting that proposal, it explained:

[W]e find that no new process need be adopted here. The Commission already has a regulation in place that provides a company under investigation with an opportunity to present its views, and staff's existing practice is to present the company's views to the Commission as part of any report or recommendation made by staff following an investigation.

Id. at P 74.

123. But the subjects are not limited to communicating with staff; they also have a right under FERC rules (unlike rules at most other agencies) to send any written arguments they want to the Commissioners while the investigation is underway. 18 C.F.R. § 1b.18 (2014).

negotiations, there invariably is another round of discussions with the subject about the facts and applicable law (except in those rare circumstances in which a subject wants no further discussions and asks staff to proceed to the 1b.19 stage).

All of that disclosure occurs before the Enforcement staff sends its rule 1b.19 notice, to which the subject has a second opportunity to respond to staff and the Commission in writing. The Commission considers that written submission, along with Enforcement staff's report and recommendation, and the subject then may receive yet another disclosure—the Order to Show Cause and attached staff report—and has yet another chance to respond with its views and additional facts. The SEC does not offer these additional rounds of disclosure and response, but rather initiates an enforcement action if it decides one is merited after reviewing the subject's response to the Wells notice. Then, of course, if the (FERC) Commission assesses a penalty or other remedy, the subject may have the opportunity to go through an adjudication before an administrative law judge or have the Commission's penalty assessment reviewed by a district court judge or both. Simply put, there is no merit to the Article's suggestion that FERC does not provide sufficient disclosure of findings and opportunity to be heard.

Moreover, FERC provides much more disclosure during the investigation than the SEC provides in its Wells notices. The SEC's rules require only that its Wells notices identify "the general nature of the investigation, including the indicated violations as they pertain to [the subject],"¹²⁴ and the SEC's Enforcement Manual does not require any more detail than is required by rule. While that manual allows staff to "refer to specific evidence regarding the facts and circumstances that form the basis for [its] recommendation," it requires only that the notice: (1) identify the charges that staff has preliminarily determined to recommend; (2) accord the subject an opportunity to respond; (3) set a limitation on the length of such response; (4) provide other procedural information; and (5) inform the subject that the response may be used against it.¹²⁵

In practice, the SEC's written Wells notices typically are brief and provide only a high-level statement of the alleged wrongdoing.¹²⁶ Here, for example, is the entire relevant substantive content of one actual SEC Wells notice:

This letter confirms our telephone conversation last week in which we advised you that the staff of the Securities and Exchange Commission (the "Commission") is considering recommending that the Commission bring a civil action against your client, CMKM Diamonds, Inc., alleging that it violated Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b), 13(b)(2)(a), and 13(b)(2)(b) of the Securities Exchange Act of 1934, and Rules 10b-5 and 12b-20 thereunder. In accordance with Rule 5(c) of the Commission's Rules on Informal and Other

124. 17 C.F.R. § 202.5(c) (2014). The SEC's enforcement manual says that the Enforcement Division simply should "[i]dentify the specific charges the staff has made a preliminary determination to recommend to the Commission" and give the subject the opportunity to respond. SEC ENFORCEMENT MANUAL, *supra* note 105, at 23.

125. SEC ENFORCEMENT MANUAL, *supra* note 105, at 23-24. FERC's rule 1b.19 requires staff to provide "sufficient information and facts to enable the entity to provide a response." 18 C.F.R. § 1b.19 (2008).

126. SEC staff, like the Enforcement staff at FERC, sometimes supplements written disclosures with telephone conversations and in-person meetings.

Procedures, 17 C.F.R. § 202.5(c), we are offering your client the opportunity to make a Wells Submission.¹²⁷

We do not suggest that there is anything wrong with the SEC's process—indeed, there is no due process obligation for any agency even to notify a subject that it is initiating an investigation,¹²⁸ let alone of its findings along the way. Nor is FERC's process necessarily better, because the additional transparency and openness take time and resources that could be put elsewhere if FERC had adopted a more streamlined process. But, contrary to the authors' claims, FERC does far more than simply identify the general nature of the alleged violations, and its process offers more information and opportunity to be heard than does the SEC's Wells process.¹²⁹

2. Enforcement Staff Properly Disclose Exculpatory Information

The Article's arguments that Enforcement staff's conduct "falls far short of *Brady's* constitutional requirements" and fails to implement the Commission's policy regarding exculpatory materials misstates applicable law and mischaracterizes FERC's current practice.¹³⁰ First, contrary to the authors' claims, regulatory agencies are not required by any principle of constitutional or statutory law to disclose exculpatory materials before imposing civil penalties¹³¹—let alone during their investigations.¹³² To the degree that agencies like FERC have adopted policies requiring disclosure of such materials, they have done so voluntarily.¹³³

127. Letter from Leslie A. Hakala, Staff Attorney, Div. of Enforcement, Sec. & Exch. Comm'n, to John T. Moran, III, Moran & Assocs. (Feb. 23, 2007), available at <http://www.cmkmdiamondsinc.com/documents/sec-wells-notice-fax.pdf>.

128. U.S. Sec. & Exch. Comm'n v. Jerry T. O'Brien, Inc., 467 U.S. 735 (1984); Knight v. U.S. Sec. & Exch. Comm'n, 403 F. App'x 622, 623-24 (2d Cir. 2010) (citing *Jerry T. O'Brien, Inc.*, 467 U.S. at 735 in rejecting Due Process argument based on conduct of SEC investigation); Gold v. U.S. Sec. & Exch. Comm'n, 48 F.3d 987, 991 (7th Cir. 1995) ("Due process does not require notice, either actual or constructive, of an administrative investigation into possible violations of the securities laws").

129. The Article also errs when it recommends forcing Enforcement staff to disclose the entire investigative record while that investigation is still pending. See, e.g., Article, *supra* note 1, at 103 n.5, 111 n.51. Its assertion that other agencies do so relies on a fundamental misreading of SEC Rule of Practice 230 and CFTC Rule of Practice 10.42(b) (both of which apply to *adjudications*, not investigations) and section 2.4 of the SEC Enforcement Manual (which gives staff the option, but not the obligation, to provide certain materials from the investigative file). SEC ENFORCEMENT MANUAL, *supra* note 105, at 22-25. We are not aware of any federal agency that requires staff to make such a disclosure while an investigation is pending.

130. Article, *supra* note 1, at Part III.C.

131. See, e.g., *Brodie v. Dep't of Health & Human Servs.*, 951 F. Supp. 2d 108, 119-20 (D.D.C. 2013) *aff'd sub nom.* *Brodie v. U.S. Dep't of Health & Human Servs.*, 2014 WL 211222 (D.C. Cir. 2014); *United States v. Project on Gov't Oversight*, 839 F. Supp. 2d 330, 343 (D.D.C. 2012) (quoting *Edwards*, 777 F. Supp. 2d at 994); *U.S. ex rel. (Redacted) v. (Redacted)*, 209 F.R.D. 475, 482-83 (D. Utah 2001). The FTC and other agencies have not adopted policies requiring disclosure of exculpatory materials. See, e.g., *In re Amrep Corp.*, 1983 WL 486352 (FTC Nov. 2, 1983).

132. See generally *United States v. Ruiz*, 536 U.S. 622, 633 (2002) (holding that even when a *criminal* (not civil penalty) investigation culminates in a guilty plea, "the Constitution does not require the Government to disclose material impeachment evidence prior to entering a plea agreement with a criminal defendant").

133. Policy Statement on Disclosure of Exculpatory Materials, *Enforcement of Statutes, Regulations, and Orders*, 129 F.E.R.C. ¶ 61,248 at P 6 (2009) [hereinafter Policy Statement on Exculpatory Materials] ("Courts have held that the Due Process Clause does not require application of *Brady* in administrative proceedings.").

Second, while the Article acknowledges that FERC has voluntarily adopted a Policy Statement on Disclosure of Exculpatory Materials,¹³⁴ it mischaracterizes Enforcement staff's practices under that policy statement. The Policy Statement on Disclosure of Exculpatory Material requires Enforcement staff to review information it has received during an investigation and to disclose evidence that would be required to be turned over in a criminal matter pursuant to *Brady v. Maryland*.¹³⁵ It expressly stated that staff is *not* required "to conduct any search for materials outside those it receives in discovery or as part of its investigatory activities" and further clarified that this means staff is not required to search through materials that "may be found in the offices of other agencies."¹³⁶ This is generally accepted practice; as the Commission expressly noted, its policy statement "is consistent with SEC and CFTC practice."¹³⁷

Staff follows the policy statement by conducting the appropriate searches and disclosing the covered materials. Staff takes very seriously the obligations adopted by the Policy Statement on Exculpatory Materials. Not only does staff affirmatively search its files for any potentially exculpatory materials, it carefully considers all *Brady* requests from subjects. All Enforcement attorneys receive training on the policy statement, and any issues routinely are elevated to supervisors and other senior attorneys who are very experienced in this area. Staff has disclosed exculpatory material in both public and non-public matters.¹³⁸

Some practitioners, particularly those who lack criminal law experience, misunderstand the *Brady* doctrine and disregard certain elements of the doctrine. The Commission explained in its 2009 policy statement that:

[t]he rationale underlying *Brady* is not to supply a defendant with all the evidence in the Government's possession which might conceivably assist in the preparation of his defense, but to assure that the defendant will not be denied access to exculpatory evidence known only to the Government. *Brady* is a rule of disclosure, not of discovery.¹³⁹

One particularly important element of the *Brady* doctrine is that it does not apply to information already in the subject's possession or which can be obtained with reasonable diligence. In nearly all of FERC's enforcement investigations, the overwhelming bulk of relevant documents—such as emails, instant messages, spreadsheets, and the firm's own trading data—comes from the company's own files. And the majority of additional evidence comes through testimony of the subject's employees. Another important element of the *Brady* doctrine is that it applies only to factual information and not to opinions. It is not uncommon for counsel representing investigative subjects to characterize many categories of

134. Article, *supra* note 1, at 117.

135. *Brady v. Maryland*, 373 U.S. 83 (1963); Policy Statement on Exculpatory Materials, *supra* note 133, at P 9.

136. *Id.* at P 11.

137. *Id.*

138. The authors complain that in providing materials to them, Enforcement staff sometimes tells subjects that the documents do not constitute exculpatory material—a view with which the authors say they disagree. Article, *supra* note 1, at 103 n.5. But an attorney's characterization of certain material as *Brady* does not make it so. In any event, the subjects in those cases received the documents and had a full opportunity to use them in their defense.

139. Policy Statement on Exculpatory Materials, *supra* note 133, at P 3.

information as *Brady* material when, in fact, such information does not fall within the *Brady* doctrine and counsel are attempting to use the Commission's policy as a discovery device.

Nor is Enforcement staff obligated to search the files of Independent System Operators (ISOs) and Market Monitors, which the Article incorrectly refers to as part of the FERC "prosecution team."¹⁴⁰ While those third parties sometimes provide information used by Enforcement staff during its investigation, and that information *is* searched by staff for potentially exculpatory information, it is inaccurate to say they have formed any kind of "team" with Enforcement staff.¹⁴¹ Those entities are outside parties, and the Policy Statement on Exculpatory Materials expressly excludes a requirement that Enforcement staff conduct any search for exculpatory material that might be found "in the offices of other agencies."¹⁴²

3. Enforcement Staff Properly Follow Rules Governing Access to Transcripts

The claim in the Article that Enforcement staff improperly withholds transcripts of witness testimony similarly is unfounded.¹⁴³ Rule 1b.12 authorizes staff to withhold transcripts when necessary to protect the integrity of an investigation or for other good cause.¹⁴⁴ Examples of good cause include situations where: there is reason to believe a witness may use the transcript to help develop false testimony; the witness may use the transcript to coach another witness (in contravention of the Commission's witness sequestration rule); and a witness may be intimidated or unwilling to testify fully and truthfully due to pressure from his or her employer, who may demand copies of the transcripts from the employee.

In the vast majority of cases, when a witness, or more commonly, the witness' attorney, requests a copy of his or her transcript, it is provided immediately, or as soon as the transcript is available from the court reporting service. In a small number of cases, Enforcement staff has temporarily denied such a request, pursuant to rule 1b.12, to protect the integrity of its investigation.¹⁴⁵ Such a decision has been made on a case-by-case, witness-by-witness basis and has been carefully reviewed by Enforcement supervisors. Because staff generally provides copies of transcripts with its preliminary findings, the only issue is when, not whether a witness can obtain such access.

140. Article, *supra* note 1, at 117-18.

141. In *Elec. Power Supply Ass'n v. FERC*, 391 F.3d 1255 (D.C. Cir. 2004), the D.C. Circuit rejected the suggestion that market monitors are part of a single entity with the Commission. The Court of Appeals pointed out that it was "undisputed . . . that market monitors are private parties who work outside the agency. They are not hired, paid, or directly managed by FERC in their work." *Id.* at 1260.

142. Policy Statement on Exculpatory Materials, *supra* note 133, at P 11. Nothing prevents the subjects from requesting such evidence from third parties themselves. *Id.*

143. Article, *supra* note 1, at 125-26.

144. 18 C.F.R. § 1b.12 (2012).

145. Since July 2009, the Office of Enforcement has opened eighty-four investigations and received testimony from hundreds of witnesses. Enforcement staff has temporarily delayed access to a transcript in nine investigations during that time.

The Article selectively quotes from a Commission order that had been non-public prior to being cited in this *Journal*.¹⁴⁶ In fact, the Commission carefully considered the arguments raised by the subject in that matter (the same arguments raised in the Article) and rejected them. Contrary to the authors' claims, nothing in either the APA or rule 1b.12 requires Enforcement staff to make transcripts available immediately upon request. After analyzing the language of the rule 1b.12, the Commission has decided to balance the witness' needs for immediate access against the risk to the investigation posed by such access. As a result, a majority of the Commission explicitly has affirmed Enforcement's ability to temporarily withhold a transcript, or access to a transcript, in appropriate circumstances.¹⁴⁷

4. The Commission's Rules Concerning Confidentiality of Non-Public Investigations

The Article also argues that FERC should "clarify" its rules regarding disclosure of information related to non-public investigations. But its rules on the point already are clear: the Commission, and only the Commission, can authorize such disclosures, unless the information is made public through adjudicatory proceedings or pursuant to a proper request under the Freedom of Information Act.¹⁴⁸ The Commission and the Office of Enforcement strictly protect the confidentiality of FERC's non-public investigations. On occasion, the Commission makes a determination that public disclosure of certain investigative information is in the public interest, as it clearly is authorized to do under rule 1b.9:

All information and documents obtained during the course of an investigation, whether or not obtained pursuant to subpoena, and all investigative proceedings shall be treated as nonpublic by the Commission and its staff except to the extent that (a) the Commission directs or authorizes the public disclosure of the investigation; (b) the information or documents are made a matter of public record during the course of an adjudicatory proceeding; or (c) disclosure is required by the Freedom of Information Act.¹⁴⁹

Under no circumstance does Enforcement staff make that determination on its own. It acts solely under the direction of the Commission.

The Article's "request for clarification" appears to focus on the act of enforcing an administrative subpoena in federal court and it proposes an expansive rule restricting the Commission's ability to make such filings in federal district court filings while an investigation is pending. But the sole example in the Article, a set of public enforcement actions filed during the J.P. Morgan investigation, illustrates why new limitations are unnecessary and contrary to governing legal authority.¹⁵⁰ The Commission authorized Enforcement staff to file that set of public actions in district court in response to the subject's refusal to comply with

146. Article, *supra* note 1.

147. It is worth noting that every witness who appears for testimony at FERC is entitled to counsel and virtually every witness appears with counsel. Such counsel, along with any co-counsel or paralegals who attend, are entitled to take reasonable notes throughout the course of the testimony.

148. 18 C.F.R. § 1b.9 (2014).

149. *Id.*

150. One of the authors, Thomas Olson, participated in the investigation of J.P. Morgan.

an administrative subpoena. While rarely necessary, going to court to enforce a subpoena is necessary when a witness refuses to comply. It also is the mechanism set forth in the governing statutes.¹⁵¹ In the J.P. Morgan matter, Enforcement staff disclosed the facts necessary to identify the specific information required and to show why that information was essential to complete the record for the proceedings. Filing that action publicly was consistent with standard practice at regulatory agencies with similar statutory authority.¹⁵²

Filing subpoena enforcement actions publicly also is consistent with public policy. As the D.C. Circuit has explained, there is a “strong presumption in favor of public access to judicial proceedings.”¹⁵³ That policy is particularly strong when the government is a party to a lawsuit: “‘in cases where the government is a party . . . [t]he appropriateness of making court files accessible’ is enhanced.”¹⁵⁴ There is nothing improper with filing such motions publicly, and there is no reason for the Commission to impose new limits on its ability to do so or depart from the practices of other agencies.¹⁵⁵

III. FERC’S EFFORTS TO COMBAT MARKET MANIPULATION

The Article raises two main concerns about the Commission’s interpretation and exercise of its authority to prohibit market manipulation—the scope of the definition of market manipulation and notice of the conduct that it covers.¹⁵⁶ The following history of the statutory and case law development shows how Congress broadly shaped the scope of the market manipulation definition, and how the Commission has sought to provide notice of prohibited conduct to the regulated community.

The Commission’s authority to prohibit market manipulation is deliberately broad, as Congress intended when it drafted that authority. The legislative history and statutory language of EAct 2005 supports the Commission’s authority to root out market manipulation schemes in all their myriad forms in the electricity and gas markets. Case law too, including precedents in the securities litigation area, reinforces the validity of the Commission’s approach. Neither statutory law,

151. See, e.g., Federal Power Act, 16 U.S.C. § 825f(c); Natural Gas Act, 15 U.S.C. § 717m(d).

152. As to subpoena enforcement in federal court, other federal agencies with similar statutory authority (such as the SEC, CFTC, and Federal Trade Commission) routinely file subpoena enforcement actions in investigations publicly. See, e.g., *FTC v. Church & Dwight Co., Inc.*, 665 F.3d 1312 (D.C. Cir. 2011); *NLRB v. Am. Med. Response, Inc.*, 438 F.3d 188, 190 (2d Cir. 2006); *Commodity Futures Trading Comm’n v. Tokheim*, 153 F.3d 474 (7th Cir. 1998); *SEC v. Brigadoon Scotch Distrib. Co.*, 480 F.2d 1047 (2d Cir. 1973). In one month in 2013 alone, the SEC publicly filed four public subpoena enforcement actions and issued press releases about them. See, e.g., U.S. Sec. & Exch. Comm’n, *Litigation Releases*, SEC.GOV, <http://www.sec.gov/litigation/litreleases/litrelarchive/litarchive2013.shtml> (last visited Oct. 26, 2014).

153. *Johnson v. Greater Se. Cmty. Hosp. Corp.*, 951 F.2d 1268, 1277 (D.C. Cir. 1991).

154. *United States v. Thomas*, 840 F. Supp. 2d 1, 3 (D.D.C. 2011) (quoting *EEOC v. Nat’l Children’s Ctr., Inc.*, 98 F.3d 1406, 1409 (D.C. Cir. 1996)).

155. It has been settled for more than forty years that agencies may properly decide when to make investigations public. See, e.g., *LaMorte v. Mansfield*, 438 F.2d 448, 451 (2d Cir. 1971) (“[t]o the extent that a privilege exists, it is the agency’s, not the witness’”. The agency is free to withdraw the veil of secrecy”); *U.S. Sec. & Exch. Comm’n v. Shanahan*, 2006 WL 3330972, at *16 (E.D. Mo. Nov. 15, 2006) (“the respondents’ contention that the SEC cannot choose to make a private investigation a matter of public record is without merit.”).

156. Article, *supra* note 1, at 107.

legislative history, nor case law supports the Article's view that the Commission must constrain its anti-manipulation authority to technical tariff violations. That limitation would ignore the abuses of Enron and the Western energy crisis, the very circumstances which led to the creation of the Commission's anti-manipulation authority in EPAct 2005. In the absence of Commission authority to act against market manipulations that do not violate tariffs, market manipulators would be free to continue to harm energy markets and burden consumers with unreasonable costs. There is no credible argument that Congress intended that result when it passed EPAct 2005.

After enactment of the new market manipulation statute, the next step was for the Commission to interpret the law, apply it to factual situations, and, through Commission or court action, render judgment—in essence, develop a common law of energy market manipulation. There is nothing new or surprising in this approach. By way of comparison, the complex body of antitrust law has developed incrementally through court cases, based on the minimal text of the Sherman Act of 1890—a law whose core concept is the broadly-phrased “restraint of trade” and which did not even define the term “monopolize.”¹⁵⁷ In the area of securities law, the prohibition against insider trading was never expressly stated in statute, but flowed from the broad anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.¹⁵⁸

Like the development of securities law, so too will the rules mature for energy market oversight as that case law develops over time.¹⁵⁹ As the Commission's Chairman has stated: “[I]t would be natural that pieces of the law evolve over time I don't think everything is in place that will ever be in place because we've only had a handful of cases up to this point.”¹⁶⁰ To provide notice to market participants, the Chairman has described how the Commission provides “as much detail as we can about the fact patterns so that we can be as transparent as we can about what are the schemes . . . where we think someone is manipulating a market or tariff.”¹⁶¹ Likewise, Commissioner Clark has emphasized the importance of “giving enough notice to industry such that the law-to-fact applications are clear

157. THOMAS O. BARNETT, ASSISTANT ATTORNEY GEN., ANTI-TRUST DIV., U.S. DEP'T OF JUSTICE, PRESENTATION TO THE LISBON CONFERENCE ON COMPETITION LAW AND ECONOMICS ON COMPETITION LAW AND POLICY MODERNIZATION: LESSONS FROM THE U.S. COMMON-LAW EXPERIENCE (Nov. 16, 2007), <http://www.justice.gov/atr/public/speeches/227755.htm>.

158. Thomas C. Newkirk, Assoc. Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, & Melissa A. Robertson, Senior Counsel, Div. of Enforcement, U.S. Sec. & Exch. Comm'n, 16th International Symposium on Economic Crime: Insider Trading – A U.S. Perspective (Sept. 19, 1998), <http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm> (“While Congress gave us the mandate to protect investors and keep our markets free from fraud, it has been our jurists, albeit at the urging of the Commission and the United States Department of Justice, who have played the largest role in defining the law of insider trading.”). The Securities and Exchange Commission subsequently issued two rules against insider trading. 17 C.F.R. §§ 240.10b5-1, 240.10b5-2 (2014).

159. Glen Boshart, *FERC's LaFleur Details Possible Need for Capacity Markets, Enforcement Process to Evolve*, SNL FINANCIAL (Aug. 12, 2014), <https://www.snl.com/InteractiveX/Article.aspx?cid=A-28877684-9767>.

160. *Id.*

161. *Id.*

enough to provide guidance on FERC's interpretation of its regulations and standards."¹⁶²

As this section will explain, FERC's decisions related to enforcement action have been carefully considered, and where the Commission has taken action in the last five years, its decisions have been unanimous.

A. *The History of Market Manipulation Authority in EAct 2005 Supports a Broad Interpretation*

In the months immediately following Enron's collapse, several House and Senate committees held hearings about its manipulative schemes in the energy market, and even undertook an investigation of the Commission's own activity with respect to policing Enron's conduct.¹⁶³ Congress' message was clear that the Commission's role was to rid energy markets of manipulative schemes like Enron's.¹⁶⁴

Congressional efforts to add broader anti-manipulation authority¹⁶⁵ were successful with the passage of the comprehensive EAct 2005. The new law amended the Federal Power Act by adding section 222 and amended the Natural Gas Act by adding section 4A, prohibiting the use or employment of "any manipulative or deceptive devices or contrivance" in connection with jurisdictional transactions in electric and gas markets.¹⁶⁶ In EAct 2005, Congress gave the Commission the authority that was necessary to carry out robust market enforcement, namely to prescribe "rules and regulations as . . . necessary or appropriate in the public interest or for the protection of electric ratepayers," and barred private rights of action for market manipulation.¹⁶⁷

Within two months, the Commission instituted a rulemaking that culminated in Order No. 670, implementing the provisions of EAct 2005 prohibiting energy market manipulation.¹⁶⁸ Because the statutory prohibition expressly incorporated the definition of "manipulative or deceptive device or contrivance" from section 10(b) of the Securities Exchange Act of 1934, the Commission modeled its rule after SEC rule 10b-5.¹⁶⁹ In doing so, the Commission drew on decades of

162. Clark & Meidhof, *supra* note 19, at 349.

163. See, e.g., *Examining Enron*, *supra* note 11; *Asleep at the Switch*, *supra* note 12; *California Energy Markets: Refunds and Reform: Hearing Before the Subcomm. On Energy Policy, Natural Resources and Regulatory Affairs of the H. Comm. On Gov't Reform*, 108th Cong. 38 (2003).

164. *Id.* Though the Article is critical of instances where the Commission has compared activities perpetuated by enforcement subjects to Enron's manipulative schemes, to disregard Enron's schemes would be to ignore the impetus behind EAct 2005 and the post-EAct enforcement regime. See, e.g., Article, *supra* note 1, at 149. See also Clark & Meidhof, *supra* note 19, at 351 ("One would be hard-pressed to find a member of Congress, industry, or the general public who does not believe that certain Enron employees . . . engaged in misconduct that included manipulative schemes and misrepresentations . . .").

165. Prior to EAct's passage in 2005, there were earlier efforts to strengthen the Commission's market manipulation authority. See, e.g., 149 CONG. REC. S13997 (daily ed. Nov. 5, 2003) (Sen. Cantwell offering an amendment to the Agriculture appropriations bill in order to prohibit energy market manipulation in the Federal Power Act).

166. 16 U.S.C. § 824v (2000), amended by EAct 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 594, 979 (2005); 15 U.S.C. § 717c-1 (1938), amended by EAct 2005 § 315.

167. *Id.*

168. Order No. 670, *supra* note 26, at P 2 (2006); 18 C.F.R. pt. 1c.

169. EAct 2005 §§ 315, 1283; Order No. 670, *supra* note 26, at PP 6-7.

precedent in securities litigation and adapted those precedents to prohibit market manipulation in wholesale natural gas and electricity markets.¹⁷⁰ Order No. 670 defined market manipulation broadly:

(a) It shall be unlawful for any entity, directly or indirectly, in connection with the purchase or sale of natural gas [or electric energy] or the purchase or sale of transportation [or transmission] services subject to the jurisdiction of the Commission,

(1) To use or employ any device, scheme, or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.¹⁷¹

In explaining the definition of market manipulation with reference to the SEC's rule 10b-5, the Commission's rule included scienter as one of the required elements of manipulation.¹⁷² Relying on Supreme Court precedent, Order No. 670 explained that "'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct . . . conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."¹⁷³ Scienter can be satisfied by a showing of recklessness.¹⁷⁴

To be sure, the Federal Power Act and Natural Gas Act require the Commission to ensure "just and reasonable" prices in wholesale natural gas and power markets and other transactions subject to the Commission's jurisdiction,¹⁷⁵ while the securities laws are generally aimed at disclosure rather than at market outcomes.¹⁷⁶ As a result, the Commission's application of its anti-manipulation rule does not track SEC precedent in all respects. Indeed, the statutory obligation to ensure just and reasonable rates may sometimes require different results than obtained in SEC precedents, which, generally speaking, are concerned more with process than with market outcomes. Thus, in Order No. 670, the Commission explained that it would follow SEC case law as appropriate, but not necessarily in every instance.¹⁷⁷ As the Commission applies its market manipulation prohibition, it necessarily does so with an eye on the functioning of the complex wholesale electricity and natural gas markets and the effect of particular conduct on just and reasonable rates in those markets.

B. *Fraud is a Question of Fact*

As with fraud under the SEC's rule 10b-5, the Commission broadly defined fraud under its anti-manipulation rule as "a question of fact that is to be determined

170. Order No. 670, *supra* note 26, at PP 6-7.

171. 18 C.F.R. § 1c.1 (2014) (Prohibition of natural gas market manipulation); 18 C.F.R. § 1c.2 (Prohibition of electric energy market manipulation).

172. Order No. 670, *supra* note 26, at P 52.

173. *Id.*

174. *Id.* at P 53.

175. *Id.* at PP 26, 30-32.

176. *See, e.g.*, *Basic v. Levinson*, 485 U.S. 224, 230-32 (1988).

177. Order No. 670, *supra* note 26, at PP 30-32.

by all the circumstances of a case”¹⁷⁸ and noted that “no list of prohibited activities could be all-inclusive.”¹⁷⁹ While a list would be a simpler approach for narrowing the range of disagreement on whether any particular set of facts gives rise to illegal conduct, it could also have the real potential, even likelihood, of preventing the Commission from proceeding against new forms of manipulative conduct that Congress intended it to prohibit. Consistent with Congressional intent, and with other areas of fraud law, including in the securities law setting, the Commission opted for a broader approach that would provide the authority and flexibility (even if less certainty to the regulated community) to safeguard the energy markets in FERC’s jurisdiction from harmful conduct.

The Article is not the first demand for a specific recitation of every market manipulation “do’s and don’ts.”¹⁸⁰ As the Commission has long held in response to such appeals:

Enron (and others) would demand that a regulatory agency have the prescience to include in a rate schedule *all* specific misconduct in which a particular market participant could conceivably engage. That standard is unrealistic and would render regulatory agencies impotent to address newly conceived misconduct and allow them only to pursue, to phrase it simply, last year’s misconduct – essentially, to continually fight the last war and deny the capability to fight the present or next one.¹⁸¹

Since EPAAct 2005 and Order No. 670, the Commission has repeatedly stated the “impossibility” of carving out specific conduct as *per se* manipulative,¹⁸² guided by the principle that “[t]he methods and techniques of manipulation are limited only by the ingenuity of man.”¹⁸³ The Supreme Court has affirmed that anti-fraud law is to be construed “not technically and restrictively, but flexibly to effectuate its remedial purpose.”¹⁸⁴ Investigations into potential fraud require wide latitude because—whether in securities law, commodities law, or other areas of law—fraud requires a judgment of manipulative or deceptive intent.¹⁸⁵ The Commission has recognized that intent need not be proved directly, but rather can be inferred from circumstantial evidence.¹⁸⁶ In its manipulation investigations, staff must therefore gather evidence sufficient to determine whether the subjects

178. *Id.* at P 50.

179. *Order Revising Market-Based Rate Tariffs and Authorizations*, 114 F.E.R.C. ¶ 61,165 at P 24 (2006).

180. Article, *supra* note 1, at 139 (“We urge the Commission to institute rulemaking proceedings to define what constitutes market manipulation and other substantive provisions of its rules in order to provide market participant with clear guidance on what conduct is permitted and what is not, based on objective criteria and grounded in coherent economic theory.”).

181. *Am. Elec. Power Serv. Corp. et al.*, 106 F.E.R.C. ¶ 61,020 at P 45 (2004) (emphasis in original) (order denying reh’g).

182. *See, e.g., In re Make-Whole Payments and Related Bidding Strategies*, 144 F.E.R.C. ¶ 61,068 at P 83 (2013) [hereinafter *JP Morgan Ventures Energy Corporation*] (approving the JP Morgan market manipulation settlement) (“Both the breadth of Congress’ authorization to the Commission and the breadth of the Anti-Manipulation Rule itself are a response to what courts have long recognized: the impossibility of foreseeing the ‘myriad means’ of misconduct in which market participants may engage.”).

183. *Id.* (citing *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971)).

184. *See, e.g., Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972).

185. *See, e.g., Clark & Meidhof, supra* note 19, at 348 nn.30-31.

186. *See, e.g., Barclays Bank PLC*, 144 F.E.R.C. ¶ 61,041 at P 75 (2013); *Order Denying Rehearing, Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 115 F.E.R.C. ¶ 61,053 at P 12 n.16 (2006) (citing *Herman & Maclean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *United States v. Flynn*, 196 F.3d 927, 929 (8th Cir. 1999); *Wechsler v. Steinberg*, 733 F.2d 1054, 1058 (2d Cir. 1984)).

acted with recklessness or intent to defraud, based on the unique facts and circumstances of each case.

Gaming schemes have been the subject of a number of market manipulation cases.¹⁸⁷ For example, in *JP Morgan Ventures Energy Corporation*, the company structured its bids to trigger artificial conditions that caused consumers to pay inflated prices for services that were worth a fraction of the inflated prices.¹⁸⁸ The Commission considered many of Enron's schemes as gaming, naming its case against Enron (and other parties) a "Gaming Order."¹⁸⁹ In a speech last year, Commissioner Clark observed that Andrew Fastow, Enron's former chief financial officer who went to prison for securities fraud, acknowledged using complexity in rules "to subvert the rules: "[T]here are people who look at the rules and find ways to structure around them. The more complex the rules, the more opportunity. . . . [T]he question I should have asked is not what is the rule, but what is the principle?"¹⁹⁰ Enforcement's fact-based approach, we believe, is appropriate in highly-complex, heavily-regulated markets and may be the only effective means of addressing all the variations of fraudulent behavior.

C. Market Manipulation is not Limited to Tariff Violations

The Article's insistence that market manipulation cases be limited to tariff violations is at least a decade behind the times. The authors assert that:

[T]he Commission has claimed that non-fraudulent conduct—in particular, open market trading or the submission of lawful bids and offers in organized markets—is fraudulent based on the bare assertion that the conduct in question interfered with or distorted "a well-functioning market" without identifying violations of applicable tariff requirements or market rules.¹⁹¹

Apart from being an inaccurate description of how the Commission has approached market manipulation cases, this assertion rests on the mistaken premise that manipulation requires a violation of a specific market rule or tariff. The Commission has explained this directly: "Market manipulation under the Commission's Rule 1c is not limited to tariff violations."¹⁹² Since the Commission

187. *JP Morgan Ventures Energy Corporation*, *supra* note 180, at PP 75-80, 87; *In re PJM Up-To Congestion Transactions*, 142 F.E.R.C. ¶ 61,088 at PP 6-11 (2013) [hereinafter *Oceanside Power*] ("Enforcement determined that Oceanside used the UTC transaction at the South Imp/South Exp pricing nodes as a pretext to reserve a large volume of transmission and thereby earn larger share of the MLSA [Marginal Loss Surplus Allocation] for the hours in which it submitted a schedule.").

188. *JP Morgan Ventures Energy Corporation*, *supra* note 182, at PP 75-80.

189. See, e.g., *Order Denying Rehearing (Gaming Order)*, 106 F.E.R.C. ¶ 61,020 at P 45 (2004) [hereinafter *Gaming Order*].

190. Clark & Meidhof, *supra* note 19, at 349; Francesca Di Meglio, *Enron's Andrew Fastow: The Mistakes I Made*, BUSINESS WEEK (Mar. 22, 2012), <http://www.businessweek.com/articles/2012-03-22/enrons-andrew-fastow-the-mistakes-i-made>.

191. Article, *supra* note 1, at 141.

192. See, e.g., *JP Morgan Ventures Energy Corporation*, *supra* note 182, at P 83 ("That Rule 1c is not so limited is by design. In the wake of Enron's schemes in the CAISO market, the Energy Policy Act of 2005 gave the Commission 'broad authority to prohibit manipulation' and 'an intentionally broad proscription against all kinds of deception, manipulation, deceit and fraud.'" (footnotes omitted)).

issued rule 1c, it has taken most of its major market manipulation enforcement actions independent of a particular tariff provision or market rule violations.¹⁹³

The reason the Commission has manipulative conduct in its scope, beyond mere tariff violations, is that Congress deliberately expanded the Commission's authority to address market manipulation in EAct 2005. The Commission explained how Congress broadened the law:

Before Congress enacted EAct 2005, we fashioned a market manipulation rule specific to certain jurisdictional entities, relying on our ability to place conditions on market-based rate authorizations. Passage of EAct 2005, however, brought about a fundamental change in circumstances because Congress specifically prohibited market manipulation by any entity in connection with a jurisdictional transaction, *not just those entities over whom the Commission has rate jurisdiction* Replacing the Commission's tariff-based prohibition of market manipulation appropriately implements Congressional intent.¹⁹⁴

No longer was jurisdiction limited to entities with market-based rate authority, rather, it was based on whether the entity—subject to a tariff or not—engaged in manipulative conduct. Proof of a tariff violation is not, and could not be, a prerequisite to a finding of market manipulation.

1. No Reason for a New Safe Harbor

The Article proposes a new safe harbor to insulate profitable trading transactions.¹⁹⁵ In pushing for this approach, the authors rely on the Commission's settlement in *Deutsche Bank Energy Trading, LLC (Deutsche Bank)*, a cross-market manipulation case.¹⁹⁶ In that matter, Enforcement staff determined that Deutsche Bank violated the Anti-Manipulation Rule “by engaging in transactions in one product, energy exports (physical purchases) at Silver Peak, with the intent to benefit a second product, its CRR position at Silver Peak.”¹⁹⁷ In arguing that the trading was profitable, or that staff failed to show it was not profitable,¹⁹⁸ however, the Article gets the facts wrong. Actually, in Deutsche Bank's stipulation with the Commission, the bank admitted just the opposite, that “[it] *lost money* on these physical transactions on every day it traded at Silver Peak.”¹⁹⁹ Thus, the bank's conduct would not even qualify for the very safe harbor that the

193. See, e.g., *id.* at P 83 n.8 (citing *Barclays Bank PLC*, 144 F.E.R.C. ¶ 61,041 (2013); *Oceanside Power*, 142 F.E.R.C. ¶ 61,088 (2013); *Deutsche Bank Energy Trading, LLC*, 142 F.E.R.C. ¶ 61,056 (2013); *Gila River Power, LLC*, 141 F.E.R.C. ¶ 61,136 (2012); *Rumford Paper Co.*, 140 F.E.R.C. ¶ 61,030 (2012); *Constellation Energy Commodities Group, Inc.*, 138 F.E.R.C. ¶ 61,168 (2012); *Energy Transfer Partners, L.P.*, 128 F.E.R.C. ¶ 61,269 (2009); *Amaranth Advisors, LLC*, 128 F.E.R.C. ¶ 61,154 (2009)); see also *In re Amanat*, Exchange Act Release No. 54,708, 89 SEC Docket 672, 2006 WL 3199181 at *7-8 (Nov. 3, 2006) (“fraud under SEC's Rule 10b-5 for submission of sham trades to earn payment based on high trade volume, where no specific rule barred submission of sham trades”), *aff'd mem. sub nom. Amanat v. SEC*, 269 Fed. App'x 217 (3d Cir. 2008)).

194. Order Denying Rehearing, *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 115 F.E.R.C. ¶ 61,053 at P 11 (2006) (emphasis added).

195. Article, *supra* note 1, at 142.

196. Order Approving Stipulation and Consent Agreement, *Deutsche Bank Energy Trading, LLC*, 142 F.E.R.C. ¶ 61,056 at PP 18-19 (2013).

197. Stipulation and Consent Agreement, *Deutsche Bank Energy Trading, LLC*, 142 F.E.R.C. ¶ 61,056 at P 19 (2013) [hereinafter *Deutsche Bank*].

198. Article, *supra* note 1, at 143.

199. *Deutsche Bank*, *supra* note 197, at PP 13, 20 (“Deutsche Bank's physical transactions were not profitable.”) (emphasis added).

Article proposes. And the Article lacks any other example (real or even hypothetical) that seeks to justify the reasons for adopting such a safe harbor.

The Article's conclusion that profitable trading transactions cannot be manipulative is also lacking in merit—as a matter of logic, Congressional intent, or public policy grounds. Any time a trader intended to manipulate markets, he could inoculate himself by showing a profit from the transaction, regardless of pretext, even where the profit was minuscule. Certainly, in cross-market manipulation cases, the bad conduct may be more obvious when a trader loses money on the physical energy trades, but it does not necessarily follow that the receipt of occasional profits rebuts strong evidence of unlawful intent. There is no reason an otherwise manipulative scheme should be given a free pass on the mere basis that the trader managed to profit to some extent in the course of defrauding consumers.

Moreover, the Article fails to recognize the parallel between Deutsche Bank's manipulative strategy and Enron's Death Star scheme. Deutsche Bank scheduled physical energy, which it neither possessed nor intended to provide, in a way that was inconsistent with market supply and demand in order to change electricity prices that benefitted the bank's corresponding Congestion Revenue Rights.²⁰⁰ Years earlier, Enron's traders carried out a similar scheme by bidding and scheduling physical energy in order to falsely increase congestion on transmission lines, which in turn generated revenue from Enron's Financial Transmission Rights (a financial product akin to Congestion Revenue Rights).²⁰¹ Members of Congress condemned the Death Star scheme, among others, in the lead-up to the passage of EPAct 2005.²⁰² Any argument that EPAct 2005's anti-manipulation provision does not even cover one of the key Enron schemes that led to this Act's passage rests on a flawed view of Congressional intent.

While the Article proposes broad "safe harbors" and a circumscribed list of prohibited acts, Congress mandated a different approach to these markets when it incorporated the anti-manipulation provision into the Federal Power Act and Natural Gas Act, and the Commission faithfully implemented Congress' mandate in promulgating the Anti-Manipulation Rule.²⁰³ Congress intended to give the Commission maximum flexibility in weeding out manipulative schemes, including the ability to proceed against the kinds of market gaming epitomized by Enron where there were no specific tariff violations.

D. The Commission Carries out its Manipulation Authority Carefully

Though there is public notice of cases where the Commission proceeds against conduct that it believes manipulates the energy markets, there are many other nonpublic investigations of potential manipulation. Following referrals,

200. *Id.* at PP 11-12.

201. *United States v. Belden*, No. CR 02-0313-MJJ at 2-3 (N.D. Cal. Oct. 17, 2002) (Plea Agreement); *United States v. Richter*, No. CR 03-0026-MJJ at 3-4 (N.D. Cal. Feb. 4, 2003) (Plea Agreement).

202. 148 CONG. REC. S3,938-42 (daily ed. May 7, 2002); *see also* 148 CONG. REC. E754-55 (daily ed. May 8, 2002) (statement of Rep. Sam Farr); *Examining Enron*, *supra* note 11, at 2 (statement of Chairman Byron Dorgan) ("The strategies were called . . . Death Star: 'Enron gets paid for moving energy to relieve congestion without actually moving any energy or relieving any congestion.' Legal? Hardly.").

203. 114 F.E.R.C. ¶ 61,165 at P 27 ("Just as we reject calls for inclusion of a list of prohibited conduct in section 1c.2, we similarly reject a list-type approach to defenses.").

hotline calls, market surveillance, or information from other sources, Enforcement staff carries out a measured review of such evidence, and frequently recommends against Commission action when an analysis of the facts against the law shows no violation, where the evidence may be insufficient, or when the harm is minor. In the last two years, more market manipulation cases were closed without Commission action than any other type of investigation, such as reliability or tariff investigations.²⁰⁴ The annual Report on Enforcement includes anonymous summaries of matters that the Commission closed without action, including summaries of market manipulation matters,²⁰⁵ to help market participants understand the parameters of the law.

When the evidence is sufficient for the Commission to contemplate enforcement action, there has been consensus among the individual Commissioners as those matters have developed. *Every* order on *every* settlement of a market manipulation case in the last five years has received the affirmative vote of all the Commissioners. That record, among a bipartisan Commission, is hardly evidence of a so-called “subjective [standard] impermissibly delegate[d] to Enforcement staff.”²⁰⁶

E. Market Participants Not Only Have Notice, They Understand What Market Manipulation Is

Most energy market participants do, in fact, understand the principle of market manipulation and the bounds of permissible market conduct. Staff routinely see internal compliance policies and training materials from a variety of regulated entities in the course of its investigations. These materials often detail the history of the Commission’s anti-manipulation authority, including its adoption of a context-specific approach to prohibited conduct, explain how the Commission evaluates intent, and provide illustrative examples using facts from prior investigations and settlements. While there may be an element of uncertainty in evaluating a potential trading strategy given the flexible and broad nature of the market manipulation definition, many compliance manuals show reliance on the correct touchstones.

For example, in the matter of *Direct Energy Services, LLC*, which the Commission recently settled, the company understood the definition of market manipulation, monitored for it, successfully trained their employees on it, and immediately caught it when it occurred.²⁰⁷ The company initially identified what it characterized as “atypical” trading behavior through two separate compliance efforts. First, within a day of trading, its back office correctly flagged the trades due to the unusual nature of the trades, showing that a company can identify red-flag patterns and put in place appropriate technical safeguards to catch it. Also, separately, a trader within the company reported the unusual trades to a supervisor immediately after attending a training session about the Commission’s

204. 2013 Report, *supra* note 44, at 24-25.

205. *See, e.g., id.* at 26.

206. Article, *supra* note 1, at 107.

207. Order Approving Stipulation and Consent Agreement, *Direct Energy Services, LLC*, 148 F.E.R.C. ¶ 61,114 (2014).

Constellation settlement, a market manipulation matter.²⁰⁸ Ultimately, staff's investigation of Direct Energy concluded that the company engaged in manipulation of natural gas prices in order to benefit related financial positions. Direct Energy did not suffer from a "confusing" market manipulation legal framework;²⁰⁹ rather, the company understood the issue at every stage.²¹⁰

Other instances demonstrating that market participants understand market manipulation have also occurred where companies correctly implemented safeguards to prevent and detect manipulative activity. In the *Deutsche Bank* matter, the "Bank Compliance Handbook section on 'Market Manipulation' stated that employees should 'take particular care and seek heightened review by a compliance officer or legal counsel in advance of . . . engaging in physical trading designed to benefit financial transactions.'"²¹¹ While some employees did not follow that section of the handbook, the Anti-Manipulation Rule was not so puzzling that the bank could not identify and describe it. Likewise, Barclays also had compliance materials explaining that uneconomic trading was evidence of manipulative conduct.²¹² Moreover, Barclays' Managing Director and Head of Commodities espoused what he called the "golden rule," which "was always, under no circumstances, lose money on a transaction for the intention of making money on another transaction."²¹³

Because the Commission's post-EPAAct enforcement program still is relatively new, the Commission certainly can and will do more over the coming years to provide greater guidance to the regulated community on the meaning and scope of its Anti-Manipulation Rule. But, we submit, the guidance that has developed since EPAAct 2005 was signed into law, the strong compliance programs many subjects have already adopted, and market participants' demonstrated ability to act in good faith—that is, trying to follow Commission rules in letter and spirit rather than seeking to game or evade those rules—allows for a great deal more certainty in avoiding investigations and enforcement actions for market manipulation than the Article suggests.

IV. CONCLUSION

The goal of the Office of Enforcement is to carry out investigations in a manner consistent with the Commission's regulations, policies, and procedures. In its enforcement efforts, it seeks to be effective and fair, and to encourage market

208. The *Constellation* matter was a precedent-setting post-EPAAct monetary settlement involving market manipulation in the trading of electric energy products. Order Approving Stipulation and Consent Agreement, *Constellation Energy Commodities Group, Inc.*, 138 F.E.R.C. ¶ 61,168 (2012).

209. Article, *supra* note 1, at 139.

210. Because the company self-reported the activity, had a robust compliance program, and had other good conduct that qualified for multiple credits under the Penalty Guidelines, the company accepted a settlement that provided for a \$20,000 civil penalty.

211. Order to Show Cause and Notice of Proposed Penalty, *Deutsche Bank Energy Trading, LLC*, 140 F.E.R.C. ¶ 61,178 App'x A at 9 (2012).

212. Order to Show Cause and Notice of Proposed Penalty, *Barclays Bank, PLC*, 141 F.E.R.C. ¶ 61,084 at 37 (2012); *see also id.* at 37 n.139 ("Gold Test at 111:9-16; Examples of Potential High Risk Areas, BARC0137583-92, at BARC0137585-86; Barclays Capital Commodities Trading and Marketing Compliance Program Presentation, BARC0137593-623, at BARC01376[6]00; BARC063492-526").

213. *Id.* at 2.

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participants to develop strong compliance cultures. And in every case, the reason that the Commission or staff initiates an investigation is because evidence indicates that some person or company may be harming the market. As Commissioner Clark recently stated:

I take the role of market oversight very seriously. Without constant and effective oversight of the markets within our jurisdiction we run the risk of permitting bad actors, be they individuals or companies, to harm our markets and ultimately innocent stakeholders, consumers, and other market participants. A few bad actors can also stymie investment in a sector that needs and deserves investment.²¹⁴

If the Commission were to ignore the vast changes in the energy marketplace that took place in the 1980s and 1990s, or not heed the lessons learned from Enron's market manipulation, it would be neglecting its statutory responsibilities. And if the Commission employed unnecessary requirements and processes, it would not only make the Commission an outlier in the field of administrative law and among independent agencies, it would introduce delays and unnecessary costs. All participants in FERC's market—energy companies, traders, market operators, and consumers—benefit from efficient and effective enforcement.

214. Clark & Meidhof, *supra* note 19, at 347.