

## THE FERC ENFORCEMENT PROCESS: TIME FOR STRUCTURAL DUE PROCESS AND SUBSTANTIVE REFORMS

*William S. Scherman\**

*Brandon C. Johnson\*\**

*Jason J. Fleischer\*\*\**

**Synopsis:** In 2008 the Commission issued its *Revised Policy Statement on Enforcement* to address concerns that practitioners and the regulated community had about the Commission's enforcement process. The Commission promised to "ensur[e] the fairness of [the] investigatory process from the commencement of an investigation until the time it is completed, [and] . . . to ensure that the subjects of an investigation receive due process both in perception and reality."<sup>1</sup> The Commission has taken several steps to deliver on those promises. Unfortunately, in practice, many of those promises have not been kept. And, while most members of the regulated community and practitioners within the energy bar are reluctant to say so publicly, there is a wide-spread view that the FERC enforcement process has become lop-sided and unfair.

In 2010 we suggested some modest reforms to address key due process concerns exposed by the Commission's enforcement proceedings in *Amaranth Advisors*, *Energy Transfer Partners*, and *Oasis Pipeline*. It was our hope then that by adopting those reforms the Commission would be able to further its stated goals of ensuring fairness and due process. But, even though the Commission formally adopted some of our suggestions and has also adopted other changes to its processes, the Commission's implementation of the enforcement process has resulted in more serious fundamental due process and substantive concerns. This article highlights those concerns and proposes

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\* Mr. Scherman is a former General Counsel of the Federal Regulatory Commission (FERC or Commission), and is currently a partner and Chair of the Energy, Regulation, and Litigation Group at Gibson Dunn & Crutcher LLP. Mr. Scherman regularly represents and advises entities and individuals in litigation and enforcement matters before the FERC and the Commodity Futures Trading Commission (CFTC). Mr. Scherman's recent public FERC enforcement representations and advisements include, among others, JP Morgan Ventures Energy Corp. (JPMVEC) and related individuals, Barclays Bank, Lincoln Paper and Tissue, Rumford Paper Company, Progress Energy, Energy Transfer Partners, and Oasis Pipeline.

\*\* Mr. Johnson is of counsel at Gibson Dunn & Crutcher LLP. Mr. Johnson represents and advises entities and individuals in litigation and enforcement matters before the FERC. Mr. Johnson's recent public FERC enforcement representations and advisements include Lincoln Paper and Tissue and certain JPMVEC employees. Mr. Johnson previously served as an attorney-advisor in the FERC Office of Enforcement, and worked on the enforcement investigations of Amaranth Advisors and related individuals, Energy Transfer Partners, and Oasis Pipeline.

\*\*\* Mr. Fleischer is a senior associate at Gibson Dunn & Crutcher LLP. Mr. Fleischer regularly represents and advises entities and individuals in litigation and enforcement matters before the FERC and the CFTC. Mr. Fleischer's recent public FERC enforcement representations and advisements include, among others, JPMVEC and related individuals, Entergy Services Inc., Barclays Bank, Lincoln Paper and Tissue, PacifiCorp, Progress Energy, Energy Transfer Partners, and Oasis Pipeline.

1. Revised Policy Statement on Enforcement, *Enforcement of Statutes, Regulations and Orders*, 123 F.E.R.C. ¶ 61,156 at P 21 (2008) [hereinafter Revised Enforcement Policy Statement].

common sense reforms that, if implemented, should help alleviate potential harm to the markets regulated by the FERC and ensure that the FERC's promises of fairness and due process are realized in both perception and reality.

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## I. INTRODUCTION

Over the last few years a wide-spread perception has formed among members of the regulated community and the energy bar that the Federal Energy Regulatory Commission's (FERC or the Commission) enforcement process has become lop-sided and unfair. That perception has been informed and fostered by the Commission's enforcement actions and its public pronouncements. When the Commission states that the staff of the Office of Enforcement (Enforcement

Staff) is “under no obligation to provide any response” to the “legal and factual arguments” raised by investigation subjects, it suggests that the Commission is not concerned with “ensur[ing] that the subjects of an investigation receive due process both in perception and reality.”<sup>2</sup> The Commission reinforces this perception when it claims that subjects of investigations receive due process because they are entitled to “submit documents [and] statements of fact[.]” to explain their “position or furnish[] evidence” but then simultaneously denies subjects of investigations any discovery rights, including access to relevant witnesses, and comparable access to the ultimate administrative decision makers—the Commission itself—that Enforcement Staff has throughout the investigatory process.<sup>3</sup> And, if there was any doubt that the process is off-kilter, one needs only to observe the fact that Enforcement Staff denies, in case after case, the existence of exculpatory or exonerating materials, only to belatedly produce a subset of those materials too late in the process to be of use to subjects in raising defenses or presenting their case to the Commission.<sup>4</sup>

By denying subjects of investigations even remotely comparable access to the Commission and any reasonable discovery rights, including production of *Brady* materials, the Commission has effectively barred investigation subjects from obtaining the documents, data, and testimony that they need to present their defenses to the Commission and from having those defenses fairly heard and considered. Even when an investigation subject does raise defenses during the Commission’s rule 1b.19 process, which is modeled on and in many ways similar to the Securities and Exchange Commission’s (SEC) “Wells Process,”<sup>5</sup> the Commission’s current *ex parte* rules grant Enforcement Staff, in its prosecutorial function, unfettered access to the Commission to present and hone their case—access that subjects are denied.<sup>6</sup> Collectively, these and other concerns undermine the confidence members of the regulated community and energy bar have in the fairness of the Commission’s current enforcement process.

The Commission needs to address these issues now, before the regulatory uncertainty created by the FERC’s enforcement actions further erodes

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2. *Barclays Bank PLC*, 144 F.E.R.C. ¶ 61,041 at P 18 (2013) [hereinafter *Barclays Penalty Assessment Order*]; Revised Enforcement Policy Statement, *supra* note 1, at P 21.

3. 18 C.F.R. § 1b.18 (2013); *see generally id.* pt. 1b.

4. *See generally* *Brady v. Maryland*, 373 U.S. 83 (1963). *See also* Answer of DB Energy Trading LLC to Order to Show Cause, *Deutsche Bank Energy Trading, LLC*, FERC Docket No. IN12-4-000 (Nov. 5, 2012) [hereinafter *Deutsche Bank Show Cause Answer*]. In some cases, Enforcement Staff has produced *exculpatory* materials as a “courtesy” but has denied that the materials are subject to *Brady*. We call those submissions, “non-*Brady*, *Brady* material.”

5. As discussed in greater detail below in Parts II and III.A, the SEC “Wells Process” is a long-standing SEC practice, codified in its regulations, whereby SEC enforcement staff provides the subject of an investigation with a written communication (referred to as a Well’s Notice) that: (1) informs the subject of SEC enforcement staff’s preliminary determination to recommend to the SEC’s commissioners that the SEC take enforcement action or seek an injunction in federal district court; (2) identifies the securities laws that staff believes the subject has violated; and (3) provides notice that the subject may make a submission to SEC staff and commissioners concerning the recommendation. *See generally* 17 C.F.R. § 202.5 (2013). The FERC’s 1b.19 rule is modeled on the SEC Wells Process; although, unlike the SEC, the FERC does not give the subject of an investigation the right to review the documents, testimony, or expert reports obtained or prepared by FERC Enforcement Staff in the course of its investigation. 18 C.F.R. § 1b.19.

6. *See, e.g.*, 18 C.F.R. § 1b.13.

confidence in the enforcement process and creates significant harm to the competitive natural gas and electricity markets the FERC has fostered and administers. That the Commission's long standing policy goal of promoting competitive markets is no longer aligned with the goals it is pursuing through its enforcement process can be seen by the number of entities that have already withdrawn or pulled back from these markets as a result of the significant reputational and financial harm from ill-advised and, at times, unfounded public enforcement actions.<sup>7</sup> And the trend appears to be increasing.<sup>8</sup>

In 2010 we wrote an article identifying some due process concerns with the Commission's enforcement process and suggested some modest reforms.<sup>9</sup> This article addresses the continued evolution of the FERC's enforcement process and

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7. See, e.g., Glen Boshart, *Key Lawyer, Economist: FERC Enforcement Could Prove Fatal to Markets*, 11 SNL ENERGY POWER DAILY 223 (Nov. 23, 2013).

8. *Id.* at 2 (summarizing statements from author William Scherman and Harvard Kennedy School of Government Professor William Hogan, explaining that “[t]raders and firms are fleeing the energy markets . . . thereby decreasing liquidity and increasing volatility” and warning “that those who have left to-date will be ‘just the tip of the iceberg’ if FERC does not offer a more coherent view, through a rulemaking or other means, of exactly what practices are considered manipulative”).

9. William Scherman, John Shepherd & Jason Fleischer, *The New FERC Enforcement: Due Process Issues in the Post-EPA Act 2005 Enforcement Cases*, 31 ENERGY L.J. 55 (2010) [hereinafter 2010 Article].

The 2010 Article addressed five main issues. First, while the Federal Power Act (FPA) and the Natural Gas Policy Act (NGPA) expressly provide for de novo review in a federal district court of civil penalties, the Natural Gas Act (NGA) is far from clear on the issue. Given that the NGA largely parallels provisions of the FPA and NGPA, we believe there is no meaningful reason why Congress would provide for de novo review under the FPA and NGPA but not the NGA. The Commission has disagreed with this interpretation and has instead found that the NGA uniquely departs from the other statutes that the Commission administers by depriving federal district courts of de novo review of civil penalties. Statement of Administrative Policy, *Process for Assessing Civil Penalties*, 117 F.E.R.C. ¶ 61,317 at P 7 (2006). These issues are discussed more fully in Part III.F below.

Second, we argued that the Commission should adopt binding requirements implementing *Brady*, which provides that the government has a broad duty to identify and disclose any “exculpatory evidence ‘material to guilt or punishment’ known to the government but unknown to the defendant.” Policy Statement on Disclosure of Exculpatory Materials, *Enforcement of Statutes, Regulations, and Orders*, 129 F.E.R.C. ¶ 61,248 at P 2 (2009) [hereinafter *Brady Policy Statement*]. Other agencies (such as the Commodity Futures Trading Commission (CFTC) and the SEC) had adopted these principles in administrative enforcement actions. While we applauded the Commission's adoption of *Brady* just prior to publication of the 2010 Article, 129 F.E.R.C. ¶ 61,248 at P 7, we remained concerned about its implementation. Those concerns were well-founded; in many instances, Enforcement Staff has failed to produce exculpatory documents when requested, as discussed more fully in Part III.C below.

Third, we argued that the differences between the more restrictive Federal Rule of Evidence 702, FED. R. EVID. 702, and the equivalent, more permissive, FERC rule 509, 18 C.F.R. § 385.509, regarding the admissibility of expert witness testimony, allow the FERC to admit and consider evidence that would be inadmissible in federal court. This problem persists at the FERC.

Fourth, we argued that the Commission's ex parte and separation of function rules create an unfair advantage for Enforcement Staff. A detailed discussion of our continuing concerns and recommendations appears in Part III.B below.

And finally, we argued that the FERC needs a robust 1b.19 “Wells Process” and should clarify what “extraordinary circumstances” permit Enforcement Staff to bypass this due process protection. While we continue to have those same concerns, recent actions have shown the process to be fundamentally flawed, as revealed by the Commission's policy decision in the Commission's Barclays investigation that Enforcement Staff is not required to engage substantively or meaningfully with the subject on the merits during the 1b.19 process. This major flaw ultimately thwarts the Commission's ability to fully evaluate and understand the facts, circumstances, and applicable law in most cases.

suggests some procedural and structural reforms needed to “ensure that the subjects of an investigation receive due process both in perception and reality.”<sup>10</sup>

The Commission’s enforcement process is largely nonpublic.<sup>11</sup> Apart from the subjects of investigations and their counsel, the first time most practitioners or members of the regulated community hear about an enforcement matter is either after the Commission has issued a Notice of Alleged Violations (NAV), a show cause order, or an order approving a settlement.<sup>12</sup> In many cases, the NAV, show cause order, and/or the settlement order will contain the only publicly available information about the Enforcement Staff’s investigative practices and the conduct it considers unlawful. Because most practitioners and members of the regulated community are not involved in many nonpublic investigations and enforcement proceedings, it is difficult to determine whether a due process concern is unique to their case, or if it is a common concern. While the Commission has taken some significant and important steps to address issues of transparency and due process, it has not done enough to ensure that subjects’ due process rights are protected. The Commission needs to do more than talk the talk; the Commission needs to walk the walk. But they cannot do it alone.

In addition to representing clients in a significant number of investigations and enforcement proceedings, we have had the privilege of personally representing or advising clients in many of the largest FERC enforcement cases and settlements starting with *Amaranth Advisors* and *Energy Transfer Partners*<sup>13</sup> and several pending cases.<sup>14</sup> While the size of a settlement is a poor proxy for the importance of a case, it can be a useful relative measure of the intensity of a case and the lengths to which both Enforcement Staff and the subject of an investigation will go to support their relative positions. As a result of our

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10. Revised Enforcement Policy Statement, *supra* note 1, at P 21. The Fifth Amendment of the U.S. Constitution requires that no person shall “be deprived of life, liberty, or property, without due process of law.” U.S. CONST. amend. V, § 2. Likewise, the Fourteenth Amendment requires that the government shall not “deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.” *Id.* amend. XIV, § 1.

11. *See generally* 18 C.F.R. pt. 1b (providing rules governing FERC investigations). As a result of the nonpublic nature of the enforcement process, much of what we will discuss below is a product of our direct personal knowledge and experiences and is not captured in publicly available records. As such, when we discuss an observation or experience, we do not identify the investigation or proceeding unless the specific incident (and the investigation) has been made public. Importantly, this article is not about one investigation, one client, or any one interaction with Enforcement Staff; this article is about ensuring that the subjects of all investigations and enforcement proceedings can know that their cases will be fairly judged and subject to due process.

12. *See, e.g., Enforcement of Statutes, Regulations, and Orders*, 129 F.E.R.C. ¶ 61,247 at P 5 (2009) [hereinafter NAV Order], *order on reh’g*, 134 F.E.R.C. ¶ 61,054 (2011) [hereinafter NAV Clarification Order].

13. *See, e.g., J.P. Morgan Ventures Energy Corp.*, 144 F.E.R.C. ¶ 61,068 (2013) (\$285,000,000 civil penalty and \$125,000,000 disgorgement); *Runford Paper Co.*, 142 F.E.R.C. ¶ 61,218 (2013) (\$10,000,000 civil penalty and \$2,836,419.08 disgorgement); *Energy Transfer Partners, L.P.*, 128 F.E.R.C. ¶ 61,269 (2009) (\$5,000,000 civil penalty and \$25,000,000 civil settlement fund); *Amaranth Advisors, L.L.C.*, 120 F.E.R.C. ¶ 61,085 (2007). While several pre-*Amaranth Advisors* and *Energy Transfer Partners* settlements had significant civil penalties, we consider the *Amaranth Advisors* and *Energy Transfer Partners* Show Cause Order proceedings to be the start of the “modern” FERC Enforcement era.

14. *See, e.g., Lincoln Paper & Tissue, LLC*, 144 F.E.R.C. ¶ 61,162 (2013) (proposed \$5,000,000 civil penalty and \$379,016 disgorgement).

experience in these cases, we have a much wider view of nonpublic FERC proceedings than many other practitioners.

In this article, we identify and suggest solutions to procedural and substantive due process issues arising in nonpublic investigations and settlement discussions, as well as in the public administrative and judicial proceedings following the issuance of show cause orders. It is not our intent to publicly re-litigate the merits of any individual enforcement investigation or proceeding. Instead, we seek to present to other practitioners and the regulated community a view from behind the nonpublic curtain and hopefully start a conversation that will benefit the entire regulated community, the defense bar, and the FERC.

As a first step towards implementing our suggestions and other necessary changes, we urge the Commission to convene one or more technical conferences to address the procedural issues with the enforcement process identified herein, just as it did in 2007.<sup>15</sup> We also urge the Commission to institute rulemaking proceedings to address substantive flaws in the Commission's rules and the overbroad application of those rules to lawful behavior, such as the statements in Order No. 670 that have been applied to characterize lawful trading as fraudulent based on the assertion that such trading interferes with a "well-functioning market."<sup>16</sup> This will provide an open forum for the regulated community to discuss these reforms and other concerns that have arisen since the Commission adopted its *Revised Policy Statement on Enforcement* and associated procedural reforms in 2008.<sup>17</sup>

We urge the Commission to consider the following procedural issues and reforms:

- The Commission should reform its section 1b.19 "Wells Process" to ensure that investigation subjects have full and fair opportunities to raise defenses to Enforcement Staff and the FERC's Commissioners and require Enforcement Staff to respond to subjects' defenses in sufficient detail to allow investigation subjects to understand the case against them and to prepare their defenses.
- The Commission should adopt reforms to its rules on ex parte communications and separation of functions to ensure that the subject of an investigation can present its case to the FERC's Commissioners on comparable terms as Enforcement Staff to help ensure that the FERC Commissioners act as impartial decision-makers in evaluating the merits of Enforcement Staff's allegations and the subject's defenses.
- The Commission should clarify Enforcement Staff's disclosure obligations under *Brady v. Maryland* and adopt regulations, similar to those adopted by the SEC, that give subjects access to the full investigative record and other important discovery rights.

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15. See generally OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, No. AD07-13-000, REPORT ON ENFORCEMENT (2007), available at <http://www.ferc.gov/EventCalendar/Files/20071114084824-Staff-report-11-14-07%20.pdf>. The FERC held the Conference on Enforcement Policy on November 16, 2007.

16. Order No. 670, *Prohibition of Energy Market Manipulation*, F.E.R.C. STATS. & REGS. ¶ 31,202 at P 50, 71 Fed. Reg. 4244, 4253 (2006) (codified at 18 C.F.R. pt. 1c) [hereinafter Order No. 670].

17. See generally Revised Enforcement Policy Statement, *supra* note 1.

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- The Commission should address the often-times burdensome nature of investigative discovery by placing soft limits on the number of data requests, interrogatories, and depositions propounded by Enforcement Staff.
- The Commission should appoint an Administrative Law Judge as a discovery master in all nonpublic investigations to resolve discovery disputes.
- The Commission should enforce the plain text of section 1b.12 of its regulations and section 555(c) of the Administrative Procedure Act (APA), each of which requires the Commission to give witnesses access to transcripts of their testimony within a reasonable period of time after the conclusion of a deposition.
- The Commission should prohibit Enforcement Staff from pursuing discovery under part 1b after a part 1b investigation is completed.
- The Commission should revise part 1b of its regulations to provide equal or greater protections for pre-show cause order settlement discussions, including the “settlement privilege,” as are accorded to settlement discussions in a part 385 proceeding under rule 602 of the Commission’s Rules of Practice and Procedure.
- The Commission should not attempt to circumvent section 31(d)(3) of the FPA, which permits a respondent to elect to require the Commission to enforce a civil penalty in the appropriate U.S. district court, which has authority to review de novo all matters of fact and law, by attempting to persuade judges to apply a deferential standard of review that is limited to a subset of the administrative “record.” The Commission should also confirm that the de novo review process is available under the parallel provisions of the NGA.
- The Commission should clarify under what circumstances Enforcement Staff is permitted to publicly disclose nonpublic investigations and when and under what circumstances a nonpublic investigation can be made public through an NAV.

The Commission should also institute new rulemakings, seeking input from the regulated community and economic and other experts, regarding the following key substantive issues:

- The Commission should institute a rulemaking to define market manipulation using coherent economic theory and objective criteria. The Commission’s current definition of market manipulation amounts to a subjective “We know it when we see it” standard that does not give market participants sufficient guidance or fair notice as to what conduct is prohibited. This subjective definition impermissibly delegates to Enforcement Staff the discretion to determine what is and is not lawful and may result in arbitrary or discriminatory enforcement of the law.
- The Commission should revise its rule prohibiting market manipulation in part 1c of its regulations (the Anti-Manipulation Rule) to adopt a safe harbor for conduct that is permitted under the applicable tariff or market rules and to clarify that it will no longer apply the dicta cited in Order No. 670 regarding interference with a “well-functioning market” to claim that lawful, non-fraudulent trading is manipulative.

- The Commission should clarify the scope of the false or inaccurate statements covered by section 35.41(b) of its regulations and the types of evidence and statements on which it may rely to establish that a violation of this rule has occurred.
- The Commission should revise its rules and procedures to ensure that future settlement orders are more robust and transparent by requiring that such orders set forth in detail the conduct constituting the alleged violation(s), the defenses raised by the subject during the preliminary findings, either 1b.19 or show cause order processes, and the Commission's reasoning for rejecting (or accepting) the asserted defenses.

## II. THE FERC ENFORCEMENT PROCESS

The Commission's enforcement process is largely nonpublic, and it can often take years from the time Enforcement Staff begins an investigation to the time when the regulated community first learns of an enforcement matter. We expect that most of our readers are familiar with the enforcement process, and therefore, this section is only meant to provide a brief, high-level overview of the different stages of the FERC enforcement process. For those readers that are less familiar with this process, we recommend that you review the FERC's Revised Enforcement Policy Statement and the most recent Report on Enforcement.<sup>18</sup>

The Commission's regulations provide Enforcement Staff with broad authority to "conduct investigations relating to any matter subject to [the Commission's] jurisdiction."<sup>19</sup> Investigations may be either "preliminary" or "formal."<sup>20</sup> Preliminary investigations may be initiated by Enforcement Staff without prior Commission approval, but Enforcement Staff cannot compel testimony in such investigations.<sup>21</sup> Formal investigations are initiated by Commission order and generally grant Enforcement Staff subpoena authority.<sup>22</sup> The FERC's rules do not place any limits on Enforcement Staff's discovery.<sup>23</sup> Conversely, the subject has no discovery rights at all.<sup>24</sup> Enforcement Staff also has unfettered access to the Commission and can communicate both orally and

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18. Revised Enforcement Policy Statement, *supra* note 1; *see also* OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, No. AD07-13-006, 2013 REPORT ON ENFORCEMENT (2013) [hereinafter 2013 REPORT ON ENFORCEMENT], *available at* <https://www.energymarketers.com/Documents/11-21-13-enforcement.pdf>.

19. 18 C.F.R. § 1b.3 (2013).

20. *Id.* § 1b.4.

21. *Id.* § 1b.6.

22. Revised Enforcement Policy Statement, *supra* note 1, at P 23 n.18 (explaining that "[e]xcept for the subpoena authority available to staff in a formal investigation, preliminary and formal investigations are handled in the same manner").

23. *Id.* at P 29 (Enforcement Staff is expected to target "its discovery requests to the specific demands of the investigation, refrain[] from seeking information unnecessary to the resolution of the issues and conduct examined, and work[] with the subject of an investigation to accommodate reasonable requests regarding the production of data.").

24. *See generally* 18 C.F.R. pt. 1b.



in writing with the Commissioners and their staffs off the record.<sup>25</sup> The subject may not communicate with the Commission except in writing.<sup>26</sup>

If Enforcement Staff concludes that a violation has occurred that warrants sanctions, it will provide a “preliminary findings letter” or orally present detailed allegations to the subject.<sup>27</sup> Enforcement Staff may also request settlement authority from the Commission and begin settlement discussions.<sup>28</sup> If Enforcement Staff and the subject reach a negotiated agreement, they will jointly submit a stipulation and consent agreement to the Commission for its consideration.<sup>29</sup> If approved, “the Stipulation and Consent Agreement and [an] order approving the settlement are generally released” to the public.<sup>30</sup>

After the investigation is concluded, but before the issuance of an order approving a settlement, the Commission will issue an NAV.<sup>31</sup> An NAV typically identifies the subject of the investigation and discloses the time and place of the alleged conduct, the rules, regulations, statutes, or orders that Enforcement Staff alleges were violated, and a short description of the alleged wrongful conduct.<sup>32</sup>

If Enforcement Staff and the subject are unable to reach a settlement, Enforcement Staff generally provides the subject with a “1b.19 letter,”<sup>33</sup> which is the functional equivalent of the SEC’s Wells Notice.<sup>34</sup> When Enforcement Staff submits its report to the Commission, it is supposed to include the subject’s “timely” response, if any.<sup>35</sup> The Commission likewise is supposed to consider both the subject’s submittal and Enforcement Staff’s report containing the recommended findings and conclusions of law when deciding whether to issue an order to show cause and notice of proposed penalty (SCO).<sup>36</sup> It is only after

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25. *Id.*

26. *Id.* § 1b.18.

27. Revised Enforcement Policy Statement, *supra* note 1, at P 32.

28. *Id.* at P 34. In some recent cases, Enforcement Staff has skipped the preliminary findings letter stage and moved directly into settlement discussions while discovery is still on-going.

29. *Id.*

30. *Id.*

31. NAV Order, *supra* note 12. The practice of providing the public with information about an agency’s identification of violations, prior to settlement or other agency enforcement action, occurs at certain other agencies as well. For example, the Department of Energy posts Preliminary Notices of Violations on its website. Office of the Gen. Counsel, *Enforcement News*, U.S. DEP’T ENERGY, <http://energy.gov/gc/enforcement-news> (last visited Apr. 6, 2014).

32. NAV Order, *supra* note 12, at P 7. As discussed below in Parts III.B and III.D.5, in some cases the Commission has permitted Enforcement Staff to continue investigating the subject after the NAV has been issued, raising questions about the fairness of the NAV process and whether the FERC’s current practice is consistent with the stated intent of issuing NAVs in the first place. *See generally Barclays Bank PLC*, 143 F.E.R.C. ¶ 61,024 (2013) [hereinafter *Barclays Discovery Order*].

33. Revised Enforcement Policy Statement, *supra* note 1, at P 35; *see also* 18 C.F.R. § 1b.19 (2013).

34. DIV. OF ENFORCEMENT, SEC. & EXCH. COMM’N, ENFORCEMENT MANUAL (2013) [hereinafter *SEC ENFORCEMENT MANUAL*], available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

35. Revised Enforcement Policy Statement, *supra* note 1, at P 35; *see also* 18 C.F.R. § 1b.19. The subject of an investigation may also make submissions directly to the Commission pursuant to section 1b.18 of the FERC’s regulations. 18 C.F.R. § 1b.18.

36. Revised Enforcement Policy Statement, *supra* note 1, at P 36. The Commission typically attaches Enforcement Staff’s report, but not the subject’s response, to the public SCO.

the issuance of an SCO<sup>37</sup> that the Enforcement Staff members who participated in the underlying investigation—after months and perhaps years of access to the Commission—become non-decisional, and the Office of General Counsel takes over advising the Commission.<sup>38</sup> Importantly, the subject is not permitted any discovery prior to its response, with the very limited exception of receiving copies of the portions of documents or deposition transcript testimony that is quoted or cited in the SCO.<sup>39</sup> Likewise, Enforcement Staff does not usually engage with the subject on the merits of the subject's response.<sup>40</sup>

If the alleged violations occurred under part II of the FPA, then section 31(d) of the FPA gives the subject the right, following the issuance of the SCO to elect to have its liability for the violation and the civil penalty to be adjudicated either through (a) an administrative hearing before an Administrative Law Judge (ALJ) at the Commission, or (b) an immediate penalty assessment by the Commission which a United States district court is authorized to review de novo.<sup>41</sup> However, under the NGPA, the subject does not have a choice and must litigate the proceeding in U.S. district court under a de novo standard and scope of review.<sup>42</sup> The NGA is silent on this issue, and the FERC has interpreted this silence to mean that it is free to assess civil penalties through “a paper hearing or a hearing before an ALJ” and that its orders under the NGA are subject to judicial review in a federal court of appeals, not de novo review by a district court.<sup>43</sup>

If the subject chooses to have its civil penalty liability adjudicated at the Commission, the matter will be set for hearing before a FERC ALJ.<sup>44</sup> Alternatively, if the subject elects to litigate in U.S. district court, the Commission is to “promptly assess” a civil penalty.<sup>45</sup> If the subject does not pay the penalty within sixty days, the Commission may institute an action in the appropriate U.S. district court to enforce the civil penalty.<sup>46</sup> According to section 31(d)(3)(B) of the FPA, “[t]he court shall have authority to review de novo the law and facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part, such assessment.”<sup>47</sup>

Notably, until recently, in almost all enforcement matters that advanced to the show cause stage alleging violations of the FPA, the respondent elected

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37. SCO proceedings are subject to part 385 of the Commission's regulations. *Id.* at P 37. *See also* 18 C.F.R. pt. 385.

38. Revised Enforcement Policy Statement, *supra* note 1, at P 36; Statement of Administrative Policy, *Separation of Functions*, 101 F.E.R.C. ¶ 61,340 at PP 7, 20-22 (2002).

39. *See generally* Revised Enforcement Policy Statement, *supra* note 1.

40. *Id.*

41. 16 U.S.C. § 823b(d)(2)(A)-(B) (2012).

42. 15 U.S.C. § 3414(b)(6)(F) (2012).

43. Statement of Administrative Policy, *Process for Assessing Civil Penalties*, 117 F.E.R.C. ¶ 61,317 at P 7 (2006).

44. 16 U.S.C. § 823b(d)(1).

45. *Id.* § 823b(d)(3)(A). In no instance of which we are aware has the Commission determined that no violation occurred after a subject elected district court review.

46. *Id.* § 823b(d)(3)(B).

47. *Id.*; *see also* 15 U.S.C. § 3414(b)(6)(F).

option (a), an evidentiary hearing to address the contested issues of material fact before a FERC ALJ. Most of those cases settled before reaching the hearing proceeding. However, within the last eighteen months there have been three instances where the subject has chosen option (b) and will have the FERC's claims against it adjudicated in a U.S. district court with de novo review.<sup>48</sup>

### III. DUE PROCESS CONCERNS AND SUGGESTED PROCEDURAL REFORMS

#### A. *The FERC's Section 1b.19 "Wells" Process*

A robust and meaningful section 1b.19 "Wells Process" is critical to the Commission's fair determination of whether Enforcement Staff has sufficient evidence to support its allegations.<sup>49</sup> In our previous article, we raised concerns about the Commission's need for a more robust 1b.19 process similar to that used by the SEC.<sup>50</sup> The SEC Wells Process not only "inform[s the SEC] of the findings made by its staff but also, where practicable and appropriate, [permits review of] the position of persons under investigation at the time it is asked to consider enforcement action."<sup>51</sup>

In Commission Order No. 711, the FERC stated that the subject of an investigation will have "the right, in all but extraordinary circumstances," to be informed of Enforcement Staff's intent to recommend institution of an enforcement action "and to have the opportunity to provide . . . a written nonpublic response to staff's recommendations."<sup>52</sup> In line with the SEC's Wells Process, the section 1b.19 notice (1b.19 Notice) to subjects must "provide sufficient information and facts to enable the subject to make such a response."<sup>53</sup> Unfortunately, in practice the Commission's implementation of its section 1b.19 "Wells Process" has raised some serious concerns regarding the Commission's commitment to give subjects the opportunity to fully and fairly present their case to the Commission.

First, Enforcement Staff and the Commission often treat the section 1b.19 process as a mere formality and not as a true opportunity to consider the defenses and arguments raised in a subject's 1b.19 response. As noted earlier, in the Barclays proceeding, the Commission endorsed Enforcement Staff's refusal to respond to the defenses raised by investigation subjects.<sup>54</sup> In that case, the

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48. See, e.g., CES and Silkman's Unopposed Motion for Enlargement and Election of Remedies, *Competitive Energy Servs., LLC*, FERC Docket Nos. IN12-12-000, IN12-13-000 (July 27, 2012); Notice of Election of Lincoln Paper and Tissue, LLC, *Lincoln Paper & Tissue, LLC*, FERC Docket No. IN12-10-000 (Aug. 14, 2012); Notice of Election of Barclays Bank PLC, *Barclays Bank PLC*, FERC Docket No. IN08-8-000 (Nov. 29, 2012).

49. See generally 2010 Article, *supra* note 9, at 73-74.

50. *Id.* at 73-76.

51. SEC ENFORCEMENT MANUAL, *supra* note 34, at 22. As discussed below in Part III.D.1, the SEC's regulations also give subjects the right to request to inspect and copy the non-privileged documents, testimony, and analyses in Staff's investigative file, which subjects may then use to prepare their response. *Id.* at 24-25; 17 C.F.R. § 201.230(a)(1) (2013).

52. Order No. 711, *Submissions to the Commission upon Staff Intention to Seek an Order to Show Cause*, 123 F.E.R.C. ¶ 61,159 at P 4 (2008) [hereinafter Order No. 711].

53. *Id.*

54. Barclays Penalty Assessment Order, *supra* note 2, at P 18.

Enforcement Staff report attached to the show cause order simply asserted that it disagreed with Barclays' defenses but did not explain why.<sup>55</sup> As a result, Barclays claimed that Enforcement Staff had deprived it of due process insofar as it "prevented Barclays from knowing, and thereby responding to, [Enforcement Staff's] reasons for rejecting th[o]se agreements."<sup>56</sup>

In the Barclays Penalty Assessment Order, the Commission tellingly rejected that argument.<sup>57</sup> According to the Commission, the purpose of the section 1b.19 process is only to inform the subject of the nature of the alleged violations and to give the subject an opportunity to respond.<sup>58</sup> Even though Enforcement Staff is to "give consideration to the legal and factual arguments put forward by the subject of [the] investigation, it is under no obligation to provide any response."<sup>59</sup> The Commission added that Barclays had not been harmed by staff's failure to respond to its arguments in the show cause order and that the Commission had considered those arguments and was responding to those arguments in the civil penalty assessment order.<sup>60</sup> But even then, the Commission barely addressed Barclay's defenses, dismissing them in broad, sweeping, conclusory pronouncements without any real analysis.<sup>61</sup> In the end, this approach hinders the subject's ability to get a fair and meaningful review of the merits and ultimately thwarts the Commission's ability to fully evaluate and understand both sides of the case. Fixing this part of the process is essential.<sup>62</sup>

Second, subjects are routinely denied "sufficient information and facts to enable the subject" to respond to Staff's allegations.<sup>63</sup> Section 1b.19 Notices frequently do not include citations to the relevant record evidence, deposition testimony, or analyses supporting Enforcement Staff's allegations. In at least

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55. Order to Show Cause and Notice of Proposed Penalty, *Barclays Bank PLC*, 141 F.E.R.C. ¶ 61,084 (2012) [hereinafter *Barclays Show Cause Order*]. Section II of the attached *Enforcement Staff Report and Recommendation* states that "[s]taff has carefully considered the subjects' 1b.19 responses and recommends the issuance of an Order to Show Cause and Notice of Proposed Penalty attaching this report." *Id.* app. A. § II.

56. Answer of Barclays Bank PLC to Order to Show Cause and Notice of Proposed Penalties, *Barclays Bank PLC*, No. IN08-8-000 (Dec. 14, 2012).

57. Barclays Penalty Assessment Order, *supra* note 2, at P 18.

58. *Id.*

59. *Id.*

60. *Id.*

61. *See generally id.* at PP 18-24.

62. While the SEC enforcement staff is not required to respond to a subject's Wells submission or to inform the subject of any comments on the Wells submission that the staff makes to the SEC's commissioners, the SEC does give careful consideration to subjects' Wells submissions and defenses. Indeed, the SEC recently released data indicating that the SEC decided not to take enforcement action against approximately 20% of individuals that received a Wells Notice during the period from September 2010 through September 2012. *See, e.g.,* Jean Eaglesham, *Probes Dry Up After 'Wells': SEC Ends 20% of Cases Against Individuals Once Warning Notice Is Issued*, WALL ST. J., Oct. 10, 2013, at C1, available at <http://online.wsj.com/news/articles/SB20001424052702304500404579125633137423664>. The FERC has not released similar data, and recent FERC Reports on Enforcement do not indicate that any FERC investigations were terminated after a subject received and responded to a 1b.19 notice. *See, e.g.,* 2013 REPORT ON ENFORCEMENT, *supra* note 18, at 22-26; OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, No. AD07-13-005, 2012 REPORT ON ENFORCEMENT 19-23 (2012), available at <http://www.ferc.gov/legal/staff-reports/11-15-12-enforcement.pdf>; OFFICE OF ENFORCEMENT, FED. ENERGY REGULATORY COMM'N, No. AD07-13-004, 2011 REPORT ON ENFORCEMENT 19-23 (2011), available at <http://www.ferc.gov/legal/staff-reports/11-17-11-enforcement.pdf>.

63. Order No. 711, *supra* note 52, at P 4.

one case, Enforcement Staff's 1b.19 Notice did not include even a *single* specific record cite. In other cases, the 1b.19 Notice is simply a letter referring back to an earlier preliminary notice of violation but, as discussed above, without any commentary by Enforcement Staff on the factual or legal arguments raised by the subject in their first response. Indeed, the inclusion of citations is meant to act as a check to ensure that Enforcement Staff's claims are supported by sufficient evidence and that Enforcement Staff members do not distort the record (for example, by paraphrasing statements or taking them out of context) to support unfounded claims. This concern is all the more significant in light of the fact that subjects generally do not have access to the investigative record and thus cannot ascertain whether the evidence relied on by Enforcement Staff is taken from documents or testimony provided by the subject or third parties.<sup>64</sup>

Third, subjects generally do not receive Enforcement Staff's response to the subject's 1b.19 response that staff provides to the Commission. This puts the subject at a significant disadvantage vis-à-vis Enforcement Staff; through this process, Enforcement Staff gains an extra opportunity to persuade the Commissioners and to respond unanswered to the subject's defenses (an opportunity that subjects do not have). Indeed, the failure of Enforcement Staff to ever meaningfully engage on the merits with the investigation subject pervades the entire investigative process.

Consequently, subjects of investigations often must guess what evidence, economic theory, or legal authority, if any, may support Enforcement Staff's claims. Refusing to engage on the merits, along with failing to provide citations, violates the requirement that the 1b.19 Notice should "provide sufficient information and facts to enable the subject" to respond to staff's allegations.<sup>65</sup> To ensure that the subjects' due process rights are protected, Enforcement Staff should be required to provide all appropriate citations and record evidence for their assertions and allegations and to respond in writing on the merits and to the arguments and defenses subjects raise in the 1b.19 process. The FERC should also require Enforcement Staff to provide the subject a copy of Enforcement Staff's response to the Commission. Ultimately, this will sharpen the focus of the issues presented to the Commission and develop a far more robust record for the Commission (and potentially the courts) to evaluate.

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64. This is concerning given recent Commission allegations of violations of section 35.41(b) of its regulations. 18 C.F.R. § 35.41(b) (2013). Section 35.41(b) does not require any showing of intent to mislead; if an investigation subject responds to a citation-less 1b.19 Notice in good faith, it may have significant repercussions if the subject is mistaken regarding the underlying facts. For instance, the Commission recently suspended JPMVEC's market based rate authority for six months for making misleading statements in violation of section 35.41(b). *See, e.g.,* Order Suspending Market-Based Rate Authority, *J.P. Morgan Ventures Energy Corp.*, 141 F.E.R.C. ¶ 61,131 (2012). The misleading communications there were legal arguments based on the premise that a condition precedent had not been met. As it turned out, the condition precedent had been met, leading to the eventual conclusion that the legal arguments, and supporting statements, were misleading.

65. Order No. 711, *supra* note 52, at P 4.

### B. *Ex Parte Communications and Separation of Functions*

Another major flaw in the current FERC enforcement process is the timing of when the Commission's ex parte and separation of functions rules are triggered in enforcement matters.

Rules on ex parte (or off-the-record) communications and separation of functions are intended to protect due process rights and ensure the integrity of proceedings by limiting off-the-record communications. In order to ensure the integrity of the process, and the subject's due process rights, the Commission should adopt ex parte rules that are triggered earlier in the process than they are under the current rules. From a conservative due process point of view,<sup>66</sup> the ex parte rules should be triggered when the Commission authorizes Enforcement Staff to conduct an investigation. If not then, at a minimum, fairness and due process require that these rules begin to apply no later than the date Enforcement Staff sends the subject a 1b.19 Notice and the process by which each side presents its position to the Commission officially begins.

When the Commission first implemented its new penalty authority under the Energy Policy Act of 2005 (EPA 2005), the Commission took the position that its ex parte and separation of functions rules<sup>67</sup> did not apply to part 1b investigations.<sup>68</sup> In response to strong objections raised by the regulated community,<sup>69</sup> the Commission revised its procedures to apply the ex parte and separation of functions rules upon issuance of a show cause order.<sup>70</sup> The Commission justified its decision to adopt the issuance of the show cause order as the triggering event for the application of these rules because, in the Commission's view, "it is the most logical and clearly delineated event to begin application of the rules" and "provides a clear demarcation point"<sup>71</sup> for Staff and subjects to comply with these rules.<sup>72</sup> However, triggering the ex parte rules this late in the process has eroded fundamental fairness. It allows only one litigant—Enforcement Staff—to have sanctioned off-the-record communications with the

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66. We recognize that a proper balance must be struck between when the ex parte rules are triggered and the Commission's orderly administration of its investigations. That being said, the current rules are tilted too far in one direction. We offer a menu of reforms on this issue in the hope that the Commission will consider the various options in the technical conference we have recommended.

67. 18 C.F.R. §§ 385.2201 to .2202 (2013).

68. See generally Statement of Administrative Policy, *Separations of Functions*, 101 F.E.R.C. ¶ 61,340 (2002).

69. These objections, particularly those raised in *Energy Transfer Partners*, 128 F.E.R.C. ¶ 61,269 (2009), were detailed in the authors' previous article. See generally 2010 Article, *supra* note 9.

70. See generally Notice of Proposed Rulemaking, *Ex Parte Contacts and Separation of Functions*, 123 F.E.R.C. ¶ 61,158 at PP 7-8, 11 (2008).

71. *Id.* at P 7.

72. The Commission adopted its proposal over the objections of several commenters who urged the Commission to extend the rules applying equal treatment of Enforcement Staff and subjects to include the early stages of the investigation, because "allowing Commission investigative staff unrestricted access to decisional employees, while allowing the subject of an investigation only written communication, puts the subject of an investigation at a disadvantage in making its case to the Commission." Order No. 718, *Ex Parte Contacts and Separation of Functions*, 125 F.E.R.C. ¶ 61,063 at P 21 (2008). The objections were made by the Industry Association, which "consist[ed] of the American Gas Association, the Edison Electric Institute, the Electric Power Supply Association, the Independent Petroleum Association of America, the Interstate Natural Gas Association of America, the Natural Gas Supply Association, and the Process Gas Consumers Group." *Id.* at P 5 n.9.

Commission during the Commission's first meaningful merits decision. As long as Enforcement Staff is permitted unfettered access to the Commission prior to the issuance of a show cause order, while the subject is limited to written communications, the subject of an investigation will be at a distinct disadvantage.

The start of an investigation or the provision of a 1b.19 Notice are each discrete, "clearly delineated events" that provide a "demarcation point" that is every bit as "clear" as the date of the show cause order.<sup>73</sup> By enacting the ex parte and separation of functions rules at the start of an investigation, the Commission could ensure that the process is not tainted by off-the-record communications with Enforcement Staff and would strengthen the subject's due process protections. At the very least, once Enforcement Staff has completed the fact-finding phase of its investigation and provided a 1b.19 Notice, there is certainly no longer any justification for Enforcement Staff to continue to enjoy exclusive or privileged access to the Commission.<sup>74</sup>

In sum, the current process on when the ex parte rules apply, combined with a form-over-substance 1b.19 "Wells" review process, undermine the due process rights of entities subject to the Commission's regulations. The current structure cannot possibly "ensure that the subjects of an investigation receive due process both in perception and reality."<sup>75</sup> The reforms we suggest in these two areas alone are essential to restoring the integrity of the Commission's administrative review of enforcement matters.

### C. Disclosure of Exculpatory Information Pursuant to *Brady v. Maryland*

One of the fundamental principles of due process is that the government is not permitted to hide information from the accused that may aid in his or her defense.<sup>76</sup> In *Brady v. Maryland*, the U.S. Supreme Court held that the government has a constitutional obligation to disclose all evidence that is "favorable to an accused" or that "would tend to exculpate him or reduce the penalty."<sup>77</sup> Because of the long acknowledged similarities between criminal sanctions and administrative penalties,<sup>78</sup> *Brady* disclosures must be made where an administrative agency seeks to impose a civil penalty.<sup>79</sup> *Brady* thus reflects a

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73. 123 F.E.R.C. ¶ 61,158 at P 7.

74. Moreover, before the ex parte rules go into effect, the FERC should require Enforcement Staff's communications with Commissioners and their advisors to be in writing. This will preserve an administrative record similar to that which is currently maintained in non-enforcement matters.

75. Revised Enforcement Policy Statement, *supra* note 1, at P 21.

76. *See, e.g., Brady v. Maryland*, 373 U.S. 83 (1963).

77. *Id.* at 87-88 (holding that the obligation to disclose "favorable" information is rooted in the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution). The failure to disclose exculpatory materials "violates due process . . . irrespective of the good faith or bad faith of the prosecution." *Id.* at 87. The Supreme Court subsequently found that the Fifth Amendment's Due Process Clause also requires *Brady* disclosure in the context of prosecutions by the federal government. *United States v. Agurs*, 427 U.S. 97, 114-15 (1976).

78. *See, e.g., Lees v. United States*, 150 U.S. 476, 478-79 (1893) ("[A]lthough the recovery of a penalty is a proceeding criminal in its nature, . . . in this class of cases it may be enforced in a civil action, and in the same manner that debts are recovered in the ordinary civil courts.").

79. *See, e.g., Sperry & Hutchinson Co. v. Federal Trade Comm'n*, 256 F. Supp. 136, 142 (S.D.N.Y. 1966) ("[T]he essentials of due process at the administrative level require similar disclosures [i.e., as *Brady*] by

commitment to the principle that the government's paramount interest in all proceedings "is not that it shall win a case, but that justice shall be done."<sup>80</sup>

The *Brady* rule is a principle of disclosure, rather than discovery.<sup>81</sup> Disclosure is mandatory; the material does not need to be requested by a defendant.<sup>82</sup> Moreover, *Brady* requires not only that prosecutors disclose exculpatory or potentially exculpatory materials known to it, but *Brady* also imposes an affirmative "duty to search" for exculpatory evidence in their own files,<sup>83</sup> as well as "a duty to learn of any favorable evidence known to the *others* acting on the government's behalf."<sup>84</sup> Because of the breadth of the *Brady* principle, the Supreme Court has repeatedly cautioned the government to "resolve doubtful questions in favor of disclosure."<sup>85</sup>

As early as 1980,<sup>86</sup> the Commodity Futures Trading Commission (CFTC) adopted *Brady*'s disclosure requirements, requiring its enforcement staff to provide subjects with all deposition transcripts and documents obtained during an investigation and to use "due diligence" to provide subjects with all "arguably exculpatory" materials "within the possession, custody or control" of the CFTC.<sup>87</sup> The SEC has also adopted *Brady*'s requirements in its regulations, requiring the SEC's enforcement division to provide to the subject of an

the agency where consistent with the public interest."); *Equal Emp't Opportunity Comm'n v. Los Alamos Constructors, Inc.*, 382 F. Supp. 1373, 1383 n.5 (D.N.M. 1974) (holding that *Brady* applies to civil enforcement proceedings because "[a] defendant in a civil case brought by the government should be afforded no less due process of law").

80. *Berger v. United States*, 295 U.S. 78, 88 (1935). The government has a broad duty to identify and disclose any materials or information "favorable" to a defendant. *See, e.g., Giglio v. United States*, 405 U.S. 150, 153-54 (1972). "The meaning of the term 'favorable' under *Brady* is not difficult to discern. It is any information in the possession of the government . . . that relates to guilt or punishment and that tends to help the defense by either bolstering the defense case or impeaching potential prosecution witnesses." *United States v. Safavian*, 233 F.R.D. 12, 16-17 (D.D.C. 2005) ("[P]retrial . . . the government must always produce any potentially exculpatory or otherwise favorable evidence without regard to how the withholding of such evidence might be viewed—with the benefit of hindsight—as affecting the outcome of the trial.").

81. *See, e.g., United States v. Bagley*, 473 U.S. 667, 675 n.7 (1985).

82. *Agurs*, 427 U.S. at 107. *Brady* actually requires less of prosecutors than the ethical standards to which all prosecutors are otherwise subject. *See, e.g., Kyles v. Whitley*, 514 U.S. 419, 437 (1995) "[T]he rule in *Bagley* (and, hence, in *Brady*) requires less of the prosecution than the ABA Standards for Criminal Justice, which call generally for prosecutorial disclosures of any evidence tending to exculpate or mitigate." *Id.* (citing STANDARDS FOR CRIMINAL JUSTICE, PROSECUTION FUNCTION & DEF. FUNCTION 3-3.11(a) (1993)). *See also* D.C. RULES OF PROF'L CONDUCT R. 3.8 (2007).

83. *United States v. Brooks*, 966 F.2d 1500, 1503 (D.C. Cir. 1992).

84. *Kyles*, 514 U.S. at 437. Where no favorable material is disclosed, courts have required the government to sufficiently describe the nature and scope of the search actually conducted in order to evaluate the thoroughness and propriety of the government's conduct. *See, e.g., United States v. Naegle*, 468 F. Supp. 2d 150, 152 n.2 (D.D.C. 2007) (noting that courts "no longer accept[] conclusory assertions by the Department of Justice that it 'understands' its *Brady* obligations and 'will comply' or 'has complied' with them").

85. *Agurs*, 427 U.S. at 108; *see also United States v. Paxson*, 861 F.2d 730, 737 (D.C. Cir. 1988).

86. The CFTC initially adopted the *Brady* rule through ALJ decisions. *See, e.g., First Guaranty Metals, Co.*, No. 79-55, 1980 WL 15696, at \*9 (CTFC July 2, 1980) ("The *Brady* rule is not a discovery rule rather it is a rule of fairness and minimum prosecutorial obligation. Since *Brady* is premised upon due process grounds we hold that its principles are applicable to administrative enforcement actions such as this which, while strongly remedial in nature, may yield substantial sanctions." (citation omitted)); *see also Bilello*, No. 93-5, 1997 WL 693557 (CFTC Oct. 1, 1997); *Schiller*, No. 96-4, 2002 WL 2007921 (CFTC Sept. 3, 2002).

87. 17 C.F.R. § 10.42(b) (2013); *see also Schiller*, 2002 WL 2007921, at \*1 n.7 (citing other relevant cases).



investigation copies of all depositions and documents produced by third parties in the course of the investigation, as well as internal staff analyses, and prohibiting staff from “withhold[ing], contrary to the doctrine in *Brady v. Maryland*, documents that contain material exculpatory evidence.”<sup>88</sup>

After the issue of *Brady* was raised in *Energy Transfer Partners* in 2009, the Commission adopted its *Brady Policy Statement*, announcing that “the principle of *Brady* should apply to [s]ection 1b investigations and administrative enforcement actions.”<sup>89</sup> The policy requires Enforcement Staff to “scrutinize materials it receives from sources other than the investigative subject(s) for material that would be required to be disclosed under *Brady*. Any such materials or information . . . not known to be in the subject’s possession *shall be provided* to the subject.”<sup>90</sup> The Commission stated that it adopted the *Brady* policy in order to advance “the Commission’s goal of providing fairness to regulated entities appearing before it,”<sup>91</sup> to “contribute to its goal of open and fair investigations and enforcement proceedings,”<sup>92</sup> and to promote “*maximum* fairness in its [s]ection 1b investigations.”<sup>93</sup>

In practice, the *Brady Policy Statement* has been poorly implemented. Enforcement Staff routinely fails to produce exculpatory documents, either in response to general requests for *Brady* materials or in response to requests for particular categories of documents. Disturbingly, in some cases Enforcement Staff has only provided *exculpatory* materials after repeated, specific requests.<sup>94</sup> Enforcement Staff has also, at times, disclosed only *inculpatory* evidence cited in the Enforcement Staff report or show cause order,<sup>95</sup> rather than the *exculpatory* evidence required under *Brady*. And, in no instance that we can recall has Enforcement Staff disclosed *Brady* materials without the subject first requesting such disclosure.

Enforcement Staff has also often failed to provide *Brady* materials obtained from third parties, in particular, from independent system operators and regional transmission organizations (ISOs/RTOs) and their market monitoring units (MMUs). It is well established that *Brady* requires government prosecutors to affirmatively search the files of both its own investigators and those of “other

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88. 17 C.F.R. § 201.230. In addition to the FERC, SEC, and CFTC, the Federal Deposit Insurance Commission and the Federal Maritime Commission have adopted the *Brady* rule. See, e.g., *Exclusive Tug Franchises*, No. 01-06, 2001 WL 1085431 (Fed. Maritime Comm’n Aug. 14, 2001); *Jenson*, No. FDIC-95-65e, 1997 WL 33774615 (Fed. Deposit Ins. Corp. Apr. 7, 1997).

89. *Brady Policy Statement*, *supra* note 9, at PP 2, 7.

90. *Id.* at P 9 (emphasis added).

91. *Id.* at P 2.

92. *Id.* at P 8.

93. *Id.* (emphasis added).

94. In at least one instance, Enforcement Staff used third-party documents in depositions that were classic *Brady* material. There, Enforcement Staff initially declined to produce the documents despite several specific requests. When Enforcement eventually produced some of the documents, it insisted that they were not *Brady* material and that it was only producing them as a “courtesy.”

95. See, e.g., *Deutsche Bank Show Cause Answer*, *supra* note 4, exhibit B. There, Enforcement Staff initially responded that there were no *Brady* materials, and then concurrent with or shortly after the issuance of the show cause order, Staff provided only those inculpatory materials cited in the show cause order itself. *Id.*

branches of government ‘closely aligned with the prosecution.’”<sup>96</sup> An entity is “closely aligned with the prosecution,” or otherwise “acting on the government’s behalf,” if the investigative agents are acting pursuant to the prosecutor’s authority,<sup>97</sup> or, in the case of parallel investigations, if “the agencies are engaged in joint fact-gathering.”<sup>98</sup> ISOs/RTOs and their MMUs are unquestionably members of the Commission’s “prosecution team.”<sup>99</sup> Consequently, in applying the *Brady* rule, FERC Enforcement Staff should be required to disclose to subjects any relevant exculpatory information that staff has in its possession, as well as any exculpatory evidence in the possession of the ISO/RTO or MMU.

Enforcement Staff’s conduct falls far short of *Brady*’s constitutional requirements. The Commission should take immediate steps to ensure that Enforcement Staff is meeting its *Brady* obligations. As discussed in the following section, we believe one way to protect a subject’s due process rights and to remove any incentive Enforcement Staff may have to withhold *Brady* materials, is to give subjects meaningful discovery rights.

#### D. Discovery

##### 1. Subjects of Investigations Should Have Reasonable Discovery Rights

The Commission could prevent *Brady* violations and protect subjects’ other due process rights by granting subjects meaningful discovery rights in enforcement investigations, including access to the full investigative record. Under the Commission’s rules, subjects of investigations have no discovery rights at all.<sup>100</sup> While the Commission’s rules permit the subject of an investigation to respond to Enforcement Staff’s allegations<sup>101</sup> or to “submit

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96. *United States v. Safavian*, 233 F.R.D. 12, 17 (D.D.C. 2005) (quoting *United States v. Brooks*, 966 F.2d 1500, 1503 (D.C. Cir. 1992)).

97. *Moon v. Head*, 285 F.3d 1301, 1309 (11th Cir. 2002); *see also United States v. Wilson*, 237 F.3d 827, 832 (7th Cir. 2001) (“[I]t is impossible to say in good conscience that the U.S. Marshal’s Service was not ‘part of the team’ that was participating in the prosecution, even if the role of the Marshal’s Service was to keep the defendants in custody rather than to go out on the streets and collect evidence.”).

98. *United States v. Gupta*, 848 F. Supp. 2d 491, 494 (S.D.N.Y. 2012) (rejecting the argument that the SEC’s pursuit of separate charges rendered it a separate “prosecutorial team” during joint investigation).

99. MMUs are “responsible for carrying out the market monitoring functions that FERC has ordered Commission-approved system operators and regional transmission organizations to perform.” 18 C.F.R. § 35.28(b)(7) (2013) (emphasis added); *see also Order No. 719, Wholesale Competition in Regions with Organized Electric Markets*, 125 F.E.R.C. ¶ 61,071 at P 314 (2008).

100. Further, as discussed below in Part III.F, the FERC has taken the extraordinary and incorrect position that the subject of an investigation should not be given any opportunity to conduct discovery in any subsequent civil penalty enforcement action in U.S. district court. *See, e.g.*, Petition for an Order Affirming the Federal Energy Regulatory Commission’s August 29, 2013 Order Assessing Civil Penalty Against Lincoln Paper and Tissue, LLC ¶ 86, *FERC v. Lincoln Paper & Tissue, LLC*, No. 1:13-CV-13056 (D. Mass. Dec. 2, 2013) [hereinafter *Petition to Affirm Lincoln Penalties*]; Petition for an Order Affirming the Federal Energy Regulatory Commission’s August 29, 2013 Orders Assessing Civil Penalties Against Richard Silkman and Competitive Energy Services, LLC ¶ 81, *FERC v. Silkman*, No. 1:13-CV-13054 (D. Mass. Dec. 2, 2013) [hereinafter *Petition to Affirm Silkman/CES Penalties*]; Petition for an Order Affirming the Federal Energy Regulatory Commission’s July 16, 2013 Order Assessing Civil Penalties Against Barclays Bank PLC, Daniel Brin, Scott Connelly, Karen Levin, and Ryan Smith ¶ 124, *FERC v. Barclays Bank PLC*, No. 2:13-cv-02093 (E.D. Cal. Oct. 9, 2013) [hereinafter *Petition to Affirm Barclays Penalties*].

101. *See generally* 18 C.F.R. § 1b.19.

*documents, statements of facts* or memoranda of law for the purpose of explaining said person's position *or furnishing evidence said person considers relevant*,<sup>102</sup> such rights are not meaningful when the subject has no opportunity to discover facts and information that it deems relevant to its position.<sup>103</sup> Moreover, as discussed below, nonpublic investigations without meaningful discovery cannot constitute an administrative record sufficient to form the basis for an ALJ's or U.S. district court's *de novo* review as the Commission has suggested in its petitions to affirm the penalties it assessed against Lincoln, Barclays, and Silkman/CES.<sup>104</sup>

Granting subjects access to the full investigative record would be relatively simple to implement. For instance, section 201.230 of the SEC's regulations could serve as a useful model for the Commission in this regard, providing the subject of a disciplinary proceeding the right to discover the documents, testimony, and expert reports obtained or prepared by SEC enforcement staff and its experts in the course of an investigation, including:

1. Each subpoena issued;
2. Every other written request to persons not employed by the Commission to provide documents;
3. The documents turned over in response to any such subpoenas or other written requests;
4. All transcripts and transcript exhibits;
5. Any other documents obtained from persons not employed by the Commission; and
6. Any final examination or inspection reports prepared by the Office of Compliance Inspections and Examinations, the Division of Market Regulation, or the Division of Investment Management, if the Division of Enforcement intends either to introduce any such report into evidence or to use any such report to refresh the recollection of any witness.<sup>105</sup>

The SEC's regulations provide that certain categories of documents may be withheld from disclosure, including privileged, confidential, or deliberative documents, but importantly, not "documents that contain material exculpatory evidence."<sup>106</sup> In the FERC context, this would mean that the FERC should provide subjects access to the full investigative record (with the exception of

102. *Id.* § 1b.18 (emphasis added).

103. The Commission has indicated that the subjects of an investigation receive "due process" because of the right provided by section 1b.18 of the FERC's regulations to submit facts and information to the Commission. But no due process can be conferred when the right providing it is itself illusory. Unless investigation subjects are granted reasonable discovery rights, there will be no mechanism by which they can reliably gain exculpatory facts and information held by third parties and, thus, no meaningful way that they can present such facts or information to the Commission.

104. The Commission has suggested to two federal courts that the courts can and "should" approve penalty assessments on the basis of administrative records where the subjects have been denied any substantive discovery. *See, e.g.*, Petition to Affirm Lincoln Penalties, *supra* note 100, ¶ 86; Petition to Affirm Silkman/CES Penalties, *supra* note 100, ¶ 81; Petition to Affirm Barclays Penalties, *supra* note 100, ¶ 124. Moreover, in the FERC's view, the "administrative record" consists only of the documents and testimony provided by the subject and the third-party materials that are cited in the SCO or penalty order.

105. 17 C.F.R. § 201.230(a)(1) (2013). As discussed above, the CFTC's regulations impose similar *Brady* disclosure requirements. *Id.* § 10.42(b).

106. *Id.* § 201.230(b)(2).

certain privileged documents) at the time it issues the 1b.19 Notice to assist subjects in making their case to the FERC's Commissioners.

In addition, if the Commission were to adopt our "discovery master" suggestion (discussed below in Part 0), we suggest that, in addition to the discovery permitted by SEC rule 230, subjects also be granted the right to pursue limited third-party discovery pursuant to the Commission's subpoena authority (as authorized by the discovery master).

2. The Commission Should Adopt Clear and Reasonable Limitations on the Scope of Enforcement Staff Discovery<sup>107</sup>

The Commission should also address the oftentimes burdensome nature of investigative discovery. At some point in almost every investigation, the subject is forced to evaluate the on-going cost and organizational burden of Enforcement Staff discovery against paying to settle the investigation regardless of the merits of the matters being investigated. Placing subjects in this type of Hobson's choice certainly does not "ensure that the subjects of an investigation receive due process both in perception and reality."<sup>108</sup>

As a result, we recommend that there be *some initial limits* on discovery and that the Commission adopt soft caps on data requests, interrogatories and depositions propounded by Enforcement Staff in 1b investigations. In the event Enforcement Staff reaches or exceeds the soft cap, it can either seek the subject's voluntary acceptance of additional discovery or, upon a showing of good cause, can request additional discovery from the relevant decisional authority (which we discuss below in Part III.D.3).<sup>109</sup>

In our experience, Enforcement Staff's discovery is either direct, targeted, and limited in nature, or it is broad, brutal, and overwhelming. To some degree, this is dependent on the type of case, the vigor with which Enforcement Staff and the subject conduct themselves, and the clarity of the subject's responses. Investigating some allegations simply requires more intensive discovery than other allegations; an alleged violation involving dozens of individuals in multiple locations over an extended period of time will reasonably require more discovery than an alleged violation by one or two individuals in a single location over a discrete period.

However, responding to Enforcement Staff's discovery requests can, at times, be more costly than paying a reasonable settlement or a civil penalty. The Commission "recognize[d] the financial and time burdens that compliance with discovery requests impose on companies, which must continue to conduct their

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107. Such limitations should also apply to any discovery rights granted to investigation subjects. See *supra* Part III.D.1.

108. Again, we recognize that a balance must be struck between protecting due process rights and not impeding the Commission's ability to investigate potential wrongdoing. But the current balance is clearly skewed. This topic should be explored in the technical conference we recommend that the Commission hold.

109. The Commission has indicated that "good faith disputes regarding discovery . . . issues, will not be considered in determining whether the subject of an investigation has cooperated with staff and will not cause the subject of an investigation to forego possible credit for exemplary cooperation." Revised Enforcement Policy Statement, *supra* note 1, at P 22. This should apply to instances where the subject opposes Enforcement Staff's requests for additional discovery.

ordinary business while at the same time meeting staff's needs."<sup>110</sup> Nonetheless, the Commission's rules impose no limitation on the volume of discovery to which Enforcement Staff is entitled.<sup>111</sup> In cases where Enforcement Staff does not voluntarily discipline itself, there is no effective mechanism for the subject of an investigation to use to resolve discovery disputes.<sup>112</sup>

For instance, in some nonpublic investigations, Enforcement Staff has propounded hundreds of data requests (with hundreds more sub-parts) and conducted as many as thirty depositions—sometimes deposing the same witnesses over and over again.<sup>113</sup> Whether such discovery was truly needed for legitimate prosecutorial purposes, or simply part of Enforcement Staff's litigation tactics, is beyond the scope of this article. But no one could legitimately dispute that the costs of such discovery can be punitive.

Placing limits on discovery is hardly a unique or novel suggestion.<sup>114</sup> The Federal Rules of Civil Procedure (FRCP or the Federal Rules) currently limit depositions and written interrogatories to no more than ten, seven-hour, depositions<sup>115</sup> and twenty-five written interrogatories,<sup>116</sup> "including all discrete

110. *Id.* at P 29.

111. *Id.*

112. *See* discussion *infra* Part III.D.3.

113. In at least one nonpublic matter, Enforcement Staff argued that six days of depositions taken over a two-year period were all part of a single, "continuing" deposition.

114. Similar arguments to the one we raise here have previously been suggested to the Commission. In the Commission's proceeding that resulted in the issuance of the *Revised Enforcement Policy Statement*, Concerned Consumers argued that rule 385.402 should be revised to create presumptive limits on discovery and that additional discovery should only be permitted by order of a FERC ALJ:

[The Commission's discovery rule] appears to permit an unlimited amount of discovery requests to be issued by a party. For example, it would appear to permit one entity to issue literally thousands of discovery requests to an adversary. This is patently unfair and results in a significant and unnecessary resource drain. Further, it encourages entities to not take the time and diligence necessary to comprehensively review materials provided in response to prior data requests, as it is easier for them to simply issue additional data requests if their particular interests are now slightly more fine-tuned than previously. In short, it encourages inefficiency and off-the-cuff action, instead of a well prepared and well thought out approach. . . . This is especially important in an adversarial proceeding as temptation may exist to improperly drain the resources of an adversary through the issuance of a large quantity of discovery requests.

. . . .

[T]he number of discovery requests one party can issue to another party in any FERC proceeding [should be limited] to no more than 50 (with any subparts in a request being counted as if they were individual separate requests). If a party has issued their maximum of 50 discovery requests in a particular proceeding and wishes to issue more, they should have to seek permission from a FERC Administrative Law Judge to do so. . . . Perhaps most importantly, [this suggestion] encourages 'quality' over 'quantity,' and that ultimately benefits all sides to a dispute (and ultimately benefits the Commission).

Comments on Conference on Enforcement Policy at 4-5, *Enforcement Policy*, FERC Docket No. AD07-13-000 (Dec. 11, 2007) (emphasis in original omitted). It should be noted that the comments of the Concerned Consumers specifically excluded the Commission Staff from limited discovery. We disagree with the Concerned Consumers exclusion of Commission Staff, at least insofar as it would apply to Enforcement investigations, but we believe the Concerned Consumers' reasoning is applicable here.

115. FED. R. CIV. P. 30(a)(2).

116. *Id.* at 33(a)(1).

subparts.”<sup>117</sup> If the needs of the case warrant, the parties may seek leave of the court to conduct additional discovery.<sup>118</sup> Recent amendments to the Federal Rules have been proposed that would reduce the cap on interrogatories even further to fifteen from twenty-five and reduce the cap on depositions to five with a presumptive duration of one day of six hours (reducing from one day of seven hours).<sup>119</sup>

While the limits in the Federal Rules may be somewhat low for Enforcement Staff to effectively conduct investigations, a proper balance must be struck between allowing a proper and efficient investigation of potential wrongdoing, especially at the very early stages of an investigation, and protecting the due process rights of the entity being investigated. For instance, we recognize that Enforcement Staff may need greater discovery after it makes a preliminary assessment of potential violations. Striking the right balance on discovery should be a critical subject of the technical conference we recommend the Commission convene.<sup>120</sup>

### 3. The Commission Should Adopt Mechanisms to Resolve Discovery Disputes During Investigations

Discovery disputes in enforcement investigations are common. As with any other type of litigation, when Enforcement Staff seeks discovery using the full arsenal of tools at its disposal—interrogatories, data requests, and depositions or interviews—sometimes their discovery sought is objectionable. Sometimes individual requests or the cumulative effect of multiple requests may result in an undue burden on the subject or the requests may seek irrelevant material or material that is privileged or otherwise protected by law. In some rare instances, requests may even be for improper purposes—such as to harass an individual or witness.<sup>121</sup>

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117. Of course, it is often unclear whether a particular subpart should be considered its own interrogatory or data request under Federal Rule of Civil Procedure 33. *See, e.g.,* Security Ins. Co. of Hartford v. Trustmark Ins. Co., No. 3:01-cv-2198, 2003 U.S. Dist. LEXIS 18196, at \*2-3 (D. Conn. Mar. 7, 2003) (“A subpart is discrete and regarded as a separate interrogatory when it is logically or factually independent of the question posed by the basic interrogatory. Or, stated differently, a subpart is independent and thus discrete when it is unnecessary to the understanding of a second subpart.” (citations omitted)).

118. The Federal Rules also prohibit deponents from being deposed a second time without leave of the court. FED. R. CIV. P. 30(a)(2)(A)(ii). We strongly recommend that the Commission adopt this limitation to prevent witnesses from being deposed over and over again during investigations.

119. Comm. on Rules of Practice & Procedure of the Judicial Conference of the U.S., Preliminary Draft of Proposed Amendments to the Federal Rules of Bankruptcy and Civil Procedure 267-70 (2013), available at <http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf>.

120. Until the Commission adopts some limits on discovery, it should not seek to apply those very same rules to targets of investigations in federal court.

121. An improper request may be one whose sole purpose is to annoy, embarrass, or harass a witness. *See, e.g.,* D.C. RULES OF PROF'L CONDUCT R. 4.4 (2007) (“[A] lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person . . .”); *Id.* R. 8.4(d) (“It is professional misconduct for a lawyer to . . . (d) [e]ngage in conduct that seriously interferes with the administration of justice.”); *see also* D.C. Legal Ethics Comm., Ethics Op. 31 (1977) (asserting that “when an attorney causes a witness to be called for the sole purpose of harassing or degrading that witness, that attorney violates [DC Rules 4.4 and 8.4(d)]”). In one recent investigation, Enforcement Staff deposed a single fact witness for ten days over a two year period. Much of the latter depositions were duplicative; when the witness

We suggest that the Commission permit the appointment of an Administrative Law Judge as a discovery master in nonpublic investigations.<sup>122</sup> A discovery master would offer an efficient means of resolving discovery disputes and would help to ensure that subjects of investigations receive due process. If, as we suggest above, the Commission were also to adopt reasonable presumptive limits on Enforcement Staff's discovery during investigations, a discovery master would be able to grant Enforcement Staff additional leeway when the situation warrants it.

Discovery masters would also enable discovery disputes to be resolved in real-time, such as during depositions. Currently, subjects have no recourse for discovery disputes during depositions other than to walk out, which poses its own substantial risks. For example, at a recent deposition (in a Commission hearing room), the seating was arranged such that defense counsel and the testifying witness were literally surrounded by Enforcement Staff. Defense counsel was seated in between two parallel tables, with the testifying witness at the head of the left hand table. Six members of Enforcement Staff (and a court reporter and videographer) were arranged around the perimeter of the parallel tables. In addition, members of Enforcement Staff sat at the judge's, clerk's, and witness's podiums, and additional members of Enforcement Staff sat in the gallery, along with defense counsel's legal assistants. When defense counsel objected to those seating arrangements, Enforcement Staff merely demurred that there was nothing that they could do even though simply flipping the seating at the main table would have resolved much of the concern. The scene is depicted in Figure A below.

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objected to being re-deposed, Enforcement Staff subpoenaed the witness and described the objections as "uncooperative."

122. The Commission already has a mechanism whereby the Commission can direct the appointment of an ALJ as a discovery master in part 385 proceedings. *See, e.g.*, Notice Directing Appointment of Administrative Law Judge as Discovery Master, at 1 n.2, *American Elec. Power Serv. Corp.*, FERC Docket Nos. ER07-1069-000, ER10-355-000 (Oct. 31, 2013) (citing 18 C.F.R. § 385.604(b)(4) (2013), which provides "for alternative means of dispute resolution in which 'a neutral may be appointed'"). The Commission has also appointed discovery masters in proceedings where the Commission has determined it would be inefficient for the decisional authority to rule on discovery disputes. *See, e.g.*, *San Diego Gas & Elec. Co. v. Sellers*, 101 F.E.R.C. ¶ 61,186 at PP 26 & n.4, 28 (2002) (directing appointment of an ALJ as discovery master to "administer discovery and resolve any potential discovery disputes").

Situations like this, where defense counsel and witnesses have no means of securing relief—other than by walking out of a deposition and being labeled as uncooperative or obstructive—are perfect examples of why a mechanism is needed to resolve real-time disputes in nonpublic investigations. Moreover, when a deponent is asked the same questions time and time again during a deposition or series of depositions, there should be some recourse short of walking out or refusing to answer and having Enforcement Staff claim that failure to give the desired answer is tantamount to noncooperation or obstruction of justice by the deponent.

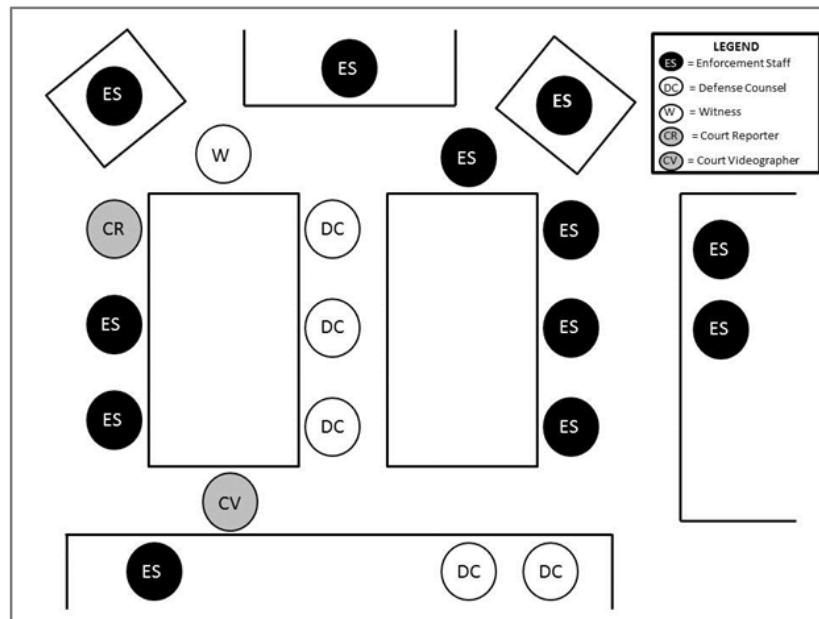


Figure A: Configuration of the Parties during Deposition

In addition to resolving disputes at depositions, discovery masters would also help “streamline discovery.” In our experience, the ability of the parties to seek immediate relief from a decisional authority tends to *decrease* the number of disputes in litigation matters, and other agencies agree. In a *Report for the President on the Use and Results of Alternative Dispute Resolution*, “[t]he Securities and Exchange Commission . . . report[ed] that mediation routinely help[ed] to streamline discovery.”<sup>123</sup> In addition, “[t]he Environmental Protection Agency . . . [reported using] a mediation program to facilitate settlement of administrative civil penalty enforcement cases.”<sup>124</sup> Likewise, “[t]he Small Business Administration National Ombudsman acts as a ‘trouble

123. FED. INTERAGENCY ALT. DISPUTE RESOLUTION WORKING GRP. SECTION & STEERING COMM., REPORT FOR THE PRESIDENT ON THE USE AND RESULTS OF ALTERNATIVE DISPUTE RESOLUTION IN THE EXECUTIVE BRANCH OF THE FEDERAL GOVERNMENT 8 (2007), available at [http://www.adr.gov/pdf/iadrsc\\_press\\_report\\_final.pdf](http://www.adr.gov/pdf/iadrsc_press_report_final.pdf).

124. *Id.* at 4.



shooter' between small businesses and federal agencies on problems perceived as unfair and excessive regulatory enforcement."<sup>125</sup>

The Commission has previously stated that it would consider the use of some form of alternative dispute resolution in investigations and that it would "re-evaluate" its decision not to adopt such alternatives "if warranted by facts and circumstances."<sup>126</sup> We submit that the facts and circumstances of recent investigations warrant re-consideration of this idea.

#### 4. Subjects Should Be Granted Access to Transcripts Within a Reasonable Time After the Conclusion of a Deposition

In a number of nonpublic cases, and in at least one nonpublic order, Enforcement Staff and the Commission have denied witnesses the right to procure copies of, or to inspect, the official transcripts of their own depositions. While the Commission's rules and the APA both unambiguously give a deponent the right to copy and inspect his or her own deposition transcript, the denial of access to transcripts has become commonplace in FERC investigations.<sup>127</sup> We recommend that the Commission end this practice immediately.

Section 1b.12 of the Commission's regulations grants a witness the right to procure or inspect the official copy of her own deposition transcript:

Transcripts, if any, of investigative testimony shall be recorded solely by the official reporter, or by any other person or means designated by the investigating officer. A witness who has given testimony in an investigation shall be entitled, upon written request, to procure a transcript of the witness' own testimony on payment of the appropriate fees, except that in a nonpublic formal investigation, the office responsible for the investigation may for good cause deny such request. In any event, any witness or his counsel, upon proper identification, shall have the right to inspect the official transcript of the witness' own testimony. This provision supersedes § 385.1904(b) of this chapter.<sup>128</sup>

Section 555(c) of the APA grants a witness the same rights to procure or inspect copies:

A person compelled to submit data or evidence is entitled to retain or, on payment of lawfully prescribed costs, procure a copy or transcript thereof, except that in a nonpublic investigatory proceeding the witness may for good cause be limited to inspection of the official transcript of his testimony.<sup>129</sup>

125. *Id.* at 8.

126. Revised Enforcement Policy Statement, *supra* note 1, at P 30; *see, e.g.*, Post-Conference Comments of the Electric Power Supply Association at 4, *Conference on Enforcement Policy*, FERC Docket No. AD07-13-000 (Dec. 17, 2007).

127. *Delegation of the Commission's Authority to Various Staff Office Directors*, 8 F.E.R.C. ¶ 61,299, at p. 61,888 (1979) (stating that there will only be "rare instances in which a denial [of copies] may be appropriate").

128. 18 C.F.R. § 1b.12 (2013).

129. 5 U.S.C. § 555(c) (2012). In passing the APA, Congress explained its reasoning clearly:

The limitation, for good cause, to inspection of the official transcript is deemed necessary where evidence is taken in a case in which prosecutions may be brought later and it is obviously detrimental to the due execution of the laws to permit copies to be circulated. In those cases the witness or his counsel may be limited to inspection of the relevant portions of the transcript. *Parties should in any case have copies or an opportunity for inspection in order to assure that their evidence is correctly*

These provisions create two distinct rights: a right to “procure a transcript” of a witness’s testimony and a right to inspect the official transcript of the witness’s testimony. The right to *inspect* contained in section 1b.12 and APA section 555(c) is unqualified and unambiguous.<sup>130</sup> Although a witness’s right to *procure* a copy of his transcript may be denied for good cause, the right to *inspect* bears no such limitation.<sup>131</sup>

Many other agencies—acting against the backdrop of section 555(c)—have adopted rules virtually identical to Commission rule 1b.12.<sup>132</sup> Each of these agencies has implicitly recognized the significance of the distinction between the right to procure and the right to inspect the official transcript. The SEC, for instance, has found that, though a witness can be denied the right to procure copies of his or her transcript if “‘good cause’ exists [such that] the circulation of copies of such transcripts might nullify the enforcement,” respondents are nonetheless allowed to inspect the relevant portions of their prior transcripts.<sup>133</sup> Likewise, the National Association of Securities Dealers interpreted a self-regulatory organization’s analogous rule to provide that “after the conclusion of his or her investigative interview, a witness is permitted to inspect the official transcript of their interview and may, under appropriate circumstances, procure a copy of such transcript.”<sup>134</sup>

In a nonpublic order, over a Commissioner’s dissent, the Commission denied certain witnesses both copies of, and access to inspect, their own prior deposition testimony before they were each deposed again by Enforcement Staff. In finding “good cause” to deny the witnesses copies of their own transcripts, the Commission relied on circumstances that exist in practically every market manipulation investigation: the alleged existence of ongoing market

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*set forth, to refresh their memories in the case of stale proceedings, and to enable them to be advised by counsel. They should also have such copies whenever needed in legal or administrative proceedings.*

S. REP. NO. 79-752, at 19-20 (1945) (emphasis added); *see also* H.R. REP. NO. 79-1980, at 33 (1946).

130. Notably, the right to *inspect* conferred by section 1b.12 of the FERC’s regulations extends to the “witness *or* his counsel.” 18 C.F.R. § 1b.12 (emphasis added). In several instances, Enforcement Staff has denied counsel alone the right to inspect and offered to permit inspection only if the witness was physically present. Such a condition places an unreasonable and unlawful burden on witnesses who have already appeared for testimony.

131. 5 U.S.C. § 555(c).

132. *See, e.g.*, 10 C.F.R. § 205.8(h)(2) (2013) (Department of Energy); 10 C.F.R. § 820.8(j)(2) (Department of Energy, Nuclear Activities); 12 C.F.R. § 19.183(d) (2013) (Office of the Comptroller of the Currency); 12 C.F.R. § 112.4 (Office of the Comptroller of the Currency); 12 C.F.R. § 238.114 (Federal Reserve); 12 C.F.R. § 390.83 (Federal Deposit Insurance Corporation); 12 C.F.R. § 622.107 (Farm Credit Administration); 12 C.F.R. § 747.806 (National Credit Union Administration); 12 C.F.R. § 1080.9 (Bureau of Consumer Financial Protection); 16 C.F.R. § 2.9(a) (2013) (Federal Trade Commission); 17 C.F.R. § 11.7(b) (2013) (Commodities Futures Trading Commission); 17 C.F.R. § 203.6 (Securities & Exchange Commission); 19 C.F.R. § 163.7(d) (2013) (Customs and Border Protection); 24 C.F.R. § 3800.50(b) (2013) (Housing and Urban Development); 29 C.F.R. § 102.31(e) (2013) (National Labor Relations Board); 29 C.F.R. § 1601.6(b) (Equal Employment Opportunity Commission); Procedures Applicable to RTC Investigations, 58 Fed. Reg. 58,938, 58,940 (Resolution Trust Corp. Nov. 5, 1993).

133. Atlantic Equities Co., Exchange Act Release No. 8818, 43 SEC Docket 354, 1967 WL 87747, at \*10 & n.19 (July 11, 1967).

134. Department of Enforcement v. Respondent, Complaint No. C02050006, 2007 WL 844852, at \*7 (Nat’l Ass’n of Sec. Dealers Feb. 12, 2007) (interpreting NASD Procedural Rule 8210(f)).

manipulation, complex trading activity, and the involvement of multiple traders and other personnel including, potentially, senior management. In denying immediate inspection rights, the Commission reasoned that it could delay exercise of the right to inspect until “an appropriate time,” to be determined at the Commission’s “reasonable discretion.”

The Commission’s decision in that nonpublic order contravenes not only the plain text of the APA and the Commission’s own regulations but also a significant body of federal case law.<sup>135</sup> Federal courts have recognized that a witness has a “significant interest . . . in reviewing a transcript” of her prior testimony before testifying again.<sup>136</sup> As those courts have held, “[i]n cases where the witness may testify again in the same investigation, as here, the witness has an additional reason to review the transcript of the prior testimony: to help prepare for the upcoming testimony.”<sup>137</sup> This interest arises because it “is not uncommon for a witness to testify honestly but inaccurately on certain points,” and thus a witness must be provided with the opportunity to review his prior testimony in order to allow him to correct or recant any such misstatements prior to or at his later testimony.<sup>138</sup>

In the course of denying deposition witnesses access to their transcripts, Enforcement Staff has also denied two related rights: Enforcement Staff has refused defense counsel the ability to take notes during enforcement depositions and has also denied the right to retain copies of exhibits used by Enforcement Staff during depositions.

Since at least 2007, we have used legal assistants to take detailed notes during enforcement depositions. Enforcement Staff has recently objected to this practice, claiming that such note taking is, in effect, creating a duplicate transcript and thus not allowed under section 1b.12 of the Commission’s regulations. Enforcement Staff also suggested that any note taking with laptops, even by defense counsel, is not permitted for the same reason, and note taking should therefore be restricted to pen and paper.

In other depositions, Enforcement Staff has refused to allow defense counsel to retain copies of exhibits used by Enforcement Staff that were entered into the record during the deposition. Such refusal has included Enforcement Staff-created exhibits, exhibits using third-party documents, and exhibits using

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135. In addition, it bears noting that Federal Rule 30(e)(1)(A) expressly requires that, upon request, a deponent be given time “to review the transcript or recording” of his deposition and make any changes or corrections warranted. FED. R. CIV. P. 30(e)(1)(A). Commission Rule 385.404(f)(1) similarly requires that “[u]nless examination is waived by the deponent, the transcription of the deposition must be submitted to the deponent for examination.” 18 C.F.R. § 385.404(f)(1).

136. *In re Grand Jury*, 566 F.3d 12, 19 (1st Cir. 2009).

137. *In re Grand Jury*, 490 F.3d 978, 988 (D.C. Cir. 2007) (citing *Burse v. United States*, 466 F.2d 1059, 1079 (9th Cir. 1972)).

138. *Id.* Repeatedly deposing or questioning a witness, over many months or years, without giving the witness access to his or her own previous testimony could also be viewed as an attempt to lay a “perjury trap.” A perjury trap is an improper investigative or prosecutorial practice in which the Government asks a witness to testify under oath primarily for the purpose of eliciting testimony it later intends to use as the basis of a criminal perjury or false statement charge. *See, e.g., United States v. Alvarez*, 489 F. Supp. 2d 714, 723 (W.D. Tex. 2007) (citing *United States v. Chen*, 933 F.2d 793, 796 (9th Cir. 1991)). Such concerns can be alleviated, at least in part, by adopting a policy whereby Enforcement Staff is required to notify a deponent or potential deponent that the Commission has either made a criminal referral or is contemplating making such a referral.

documents produced to Enforcement Staff by the subject of the investigation. Presumably the refusal to permit counsel to retain copies of exhibits is grounded in the same principles as the refusal to provide access to transcripts or permit note taking. These situations highlight why prompt access to transcripts—and other elements of the record—are so important. Without such access, subjects of investigations are precluded from accessing the record of the proceeding until such time as Enforcement Staff or the Commission permits it, if ever. That is not due process.

5. Discovery Under Part 1b Should Terminate When the Part 1b Investigation Is Completed, and No Later Than the Election of De Novo Review

Once an NAV has been issued, Enforcement Staff should not be permitted to pursue discovery (under part 1b or part 385), unless and until the matter is set for an administrative hearing or, if the respondent elects de novo review in U.S. district court, until the district court judge has adopted a discovery plan pursuant to the Federal Rules. Continuing discovery after an NAV or election of de novo review is directly inconsistent with the assurances the Commission gave in the NAV Clarification Order and section 31(d)(3) of the FPA.

In the NAV Clarification Order, the Commission stated that NAV notices will not be made public until after Enforcement Staff “has completed its fact-finding process” (and after completion of the Wells Process), and thus “only after the investigation is completed.”<sup>139</sup> Section 31(d)(3) provides that if the Commission finds a violation, it shall make an immediate penalty assessment, which a United States District Court is authorized to review de novo both the facts and the law at issue.<sup>140</sup>

These assurances have been quite fleeting.

In the investigation of Barclays, the Commission permitted Enforcement Staff to pursue discovery pursuant to a subpoena after the issuance of an NAV, a show cause order, and Barclay’s election of federal district court review pursuant to section 31(d)(3) of the FPA.<sup>141</sup> After electing de novo review, Barclays sought to quash the subpoena, arguing that Enforcement Staff’s part 1b discovery rights terminated upon the issuance of the NAV.<sup>142</sup> Barclays further argued that continued discovery after Barclays’ election of de novo review in district court, violated section 31(d)(3) of the FPA insofar as it would “deprive Barclays of its right . . . [to] de novo review,” and that “Enforcement Staff’s next available forum in which to seek discovery [was] in federal court.”<sup>143</sup> As such, Barclays argued, Enforcement Staff’s attempt to engage in pre-trial discovery

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139. NAV Clarification Order, *supra* note 12, at P 17.

140. 16 U.S.C. § 823b(d)(3)(A) (2012).

141. *See generally* Barclays Discovery Order, *supra* note 32.

142. Barclays Bank PLC’s Motion to Quash FERC Enforcement Staff’s June 29, 2012 Subpoena, Motion for Protective Order and for Oral Argument and Request for Expedited Treatment, *Non-Public Formal Investigation into Allegations of Market Manipulation of the Electric Energy Markets in the West*, FERC Docket No. IN08-8-000 (Dec. 10, 2012) [hereinafter Barclays Motion to Quash]. According to Barclays Motion to Quash, the subpoena stated that Enforcement Staff was “resuming discovery to prepare for trial.” *Id.* at 3.

143. *Id.* at 15-16.

was inconsistent with Barclays' election of U.S. district court review and the Federal Rules, which govern discovery in such proceedings, and federal courts have consistently rejected attempts by U.S. government agencies to continue such post-investigation discovery.<sup>144</sup>

The Commission rejected Barclays' arguments, holding that Enforcement Staff may continue discovery after issuance of the NAV and show cause order pursuant to section 307 of the FPA<sup>145</sup> and that "the Commission's investigative authority does not terminate upon the issuance of either" an NAV or a show cause order.<sup>146</sup> Commissioner LaFleur, currently the Acting Chairman of the FERC, supported the majority's finding but dissented from the order insofar as it permitted discovery after the election of district court review pursuant to section 31(d)(3) of the FPA. According to Commissioner LaFleur: "[w]hen the respondent chooses to accept a penalty from [the] FERC, the plain meaning of 'promptly' would seem to foreclose the possibility of further investigation into the conduct alleged in the notice."<sup>147</sup> She added that this interpretation was supported by the statute's structure, which gave the Commission the ability to complete the investigation and issue the show cause order "at a time entirely of its own choosing."<sup>148</sup> The statute then requires the respondent to elect, within thirty days thereafter, where to defend the action, which, in Commissioner LaFleur's view, "suggests speed"<sup>149</sup> and "invests respondents with rights that assume the investigation is concluded."<sup>150</sup>

We urge the Commission to reverse the policy decision embedded in the Barclays Discovery Order. In its NAV Order, the Commission promised regulated entities that an investigation would remain nonpublic until Enforcement Staff's investigation was complete *and* it had fully evaluated its case.<sup>151</sup> The Commission found that this promise struck the appropriate balance between the public interest in transparency and the detrimental effects of public disclosure.<sup>152</sup> If Enforcement Staff continues discovery after the issuance of an NAV, this means that the Commission will have publicly disclosed an investigation and levied allegations *before* completing its fact-finding and evaluation of its case and is, therefore, inconsistent with the fundamental purpose of the NAV process and the balance between due process and transparency that the Commission claims to have struck. The Commission

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144. Barclays Discovery Order, *supra* note 32, at P 6 (discussing *Resolution Trust Corp. v. Thornton*, 41 F.3d 1539, 1547 (D.C. Cir. 1994) (holding that an agency's attempt to use administrative "subpoenas in aid of ongoing [litigation is] utterly foreign to the law defining the traditional scope of investigative authority").

145. *Id.* at P 24 (citing 16 U.S.C. § 825f; 18 C.F.R. § 1b.1 (2013)).

146. *Id.* at PP 24, 28.

147. *Id.* at 3 (LaFleur, Comm'r, dissenting).

148. *Id.* at 4.

149. *Id.* at 3.

150. *Id.* at 4.

151. Targets were assured that public notice of an investigation would occur only after:

(1) staff has completed its fact-finding process, (2) staff has presented the subject of the investigation with its preliminary findings, (3) the subject has had the chance to respond in writing to . . . staff's preliminary findings, and (4) staff has had a full opportunity to review and analyze the subject's responses.

NAV Clarification Order, *supra* note 12, at P 17.

152. *Id.* at P 14.

should not publicly release information about an enforcement proceeding, through an NAV or otherwise, until Enforcement Staff has concluded its investigation.

Finally, we note that in other cases, Enforcement Staff has not only issued new data requests under part 1b after the election of district court review, but it has asserted that targets have an ongoing, and indefinite, obligation to supplement responses to pre-election data requests after the election of de novo review has been made. This is inconsistent with the Commission's rules and precedent. Nothing in the Commission's rules imposes a requirement to supplement data responses, especially once an investigation has closed. In fact, the part 385 rules generally provide that there is no continuing duty to supplement responses "to include information later acquired."<sup>153</sup>

Taken together, these discovery abuses call for changes to the FERC's regulations to explicitly prohibit discovery under these circumstances and to adopt a discovery dispute resolution mechanism.

#### *E. Part 385 Rule 602 (Settlements) Should Apply to 1b Investigation Settlements*

Pre-show cause order settlement discussions with FERC Enforcement staff about an investigation are not automatically protected under the Commission's so-called settlement privilege, rule 602(e).<sup>154</sup>

The Commission's Rules of Practice and Procedure do "not apply to investigations under part 1b."<sup>155</sup> In the *Revised Enforcement Policy Statement*, the Commission indicated that "an Order to Show Cause commences a [p]art 385 proceeding" and, only following such an order may "potential settlement . . . proceed in accordance with the requirements of [r]ule 602."<sup>156</sup> The *Revised Enforcement Policy Statement* is otherwise silent on the applicability of rule 602, or any other similar "settlement privilege," to pre-show cause order investigation settlements, even though it describes a lengthy settlement process *prior* to the issuance of a show cause order.<sup>157</sup>

Indeed, in a recent nonpublic order, the Commission confirmed that "potential settlements of [p]art 1b investigations are not governed by the Commission's Rules of Practice and Procedure (including the requirements of [r]ule 602)." Thus, the protections of rule 602—like the "settlement privilege" or being severed from a contested settlement—do not, according to recent Commission pronouncements, apply to pre-show cause order settlements of investigations.<sup>158</sup> To address this glaring hole in the Commission's rules, we urge the Commission to add to part 1b of its regulations a new provision that provides the same protections to settlement discussions in the context of part 1b

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153. 18 C.F.R. § 385.403(d) (2013); *see also Southern Cal. Edison*, 23 F.E.R.C. ¶ 61,261 (1983).

154. 18 C.F.R. § 385.602(e).

155. *Id.* § 385.101(b)(1).

156. Revised Enforcement Policy Statement, *supra* note 1, at PP 37-38.

157. *Id.* at PP 33-34.

158. *See, e.g.*, 18 C.F.R. § 385.602(e), (h). The Commission's Rules of Practice and Procedure and pronouncements notwithstanding, in many cases it is Enforcement Staff's practice to mark documents during settlement discussions as being subject to rule 602. While a federal court may accept that as binding upon Enforcement Staff, it is unclear whether the Commission would do the same.

investigations as are accorded to settlement discussions conducted under rule 602.

Aside from the obvious concern about application of the “settlement privilege,” some of the Commission’s current settlement practices are equally disturbing and raise significant due process concerns. For instance, in one recent case the Commission issued an NAV to an entity,<sup>159</sup> entered into a settlement (the next day) with that same entity, and then publicly identified a number of individuals in the settlement order while declining to allege that they committed any violations or to impose any civil penalty on any of them.<sup>160</sup>

The U.S. Department of Justice specifically forbids that type of action.<sup>161</sup> “In the context of public plea and sentencing proceedings,” U.S. Attorneys generally should not “identify (either by name or unnecessarily-specific description), or cause a defendant to identify, a third-party wrongdoer unless that party has been officially charged with the misconduct at issue.”<sup>162</sup> The Antitrust Division of the Department of Justice also recently announced that, in plea agreements with corporations, it will not publicly name “carved out” employees who may be subject to prosecution.<sup>163</sup> It seems odd that the Commission would engage in a practice that the Department of Justice has determined is “not appropriate.”

Moreover, numerous courts have held that due process prohibits the government from making accusations of wrongdoing against persons in plea agreements or indictments without naming those persons as defendants and providing them an opportunity to be heard. For example, in *In re Smith*, the

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159. Staff Notice, Fed. Energy Regulatory Comm’n, Notice of Alleged Violations by JP Morgan Ventures Energy Corporation (July 29, 2013) [hereinafter JPMVEC Notice of Alleged Violations], available at <http://www.ferc.gov/enforcement/alleged-violation/notices/2013/jpmorgan-07-29-2013.pdf>.

160. *Make-Whole Payments and Related Bidding Strategies*, 144 F.E.R.C. ¶ 61,068 (2013) [hereinafter JPMVEC Settlement Order]. The Commission is increasingly focusing on individuals in the enforcement process, exacerbating some of these due process concerns. For example, Commissioner Norris noted at the Commission’s November 21, 2013, open meeting that he hopes to see more “individual trader responsibility and individual trader penalties.” Meeting Transcript, Fed. Energy Regulatory Comm’n 999th Commission Meeting, at 17 (Nov. 21, 2013), available at <http://www.ferc.gov/CalendarFiles/20131209081607-transcript.pdf>. In part, this may be due to outside pressure. Recently, Massachusetts Senators Elizabeth Warren and Edward J. Markey wrote a letter to the Commission asking, among other things, “[w]hy did the Commission decide to take no action against JPMorgan executives who planned and executed market manipulations or who impeded the Commission’s investigations? Is the Commission concerned that these executives will continue to engage in illicit activities at other institutions?” Letter from Senators Elizabeth Warren & Edward J. Markey to Jon Wellinghoff, Chairman, FERC (July 31, 2013), available at <http://www.warren.senate.gov/files/documents/Warren%20Markey%20-%20Letter%20to%20FERC%20-%20JPMorgan%20-%20July31.pdf>; see also *FERC to Boost Enforcement in 2014, Pitch Trader Licensing, Commissioners Say*, PLATTS MEGAWATT DAILY (Jan. 6, 2014), <http://www.platts.com/products/megawatt-daily> (subscription required).

161. See generally U.S. DEP’T OF JUSTICE, U.S. ATTORNEY’S MANUAL § 9-27.760 (2002).

162. *Id.* § 9-11.130 (providing that, unless the allegations against a person are already a matter of public record or knowledge, U.S. Attorneys should not “identify unindicted co-conspirators in conspiracy indictments”); see generally *id.* § 9-27.760.

163. Press Release, Office of Public Affairs, U.S. Dep’t of Justice, Statement of Assistant Attorney General Bill Baer on Changes to Antitrust Division’s Carve-Out Practice Regarding Corporate Plea Agreements (Apr. 12, 2013), available at <http://www.justice.gov/opa/pr/2013/April/13-at-422.html> (“Absent some significant justification, it is ordinarily not appropriate to publicly identify uncharged third-party wrongdoers.”).

Fifth Circuit held that, when the government accused an uncharged person of misconduct in the factual statement submitted with a guilty plea, it “so damaged [that person’s] name, reputation, and economic interests that the government’s actions [violated] his liberty and property interests contrary to the due process protection afforded by the Fifth Amendment of the United States Constitution.”<sup>164</sup> “[N]o legitimate governmental interest is served,” the court explained, “by an official public smear of an individual when that individual has not been provided a forum in which to vindicate his rights.”<sup>165</sup>

#### F. *De Novo Review of Civil Penalties*

The Commission should also confirm and clarify its stance on *de novo* review of civil penalties under its organic statutes.<sup>166</sup> In three recent court filings, the Commission’s Enforcement Staff urged a district court to disregard the plain language of FPA section 31(d)(3) and affirm a civil penalty assessment without a *de novo* trial.<sup>167</sup> In those cases, the Commission’s Enforcement Staff has filed “Petitions” requesting that the court “affirm” the FERC’s penalty determination, applying a deferential standard of review limited to a deficient administrative record.<sup>168</sup>

The FERC staff’s position in this regard is inconsistent with the plain meaning of the statute, as well as with the only judicial decision to apply this provision, the legislative history, the ERC’s own prior statements, and Supreme Court and other precedent interpreting similar *de novo* review provisions. In

164. *In re Smith*, 656 F.2d 1101, 1105 (5th Cir. 1981); *see also* *United States v. Briggs*, 514 F.2d 794, 804 (5th Cir. 1975) (holding that due process, therefore, prohibits naming an unindicted co-conspirator in a grand jury indictment because the unindicted co-conspirator “is not a party to the criminal trial” and thus does not have an opportunity to be heard); *Doe v. Hammond*, 502 F. Supp. 2d 94, 101 (D.D.C. 2007) (explaining that “[t]he Due Process Clause of the Fifth Amendment protects an individual from governmental accusations of criminal misconduct without providing a proper forum for vindication.”); *United States v. Anderson*, 55 F. Supp. 2d 1163, 1169-70 (D. Kan. 1999).

165. *Smith*, 656 F.2d at 1106.

166. FPA section 31(d)(3) provides that:

[T]he Commission shall institute an action in the appropriate district court of the United States for an order affirming the assessment of the civil penalty. The court shall have authority to *review de novo the law and facts involved*, and shall have jurisdiction to enter a judgment enforcing, modifying, or enforcing as so modified, or setting aside in whole or in [p]art, such assessment.

16 U.S.C. § 823b(d)(3)(B) (2012) (emphasis added).

167. Petition to Affirm Barclays Penalties, *supra* note 100, ¶ 124 (“[T]he Commission respectfully submits that this Court can and should affirm the penalty assessment without modification following a review of the Commission’s Order Assessing Civil Penalties and the materials presented to the Commission during the penalty assessment process.”); Petition to Affirm Lincoln Penalties, *supra* note 100, ¶ 86 (making the same assertion as in *Barclays*); Petition to Affirm Silkman/CES Penalties, *supra* note 100, at ¶ 81 (making the same assertion as in *Barclays* and *Lincoln*).

168. The materials made available to respondents in a FERC enforcement proceeding are not an “administrative record,” at least not as that term is normally understood. The administrative record “consists of all documents and materials directly or indirectly considered by agency decision-makers and includes evidence contrary to the agency’s position.” *Exxon Corp. v. Dep’t of Energy*, 91 F.R.D. 26, 36 (N.D. Tex. 1981). In a FERC enforcement proceeding, however, the FERC does not make available to the respondent (or the public) all materials that the FERC or Enforcement Staff considered in finding the violation or assessing the penalty. Most importantly, the materials presented to the Commission are only of limited use because the subject of the investigation has not had an opportunity to conduct discovery, either of third parties or of Enforcement Staff’s testifying experts.



*FERC v. MacDonald*, the New Hampshire district court held that FPA section 31(d)(3)'s de novo review provision requires the court to "give no deference to [the] FERC's decision," and the court must instead "make a fresh, independent determination of the matter at stake."<sup>169</sup> The *MacDonald* court also permitted the defendant to conduct discovery.<sup>170</sup> Similarly, the legislative history of section 31(d) and comparable provisions, and the FERC's 1988 policy statement setting forth the FERC's interpretation, both indicate that election of the procedures in section 31(d)(3) of the FPA gives an alleged violator the right to have the FERC's proposed penalty reviewed by the district court in a full trial de novo,<sup>171</sup> rather than in some APA-style deferential review limited to the administrative record.

Courts have consistently interpreted similar de novo review provisions as requiring the court to make an independent determination on all matters without giving deference to the agency's factual findings or legal conclusions. For example, Title VII of the Civil Rights Act has been interpreted as requiring a de novo trial for employment discrimination claims.<sup>172</sup> In *Timmons v. White*,<sup>173</sup> the Tenth Circuit interpreted this language to mean precisely what it says:

169. *FERC v. MacDonald*, 862 F. Supp. 667, 672 (D.N.H. 1994) (internal quotation marks omitted).

170. The paper case file for this nearly twenty-year old proceeding, Civ. No. 90-cv-00530-PB, has been destroyed, but the docket sheet is available on PACER. The notes to Document 10, a February 21, 1991, Order, state that depositions were to be taken in Concord, New Hampshire, coincident to the pre-trial conference. (D.I. 10). Further, the Pretrial Order set a discovery deadline of January 31, 1992, and set the pre-trial material deadline for February 15, 1992. (D.I. 12).

171. Section 31(d) of the FPA was added by the Electric Consumers Protection Act of 1986, Pub. L. No. 99-495, § 12, 100 Stat. 1243, 1255. In a 1988 policy statement, the FERC explained that "the assessment of civil penalties by the Commission" under section 31(d)(3) "merely triggers the process leading to a de novo trial." Order No. 502, *Procedures for the Assessment of Civil Penalties Under Section 31 of the Federal Power Act*, F.E.R.C. STATS. & REGS. ¶ 30,828, at p. 31,220, 53 Fed. Reg. 32,035, 32,039 (1988) (codified at 18 C.F.R. pt. 385). While the legislative history of section 31(d) is scant, a virtually identical provision was added to the Atomic Energy Act of 1954 through the Price Anderson Act Amendments Act of 1987, which was enacted as the Price Anderson Amendments Act of 1988, Pub. L. No. 100-408, § 17, 102 Stat. 1081 (Aug. 20, 1988) (codified at 42 U.S.C. § 2282a). The legislative history of this bifurcated penalty assessment scheme identical to section 31(d), indicates that:

Any person subject to such penalty under this amendment may elect administrative assessment of the penalty by the [Commission] after opportunity for an agency hearing before an administrative law judge, or a trial de novo in the appropriate district court of the United States.

S. REP. NO. 100-70, at 23 (1988) (emphasis added).

Similarly, the civil penalty provisions of the FPA, chapter 12, subchapter II, were added by the EPA Act 2005. 16 U.S.C. § 825o-1; Energy Policy Act of 1992, Pub. L. No. 102-486, § 725, 106 Stat. 2776. The report by the House Committee on Energy and Commerce explained that the civil penalty provisions were "modeled on similar provisions of the Natural Gas Policy Act of 1978." H.R. REP. NO. 102-474, pt. 1, at 78, 196 (1992). The legislative history for the NGPA's civil penalty provision states that "[v]iolators may obtain review of the Commission's assessment through a trial de novo in federal district court." H.R. REP. NO. 95-1752, at 121 (1978) (Conf. Rep.).

172. Certain statutes also use the phrase "de novo trial," but courts have interpreted "de novo review" and "de novo trial" interchangeably. *See, e.g.*, *United States v. First City Nat'l Bank*, 386 U.S. 361, 368 (1967) ("It is argued that the use of the word 'review' rather than 'trial' indicates a more limited scope to judicial action. The words 'review' and 'trial' might conceivably be used interchangeably. The critical words seem to us to be 'de novo' and 'issues presented.' They mean to us that the Court should make an independent determination of the issues.").

173. *Timmons v. White*, 314 F.3d 1229 (10th Cir. 2003).

*Black's Law Dictionary* defines such a trial as “[a] new trial on the entire case—that is, on both questions of fact and issues of law—as if there had been no trial in the first instance.”<sup>174</sup> . . . [Such] de novo proceedings . . . [are] “unfettered by any prejudice from the prior agency proceeding and free from any claim that the agency’s determination is supported by substantial evidence.”<sup>175</sup>

Similarly, in a case under the Food Stamps Act, the court held that de novo review means that “the district court must reach its own factual and legal conclusions based on the preponderance of the evidence, and should not limit its consideration to matters previously appraised in the administrative proceedings.”<sup>176</sup>

Second, the scope of review in a de novo proceeding is not limited to the administrative record. Where Congress intends the review to be so limited, it will say so explicitly or through terms of art such as “substantial evidence.”<sup>177</sup> In *Wong v. United States*,<sup>178</sup> the Ninth Circuit held that, in a de novo trial under the Food Stamps Act, the trial is not limited to the administrative record, in which the plaintiff may offer any relevant evidence available to support his case whether or not it has previously been submitted to the agency.<sup>179</sup> Moreover, the Supreme Court has explained that in such a de novo proceeding, “the usual rights of discovery are available,”<sup>180</sup> and the parties are permitted to engage in discovery pursuant to the Federal Rules of Civil Procedures, just as they would in any other civil action.<sup>181</sup> As the Sixth Circuit explained in another Food Stamps Act case:

Since the procedures followed at the administrative level do not provide for discovery or testing the evidence . . . by cross-examination, it is particularly important that an aggrieved person who seeks judicial review in a trial de novo not be deprived of these traditional tools unless it is clear that no issue of fact exists.<sup>182</sup>

Finally, the structures of section 31(d) of the FPA and section 504(b)(6)(f) of the NGPA indicate that Congress intended to provide respondents with the right to a hearing, either before a FERC ALJ or a U.S. district court, without any limits on the discovery of relevant evidence beyond those that would normally apply in such proceedings.<sup>183</sup> Specifically, section 31(d)(2) requires a hearing before a FERC ALJ to be conducted under the part 385 rules, which provides for discovery, examination of witnesses, and other matters normally addressed at hearing; neither the statute nor the Commission’s Rules of Practice and

174. *Id.* at 1233 (quoting BLACK’S LAW DICTIONARY (7th ed. 1999)).

175. *Id.* (quoting *United States v. Raddatz*, 447 U.S. 667, 690 (1980) (Stewart, J., dissenting)).

176. *Sims v. U.S. Dep’t of Agric. Food & Nutrition Serv.*, 860 F.2d 858, 862 (8th Cir. 1988) (internal quotation marks omitted).

177. *Chandler v. Roudebush*, 425 U.S. 840, 862 n.37 (1976) (“In most instances, of course, where Congress intends review to be confined to the administrative record, it so indicates, either expressly or by the use of a term like ‘substantial evidence,’ which has become a term of art to describe the basis on which an administrative record is to be judged by a reviewing court.”).

178. *Wong v. United States*, 859 F.2d 129 (9th Cir. 1988).

179. *Id.* at 132 (The district court reviewed the administrative findings de novo, took new evidence, and found by a preponderance of the evidence that there was a violation of the Food Stamps Act.).

180. *Renegotiation Bd. v. Bannerkraft Clothing Co.*, 415 U.S. 1, 23 (1974).

181. *Kappos v. Hyatt*, 132 S. Ct. 1690, 1696-97, 1700 (2012).

182. *Saunders v. United States*, 507 F.2d 33, 36 (6th Cir. 1974).

183. *See generally* 15 U.S.C. § 3414 (2012); 16 U.S.C. § 823b(d) (2012).

Procedure require the ALJ's review to be limited to the evidence gathered by Enforcement Staff during the investigation.<sup>184</sup> We urge the Commission not to seek to circumvent the de novo review protections built into the relevant statutes. Congress obviously meant for subjects to get “[a] new trial on the entire case—that is, on both questions of fact and issues of law.”<sup>185</sup> While we understand why the Commission's Enforcement Staff wants to evade de novo review, the Commission's attempts to do so in these recent district court proceedings erodes confidence in the fairness of the process.

### G. Penalty Guidelines and Penalty Calculations

While substantial effort has been expended by the Commission on the Penalty Guidelines,<sup>186</sup> there is still a significant lack of clarity as to how Enforcement Staff and the Commission actually calculate the penalties, determine the culpability factors, and apply the penalty multipliers when assessing penalties. While the Commission's penalty calculations can be reverse engineered using the penalty guidelines, several discretionary elements make it difficult to do so with any degree of precision.<sup>187</sup> As a result, it is unclear whether entities accused of similar violations are being treated similarly in the penalty calculations.

The solution to this problem is simple: Investigation subjects should receive detailed penalty calculations from Enforcement Staff as part of the section 1b.19 “Wells Process” (and, as necessary, during settlement discussions) including the culpability factors and penalty multipliers applied by the FERC. In addition, when the Commission issues a show cause order, an order approving a settlement, or a penalty assessment order, the Commission should publicly release a detailed breakdown of the penalty calculation.

At a minimum, the detailed penalty calculations should identify the base penalty,<sup>188</sup> the culpability factors and culpability score,<sup>189</sup> and the final multiplier chosen from the applicable range.<sup>190</sup> As part of the detailed calculation, Enforcement Staff or the Commission should explain the reasoning used to determine the base penalty level (and, as necessary, the calculation of market harm), why certain culpability factors and not others were used, and how the

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184. 16 U.S.C. § 823b(2)(A); 18 C.F.R. pt. 385 (2013).

185. *Timmons v. White*, 314 F.3d 1229, 1233 (10th Cir. 2003).

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

187. See, e.g., Revised Penalty Guidelines, *supra* note 186, at FERC Penalty Guidelines pt. C.

188. *Id.* at FERC Penalty Guidelines § 1C2.2 (explaining that the base penalty is the greatest of either (1) the corresponding amount in the violation level penalty table that corresponds to the violation level determined by the Commission, (2) the “pecuniary gain to the organization from the violation[.] or (3) the pecuniary loss from the violation caused by the organization”).

189. *Id.* at FERC Penalty Guidelines § 1C2.3 (starting with a culpability score of five and adding or reducing this score based on whether any of the following are present: involvement or tolerance of the violations; prior history; violation of an order; obstruction of justice; effective compliance program; and self-reporting, cooperation, avoidance of trial-type hearing, and acceptance of responsibility).

190. *Id.* at FERC Penalty Guidelines § 1C2.4 (explaining that the minimum and maximum multipliers will be calculated using the culpability score and “applying any applicable special [penalty] instructions”).

multiplier was determined. If the Commission deviates from the penalty guidelines, it should provide a clear and concise explanation of why the situation warranted such a deviation.<sup>191</sup>

The need for such information is bolstered by the potential for “double counting” under the Revised Penalty Guidelines. For example, as Acting Chairman, and then-Commissioner, LaFleur explained in her dissent in part from multiple Commission orders assessing civil penalties for violations,<sup>192</sup> strict adherence to the penalty guidelines is not appropriate in all circumstances.<sup>193</sup> In those cases, the application of the Revised Penalty Guidelines caused the duration of the alleged fraud to be double-counted as part of the base penalty, which resulted in a penalty range that was three times higher than it would have otherwise been without the double counting.<sup>194</sup> Similarly, in cases of market manipulation, the Revised Penalty Guidelines prescribe a higher base violation level because manipulations are rooted in fraud.<sup>195</sup> If the Commission were to choose a higher penalty multiplier within the accepted range because of evidence of fraud, the result would be to penalize an entity twice for the same allegedly fraudulent activity.<sup>196</sup>

Without more detailed explanations from the Commission regarding what base penalty, culpability factors, and multipliers are applied when calculating each civil penalty, investigation subjects will potentially be subject to penalties that are larger than they should be or larger than those assessed against other entities under similar circumstances. Further, as Acting Chairman LaFleur noted in her dissents, “unlike a rulemaking, a policy statement [such as the Revised Penalty Guidelines] requires the Commission to justify its use with each application. When the Commission cannot explain why it is appropriate to strictly adhere to the Penalty Guidelines, it cannot rely on them.”<sup>197</sup> Therefore, the Commission should provide additional clarification, both on a general basis to the public and on an individual basis to investigation targets, explaining its methods for calculating the penalties, determining the culpability, and applying the penalty multipliers and its rationale for why the application of (or deviation from) the Revised Penalty Guidelines was appropriate.

#### *H. Nonpublic Matters Should Stay Nonpublic*

In several recent investigations, nonpublic matters have been prematurely disclosed or events have created the possibility of premature exposure. We

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191. The Revised Penalty Guidelines anticipated such a practice. *See, e.g., id.* at P 32 (stating that “[w]hen the Commission determines that it is appropriate to depart upward or downward from the Penalty Guidelines, [it] will set out on the record the considerations that caused [it] to conclude a departure was appropriate”).

192. *Silkman*, 144 F.E.R.C. ¶ 61,164 (2013); *Competitive Energy Servs., LLC*, 144 F.E.R.C. ¶ 61,163 (2013); *Lincoln Paper & Tissue, LLC*, 144 F.E.R.C. ¶ 61,162 (2013).

193. *Lincoln Paper*, 144 F.E.R.C. at ¶ 61,932 (LaFleur, Comm’r, dissenting) (explaining that “[i]n some situations, the Commission may have to depart from the Guidelines and assess a civil penalty that is more tailored to the circumstances at hand”).

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.* at 61,933 (footnote omitted).

suggest that the Commission clarify its rules and take whatever additional steps are necessary to ensure that nonpublic matters are not improperly made public.

First, the Commission should clarify under what circumstances, and under whose authority, Enforcement Staff is permitted to publicly disclose nonpublic investigations. Section 1b.9 of the FERC's regulations states that:

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, 5 U.S.C. 552.<sup>198</sup>

However, it is unclear how the authorization in part (a) is granted, and it is further unclear whether part (b) permits Enforcement Staff to *initiate* a public proceeding as a matter of right, disclosing a nonpublic matter, or if it may only do so after it has received Commission authorization under part (a).<sup>199</sup>

In perhaps the most public example of this lack of clarity, Enforcement Staff's July 2, 2012, D.C. district court petition for an order to show cause publicly exposed JP Morgan as the subject of a nonpublic investigation.<sup>200</sup> To the best of our knowledge, neither Enforcement Staff nor the Commission has ever produced an order authorizing the disclosure of that nonpublic investigation as required under section 1b.9(a) of its regulations. Tellingly, more than a year after Enforcement Staff publicly disclosed the existence of the investigation, the Commission still referred to *JP Morgan* as "a nonpublic formal investigation."<sup>201</sup>

In the district court proceeding, the court rejected Enforcement Staff's efforts to compel production of redacted emails protected by the attorney-client privilege.<sup>202</sup> As relevant here, Enforcement Staff's initial petition went into significant detail about the alleged manipulation underlying the nonpublic investigation and—for the first time—publicly identified JP Morgan as the subject of what would become one of the most closely watched "nonpublic" investigations in the Commission's history.<sup>203</sup> During the public oral arguments,

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198. 18 C.F.R. § 1b.9 (2013) (citing Freedom of Information Act, 5 U.S.C. § 552 (2012)).

199. It is reasonably clear that, under section 1b.9(b), if the issues in the nonpublic proceeding have been made public by the subject or through a third-party proceeding, Enforcement Staff may publicly disclose information to the extent the information has already been made public.

200. Petition by Federal Energy Regulatory Commission for an Order to Show Cause Why This Court Should Not Enforce Subpoenas for Production of Documents, *FERC v. J.P. Morgan Ventures Energy Corp.*, Misc. No. 12-352 (D.D.C. July 2, 2012) [hereinafter D.D.C. Petition]; see also Agustino Fontevicchia, *JPMorgan Potentially Manipulating Energy Markets Using Abusive Bidding Strategies*, FORBES (July 3, 2012, 5:56 PM), <http://www.forbes.com/sites/afontevicchia/2012/07/03/jpmorgan-potentially-manipulating-energy-markets-using-abusive-bidding-strategies/>; Scott DiSavino & David Sheppard, *JPMorgan Probed over Possible Power Market Manipulation*, REUTERS (July 3, 2012), <http://www.reuters.com/article/2012/07/03/us-utilities-jpmorgan-ferc-idUSBRE8620LK20120703>.

201. JPMVEC Notice of Alleged Violations, *supra* note 159.

202. *FERC v. J.P. Morgan Ventures Energy Corp.*, Misc. No. 12-352, slip op. at 2 (D.D.C. Nov. 29, 2012) (vacated by request of the parties).

203. D.D.C. Petition, *supra* note 200. In addition to the district court filing, the JP Morgan investigation also received significant press when Enforcement Staff's nonpublic 1b.19 notice was leaked to the New York Times. See, e.g., Dan Fitzpatrick et al., *J.P. Morgan Staring at Record Fine over Energy*, WALL ST. J. (July 17, 2013, 8:17 PM), <http://online.wsj.com/news/articles/SB10001424127887323993804578611940638603204>; Michael Hiltzik, *Ban JPMorgan from California's Electricity Trading Business*, L.A. TIMES (July 23, 2013, 6:29 PM), <http://www.latimes.com/business/la-fi-hiltzik-20130724,0,2146388.column#axzz21QYyixRv>; Ben

with members of the press clearly present in the court room, the magistrate judge cautioned Enforcement Staff not to “discuss the investigation because that is simply not before me.”<sup>204</sup> Indeed, there was no reason for Enforcement Staff to disclose the existence of the nonpublic investigation, particularly because the courts have means to permit such efforts to compel production of documents while keeping the existence of an underlying investigation confidential. Thus, it would be helpful for the Commission to clarify whether section 1b.9(b) authorizes Enforcement Staff to disclose the existence of a nonpublic investigation when it initiates the public action, or whether the Commission must authorize such a disclosure under section 1b.9(a).

Second, as noted above, the NAV process is broken. The Commission should clarify when and under what circumstances a nonpublic investigation can be made public through an NAV. NAVs were “designed to increase the transparency of staff’s nonpublic investigations” by “provid[ing] the public with notice of and information about enforcement activities.”<sup>205</sup> But, such public disclosure comes along “with possible adverse consequences” to the subject’s reputation:

[P]ublic disclosure does not now generally occur until a settlement is reached or the Commission issues an order to show cause. The timing of any public disclosure of an investigation conducted under [p]art 1b prior to the conclusion of the investigation is important because premature disclosure could adversely affect the reputation of the subject. Public disclosure at the outset of an investigation would risk exposing the subject to undue public suspicion without staff having conducted sufficient discovery to reach a preliminary finding that the subject may have violated a Commission requirement.

One cost of accelerated public disclosure is that *the entity under investigation is placed in the public eye, with possible adverse consequences to its reputation*. However, in our experience, once staff provides its preliminary conclusions to a subject, the existence of the investigation is likely to become public in any event, through a negotiated settlement, an order to show cause, or, in the case of a publicly traded company, a securities filing.<sup>206</sup>

The timing of NAVs in various Enforcement investigations has raised serious due process concerns about whether all investigation subjects are being treated equally. In some instances, NAVs have been publicly released years before other public pronouncements; in other instances NAVs have been released just days before a public order approving a settlement has been issued.<sup>207</sup> Not only does this obvious disparity suggest that some investigation

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Proress & Jessica Silver-Greenberg, *JPMorgan in Talks to Settle Energy Manipulation Case for \$500 Million*, N.Y. TIMES (July 17, 2013, 3:44 PM), [http://dealbook.nytimes.com/2013/07/17/jpmorgan-in-talks-to-settle-energy-manipulation-case-for-500-million/?ref=federalenergyregulatorycommission&\\_r=0](http://dealbook.nytimes.com/2013/07/17/jpmorgan-in-talks-to-settle-energy-manipulation-case-for-500-million/?ref=federalenergyregulatorycommission&_r=0).

204. Transcript of Status/Scheduling Conference at 15, *JP Morgan*, No. 12-352 (D.D.C. Aug. 30, 2012).

205. NAV Order, *supra* note 12, at P 1.

206. *Id.* at PP 5-6 (emphasis added).

207. Compare Staff Notice, Fed. Energy Regulatory Comm’n, Notice of Alleged Violations by Joseph Polidoro (Feb. 25, 2011), available at <http://www.ferc.gov/enforcement/alleged-violation/notices/2011/joseph-polidoro.pdf>, and *Polidoro*, 138 F.E.R.C. ¶ 61,018 (2013), with JPMVEC Notice of Alleged Violations, *supra* note 159, and JPMVEC Settlement Order, *supra* note 160. See also *EnerNOC, Inc.*, 141 F.E.R.C. ¶ 61,211 (Dec. 17, 2012); *Gila River Power, LLC*, 141 F.E.R.C. ¶ 61,136 (Nov. 19, 2012); Staff Notice, Fed. Energy Regulatory Comm’n, Notice of Alleged Violations by EnerNOC, Inc. and Celerity Energy Partners San Diego LLC (Dec. 14, 2012), available at <http://www.ferc.gov/enforcement/alleged-violation/notices/2012/EnerNOC-12-14-12.pdf>; Staff Notice, Fed. Energy Regulatory Comm’n, Notice of Alleged Violations by Gila River

subjects may be treated discriminatorily, in that their nonpublic investigations are made public earlier, “plac[ing the subject] in the public eye, with possible adverse consequences to its reputation,” the practice of disclosing investigations mere days before releasing public settlement orders also defeats the Commission’s “transparency” objective in authorizing the use of NAVs.<sup>208</sup> Further, the temporal proximity between many NAVs and corresponding settlement orders suggests that the threat of public exposure accompanying an NAV may be improperly being used to extract settlements or more favorable settlement terms from investigation subjects.

#### IV. SUBSTANTIVE ISSUES

In addition to the procedural due process issues identified above, the FERC’s enforcement practices and policies raise serious due process concerns on substantive grounds as well. In particular, the Commission has applied its Anti-Manipulation Rule in a subjective and confusing manner that denies market participants fair notice of what conduct is prohibited and what is permitted. The Commission’s “we know it when we see it” approach to defining manipulation has already caused significant harm to the markets it regulates. As noted previously, many entities, in particular financial institutions, that provide needed liquidity to the markets have withdrawn, or are considering withdrawing, from Commission-jurisdictional markets due to the regulatory uncertainty and risk engendered by the Commission’s arbitrary and unpredictable implementation of its anti-manipulation authority.<sup>209</sup> Simply put, the Commission’s policy objective of promoting competitive markets is no longer aligned with goals that it appears to be pursuing through its enforcement activities.

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 participants with clear guidance on what conduct is permitted and what is not, based on objective criteria and grounded in coherent economic theory. To satisfy the constitutional requirement to give regulated entities fair notice of the conduct that the Commission considers unlawful, the Commission should revise its Anti-Manipulation Rule in part 1c of its regulations to reinstate the safe harbor for conduct permitted under the applicable tariff or market rules that it adopted in Order No. 670<sup>210</sup> (but has apparently subsequently abandoned) and to clarify that it will no longer assert that interference with a “well-functioning market” justifies the extension of its Anti-Manipulation Rule to cover lawful, non-fraudulent activity. The Commission should also distinguish fraud based manipulation from market power manipulation; they are two distinct forms of manipulative activity.<sup>211</sup> Finally, the Commission should clarify the scope of the false or inaccurate

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Power LLC (Nov. 14, 2012), *available at* <http://www.ferc.gov/enforcement/alleged-violation/notices/2012/Gila.pdf>.

208. NAV Order, *supra* note 12, at PP 1, 6.

209. *See, e.g.*, Boshart, *supra* note 7.

210. Order No. 670, *supra* note 16, at P 67.

211. *See, e.g.*, Craig Pirrong, *Energy Market Manipulation: Definition, Diagnosis, and Deterrence*, 31 ENERGY L.J. 1, 11-13 (2010).

statements covered by section 35.41(b) of its regulations and the types of evidence and statements on which it may rely to establish that a violation of this rule has occurred.

#### A. Fair Notice

The Due Process Clause of the Fifth Amendment of the U.S. Constitution requires that “[l]aws which regulate persons or entities must give fair notice of conduct that is forbidden or required,”<sup>212</sup> so as to give “the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly.”<sup>213</sup> Such notice is necessary to provide sufficient “precision and guidance . . . so that those enforcing the law do not act in an arbitrary or discriminatory way.”<sup>214</sup> In other words, due process requires that regulated entities or persons must have fair notice of conduct that may subject them to liability or punishment *before* such punishment may be imposed.<sup>215</sup> Even where an administrative agency’s interpretation of a statute or regulation is otherwise entitled to deference, a penalty under that interpretation cannot be sustained unless the regulation and available guidance permitted the regulated entity “to identify, with ascertainable certainty, the standards with which the agency expects parties to conform.”<sup>216</sup>

Moreover, an administrative agency may not penalize a regulated person or entity for violating a novel interpretation of a rule or regulation without violating a person’s or entity’s constitutional right to fair notice.<sup>217</sup> Where an enforcement action serves as the “initial means for announcing a particular interpretation—or for making [the agency’s] interpretation clear,” the court “must ask whether the regulated party received, or should have received notice of the agency’s interpretation in the most obvious way of all: by reading the regulations.”<sup>218</sup> If the Commission intends to adopt a novel interpretation of an existing regulation or tariff requirement, due process requires that it announce its intention to do so,

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212. *Federal Commc’ns Comm’n v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012); *Kourouma v. FERC*, 723 F.3d 274, 279 (D.C. Cir. 2013) (Due process requires an administrative agency to provide “notice of the actions they consider unlawful.”).

213. *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972).

214. *Fox Television Stations*, 132 S. Ct. at 2317 (citing *Grayned*, 408 U.S. at 108-09); see also Theodore J. Boutros, Jr. & Blaine H. Evanson, *The Enduring and Universal Principle of “Fair Notice,”* 86 S. CAL. L. REV. 193, 194 (2013) (“The fair notice requirement is an essential protection of the due process clause [that] shields . . . defendants from unfair and arbitrary punishment” in administrative enforcement proceedings.).

215. *Fabi Constr. Co. v. Secretary of Labor*, 508 F.3d 1077, 1088 (D.C. Cir. 2007).

216. *General Elec. Co. v. U.S. Envtl. Prot. Agency*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (internal quotation marks omitted).

217. *Id.* at 1328-29 (If a “regulation is not sufficiently clear to warn a party about what is expected of it—an agency may not deprive a party of property by imposing civil or criminal liability.”). Due process also precludes “novel construction” of laws or regulations that expands the scope of conduct that can be prosecuted thereunder if “neither the statute nor any prior judicial decision ha[d] fairly disclosed [the conduct at issue] to be within its scope.” *United States v. Lanier*, 520 U.S. 259, 266 (1997). This is also known as the “antiretroactivity doctrine.” Boutros & Evanson, *supra* note 214, at 196.

218. *General Elec.*, 53 F.3d at 1329.



on a prospective basis, and refrain from imposing liability for past violations of the new rule.<sup>219</sup>

The Commission has failed to provide regulated entities constitutionally sound fair notice of the conduct prohibited by the Commission's Anti-Manipulation Rule. First, it has found that conduct that is either explicitly permitted, or not prohibited, by applicable tariffs or other Commission rules, regulations, or precedent may be manipulative. Second, the 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. The Commission has relied on this theory in a number of recent show cause and/or civil penalty assessment orders—including *Lincoln Paper*,<sup>220</sup> *Barclays*,<sup>221</sup> *Deutsche Bank Energy Trading, LLC (Deutsche Bank)*,<sup>222</sup> *BP America, Inc.*<sup>223</sup>—and in a series of orders alleging improper “multiple-affiliate bidding” for capacity in natural gas pipeline open seasons.<sup>224</sup> The Commission also relied on this theory in its recent investigation of, and settlement with, JPMVEC.<sup>225</sup>

Recently, in response to questions posed by members of Congress regarding the FERC's anti-manipulation rule, Acting-Chairman LaFleur acknowledged that the Commission is “early in our work on manipulation cases and I believe the Commission should continue to assess whether additional guidance may be helpful going forward.”<sup>226</sup> We believe additional guidance is necessary regarding the application of Order No. 670 and that a technical conference followed by a rulemaking proceeding is the appropriate means for providing this guidance.

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219. See, e.g., *Satellite Broad. Co. v. Federal Commc'ns Comm'n*, 824 F.2d 1, 3-4 (D.C. Cir. 1987) (“The [agency] through its regulatory power cannot, in effect, punish a member of the regulated class for reasonably interpreting [agency] rules. Otherwise the practice of administrative law would come to resemble ‘Russian Roulette.’”).

220. *Lincoln Paper & Tissue, LLC*, 144 F.E.R.C. ¶ 61,162 at P 30 (2013).

221. *Barclays Bank PLC*, 144 F.E.R.C. ¶ 61,041 at P 56 (2013).

222. *Deutsche Bank Energy Trading, LLC*, 140 F.E.R.C. ¶ 61,178 at PP 2, 3 (2012) [hereinafter *Deutsche Bank Show Cause Order*].

223. *BP America Inc.*, 144 F.E.R.C. ¶ 61,100 at PP 1, 2 (2013) (alleging that open market natural gas trading constituted market manipulation).

224. *National Fuel Mktg., LLC*, 126 F.E.R.C. ¶ 61,042, at p. 61,280 (2009) [hereinafter *National Fuel Show Cause Order*]; *Seminole Energy Servs., LLC*, 126 F.E.R.C. ¶ 61,041, at p. 61,255 (2009) [hereinafter *Seminole Show Cause Order*]. On the same day that these show cause orders were issued, the FERC issued an order approving stipulation and consent agreements with several other entities to settle alleged violations arising from similar conduct. *Tenaska Mktg. Ventures*, 126 F.E.R.C. ¶ 61,040 at P 1 (2009). As discussed below, Commissioners Moeller and Spitzer issued dissents in all three of these orders.

225. JPMVEC Settlement Order, *supra* note 160, at P 81.

226. Letter from Cheryl A. LaFleur, Acting Chairman, FERC, to Honorable Ed Whitfield, Chairman, Subcomm. on Energy & Power of the H. Comm. on Energy & Commerce 24 (Jan. 24, 2014), available at <http://docs.house.gov/meetings/IF/IF03/20131205/101553/HHRG-113-IF03-Wstate-LaFleurC-20131205-SD003.pdf>.

### 1. The Commission Should Reinstate the Safe Harbor for Conduct Permitted by the Tariff Adopted in Order No. 670

The Commission should clarify and expand the safe harbor provisions described in Order No. 670.<sup>227</sup> Order No. 670 states that if “a market participant undertakes an action or transaction that is explicitly contemplated in Commission-approved rules and regulations, we will presume that the market participant is not in violation of” the Commission’s Anti-Manipulation Rule.<sup>228</sup> The Commission has further stated that “actions taken in conformity with FERC-approved market rules adopted by an ISO or RTO identify behaviors that are presumptively not fraudulent and hence would not be violations of this Final Rule.”<sup>229</sup> The Commission has also held that it is not fraudulent or manipulative to respond rationally to economic incentives created by a tariff.<sup>230</sup> Those lawful responses should not suddenly become unlawful when a rule-maker decides, *post hoc*, that it could have better designed its price signals. There are compelling policy reasons for Order No. 670’s safe harbor and this conclusion. In organized ISO markets, with bid-based economic dispatches, the tariffs set up the market rules and how one participates. The only logical guide for market participants is the tariff.

The Commission should also create a safe harbor for profitable trading that lacks a fraudulent element and reverse its pronouncement in the proceeding against Deutsche Bank that “profitability . . . does not inoculate trading from any potential manipulation claim.”<sup>231</sup> In *Deutsche Bank*, the Commission sought to dramatically expand the scope of its “related markets” theory of manipulation that was applied in the *Amaranth* and *Energy Transfer Partners* proceedings.<sup>232</sup> In *Deutsche Bank*, Enforcement Staff alleged that Deutsche Bank engaged in

227. Order No. 670, *supra* note 16, at PP 64-67.

228. *Id.* at P 67.

229. *Id.* at P 59.

230. *Blumenthal v. ISO New England Inc.*, 132 F.E.R.C. ¶ 63,017 at P 111 (2010), *order aff’g initial decision*, 135 F.E.R.C. ¶ 61,117 at P 44 (2011); *New York Indep. Sys. Operator, Inc.*, 128 F.E.R.C. ¶ 61,049, at pp. 61,257-58 (2009) (finding that conduct in question was not fraudulent because the transactions “were entered into in response to price signals, were economically justified on their own account and were not the result of any actions that were designed to or did influence those price signals”); *see also Intertie Bidding in the California Independent System Operator’s Supplemental Energy Market*, 112 F.E.R.C. ¶ 61,333, at p. 62,487 (2005) (Enforcement concluded that bids that the California ISO (CAISO) alleged to have been made for the improper purpose of seeking uplift payments did not constitute manipulation, in part, because the uplift payments in question “were a CAISO-requested and [FERC]-approved incentive for increased bidding activity.”).

231. *Deutsche Bank Energy Trading, LLC*, 142 F.E.R.C. ¶ 61,056 at P 20 (2013) [hereinafter *Deutsche Bank Settlement Order*].

232. *Id.* at PP 19-21. Under this theory, the FERC considers it to be unlawful market manipulation where a firm trades against interest and suffers losses in one market in order to earn profits based on a leveraged and opposite position in another market, in a number of its most significant recent enforcement actions, including those against Amaranth Advisors, Energy Transfer Partners, and Barclays. *See, e.g., Energy Transfer Partners, L.P.*, 120 F.E.R.C. ¶ 61,086 at P 41 (2007) (asserting that manipulation occurs “where a firm uses some combination of market power and trading activity, against its economic interest in one market, in order to benefit its position in another market by artificially moving the market price”); *Amaranth Advisors*, 120 F.E.R.C. ¶ 61,085 at P 58 (2007) (“[W]here a firm uses some combination of market power and trading activity, against economic interest in one sector, in order to benefit its position in a related financial instrument by artificially moving the price, the firm likely crosses the line into the realm of manipulation.”).

market manipulation through its “Export Strategy” whereby it traded Congestion Revenue Rights (which are analogous to financial transmission rights in other markets) on a path the reflected exports from California Independent System Operator (CAISO) at one point (Silver Peak), exported small amounts of physical power out of CAISO at Silver Peak, and imported physical power back into CAISO at a nearby point (Summit).<sup>233</sup> Enforcement Staff failed to demonstrate that Deutsche Bank’s trading was not profitable, or that trading of any of the physical or financial products was not intended to be profitable, or otherwise against Deutsche Bank’s interest, on a stand-alone basis.<sup>234</sup> Deutsche Bank argued, correctly in our view, that Enforcement Staff took the “radical” position that “knowingly trading in two related markets is per se unlawful market manipulation, even if the trading is profit-seeking in both markets.”<sup>235</sup> The Commission’s attempt to expand the use of the “related markets” theory to profit-seeking trading in related markets is deeply disturbing.

A similar fair notice argument applies in cases where the Commission and Enforcement Staff have sought to impose liability for practices that the Commission has expressly permitted in previous orders. For example, in the Seminole and National Fuel Show Cause Orders, the Commission alleged that bidders used “multiple-affiliate bidding” to acquire more capacity for themselves than they could have acquired on their own, thereby “gaming” the pipeline’s pro rata allocation rules.<sup>236</sup> In each case, the Enforcement Staff Reports acknowledged that the Commission had explicitly permitted multiple-affiliate bidding in the past.<sup>237</sup> Nevertheless, Enforcement Staff concluded that this precedent was not controlling and does not prevent such conduct from violating the Anti-Manipulation Rule because, at the time these previous instances of multiple-affiliate bidding occurred, the Commission lacked the anti-manipulation authority granted in EAct 2005.<sup>238</sup> Commissioners Moeller and Spitzer each dissented from these orders (which were approved by a 3-2 majority) because the orders violated fundamental principles of fairness and due process, as they each sought to penalize companies millions of dollars for conduct that reasonably may be viewed as consistent with the Commission policy.<sup>239</sup>

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233. Deutsche Bank Show Cause Order, *supra* note 222, app. A, at 2-3.

234. Enforcement Staff simply disregarded as “not . . . credible” evidence and testimony of Deutsche Bank employees indicating that the trades in question were always intended to be profitable, on a stand-alone basis, and that Deutsche Bank did not discover until weeks later that certain trades had been unprofitable. *Id.* app. A, at 15.

235. Deutsche Bank Show Cause Answer, *supra* note 4, at 1.

236. National Fuel Show Cause Order, *supra* note 224, at 61,280; Seminole Show Cause Order, *supra* note 224, at 61,254-55.

237. *E.g.*, National Fuel Show Cause Order, *supra* note 224, at 61,288-89 (discussing *Trailblazer Pipeline Co.*, 103 F.E.R.C. ¶ 61,225 at P 71 (2003), *order on reh’g and compliance filing*, 108 F.E.R.C. ¶ 61,049 (2004); *Pacific Gas Transmission Co.*, 56 F.E.R.C. ¶ 61,192, at p. 61,721 (1991)).

238. *E.g.*, *id.*

239. *Id.* at 61,294 (Moeller, Comm’r, dissenting); *Tenaska Mktg. Ventures*, 126 F.E.R.C. ¶ 61,040, at p. 61,247 (2009) (Spitzer, Comm’r, dissenting). Notably, the stipulations negotiated in these two show cause proceedings settled alleged violations of other Commission rules (namely, the shipper-must-have-title requirement and capacity release rules) but did not address multiple-affiliate bidding. Thus, the Commission

## 2. The FERC's Catch-All Theory of Impairing a "Well-Functioning Market" Unlawfully Eliminates the Requirement to Prove Fraudulent Conduct and Fraudulent Intent

In a number of cases, the Commission and Enforcement Staff have relied on the Commission's statement in Order No. 670, which purports to "define[] fraud generally . . . to include any action, transaction, or conspiracy for the purpose of impairing, obstructing, or defeating a well-functioning market,"<sup>240</sup> to find that open market trading, without further evidence of fraudulent conduct or intent, violates the Anti-Manipulation Rule. But Order No. 670 does not—nor could it—relieve the Commission of the statutory requirement to prove that *false* and *deceptive* statements and other fraudulent conduct were the means for carrying out such objectives. As the Supreme Court made clear in the case on which Order No. 670 relies for its definition of fraud, *Dennis v. United States*,<sup>241</sup> the government is allowed to charge that "impairing, obstructing, or defeating" a "lawful function" was a scheme's unlawful "purpose," but that does not replace the requirement to prove that such a purpose was to be *accomplished* through fraud.<sup>242</sup> Moreover, forty years before the Supreme Court decided *Dennis*, it already had "made it clear that 'defraud' is limited to wrongs done 'by deceit, craft or trickery, or at least by means that are dishonest.'"<sup>243</sup> If *Dennis* intended to eliminate dishonesty as a bedrock proof requirement for schemes to defraud, surely it would have said so.

Under the precedent developed under section 10(b) of the Securities Exchange Act and SEC rule 10b-5, upon which the FERC's statutory and regulatory authority are based, open market trading does not constitute fraudulent conduct unless the activity was undertaken with manipulative intent and combined with some additional, intentional conduct intended to defraud or mislead other market participants.<sup>244</sup> In *ATSI Communications, Inc. v. Sharr Fund, Ltd.*,<sup>245</sup> for example, the Second Circuit held that trading in the open market to affect a price does not constitute manipulation unless it is "willfully

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may have ultimately accepted the respondents' fair notice arguments, though the orders approving the settlements are silent on this point.

240. Order No. 670, *supra* note 16, at P 50.

241. *Dennis v. United States*, 384 U.S. 855 (1966).

242. *Dennis* involved charges of conspiracy to defraud the government, brought under a general conspiracy statute against individuals alleged to have filed false affidavits denying their affiliation with the Communist Party. *Id.* In *Dennis*, immediately after providing case citations for the language that Order No. 670 quoted, the Supreme Court gave an illustration of what it meant by describing the allegations in "the present case." *Id.* The Supreme Court explained that the petitioners, "unable to secure for their union the benefit of Labor Board process except by submitting non-Communist affidavits, coldly and *deliberately concocted a fraudulent scheme; and in furtherance of that scheme, some of the petitioners did in fact submit false affidavits.*" *Id.* (emphasis added). In other words, in *Dennis*, the fraudulent impairment started with actual fraud.

243. *United States v. Caldwell*, 989 F.2d 1056, 1059 (9th Cir. 1993) (quoting *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924)).

244. 15 U.S.C. § 78i (2012); 17 C.F.R. § 240.10(b)(5) (2013). In this regard, we would note that courts have generally been very skeptical of open market manipulation claims, in the rare cases where they have accepted the theory at all. The discussion below addresses only the small number of cases relied on by the Commission that have taken this theory seriously; it does not address the larger number of cases where the argument has been dismissed out of hand.

245. *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007).

combined with something more to create a false impression of how market participants value a security.”<sup>246</sup> Likewise, in *Securities & Exchange Commission v. Masri*,<sup>247</sup> the Second Circuit held that, for the government to impose liability for open market trading, it “must prove that *but for* the manipulative intent, the defendant would not have conducted the transaction.”<sup>248</sup> That is because, in the court’s view:

[I]f a transaction would have been conducted for investment purposes or other economic reasons, and regardless of the manipulative purpose, then it can no longer be said that it is ‘artificially’ affecting the price of the security or injecting inaccurate information into the market, which is the principal concern about manipulative conduct.<sup>249</sup>

Federal courts have taken a similar approach to defining manipulation under the Commodities Exchange Act (CEA). In *United States v. Radley*,<sup>250</sup> for example, the court held that allegedly fraudulent bids or offers are not misleading or manipulative where the alleged manipulator is “willing and able to follow through on all of the bids.”<sup>251</sup>

Even assuming fraud could somehow be premised on truthful statements that “interfered with” or “distorted” well-functioning energy markets, regulated entities—especially energy-commodity traders—do not have fair notice of what the law requires them to do to avoid a charge that they engaged in fraud through open market trading. In particular, the Commission’s anti-fraud rules do not give participants any indication as to what they must add to their otherwise truthful statements to avoid manipulation claims.

It is vitally important that members of the regulated community understand what is expected of them, so that they can abide by the rules while at the same

246. *Id.* at 101.

247. *Securities & Exch. Comm’n v. Masri*, 523 F. Supp. 2d 361 (S.D.N.Y. 2007).

248. *Id.* at 372 (citing *United States v. Mulheren*, 938 F.2d 364, 368 (2d Cir. 1991)).

249. *Id.* at 373. The *Masri* court further explained that “[t]he difficulty in such ‘open-market’ cases, where the activity in question is not expressly prohibited, is to ‘distinguish between legitimate trading strategies intended to anticipate and respond to prevailing market forces and those designed to manipulate prices and deceive purchasers and sellers.’” *Id.* at 367 (quoting *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 205 (3d Cir. 2001)).

250. *United States v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff’d*, 632 F.3d 177 (5th Cir. 2011).

251. *Id.* at 815. The court in *In re Amaranth Natural Gas Commodities Litigation*, 587 F. Supp. 2d 513 (S.D.N.Y. 2008), *aff’d*, 730 F.3d 170 (2d Cir. 2013), addressed open market manipulation theories under the CEA and held as follows:

[E]ntering into futures contracts or swaps, without more, cannot constitute commodities manipulation. If a trading pattern is supported by a legitimate economic rationale, it cannot be the basis for liability under the CEA because it does not send a false signal. There must be “something more,” some additional factor that causes the dissemination of false or misleading information.

....

Permitting intent to be the “something more” causes difficulty in distinguishing between legitimate trading strategies and deliberate attempts at market manipulation. In close cases, there should be no liability. The laws that forbid market manipulation should not encroach on legitimate economic decisions lest they discourage the very activity that underlies the integrity of the markets they seek to protect.

*Amaranth*, 587 F. Supp. 2d at 534-35.

time be free to operate their businesses as they see fit.<sup>252</sup> As Judge Kozinski of the Ninth Circuit eloquently stated:

There are places where, until recently, “everything which was not permitted was forbidden. Whatever was permitted was mandatory. Citizens were shackled in their actions by the universal passion for banning things.” *Yeltsin Addresses RSFSR Congress of People’s Deputies*, BBC Summary of World Broadcasts, Apr. 1, 1991, available in LEXIS, Nexis Library, OMNI file. Fortunately, the United States is not such a place, and we plan to keep it that way. If the government wants to forbid certain conduct, it may forbid it. If it wants to mandate it, it may mandate it. But we won’t lightly infer that . . . Congress meant to forbid all things that obstruct the government, or require citizens to do all those things that could make the government’s job easier. So long as they don’t act dishonestly or deceitfully, and so long as they don’t violate some specific law, people living in our society are still free to conduct their affairs any which way they please.<sup>253</sup>

### B. False Statements

The Commission should also clarify the scope of its rule prohibiting regulated entities from making false or misleading statements to the Commission, ISOs/RTOs, MMUs, and jurisdictional transmission providers in section 35.41(b) of its regulations. In a number of recent cases, Enforcement Staff has claimed that false statements were made to Enforcement Staff, ISOs/RTOs, or MMUs during investigations in violation of section 35.41(b) of the Commission’s regulations.<sup>254</sup> Section 35.41(b) is one of the “Market Behavior Rules,” and it requires a “Seller” to “provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, [ISOs/RTOs], or other jurisdictional transmission providers, unless such Seller exercises due diligence to prevent such occurrences.”<sup>255</sup>

In some cases, the basis for Enforcement Staff’s allegations of violations of section 35.41(b) appears to be that statements made in response to the investigation were at odds with Enforcement Staff’s beliefs regarding the motivation for the conduct in question, i.e., what Enforcement Staff believed to be the “true intent” for the conduct or trading in question.<sup>256</sup> This simply cannot be the case. An alleged conflict between an individual’s or an entity’s explanation of its own behavior and Enforcement Staff’s speculation as to why the individual or entity engaged in that behavior cannot be the basis for charges of false statements without actual proof that the statement was, in fact, false.<sup>257</sup> Given that Enforcement Staff often “infers” intent from the circumstances of a case, it is unlikely that it would be able to provide a reasonable basis for such

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252. See, e.g., *United States v. Caldwell*, 989 F.2d 1056, 1061 (9th Cir. 1993).

253. *Id.*

254. 18 C.F.R. § 35.41(b) (2013).

255. *Id.* As a preliminary matter, this provision does not generally apply to individuals. This provision applies only to a “Seller,” i.e., an entity with market-based rate authority. *Id.* § 35.36(a)(1). Consequently, an individual would not normally (if ever) be a “Seller” within the meaning of this provision.

256. E.g., *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 368-69 (1993).

257. See, e.g., *id.*

allegations, and courts have refused to find liability for such statements under analogous securities fraud or criminal law provisions.<sup>258</sup>

In other cases, Enforcement Staff has alleged that entities made false statements where there was a purported conflict between statements made at an informal meeting, which was not transcribed, and subsequent statements made in deposition testimony or in other documents. In other words, Enforcement Staff alleged that entities should be subjected to liability based on a conflict between deposition testimony and Enforcement Staff's recollection and notes of statements made at informal meetings or on telephone calls. Similarly, Enforcement Staff has alleged that false statements have been made to ISOs/RTOs or their market monitors in conversations where there is no written record or other recording of the conversations.

More troubling still, no showing of intent to make a false or inaccurate statement is necessary to establish a violation of section 35.41(b).<sup>259</sup> This strict liability standard for unintentionally inaccurate statements creates at least two serious concerns regarding due process. First, Enforcement Staff has argued that incorrect statements to ISOs/RTOs, in and of themselves and without a showing that misstatements were intentional, can cause the conduct in question to become fraudulent.<sup>260</sup> Fraud, of course, requires intent or scienter.<sup>261</sup> Thus, once again, the Commission is attempting to relieve itself of the statutory requirement to prove fraud (and thereby reading the scienter requirement out of the statute) by lowering the standard for fraud to include unintentionally incorrect statements.<sup>262</sup> Fair notice, as well as the requirements of the FPA and NGA anti-manipulation provisions, do not permit the Commission to bootstrap a manipulation claim on inadvertent false statements.

Second, alleged violations of section 35.41(b) could easily lead to criminal liability under 18 U.S.C. § 1001, which can result in substantial jail time or criminal fines, in addition to the substantial civil penalties and other sanctions that the Commission could impose (e.g., suspension from practicing before the Commission).<sup>263</sup> Thus, given the serious nature of such allegations, the Commission should revise its regulations to add a separate intent element, i.e., that to violate section 35.41(b), a regulated entity must have intended to make a

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258. *Id.*

259. *See, e.g., J.P. Morgan Ventures Energy Corp.*, 141 F.E.R.C. ¶ 61,131 at P 45 (explaining that “[n]o showing of the respondent’s intent or mindset is necessary in order to demonstrate that a violation of section 35.41(b) has occurred”); *Kourouma*, 135 F.E.R.C. ¶ 61,245 at P 20 (2011) (“We find that section 35.41(b) does not include an intent requirement.”); *see also Kourouma v. FERC*, 723 F.3d 274 (D.C. Cir. 2013).

260. In particular, in the Deutsche Bank proceeding, Enforcement Staff concluded that Deutsche Bank had incorrectly designated certain transactions as Wheeling-Through transactions (based on Staff’s determination that the trades did not meet the tariff requirements), and without alleging that the incorrect statement was made knowingly, or even negligently, concluded that these incorrect statements were “fraudulent.” Deutsche Bank Show Cause Order, *supra* note 222, app. A, at 3-4. In its settlement of this investigation, the Commission repeated Enforcement Staff’s allegations, and staff’s conclusion, that the inaccurate designations “operated as a ‘fraud or deceit.’” Deutsche Bank Settlement Order, *supra* note 231, at P 21.

261. *See, e.g., id.* at 61,809.

262. *Supra* note 260.

263. *See generally* 18 U.S.C. § 1001 (2012); 18 C.F.R. § 35.41(b) (2013).

false or misleading statement and, where necessary, to clarify that the Commission must prove that the statement was actually false.

### C. Settlement Orders and Unadjudicated Allegations as Precedent

The unadjudicated allegations found in settlement orders, and, in particular, settlements that neither “admit nor deny” the allegations, should not be relied upon by the Commission or Enforcement Staff as precedent for allegations against other investigation subjects.<sup>264</sup> Settlement orders often do not adequately explain or provide sufficient detail as to the alleged violations, the subject’s defenses, or the reasoning behind the Commission’s finding that violations have occurred such that accepting the settlement was just and reasonable.<sup>265</sup> Indeed, the precedential value of settlement orders is highly suspect; regulated entities reviewing recent settlement orders will find little guidance or indication of what specific activities are permitted or prohibited.<sup>266</sup>

Most settlements are “black boxes;” the reasoning behind why the allegations were settled (rather than being litigated), or the terms that were agreed to, are completely obscured from public view. Sometimes the subject sees validity in the allegations and does not want to risk trial. Sometimes the cost of settling is less than the cost of contesting the allegations. And sometimes the cost of contesting the allegations will have severe repercussions to the subject beyond the sheer monetary cost of a civil penalty or settlement.<sup>267</sup> Simply put, just because an allegation has been made and not defended (or a settlement has been reached) does not mean that the allegations in that matter, or the theories underlying them, are valid or supportable.

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264. The use of the “neither admit nor deny” settlement language has recently come under debate. *U.S. Sec. & Exch. Comm’n v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328, 333-35 (S.D.N.Y. 2011), *rev’d*, 673 F.3d 158 (2d Cir. 2012) (explaining that the SEC’s decision to enter into a settlement with Citigroup that did not involve any admissions makes it impossible or difficult to discern “what the S.E.C. is getting from this settlement other than a quick headline,” and that it was “forced to conclude that a proposed Consent Judgment that asks the [c]ourt to impose substantial injunctive relief . . . on the basis of allegations unsupported by any proven or acknowledged facts whatsoever, is neither reasonable, nor fair, nor adequate, nor in the public interest”).

265. See, e.g., *Natural Gas—MISO Virtual & FTR Trading*, 146 F.E.R.C. ¶ 61,072 at PP 18-24, 33-47 (2014); *JPMVEC Settlement Order*, *supra* note 160, at PP 65-82; *Entergy Services, Inc.*, 142 F.E.R.C. ¶ 61,241 at PP 34-56 (2013); *Deutsche Bank Settlement Order*, *supra* note 231, at PP 24-39; *PacifiCorp*, 137 F.E.R.C. ¶ 61,176 at PP 48-66 (2011).

266. See sources cited *supra* note 265.

267. When the Commission settled its enforcement proceeding with Constellation, it conditioned the effective date of the settlement agreement until “the merger pursuant to the Agreement and Plan of Merger among Constellation Energy Group, Inc., [and] Exelon Corporation . . . is consummated.” *Constellation Energy Commodities Grp., Inc.*, 138 F.E.R.C. ¶ 61,168 at P 44 (2012). This leveraging of an enforcement proceeding with other regulatory approvals generated some concern. See, e.g., Raymond B. Wuslich & Gordon A. Coffee, *FERC Aggressively Investigating Cross-Market Hedging Activities*, WINSTON & STRAWN (Apr. 9, 2012), <http://www.winston.com/en/energy-industry-watch/ferc-aggressively-investigating-cross-market-hedging-activities.html> (explaining that “the resolution of the investigation—as well as the remarkably large penalty amounts—may have been the price paid to secure approval of the pending Constellation-Exelon merger”). Subjects of investigations often feel compelled to settle or otherwise resolve an enforcement investigation—against its interests—in order to secure other regulatory approvals or avoid other regulatory entanglements.



Even though it should not do so, the Commission regularly relies upon unadjudicated allegations as precedent of what is, and is not, violative activity. For example, the Commission liberally sprinkles “Enron dust” across its manipulation allegations, seeking to vilify enforcement subjects by comparing their activities to “Enron Corporation’s manipulative schemes in the western U.S. electricity markets.”<sup>268</sup> But no Enron trading “scheme” was ever found to be unlawful. For sure, Enron’s activities have been roundly criticized.<sup>269</sup> But seeking to taint an investigation subject by comparing their activities to the unadjudicated allegations against Enron, or any other unadjudicated allegations, is improper and should be stopped.

Regardless of whether the Commission continues to use settlement orders and unadjudicated allegations as precedent, the Commission should revise its rules and procedures to ensure that future settlement orders are more robust and transparent. Settlement orders, and particularly those in settlements in which the subjects neither “admit nor deny” the allegations, should set forth, in detail, the conduct constituting the alleged violation, the defenses asserted by the subject during the preliminary findings, 1b.19 or show cause processes, and the Commission’s reasoning for rejecting (or accepting) the asserted defenses. Such transparency and improved information dissemination will benefit the regulated community. Not only will it ensure that regulated entities have notice of conduct that the Commission believes violates its rules and regulations, but greater transparency in settlement orders will also provide regulated entities notice of defenses and factual circumstances that the Commission has rejected or accepted as justifying, extenuating, or mitigating the alleged violation. Greater transparency can only lead to more due process.

## V. CONCLUSION

Reforming the Commission’s enforcement process to “ensure that the subjects of an investigation receive due process both in perception and reality” will require significant structural changes, as well as effective safeguards against inappropriate and objectionable behavior by Enforcement Staff.<sup>270</sup> To begin this process, we urge the Commission to convene technical conferences to address the procedural issues with the Enforcement process and to also institute rulemaking proceedings to address substantive flaws in some of the Commission’s rules, especially as it pertains to what constitutes market manipulation. In addition, we urge the regulated community and other practitioners to publicly speak out on these and other issues.

Perhaps if the Commission indicates that it is ready to walk the walk instead of merely talking the talk it will counteract the perception among members of the regulated community and the energy bar that the Commission’s enforcement process is lop-sided and unfair.

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268. See, e.g., Petition to Affirm Lincoln Penalties, *supra* note 100, ¶ 19; Petition to Affirm Silkman/CES Penalties, *supra* note 100, ¶ 20; Petition to Affirm Barclays Penalties, *supra* note 100, ¶ 13.

269. Press Release, SEC, SEC Charges Kenneth L. Lay, Enron’s Former Chairman and Chief Executive Officer, with Fraud and Insider Trading (July 8, 2004), available at <http://www.sec.gov/news/press/2004-94.htm>.

270. Revised Enforcement Policy Statement, *supra* note 1, at P 21.