

ENERGY LAW JOURNAL

Volume 27, No. 2

2006

WARNINGS TO THE UNWARY: MULTI- JURISDICTIONAL FEDERAL ENFORCEMENT OF MANIPULATION AND DECEPTION IN THE ENERGY MARKETS AFTER THE ENERGY POLICY ACT OF 2005

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“Oh what a tangled web we weave,
When first we practise to deceive!”
Sir Walter Scott, Marmion, Canto vi. Stanza 17

I. INTRODUCTION

Some energy markets in the United States, notably California’s, have proven to be vulnerable to manipulation.¹ In response, Congress included provisions in the Energy Policy Act of 2005, now implemented by the Federal Energy Regulatory Commission (FERC),² that enhanced the power of the FERC to address manipulation and deception that affects transactions within the FERC’s jurisdiction.³ These far-reaching rules subject transactions and actors who were not previously exposed to FERC jurisdiction to the enforcement powers of that agency,⁴ including very substantial penalties.⁵ Under the FERC’s new rules, *all* participants in the organized energy markets, including

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1. *See infra* text accompanying notes 29-32, 90-114. References are made in this Article to several different markets involving energy, referred to collectively as “the energy markets.” A distinction is drawn between, on the one hand, the market for electricity and for natural gas, sometimes called the “physical market,” and, on the other hand, the “financial” or “derivatives” market, which refers to transactions in futures and options on electricity or natural gas. The “spot” or “forward” markets are aspects of the physical market for the actual energy. Some transactions in the financial markets are conducted on exchanges regulated by the Commodities Futures Trading Commission (CFTC); many financial market transactions are conducted in the over-the-counter (OTC) market, which is not currently regulated by the CFTC. Reference is also made to transactions in transmission or transmission capacity, for electricity, and pipeline transportation or capacity, for natural gas. References to a “geographic” market refer to a physical market serving a particular geographic area. Many of the markets are interdependent, or at least influence one another. For example, the market for natural gas may influence the market for electricity in a geographic area where a significant amount of electricity is generated using natural gas. For a brief discussion of the interplay between the physical and financial markets, *see infra* notes 94, 222.

2. The term “Commission” will also be used in this Article to refer to a federal agency such as the FERC; the identity of the specific agency is apparent from the related text.

3. *See infra* text accompanying notes 42-45, 52-54.

4. *See, e.g., infra* text accompanying notes 156-58.

5. *See, e.g., infra* text accompanying notes 47-50.

those who trade in the retail portion, governmental, and certain cooperative utilities, and quite possibly including those who trade in the financial markets with an impact on FERC jurisdictional transactions, have become subject to the FERC's enforcement jurisdiction.⁶ This Article addresses the scope and meaning of the new FERC rules.⁷

Consideration of the enhanced powers of the FERC is an occasion to reflect on the fact that a single transaction with an impact on an energy market may be subject to civil enforcement action by multiple federal regulatory agencies as well as to criminal prosecution.⁸ Thus, one who trades in energy derivatives on an exchange, who may have a natural tendency to focus on the potential for enforcement action by the Commodities Futures Trading Commission (CFTC), must recognize that he may *also* be subject to action by the FERC. For example, a hedge fund that might take comfort that it is largely unregulated by the Securities and Exchange Commission (SEC) and focus solely on its vulnerability to oversight by the CFTC when trading in a regulated market might nevertheless also be in the sights of the FERC if that hedge fund were to engage in transactions in derivatives that affected the FERC jurisdictional market for natural gas or electricity. Similarly, one—such as a utility—who engages in transactions in energy with a propensity to focus on enforcement by the FERC must take into account that it may also be exposed to action by the CFTC if the transaction in the energy market had a manipulative effect on a market for derivatives that is regulated by the CFTC. At all times there also lurks the potential that a manipulation of the markets will violate the antitrust laws.

In order to present the full picture of civil and criminal financial penalties and other remedies that can be imposed on those who engage in misconduct affecting any of these markets, this Article outlines the other significant regulatory regimes that intersect or overlap with the FERC's anti-manipulation enforcement powers in the energy market.⁹ Finally, there is a detailed discussion of factors that enforcement agencies, such as the FERC and the CFTC, consider in determining whether to bring an enforcement action and what remedies will be sought under the facts of a specific case. These factors provide significant guidance on the steps that can be taken to minimize any enforcement sanction, before or even after there has been a violation.¹⁰

II. THE FEDERAL ENFORCEMENT FRAMEWORK

This section describes the regulatory regimes for enforcement of the most pertinent federal laws and regulations that could affect energy markets.

6. *See infra* text accompanying notes 156-67.

7. *See infra* Part III. This Article focuses on government enforcement and thus does not address in detail the extent to which a private party may initiate an action to claim damages sustained as a result of a violation of any of the statutes or rules discussed.

8. *See infra* Part IV. This Article does not address state enforcement powers under state laws—either utility law or some other potentially applicable law—or the extent to which federal law preempts state enforcement activity.

9. The focus in this Article is the substantive law under several federal regulatory regimes. There is only limited discussion of the procedural aspects of enforcement by the agencies that are discussed.

10. *See infra* Part VII.A.

A. *Enforcement by the Federal Energy Regulatory Commission*

1. The FERC Enforcement Regime Prior to the Energy Policy Act of 2005

The FERC has long had authority to address overcharges in the regulated electricity and natural gas sales, which it exercises through orders, rules, regulations, and regulatory enforcement proceedings. This authority stems from the FERC's primary mission to protect natural gas and electricity consumers from exploitation by natural gas companies and electric utilities.¹¹ The Natural Gas Act¹² and the Federal Power Act¹³ obligate the Commission to ensure that the rates charged for wholesale sales of natural gas and electricity are "just and reasonable."¹⁴ The Commission has carried out that mandate in various ways since these laws were enacted in the 1930s.¹⁵

Some basic background of the overall regulatory framework places the enforcement powers in context. The FERC currently exercises more authority over wholesale electric sales than over wholesale sales of natural gas. In 1989, Congress enacted the Natural Gas Wellhead Decontrol Act, which reflected the judgment of Congress that substantial competition existed at the wellhead for commodity sales of natural gas.¹⁶ The Wellhead Decontrol Act thus repealed the FERC's authority over the prices charged for "first sales" of natural gas.¹⁷ The Commission later effectively lifted all remaining price restrictions on wholesale gas sales.¹⁸ Under the Commission's regulations, except for interstate pipelines, all regulated sellers of natural gas at wholesale are granted authority to make all sales at market-based rates.¹⁹ As a result of the Wellhead Decontrol Act, merchant energy traders, unaffiliated with any pipeline or local distribution company, entered the market to sell natural gas to other traders, to electric utilities that use natural gas to generate electricity, and to local gas distribution companies for resale to end users of natural gas, including both individual consumers and industrial firms.²⁰

11. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

12. 15 U.S.C. §§ 717 (2000).

13. 16 U.S.C. §§ 824 (2000).

14. Natural Gas Act, 15 U.S.C. §§ 717c, 717d (2000); Federal Power Act, 16 U.S.C. §§ 824d, 824e (2000).

15. Federal Power Act, ch. 687, 49 Stat. 847, 854 (1935); Natural Gas Act, ch. 556, 52 Stat. 821 (1938).

16. Natural Gas Wellhead Decontrol Act, Pub. L. No. 101-60, 103 Stat. 157 (1989).

17. 15 U.S.C. § 3301 (2000). These "first sales" include not only the sale at the wellhead by the producer but also any subsequent sales until the gas is acquired by a pipeline, a pipeline affiliate, a local distribution company, or an affiliate of a local distribution company. *Id.* § 3301(21)(A).

18. Regulations Governing Blanket Marketer Sales Certificates, 57 Fed. Reg. 57,952, 57,953 n. 4 (Apr. 16, 1992) (to be codified at 18 C.F.R. pt. 284).

19. 18 C.F.R. § 284.402 (2006). Interstate pipelines are authorized to make unbundled sales of natural gas at market-based rates pursuant to 18 C.F.R. § 284.284 (2006). "Market-based" rates are those that a willing seller may charge a willing buyer. Market-based rates need not bear any relationship to the costs of providing service. In contrast, "cost-based" rates permit the buyer to recover its costs incurred in providing service plus a reasonable rate of return.

20. For a general discussion of the development of the unregulated market for natural gas, see Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation under Part 284 of the Commission's Regulations, Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol*, [Regs. Preambles 1991-1996] F.E.R.C. STATS. & REGS. ¶ 30,939, at p. 30,394-398 (1992), 57 Fed.

In contrast, Congress and the Commission moved more slowly toward market-based rates for wholesale electric transactions. With the passage of the Public Utility Regulatory Policies Act in 1978 (PURPA), Congress began encouraging alternate suppliers, such as industrial customers, to generate electricity. The Energy Policy Act of 1992²¹ provided further regulatory relief to encourage non-traditional generators by creating the concept of an exempt wholesale generator.²²

As a result of the creation of new-style generation, the FERC began permitting entities to sell power at market-based rates if they could demonstrate a lack of market power in the appropriate geographic markets for generation and transmission, that the entity did not create barriers to entry in those markets, and that the entity agreed to comply with rules regarding transactions with its affiliates.²³

The Commission continues to have plenary jurisdiction over wholesale sales of electricity.²⁴ Unlike the broad authority granted in Order No. 547 to those selling natural gas,²⁵ the FERC has continued to make determinations to permit market-based sales of electricity only on a company-by-company basis. Thus, jurisdictional sellers with market-based rate authority are required to submit quarterly reports regarding their sales activities.²⁶ The courts have pointed to the FERC's oversight activity as a basis for approving Commission orders permitting market-based sales.²⁷

In recent years the FERC acted, within the confines of its limited authority, to protect consumers from manipulation of energy markets.²⁸ The FERC's concerns regarding market manipulation were triggered in large measure by its investigation into the causes of the California market meltdown that occurred in the summer of 2000. The Commission found evidence that a number of companies had engaged in manipulative conduct designed to affect the price of electricity in the California market.²⁹ The now infamous internal Enron memorandum described a number of manipulative tactics used by Enron

Reg. 13,267 (1992), *reh'g granted*, 59 F.E.R.C. ¶ 61,216 (1992), and 60 F.E.R.C. ¶ 61,102 (1992), *reh'g denied, clarification granted*, 61 F.E.R.C. ¶ 61,272 (1992) and 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and remanded in part*, United Dist. Cos. v. FERC, 88 F.3d 1105 (D.C. Cir. 1996).

21. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, (codified in scattered sections of 15, 16, 38, and 42 U.S.C.).

22. 15 U.S.C. § 79z-5a (repealed 2005).

23. *AEP Power Mktg., Inc.*, 97 F.E.R.C. ¶ 61,219 (2001), *reh'g granted*, 107 F.E.R.C. ¶ 61,018 (2004), *reh'g denied*, 108 F.E.R.C. ¶ 61,026 (2004), *appeal dis'd sub nom.* Entergy Servs., Inc. v. FERC, No. 04-124, 2005 U.S.App. LEXIS 2220 (D.C. Cir. 2005); *see also* Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 8-14 (2005) [hereinafter Kelliher].

24. Federal Power Act, 16 U.S.C. §§ 824c, 824d (2000).

25. *See supra* note 18.

26. Order No. 2001, *Revised Public Utility Filing Requirements*, 67 Fed. Reg. 31,043 (Apr. 25, 2002).

27. *California v. FERC*, 383 F.3d 1006, 1013 (9th Cir. 2004); *see also* Kelliher, *supra* note 23, at 12-13.

28. Kelliher, *supra* note 23, at 14-32.

29. FERC STAFF, FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS: FACT-FINDING INVESTIGATION OF POTENTIAL MANIPULATION OF ELECTRIC AND NATURAL GAS PRICES, FERC DOCKET NO. PA02-2 (2003), *available at* <http://www.ferc.gov/legal/staff-reports.asp> (hyperlink to "Electric"; then "Staff Report on Western Markets Investigation") [hereinafter FINAL REPORT].

Corporation (Enron).³⁰ For example, Enron engaged in trading designed to increase congestion over transmission lines, and then engaged in transactions, for which it was paid by the California Independent Transmission System Operator, that relieved the same congestion.³¹

A number of sellers also engaged in improper “wash trades,” transactions that lacked a proper business purpose and were manipulative. In a wash trade a seller sells a party a specified amount of power to be delivered at a specified point for a specified period; that buyer then almost immediately resells exactly the same power back to the first seller.³² Wash trades can, if misused, inflate both the sales volumes in the market as a whole and the volume for the specific traders who report inflated sales, which give the appearance of greater total market volume as well as overstating the significance of the misreporting traders as market participants. The Commission approved many settlements of enforcement charges involving those alleged to have engaged in misconduct in the western markets.³³

In reaction to this misconduct, the FERC adopted its Market Behavior Rules. The FERC modified its regulations to require all jurisdictional wholesale sellers of natural gas to comply with the Market Behavior Rules,³⁴ and for sellers of electricity modified all tariffs that permitted the wholesale sale of electricity at market based rates to include the Market Behavior Rules.³⁵ Market Behavior Rule No. 2, applicable to wholesale sellers of gas and electricity, prohibited actions without a “legitimate business purpose” that were “intended to or foreseeably could manipulate market prices, market conditions, or market rules”³⁶ The rule expressly prohibited sellers from engaging in the type of conduct described in the Enron memorandum, including wash trades and the submission of false information.³⁷ The Commission stated that sellers found to violate the Market Behavior Rules could be subject to sanctions, including disgorgement of profits reaped as a result of the violation or revocation of the

30. *Id.* at IX-2.

31. FINAL REPORT, *supra* note 29, at VI-12, 13.

32. *Id.* at ch. VII.

33. *E.g., San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services; Investigation of the Practices of the California Independent System Operator and the California Power Exchange; Investigation of Anomalous Bidding Behavior and Practices in the Western Markets; Fact-Finding Investigation into Possible Manipulation of Electric and Natural Gas Prices; Enron Power Marketing, Inc., Enron Energy Services, Inc.; Portland General Electric Co.; El Paso Electric Co., Enron Capital and Trade Resources Corp.*, 113 F.E.R.C. ¶ 61,226 (2005), *reh'g denied*, 115 F.E.R.C. ¶ 61,032 (2006) (approving settlement of numerous proceedings involving claims against Enron entities). *See generally* FERC STAFF, ENERGY MARKET OVERSIGHT AND ENFORCEMENT: ACCOMPLISHMENTS AND PROPOSAL FOR ENHANCED PENALTY AUTHORITY 5-7 (2005), available at <http://www.ferc.gov/legal/staff-reports.asp> (hyperlink to “General”; then hyperlink to “Energy Market Oversight and Enforcement: Accomplishments And Proposal For Enhanced Penalty Authority”) (describing settlements) [hereinafter FERC ENERGY MARKET OVERSIGHT].

34. Amendments to Blanket Sales Certificates, 68 Fed. Reg. 66,323 (Nov. 26, 2003) (codified at 18 C.F.R. § 284.288), *reh'g denied*, 107 F.E.R.C. ¶ 61,174 (2004).

35. Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 F.E.R.C. ¶ 61,218 (2003), *reh'g denied*, 107 F.E.R.C. ¶ 61,175 (2004). The Market Behavior Rules applicable to the natural gas industry and the Market Behavior Rules applicable to the electric industry are substantially identical.

36. 105 F.E.R.C. ¶ 61,218, at P 35; *see also* Kelliher, *supra* note 23, at 17.

37. 105 F.E.R.C. ¶ 61,218, at P 46.

offender's authority to sell at market based rates.³⁸ When it adopted the Market Behavior Rules, however, the Commission had only limited enforcement powers.³⁹

2. Changes Effectuated in the FERC's Enforcement Powers as a Result of the Energy Policy Act of 2005

The Enron experience⁴⁰ gave rise to the concern that the FERC lacked adequate tools to deal with manipulation and deception in the energy markets. In particular, after surveying changes in the market for electric energy and assessing the authority the FERC had to address misconduct, Joseph T. Kelliher, chairman of the FERC, advocated for legislation that would grant additional enforcement power to the FERC:

In my view, [the FERC] lacks the necessary tools to address these dramatic industry changes, including the threat of market manipulation. A comparison of the Federal Power Act with other federal economic regulatory laws makes that plain. Securities and commodities laws include express prohibitions of market manipulation. This is lacking in the Federal Power Act. Securities and commodities laws also provide for tough and effective penalties for both attempts to manipulate markets and manipulation itself. There is no valid public policy reason why [the FERC] should not have the same enforcement tools as other federal economic regulatory agencies. A comparison of the Federal Power Act with other federal economic regulatory laws also demonstrates that there is a need for tough civil and criminal penalties. If violations of market rules can go unpunished,⁴¹ they will become more frequent. Again, the Federal Power Act comes up short.⁴¹

Congress sought to meet this challenge by including provisions in the Energy Policy Act of 2005⁴² (EPAct 2005) that granted additional enforcement power to the FERC and added to the array of and increased the existing civil and criminal penalties for manipulative and deceptive conduct.

Sections 315 and 1283 of the EPAct 2005 are the focus of this article insofar as the FERC's enforcement powers are concerned.⁴³ Section 315 of the EPAct 2005 added new section 4A to the Natural Gas Act:

It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 78j(b) of this title) in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers.⁴⁴ Nothing in this section shall be construed to create a private right of action.

38. *Id.* at P 6; *see also* Kelliher, *supra* note 23, at 19.

39. Kelliher, *supra* note 23, at 22-25.

40. FINAL REPORT, *supra* note 29, chs. I-III.

41. Kelliher, *supra* note 23, at 30 (internal footnotes and citations omitted). *See also id.* at 23-25 (contrasting the powers of the other agencies with that of the FERC to address market manipulation); *id.* at 31 (“[N]early five years after the electricity crisis in California and the West, not one of the manipulative practices Enron used has been prohibited by law.”); FERC ENERGY MARKET OVERSIGHT, *supra* note 33 (proposing enhanced penalties for violations of statutes administered by the FERC).

42. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594.

43. Energy Policy Act of 2005 §§ 315, 1283.

44. 15 U.S.C. § 717c-1 (2000).

Section 1283 of the EPAct 2005 added new section 222 to the Federal Power Act:

(a) In general [–] It shall be unlawful for any entity (including an entity described in section [201](f)⁴⁵ of this title), directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 78j(b) of Title 15), in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers.

(b) [N]o [P]rivate [R]ight of [A]ction [–] Nothing in this section shall be construed to create a private right of action.⁴⁶

Neither of these provisions is self-executing, in that the conduct rendered unlawful is conduct that violates any rules the FERC enacts pursuant to its new authority.

The EPAct 2005 also increased the penalties for violations. On the civil side, sections 314(b)⁴⁷ and 1284⁴⁸ of the EPAct 2005 provide that the FERC itself can impose a civil penalty of up to \$1,000,000 per day per violation for any violation of the respective statute or any FERC rule. The amendment to the Natural Gas Act specified that the amount of the penalty is to “take into consideration the nature and seriousness of the violation and the efforts to remedy the violation.”⁴⁹ The maximum criminal fine for a violation of either statute was increased from \$5,000 to \$1,000,000, and the maximum prison term was increased from two years to five years.⁵⁰ The EPAct 2005 enhanced enforcement and disclosure requirements in several other respects.⁵¹

45. Section 201(f) of the Federal Power Act refers to the United States, a State or any political subdivision of a State, or any agency, authority, or instrumentality of any one or more of the foregoing (i.e., public utilities), or any corporation which is “wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty . . .” 16 U.S.C. § 824(f) (2000). Thus, section 222 and any implementing rules encompass conduct by these governmental entities and their instrumentalities that are otherwise generally unregulated by the FERC. Energy Policy Act 2005 § 1283 (to be codified at 16 U.S.C. § 824v).

46. Energy Policy Act of 2005 § 1283.

47. *Id.* at 314(b) (adding new section 22 to the Natural Gas Act, to be codified at 15 U.S.C. § 717t-1).

48. Energy Policy Act of 2005 § 1284 (amending section 316A of the Federal Power Act, 16 U.S.C. § 825o-1(b) (2000), increasing the penalty from \$10,000 to \$1,000,000 per day per violation).

49. Energy Policy Act of 2005 § 314(c). The comparable, pre-existing, language in the Federal Power Act, which was not amended by the EPAct 2005, directs the FERC to “take into consideration the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner.” 16 U.S.C. § 825o-1(b) (2000). Thus, the Natural Gas Act has a “nature” of the violation criterion that does not appear in the Federal Power Act, a distinction with little apparent difference.

50. Energy Policy Act of 2005, Pub. L. No. 109-58, § 314(a)(1), 119 Stat. 594 (amending section 21 of the Natural Gas Act, 15 U.S.C. § 717t (2000)); Energy Policy Act of 2005 § 1284(d) (amending section 316 of the Federal Power Act, 16 U.S.C. § 825o (2000)).

51. EPAct 2005 sections 318 and 1288 amended section 20 of the Natural Gas Act (15 U.S.C. § 717s (2000)), and section 314 of the Federal Power Act (16 U.S.C. § 825m (2000)), respectively, by giving federal district courts the power to impose on a natural person as a remedy for a violation of new section 4A of the Natural Gas Act or section 222 (incorrectly stated as “221” at 119 Stat. 982) of the Federal Power Act and the rules and regulations thereunder (*supra* text accompanying notes 44-45) a suspension or bar, as applicable depending on whether the violation relates to natural gas or electric energy, from acting as a director or officer of a natural gas company or electric utility or engaging in the business of purchasing or selling natural gas,

The FERC acted expeditiously to implement sections 315 and 1283 of the EPAAct 2005 by adopting two rules, which became effective on January 26, 2006.⁵² The rule for the gas market provides:

Prohibition of natural gas market manipulation.

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

(1) To use or employ any device, scheme, or artifice to defraud, (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.

(b) Nothing in this section shall be construed to create a private right of action.⁵³

The rule for the electric energy market provides:

Prohibition of electric energy market manipulation.

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

(1) To use or employ any device, scheme, or artifice to defraud, (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity.

(b) Nothing in this section shall be construed to create a private right of action.⁵⁴

The scope and meaning of these rules is discussed in Part III of this Article.

electric energy, or transmission services therefore. This is comparable to the provisions under the securities laws that empower a court or the SEC to prohibit a person from serving as a director or officer of a public company as a sanction for violating section 10(b) of the Securities Exchange Act of 1934 (Securities Exchange Act), 15 U.S.C. § 78j(b) (2000). *See, e.g.*, Energy Policy Act of 2005 §§ 21(d)(2) and 21C(f); 15 U.S.C. §§ 78u(d)(2), 78u-3(f) (2000) (granting power to federal district court on the application of the SEC and to the SEC administratively, respectively, to prohibit a person, conditionally or unconditionally, permanently or for a specified period, from acting as a director or officer of a public company where the person has violated section 10(b) and the conduct demonstrates that the person is unfit to serve as an officer or director of a public company). For purposes of this article, the phrase “public company” means a company a class of whose securities are registered for trading under section 12 of the Securities Exchange Act, 15 U.S.C. § 78l (2000), or that is required to file reports pursuant to section 15(d) of the Securities Exchange Act, 15 U.S.C. § 78o(d) (2000). One distinction between the provisions under the energy laws and the securities laws is that the bar under the energy laws is not conditioned on a finding that the person is “unfit” to serve. Energy Policy Act of 2005 § 1282 added new section 221 to the Federal Power Act (to be codified at 16 U.S.C. § 824u), a prohibition on willfully and knowingly reporting to a Federal agency any information relating to the price of electricity sold at wholesale or the availability of transmission capacity, which the person or entity knew to be false at the time of reporting, with the intent to fraudulently affect the data being compiled by the agency.

52. Order No. 670, *Prohibition of Energy Market Manipulation*, 114 F.E.R.C. STATS. & REGS. ¶ 31,202, 71 Fed. Reg. 4244 (2006) [hereinafter Order 670].

53. Order 670, *supra* note 52, at § 1c.1 (to be codified at 18 C.F.R. § 1c.1).

54. *Id.* § 1c.2 (to be codified at 18 C.F.R. § 1c.2).

In connection with the adoption of these rules, the FERC revamped its Market Behavior Rules. Under the Federal Power Act⁵⁵ the FERC rescinded Market Behavior Rules two (generally prohibiting manipulation)⁵⁶ and six (directing sellers not to violate market-based rate codes of conduct or the Standards of Conduct⁵⁷),⁵⁸ and codified Market Behavior Rules one, three, four, and five.⁵⁹ Former rule one as codified provides that “[w]here a seller participates in a Commission-approved organized market seller will operate and schedule generating facilities, undertake maintenance, declare outages and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations”⁶⁰ Former rule three as codified generally provides that the “[s]eller will 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,” or specified others.⁶¹ Former rule four as codified provides that to the extent that a seller reports transactions to publishers of electricity or gas price indices it will do so accurately and factually and not knowingly submit false or misleading information.⁶² Finally, former rule five as codified requires retention of certain records for three years.⁶³

Under its current organizational structure, the FERC’s Office of Enforcement (OE) is responsible for the enforcement functions of the FERC.⁶⁴ Among other activities, the OE “[i]nitiate[s] and execute[s] investigations of possible violations of the statutes administered by the Commission and the rules, orders, and regulations issued thereunder. Recommends remedies to address violations and pursues remedies through negotiation or litigation.”⁶⁵

55. Comparable action was taken under the Natural Gas Act. Order No. 673, *Amendments to Codes of Conduct for Unbundled Sales Service and for Persons Holding Blanket Marketing Certificates*, 114 F.E.R.C. STATS. & REGS. ¶ 61,166, 71 Fed. Reg. 9709 (2006) (rescinding 18 C.F.R. §§ 284.288(a), (d), (e), and 284.403(a), (d), (e)).

56. See *supra* text accompanying notes 36-38.

57. 18 C.F.R. Pt. 358 (2005).

58. *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 F.E.R.C. ¶ 61,165 at PP 21, 46 (Feb. 16, 2006) [hereinafter *Investigation of Market-Based Rate Authorizations*]. One element of the rationale for this action is discussed *infra* at note 162.

59. Order No. 674, *Conditions for Public Utility Market-Based Rate Authorization Holders*, 114 F.E.R.C. ¶ 61,163 at PP 21 (Feb. 16, 2006) (as corrected at 71 Fed. Reg. 11,304 (Mar. 7, 2006) and 71 Fed. Reg. 13,000 at P 8 (Mar. 14, 2006)) (to be codified at 18 C.F.R. pt. 35).

60. 18 C.F.R. § 35.37(a) (2006).

61. 18 C.F.R. § 35.37(b) (2006).

62. 18 C.F.R. § 35.37(c) (2006).

63. 18 C.F.R. § 35.37(d) (2006); see also Order 677, *Revisions to Record Retention Requirements for Unbundled Sales Service, Persons Holding Blanket Marketing Certificates, and Public Utility Market-Based Rate Authorization Holders*, 115 F.E.R.C. STATS. & REGS. ¶ 31,218, 71 Fed. Reg. 30,284 (May 19, 2006) (to be codified at 18 C.F.R. § 35.37(d)) (extending record retention requirement from three years to five years for transactions pursuant to blanket certificates for unbundled natural gas sales services held by interstate pipelines and others).

64. About FERC Office of Enforcement, <http://www.ferc.gov/about/offices/oe.asp> (describing the functions of the Office of Enforcement) [hereinafter About FERC].

65. *Id.* (describing the mission of the Division of Investigations).

The OE has four divisions, including the Division of Investigations and the Division of Energy Market Oversight.⁶⁶ The OE has a staff that includes engineers, accountants, lawyers, auditors, financial analysts, and regulatory specialists.⁶⁷ The OE may investigate conduct on its own initiative or be prompted by information brought to the FERC's attention, such as through the FERC's hotline.⁶⁸ The OE was empowered to conduct audits of jurisdictional entities.⁶⁹ During the investigational phase, the activities of the OE Division of Investigation are generally kept confidential;⁷⁰ if the OE determines that violations have occurred, "the Commission may institute administrative proceedings"⁷¹ Charges are resolved through adversarial proceedings or by settlement.

B. Enforcement by the Commodity Futures Trading Commission

As stated by FERC Chairman Kelliher in his proposal for broader regulatory authority for the FERC, the CFTC has long had powers to address manipulation in certain futures and options markets.⁷² The EPAct 2005 expressly preserved the jurisdiction of the CFTC under the Commodity Exchange Act.⁷³ In analyzing multi-agency enforcement, it is therefore essential to understand the scope of the CFTC's powers.

Contracts for the sale of a commodity for future delivery, and options on such contracts, are subject to the exclusive jurisdiction of the CFTC under the Commodity Exchange Act.⁷⁴ Accordingly, no other federal or state agency can regulate these contracts unless the Commodity Exchange Act explicitly contemplates shared jurisdictional authority.⁷⁵ The term "futures contract" is not defined in the Commodity Exchange Act. The Commodity Exchange Act, however, was never intended to reach bona fide commercial contracts for the subsequent delivery of a commodity as futures contracts; it explicitly provides that, "[t]he term 'future delivery' does not include any sale of any cash

66. About FERC, *supra* note 64 (describing the organizational structure of the OE).

67. *Id.*

68. 18 C.F.R. §§ 1b.1-1b.21 (2006); *see also* About FERC, *supra* note 64 (explaining the FERC enforcement hotline).

69. About FERC, *supra* note 64. *See, e.g.*, Natural Gas Act, 15 U.S.C. § 717g(c) (2000).

70. 18 C.F.R. § 1b.9 (2006).

71. 18 C.F.R. § 1b.7 (2006).

72. *See supra* text accompanying note 41.

73. Energy Policy Act of 2005, Pub. L. No. 109-58, § 316, 119 Stat. 594 (to be codified at 15 U.S.C. § 717t-2(c)(2)) (adding new section 23(c)(2) to the Natural Gas Act); Energy Policy Act of 2005, Pub. L. No. 109-58, § 1281, 119 Stat. 594 (2005) (to be codified at 16 U.S.C. § 824(c)(2)) (adding new section 220(c)(2) to the Federal Power Act). The Commodity Exchange Act is found at 7 U.S.C. §§ 1-27 (2006). While the FERC's enforcement powers now at least indirectly extend to activities that have largely been the province of the CFTC, there is no reason to expect that the CFTC is going to become less active in enforcing the Commodity Exchange Act where energy-related transactions are involved. *See also infra* text accompanying notes 226-30. (describing ongoing cooperation between the FERC and the CFTC, in accordance with Congressional mandate).

74. Commodity Exchange Act, 7 U.S.C. § 2a(1) (2000).

75. PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS ET AL., OVER-THE-COUNTER DERIVATIVES MARKETS AND THE COMMODITY EXCHANGE ACT (Nov. 1999), *available at* www.treasury.gov/press/releases/reports/otcact.pdf.

commodity for deferred shipment or delivery.”⁷⁶ These contracts for deferred delivery are commonly referred to as “forward contracts.” Thus, for example, a farmer’s contract to sell corn from a future crop year to a grain elevator at a price negotiated currently is a forward contract and thus excluded from regulation under the Commodity Exchange Act as a futures contract.⁷⁷

When the Commodity Futures Modernization Act (CFMA) was enacted in 2000, it created a more flexible structure for the regulation of futures trading.⁷⁸ Congress intended that the CFMA would, in large part, provide legal certainty to the OTC derivatives markets by excluding most OTC derivative transactions from the Commodity Exchange Act.⁷⁹ The CFMA essentially divided commodities into three categories. The first category consists of agricultural commodities. The second category includes commodities known as “excluded commodities” that are interest rates, exchange rates, currencies, securities, or other rates, differentials, and indices or measures that are not within the control of any party to the transaction.⁸⁰ The third category, known as “exempt commodities,” consists of commodities that are neither agricultural commodities nor excluded commodities.⁸¹ Oil, gas, electricity, and other energy products fall in this third category, because they are neither an agricultural commodity nor an excluded commodity.

The CFMA added section 2(h) to the Commodity Exchange Act.⁸² That section specifies that most provisions in the Commodity Exchange Act shall not apply to a contract, agreement or transaction in an exempt commodity (*e.g.*, energy products) that (1) is entered into solely between persons that are “eligible contract participants”⁸³ and (2) is not entered into on a “trading facility.”⁸⁴ Importantly for purposes of the topics addressed in this Article, however, Section 2(h) does not deprive the CFTC of enforcement authority in many situations involving alleged fraud or market manipulation involving the energy markets because section 2(h)(2)(C) provides that transactions in an exempt commodity are subject to the prohibitions on manipulation in the Commodity Exchange Act.⁸⁵

76. Commodity Exchange Act, 7 U.S.C. § 1a(19) (2000).

77. *The Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 317-22 (6th Cir. 1998); *see also* CFTC v. Zelener, No. 03 C 4346, 2003 WL 22284295, at *5 (N.D. Ill. Oct. 3, 2003) (holding that transactions in the spot market are also beyond the scope of the CFTC), *aff’d*, 373 F.3d 861 (7th Cir. 2004), *reh’g denied*, 387 F.3d 624 (7th Cir. 2004); *see also* *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 970 (4th Cir. 1993) (“Because the Act was aimed at manipulation, speculation, and other abuses that could arise from the trading in futures contracts and options, as distinguished from the commodity itself, Congress never purported to regulate ‘spot’ transactions (transactions for the immediate sale and delivery of a commodity) or ‘cash forward’ transactions (in which the commodity is presently sold but its delivery is, by agreement, delayed or deferred).”).

78. Enacted as part of the Consolidated Appropriations Act, Pub. L. No. 106-554, 114 Stat. 2763 (2000).

79. Press Release, CFTC, Congress Passes Commodity Futures Modernization Act (Dec. 15, 2000), available at <http://www.cftc.gov/opa/press00/opa4479-00.htm> (CFTC Release No. 4479-00).

80. Commodity Exchange Act, 7 U.S.C. § 1a(13) (2000).

81. Commodity Exchange Act, 7 U.S.C. § 1a(14) (2000).

82. Commodity Exchange Act, 7 U.S.C. § 2(h) (2000).

83. This term is defined in the Commodity Exchange Act, 7 U.S.C. § 1a(12) (2000).

84. This term is defined in the Commodity Exchange Act, 7 U.S.C. § 1a(33) (2000).

85. *E.g.*, *United States v. Reliant Energy Serv., Inc.*, 420 F. Supp. 2d 1043 (N.D. Cal. 2006) (holding that price manipulation of the spot market is within the scope of § 9(a)(2) of the Commodity Exchange Act). Section 9(a)(2) of the Commodity Exchange Act makes it a crime for “[a]ny person to manipulate or attempt to

The Commodity Exchange Act grants the CFTC broad authority to take action against any person who is:

manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or has willfully made any false or misleading statement of a material fact in any registration application or any report filed with the Commission . . . or otherwise is violating or has violated [the Commodity Exchange Act or any CFTC rule]⁸⁶

In an enforcement proceeding, the CFTC must establish: that the wrongdoer had the ability to influence market prices; that an artificial price was created that did not reflect legitimate supply and demand; that the alleged wrongful conduct caused the artificial price; and that the wrongdoer acted with scienter.⁸⁷ To prevail on a claim for attempted manipulation, the CFTC must satisfy a two-prong test, establishing both “(1) an intent to affect the [commodity’s] market price; and (2) some overt act in furtherance of that intent.”⁸⁸

Section 13(a) of the Commodity Exchange Act makes it a crime for:

manipulate the price of *any commodity in interstate commerce*, or for future delivery on or subject to the rules of any registered entity” 7 U.S.C. § 13(a)(2) (emphasis added). “The comma, followed by the ‘or’ leads the court to conclude, as other courts have, that ‘Congress clearly intended the term ‘interstate commerce’ to have a meaning distinct from the phrase ‘for future delivery on or subject to the rules of any registered entity.’” *Reliant Energy Serv.*, 420 F. Supp. 2d at 1062 (Emphasis in original).

In addition to the cases discussed *infra* text accompanying notes, 90-105, *see* CFTC v. Atha, 420 F. Supp. 2d 1373, 1379 (N.D. Ga. 2006), and CFTC v. Bradley, 408 F. Supp. 2d 1214, 1218-19 (N.D. Okla. 2005) (holding that false reporting of gas prices is within the scope of the Commodity Exchange Act because it is not a “contract, agreement, or transaction” covered by the exception in section 2(h)); and Michael S. Sackheim, *False Reporting of OTC Energy Transactions*, 37 REV. OF SEC. & COMM. REG. 149 (2004). Additionally, the CFTC recently filed an action seeking sanctions for alleged manipulation of the physical propane market. CFTC v. BP Prod. N. Am., Inc., No. 06C 3503 (N.D. Ill.), *available at* <http://www.cftc.gov/files/enf/06orders/enfbpproductscomplaint.pdf>.

There may be changes to the scope of the CFTC’s jurisdiction, depending upon the final contours of the proposed Commodity Exchange Reauthorization Act of 2005. The CFTC was established as a “sunset” agency, that is, the authorization for the CFTC’s existence periodically expires. *See, e.g.*, 7 U.S.C. § 16(d) (2000) (providing that the CFTC is funded from fiscal 1995 through fiscal 2005). To prevent expiration, Congress uses “reauthorization” not only to renew the agency’s existence but also to evaluate proposed substantive amendments to the Commodity Exchange Act. The Commodities Futures Trading Commission Reauthorization Act of 2005 (H.R. 4473), was passed by the House on December 14, 2005, (*available at* <http://www.agriculture.house.gov/press/109/pr051214-2.html>). The Senate version of the legislation, S. 1566, was passed by the Senate Committee on Agriculture, Nutrition and Forestry on July 29, 2005, and is pending in the Senate. (*available at* <http://www.congress.gov/cgi-bin/bdquery/z?d109:SN01566>). This legislation could expand the CFTC’s jurisdiction to reach principal-to-principal, i.e., OTC, derivative transactions. *See* S. 1566, 109th Cong. § 2 (2005).

86. 7 U.S.C. § 9 (2000); *see also* 7 U.S.C. §§ 4b, 6b (2000) (rendering fraud by members of a commodity exchange unlawful).

87. *In re Soybeans Futures Litig.*, 892 F. Supp. 1025, 1045 (N.D. Ill. 1995) (adopting as elements of a manipulation claim under section 9(a) of the Commodity Exchange Act an ability to influence market prices; the existence of an artificially-created price; causation; and intent to cause the artificial price). For an extensive discussion of manipulation claims under the Commodity Exchange Act, *see* 13 JERRY W. MARKHAM, *COMMODITIES REGULATION: FRAUD, MANIPULATION & OTHER CLAIMS* ch. 16 (2006) (Decisions on Manipulation after 1974). The concept of scienter is also discussed *infra* text accompanying notes 161-63.

88. *In re Dynegy Mktg. & Trade and W. Coast Power, LLC*, [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,262, at *3 (C.F.T.C. Dec. 18, 2002) [hereinafter *Dynegy Mktg.*].

(2) Any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to corner or attempt to corner any such commodity or knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce

(3) Any person knowingly to make, or cause to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement required under this chapter, or by any registered entity or registered futures association in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, or knowingly to omit any material fact required to be stated therein or necessary to make the statements therein not misleading.

(4) Any person willfully to falsify, conceal, or cover up by any trick, scheme, or artifice a material fact, make any false, fictitious, or fraudulent statements or representations, or make or use any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry to a registered entity, board of trade, or futures association designated or registered under this chapter acting in furtherance of its official duties under this chapter.⁸⁹

The CFTC has brought a number of actions to enforce the anti-manipulation provisions of the Commodity Exchange Act in the context of energy-related trading. For example, the CFTC sued El Paso Merchant Energy, L.P. (El Paso) in a proceeding before that agency, alleging that El Paso “reported false natural gas information, including price and volume information about natural gas cash transactions it purportedly made to certain reporting firms and thereby attempted to manipulate the natural gas market.”⁹⁰ The CFTC found that the reporting firms relied on the false information in “calculating published indexes of natural gas prices,” and that the indexes were used by participants in the natural gas markets to price and settle their commodities transactions.⁹¹ The CFTC found that El Paso intentionally reported incorrect trade data to the reporting firms in an effort to skew the indexes in El Paso’s favor and thus knowingly attempted to manipulate the price of natural gas in violation of the Commodity Exchange Act.⁹² El Paso entered into a consent order, without admitting or denying the CFTC’s findings, in which it agreed to cease and desist from further violations of the Commodity Exchange Act and to pay a civil penalty of \$20 million.⁹³

One of the many cases involving Enron demonstrates the regulatory interaction between the market for the physical commodity and the market for

89. 7 U.S.C. § 13(a) (2000). The maximum fine is \$1,000,000 and the maximum imprisonment is five years for each felonious violation. *Id.* Manipulative criminal conduct at the misdemeanor level is dealt with at 7 U.S.C. § 9, which provides that maximum penalties are imprisonment of up to six months and fines up to \$100,000.

90. *In re El Paso Merchant Energy, L.P.*, No. 03-89, 2003 WL 1539777, at *1 (C.F.T.C. Mar. 26, 2003); see also *infra* text accompanying notes 221-22.

91. *El Paso Merchant Energy*, 2003 WL 1539777 at *1, *2.

92. *Id.* at *1 - *3 (referring to 7 U.S.C. §§ 9, 13(a)(2), and 13(b) (2000)).

93. *El Paso Merchant Energy*, 2003 WL 1539777 at *5.

related derivatives.⁹⁴ The CFTC alleged that several traders, including the two defendants, Enron and Enron employee Hunter Shively, engaged in a scheme to manipulate the next day spot price for natural gas at a major trading hub, causing a direct and adverse effect on the futures for delivery of gas at that hub, causing prices on the New York Mercantile Exchange (NYMEX) to be artificial.⁹⁵ This was allegedly accomplished by buying an extraordinarily large amount of spot market gas within a short period of time.⁹⁶ The CFTC alleged that Shively made a large gas purchase through EnronOnline, causing an artificial rise in the price. Enron allegedly knew this in advance and began selling its spot market position, before Shively's position was sold.⁹⁷ Shively moved to dismiss the claim, asserting that the CFTC had failed to state a cause of action under sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act.⁹⁸ The court upheld the complaint, finding that, accepting the factual allegations as true, Enron and Shively had the ability to influence prices in both the spot market and the futures market, that actionable manipulation does not always require proof of control of the market, that artificial prices existed in both the spot and futures market as a result of the alleged conduct, that Enron and Shively may have caused the artificial price (although they need not have been the sole cause to be liable under the Commodity Exchange Act), that Enron and Shively intended to manipulate the prices in the spot market, and, alternatively, that Enron attempted to manipulate spot-market prices.⁹⁹ Shortly after the motion to dismiss was denied, the parties agreed to a settlement, subject to approval by the Enron bankruptcy court, providing for a payment by Enron of \$35 million.¹⁰⁰

The CFTC's enforcement action against Dynegy Marketing and Trade (Dynegy) and West Coast Power LLC (West Coast) is another noteworthy case

94. CFTC v. Enron Corp., [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,714 (S.D. Tex. Mar. 10, 2004). Sharon Brown-Hruska recently described the interaction of the price for a regulated commodity and the price for the physical energy as follows: "[F]utures prices are often used by various industry participants to set the prices for the commodities they are buying and selling. . . . Gas buyers often utilize the NYMEX monthly settlement prices to determine the prices for swaps and physical transactions. Both sides are willing to reference such a price because they believe that the price is determined in a liquid, efficient and, importantly, transparent market." Sharon Brown-Hruska, Comm'r of U.S. Commodity Futures Trading Comm'n, Address at the 2006 Planalytics GasBuyer Client Conference: The Functions of Derivative Markets and the Role of the Market Regulator (May 18, 2006), available at http://www.cftc.gov/opa/speeches06/opabrown_hruska-45.htm. See also *infra* note 222. This case also demonstrates that the CFTC proceeds against natural persons for violations of the Commodity Exchange Act. CFTC v. Bradley, 408 F. Supp. 2d 1214 (N.D. Okla. 2005) is another case involving the energy markets that involved individual defendants.

95. *Enron Corp.*, ¶ 29,714 at *2.

96. *Id.* at *5. The transactions were effected through Enron Corporation's trading platform, EnronOnline. *Enron Corp.*, ¶ 29,714 at *2.

97. *Enron Corp.*, ¶ 29,714, at *2 - *5.

98. See *supra* text accompanying notes 86 and 89.

99. *Enron Corp.*, ¶ 29,714 at *4, *5. The focus of the court's analysis was on the allegation that the defendants had manipulated the spot market, but the court also referred to the allegations that these effects on the spot market caused the prices in the futures market to become artificial.

100. Press Release, CFTC, Enron Seeks Bankruptcy Court Approval to Enter into Proposed Settlement with the CFTC (Apr. 28, 2004) (stating that Enron was also alleged to have operated an illegal futures exchange), available at <http://www.cftc.gov/opa/enf04/opa4920-04.htm>; see also report of settlement in *CFTC v. Enron Corp.*, No. H-03-909, 2004 WL 1594978 (S.D. Tex. Apr. 28, 2004) (reporting that the settlement did not provide for any monetary payment by Shively but he did agree to restrictions on his activities).

involving energy trading. The respondents were charged with reporting false natural gas trading information to “reporting firms,” which are entities that publish price indexes. By providing false information the respondents allegedly caused the natural gas price indexes to be inaccurate.¹⁰¹ Similar to the El Paso case,¹⁰² the CFTC found that Dynegy intentionally reported incorrect trade data to the reporting firms in an effort to skew the indexes in Dynegy’s favor. The false reports contained bogus price and volume information for actual trades, as well as purported information for nonexistent trades.¹⁰³ The CFTC also found that Dynegy caused West Coast to submit false information to the index publishers in order to suggest that West Coast was acting as a counterparty to Dynegy’s falsified transactions.¹⁰⁴ Without admitting or denying the CFTC’s findings of fact, Dynegy and West Coast each entered into a consent order with the CFTC that included an agreement to cease and desist any further violations of the Commodity Exchange Act and to pay a monetary penalty of \$5 million.¹⁰⁵

Private litigation has also arisen from the type of misconduct that was the subject of the enforcement actions just discussed, thus providing further insight into the scope of the substantive provisions of the Commodity Exchange Act.¹⁰⁶ Traders of natural gas futures contracts on the NYMEX sued several energy companies alleging manipulative conduct.¹⁰⁷ The traders claimed that the energy companies acted together to falsely report data on natural gas trades in the physical market and, as a result, manipulated the price of natural gas futures to the benefit of the energy companies and to the detriment of the traders.¹⁰⁸ The traders claimed that the energy companies:

intentionally submitted false price and volume information on spot trades to several of the gas industry publications that collect that information with the goal of artificially skewing the published reports on natural gas trades in the physical market, and thereby artificially altering the futures market for natural gas, which is determined at least in part by those published reports [The companies] “planned and executed a scheme designed to cause price instability and increase volatility in spot prices and thereby manipulate the price of natural gas futures and options traded on the NYMEX to artificial levels.”¹⁰⁹

The traders’ lawsuit stemmed from the western markets investigations conducted by the FERC and the CFTC and ensuing enforcement proceedings.¹¹⁰ As summarized by the court, the FERC “found significant manipulation of the natural gas market in the form of efforts by gas companies to alter the published price indices of natural gas through false reporting of trade data.”¹¹¹ Likewise, as recounted by the court, the CFTC found liability for price manipulation and subsequently entered into settlement agreements with many of the named

101. Dynegy Mktg., *supra* 88, ¶ 29,262 at P 54,500.

102. *Supra* text accompanying notes 90-93.

103. Dynegy Mktg., ¶ 29,262 at P 54,500.

104. *Id.*

105. Dynegy Mktg., ¶ 29,262 at P 54,502.

106. Commodity Exchange Act, 7 U.S.C. § 25 (2000) (providing for a private right of action).

107. *In re Natural Gas Commodity Litig.*, 337 F. Supp. 2d 498 (S.D.N.Y. 2004).

108. *Id.* at 500.

109. *Natural Gas Commodity Litig.*, 337 F. Supp. 2d at 503 (internal citation omitted).

110. *Id.* at 503.

111. *Natural Gas Commodity Litig.*, 337 F. Supp. 2d at 503; *see also* FINAL REPORT, *supra* note 29.

defendants, collecting at least \$180 million in civil monetary penalties.¹¹² The Department of Justice (DOJ) had also successfully brought criminal prosecutions against several former energy company employees as a result of the underlying investigations.¹¹³ The court denied most of the defendants' motions to dismiss.¹¹⁴

The CFTC has a wide range of sanctions at its disposal.¹¹⁵ At the administrative level the CFTC can, among other things, issue cease and desist orders and injunctions, prohibit certain transactions including further manipulative or fraudulent conduct, suspend and revoke registrations, and seek disgorgement of ill-gotten gains.¹¹⁶ Each misrepresentation or other occurrence of misconduct constitutes a separate violation of the Commodity Exchange Act.¹¹⁷

The enforcement process at the CFTC is similar to that of the other regulatory agencies discussed in this Article.¹¹⁸ The CFTC's:

investigative authority is exercised by the Division of Enforcement after receiving authorization to conduct an investigation from the CFTC. The Division obtains such authorization through a confidential memorandum to the CFTC describing the activities that it seeks to investigate and the potential violations that might be existent. If the Commission approves this request, which it almost universally does, the CFTC will issue a "formal order of investigation" that designates staff officials who may subpoena witnesses and records and gives a general, but very broad and vague, description of the scope of the investigation.

Investigations conducted by the CFTC staff are governed by a set of rules adopted by the CFTC for such investigations. The CFTC's rules of investigation apply also to investigations that are conducted without the formal authorization of the CFTC to issue subpoenas [sic]. These "informal" investigations are often used as the preliminary basis for the information submitted to the CFTC as justification for issuing subpoenas [sic] The Division of Enforcement is directed to report to the CFTC on the results of its investigations and to recommend to the CFTC such enforcement actions as may be appropriate.

The rules of investigation also authorize other divisions to conduct investigations within the scope of their responsibilities. These investigations, however . . . generally relate to broad market issues, with any apparent violations being referred to the Division of Enforcement for further investigation and prosecution.

The rules of investigation state that all information and documents obtained during the course of an investigation, whether obtained pursuant to a subpoena or otherwise, and all investigative proceedings are to be treated as non-public by the

112. *Natural Gas Commodity Litig.*, 337 F. Supp. 2d at 503.

113. *Id.*

114. *Natural Gas Commodity Litig.*, 337 F. Supp. 2d at 510. The motions of defendants Cinergy Corporation, Encana Corporation, and El Paso Corporation—all parent companies charged with aiding and abetting liability for the conduct of their subsidiaries—were granted. *Id.* at 523.

115. Commodity Exchange Act, 7 U.S.C. § 9 (2000).

116. *Id.*; see also 7 U.S.C. § 13a-1 (2000) (providing additional injunctive sanctions available to the CFTC upon application to a federal court). The CFTC can also seek restitution for the benefit of harmed parties. *CFTC v. Commercial Hedge Serv., Inc.*, 422 F. Supp. 2d 1057 (D. Neb. 2006) (recognizing power of the CFTC to seek restitution pursuant to 7 U.S.C. § 13a-1 (2000)).

117. *CFTC v. McGraw-Hill Cos.*, 390 F. Supp. 2d 27, 31 n.3 (D. D.C. 2005).

118. The principal rules regarding the CFTC's enforcement and administrative reparations processes appear at 17 C.F.R. pts. 10-12 (2006).

CFTC and its staff except to the extent that the CFTC otherwise directs that they be publicly disclosed, or they are disclosed in an adjudicatory proceeding or are disclosures required under [the Freedom of Information Act].¹¹⁹

C. Enforcement of the Antitrust Laws by the Department of Justice and the Federal Trade Commission

The most frequently used and most powerful of the federal antitrust laws is section 1 of the Sherman Act, which prohibits “[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States”¹²⁰ Conduct in the electric energy, natural gas, and petroleum markets is reached by this federal statute,¹²¹ which is enforced by governmental agencies as well as by private parties.

Violations of the Sherman Act are felonies, and the Attorney General of the United States (acting through the Antitrust Division of the DOJ) may bring either criminal or civil actions to redress a violation.¹²² Price fixing and market allocation are among the serious violations of section 1 of the Sherman Act; these are generally prosecuted criminally.¹²³ The Federal Trade Commission (FTC) may seek civil relief for a violation of the antitrust laws; this includes administrative cease and desist orders and judicially granted injunctive relief as well as the payment of restitution or damages to victims.¹²⁴ The DOJ and FTC have concurrent jurisdiction over many possible violations of the antitrust laws; they have essentially allocated industry sectors between them to avoid duplication, albeit without actually ceding any jurisdiction.¹²⁵

119. 13A JERRY W. MARKHAM, *COMMODITIES REGULATION: FRAUD, MANIPULATION & OTHER CLAIMS* § 22.4, at 22-15, 16 (2006) (footnotes omitted).

120. 15 U.S.C. § 1 (2000). Section 2 of the Sherman Act prohibits both monopolization and attempts to monopolize. 15 U.S.C. § 2 (2000). In addition, among the federal laws regulating competition the Clayton Act prohibits price discriminations, exclusive dealing and tying arrangements, and mergers that may substantially lessen competition, 15 U.S.C. §§ 13, 14, and 18 (2000), and the Federal Trade Commission Act prohibits “[u]nfair methods of competition . . . and unfair or deceptive acts or practices” 15 U.S.C. § 45 (2000).

121. See *infra* text accompanying notes 126-128. The antitrust laws reach anti-competitive behavior in the commodity markets. *United States v. Patten*, 226 U.S. 525 (1913) (applying antitrust laws to claim of attempted cornering of the market on the New York Cotton Exchange). The federal antitrust laws reach an array of anticompetitive behaviors; the focus of the discussion here is on the types of violation that are most likely to occur in energy-related transactions.

122. See generally 3 *THE DEPARTMENT OF JUSTICE MANUAL* TIT. 7 (ANTITRUST) (2d ed. 2006).

123. *Id.* at 7-153 (“*per se* price fixing is pursued criminally”). Recent amendments to section 1 of the Sherman Act increased the maximum corporate fine to \$100,000,000, the maximum individual fine to \$1,000,000, and the maximum jail term to ten years. Sherman Act, Pub. L. No. 108-237, § 215, 118 Stat. 661 (2004) (amending 15 U.S.C. § 1). An antitrust violation is subject to the alternative fine provision in 18 U.S.C. § 3571(d) (2000), which permits a fine of up to twice the gross financial loss or gain resulting from a violation. The largest corporate fine imposed for a price-fixing conspiracy is \$500 million. David Barboza, *Six Big Vitamin Makers are Said to Agree to Pay \$1.1 Billion to Settle Pricing Lawsuit*, N.Y. TIMES, Sept. 8, 1999, at C2 (reporting payment of fine by Hoffman-LaRoche Inc.).

124. The FTC has the power administratively to issue “cease and desist” orders under section (b) of the Federal Trade Commission Act, 15 U.S.C. § 45(b) (2000), for an unfair method of competition or deceptive act or practice in or affecting commerce. Section 57(b) of that act authorizes the Commission to seek judicial redress for consumers or other persons injured by unfair or deceptive acts or practices, including “rescission or reformation of contracts, the refund of money or return of property, [and] the payment of damages” 15 U.S.C. § 57b (2000).

125. See also, *infra* text accompanying notes 231-32.

A leading case applying section 1 of the Sherman Act to price fixing arose in the energy field. The Supreme Court held, in a case that involved an alleged complex scheme to raise prices for gasoline during the Depression,¹²⁶ that naked price-fixing agreements are “per se” unreasonable and hence illegal, regardless of whether the conspirators had the power to affect prices or did in fact affect prices in the market.¹²⁷ While there are no reports of recent antitrust investigations in the natural gas or electricity markets, it is manifest that these industries are within the purview of the enforcement of the federal antitrust laws.¹²⁸

The California energy crisis has not resulted in government antitrust action, but has given rise to a number of private lawsuits brought in California state courts under California state antitrust and unfair competition statutes alleging in one case, for example, “anti-competitive conduct while participating in California’s energy market by conspiring to drive up the retail price of either natural gas or electricity in California through alleged manipulation of pipeline capacity or energy production and transmission projects.”¹²⁹ Although the cited case and other private cases under state law are not federal government enforcement actions, at the very least they are suggestive of the potential scope of the application of the federal antitrust laws to energy-related conduct in an enforcement context because the substantive elements of a claim under the California antitrust laws are similar, though not identical, to those under federal law.¹³⁰

In another notable case, municipalities and other natural gas consumers claimed that senior executives of the two largest Southern California utility companies (which later merged to become Sempra Energy) secretly met with executives of El Paso Natural Gas and illegally agreed not to compete against each other in the Southern California natural gas delivery markets; thereby eliminating competition in natural gas, driving up gas prices, increasing the price of electricity, and discouraging the construction of new gas-fired electric generation facilities.¹³¹ El Paso settled the claims in March 2003, agreeing to

126. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

127. *Id.* at 218.

128. *E.g.*, *United States v. Rochester Gas & Elec. Corp.*, 4 F. Supp. 2d 1052, 1055 (W.D.N.Y. 1998) (denying motion to dismiss civil action alleging that utility engaged in an anticompetitive act in violation of the antitrust laws by entering into a contract in which the customer agreed not to compete against the utility by building its own power production facility); *see also* *Apex Oil Co. v. DiMauro*, 822 F.2d 246 (2d Cir. 1987) (reversing grant of summary judgment in favor of certain defendants with respect to claims of antitrust violation and commodity market manipulation in connection with transactions in fuel oil futures).

129. *In re* Cal. Retail Natural Gas and Elec. Antitrust Litig., 170 F. Supp. 2d 1052, 1055 (D. Nev. 2001) (remanding removed cases to state court because, among other grounds, the Federal Power Act did not preempt the California state law claims).

130. *Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979, 985-86 (9th Cir. 2000) (noting that interpretation of the Sherman Act is similar, though not identical, to the interpretation of the California Cartwright Act (CAL. BUS. & PROF. CODE §§ 16700-770 (West 1997)) and applying Sherman Act precedents to a case under the Cartwright Act).

131. Complaint at ¶ 4, *Cont’l Forge Co. v. S. Cal. Gas Co.*, No. BC 237336 (Cal. Super. Ct., L.A. Co.) (on file with author). Motions to dismiss were denied in similar cases. *Natural Gas Anti-Trust Cases*, Cases I, II, III, and IV, 2003-1 Trade Cases ¶ 73,959 (Cal. Super. Court, San Diego County Oct. 16, 2002) (alleging violation of state antitrust laws). Those cases grew out of facts that were also considered by the FERC on a complaint by the Public Utilities Commission of California. As summarized by the FERC, the complaint

pay private parties \$1.7 billion,¹³² and Sempra settled during trial in January 2006, agreeing to pay \$377 million.¹³³

Other private antitrust actions have been filed in recent years alleging manipulation of energy markets. One set of cases alleged that various energy trading firms, including the bankrupt Enron, had used their market positions to manipulate short-term prices for electric energy and natural gas and otherwise exercised undue influence over wholesale electric prices in the Western United States after January 1, 2000. Some were filed in state court, removed to federal court, and remanded for lack of federal issues,¹³⁴ while others remained in federal court.¹³⁵ Some antitrust claims have been dismissed under the filed rate and federal preemption doctrines.¹³⁶

Another set of private antitrust cases were based on allegations that dysfunctions in the natural gas market occurring in 2000-2001 stemmed from efforts by various trading companies to manipulate natural gas price indexes compiled by the reporting firms, including reporting of false data and wash trading.¹³⁷ Several cases originally filed in state court under the California

before the FERC “alleg[ed] that El Paso Pipeline and El Paso Merchant, acting individually or in concert, manipulated California energy markets by withholding pipeline transportation capacity to drive up natural gas prices in the periods immediately before and during the California energy crisis of 2000-2001. In addition, the complaint alleged that the award of three transportation contracts (El Paso Contracts) by El Paso Pipeline to its marketing affiliate, El Paso Merchant, was unduly preferential as the result of an intra-corporate sharing of information, in violation of the Commission’s Standards of Conduct for Pipelines With Marketing Affiliates (Standards of Conduct or Affiliate Standards).” *Public Util. Comm’n of Cal. v. El Paso Natural Gas Company, El Paso Merchant Energy-Gas, L.P., and El Paso Merchant Energy Company*, 105 F.E.R.C. ¶ 61,201 at PP 1-7 (2003) (approving settlement), *reh’g denied and clarification granted*, 106 F.E.R.C. ¶ 61,315 (2004), *pet. for review dis’d*, 168 Fed. App’x 447 (D.C. Cir. 2005).

132. The settlement was approved by the FERC in *Pub. Util. Comm’n of Cal. v. El Paso Natural Gas Co.*, 105 F.E.R.C. ¶ 61,201; *see also Calif., El Paso Reach \$1.7-Billion Deal to End Energy Pricing Probe*, L. A. TIMES, Mar. 21, 2003, pt. 3, Bus. Desk at 1 (reporting settlement).

133. Foster Associates, *Sempra Settles “Continental Forge” Class-Action Suit, Other Energy-Crisis-Related Litigation, for Around \$377 Million*, FOSTER ELECTRIC REPORT, Jan. 11, 2006, No. 439 at 10.

134. *E.g., Hendricks v. Dynegy Power Mktg., Inc.*, 160 F. Supp. 2d 1155 (S.D. Cal. 2001) (alleging claims under California antitrust law).

135. *E.g., T&E Pastorino Nursery v. Duke Energy Trading and Mktg., L.L.C.*, 268 F. Supp. 2d 1240 (S.D. Cal. 2003) (denying motion to remand claims purportedly brought under state law). In that case the defendants were alleged to have used their power in the electric energy market to manipulate that market, creating a state of emergency in California with resultant high prices that were unfairly passed on to consumers and taxpayers, giving rise to an unfair business practice claim under state law. *Id.* at 1243, 1249.

136. *E.g., City of Moundridge v. Exxon Mobil Corp.*, 429 F. Supp. 2d 117, 135-38 (D. D.C. Apr. 19, 2006) (rejecting motion for preliminary injunction based on alleged antitrust violation by reseller of natural gas on basis of, among other grounds, filed rate doctrine); *Pub. Util. Dist. No. 1 v. Dynegy Power Mktg., Inc.*, 244 F. Supp. 2d 1072 (S.D. Cal. 2003), *aff’d*, 384 F.3d 756 (9th Cir. 2004) (dismissing state antitrust and unfair competition claims based on filed rate and federal preemption doctrines). A full discussion of the filed rate doctrine and federal pre-emption is beyond the scope of this Article. As recently explained by the Supreme Court: “The filed rate doctrine requires ‘that interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates.’ [quoting *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962 (1986)]. When the filed rate doctrine applies to state regulators, it does so as a matter of federal pre-emption through the Supremacy Clause. [*Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 581-82 (1981)].” *Entergy La., Inc. v. Louisiana Pub. Serv. Comm’n*, 539 U.S. 39, 47 (2003).

137. Some of this conduct was discussed earlier in the contexts of FERC regulation (*supra* notes 28-33) and CFTC regulation (*supra* notes 90-114).

antitrust act were removed to federal court and later remanded,¹³⁸ while others that remained in federal court were dismissed under the filed rate doctrine.¹³⁹

Thus, while neither the FTC nor the DOJ has taken an active public role in pursuing alleged manipulative activity in the natural gas and electric energy markets, the filed rate doctrine remains a potential barrier where the claims relate to transactions in the physical energy markets under the FERC's jurisdiction. Conduct that manipulates the energy markets, including the financial markets, is vulnerable to charges of violating state or federal antitrust laws.¹⁴⁰

D. Enforcement by the Securities and Exchange Commission

FERC Chairman Kelliher also noted the powers granted by Congress to the SEC to address manipulation in the securities markets.¹⁴¹ While the SEC cannot reach energy-specific matters in the same direct way that the FERC, the CFTC, the DOJ Antitrust Division, and the FTC do, the SEC enforcement regime is pertinent to the FERC's newly granted authority because of the specific directive in the EPAct 2005 that the FERC be guided by section 10(b) of the Securities Exchange Act when adopting rules under the authority granted by the EPAct 2005.¹⁴² SEC rule 10b-5,¹⁴³ adopted pursuant to section 10(b), will be discussed in greater detail in Part III of this Article, which addresses how the new FERC rules are to be, or may be, interpreted. Part VI of this Article also discusses

138. *E.g.*, *In re Western States Wholesale Natural Gas Antitrust Litig.*, 346 F. Supp. 2d 1123 (D. Nev. 2004).

139. *E.g.*, *In re Western States Wholesale Natural Gas Antitrust Litig.: Texas-Ohio, Inc. v. Centerpoint Energy, Inc.*, 368 F. Supp. 2d 1110 (D. Nev. 2005); *Fairhaven Power Co. v. Encana Corp.*, 408 F. Supp. 2d 1055 (D. Nev. 2005).

140. *See also, supra* text accompanying notes 129-33, 135. It has been argued, relying on cases under the Securities Exchange Act (*e.g.*, *Gordon v. N.Y. Stock Exch.*, 422 U.S. 659 (1975) (finding implied repeal of the antitrust laws where necessary to make the Securities Exchange Act function effectively in area regulated by the SEC)), that the Commodity Exchange Act reflects an implied repeal of the application of the antitrust laws to the commodity markets, so that courts should not entertain antitrust claims for conduct that is within the scope of the prohibitions of the Commodity Exchange Act. The prevailing rule, however, is that the "Commodity Exchange Act did not effect a repeal of the antitrust laws," nor do the more targeted prohibitions in the Commodity Exchange Act preclude the application of the more general prohibitions in the antitrust laws. *Strobl v. N.Y. Mercantile Exch.*, 768 F.2d 22, 29-31 (2d Cir. 1985) (rejecting arguments that the Commodity Exchange Act effected an implied repeal of the antitrust laws and that specific provisions of the Commodity Exchange Act should preclude application of the more general provisions of the antitrust laws, in private antitrust action for damages for manipulation of commodity prices); *contra Smith v. Groover*, 468 F. Supp. 105, 116 (N.D. Ill. 1979) (precluding maintenance of antitrust claim when more specific claim was available under the Commodity Exchange Act for price manipulation, though not finding implied repeal of the antitrust laws). For a summary of cases on this issue, including antitrust cases involving trading in commodities, *see* 13 JERRY W. MARKHAM, *COMMODITIES REGULATION: FRAUD, MANIPULATION & OTHER CLAIMS* § 17:6 (2006).

141. *See supra* text accompanying note 41.

142. 15 U.S.C. § 78j(b) (2000); *see supra* text accompanying notes 44-45.

143. Rule 10b-5, 17 C.F.R. § 240.10b-5 (2006), provides: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

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

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

some of the ramifications under the Securities Exchange Act of violations of laws enforced by the FERC and the CFTC.

E. Enforcement of the Criminal Laws by the Department of Justice

The Natural Gas Act, the Federal Power Act, the Commodity Exchange Act, and the Sherman Act all have criminal penalty provisions.¹⁴⁴ In all of these situations, the criminal prosecution is undertaken by, and at the discretion of, the DOJ.¹⁴⁵ That is, the regulatory agency itself does not prosecute crimes, but instead refers matters to the DOJ, which can also act on its own initiative.¹⁴⁶ There has been prosecution of crimes related to energy trading.¹⁴⁷

In addition to the substantive offenses, misconduct in connection with a regulatory investigation itself can give rise to criminal penalties. For example, it is a crime to knowingly provide false information to a federal investigator, irrespective of whether the statement is under oath.¹⁴⁸ Likewise, it is a criminal offense to obstruct an investigation.¹⁴⁹

144. See *supra* text accompanying notes 50, 89, 122-23.

145. See Natural Gas Act, 15 U.S.C. § 717(a) (2000); Federal Power Act, 16 U.S.C. § 825(a) (2000); and the Commodity Exchange Act, 7 U.S.C. § 13a-1 (2000) (each of which provides for referral by the agency to the DOJ). In this regard, the FERC has stated that in making a criminal referral it will “take all factors into account . . . including the seriousness of the violation, the extent of the harm done, the evidence of willful behavior, and the strength of the evidence of wrongdoing.” *Enforcement of Statutes, Orders, Rules, and Regulations*, 113 F.E.R.C. ¶ 61,068 at P 15 (2005) [hereinafter *Enforcement Policy Statement*].

146. DONNA M. NAGY ET AL., *SECURITIES LITIGATION AND ENFORCEMENT CASES AND MATERIALS* 14 (2003) (“the DOJ prosecutes numerous securities cases that did not originate with the SEC”).

147. *United States v. Reliant Energy Serv., Inc.*, 420 F. Supp. 2d 1043 (N.D. Cal. 2006) (denying motion to dismiss indictment for violation of the Commodity Exchange Act, among other criminal laws); 3 *Plead Guilty in Natural Gas Trading Case*, HOUS. CHRON., June 19, 2006, available at <http://www.chron.com/cs/CDA/printstory.mpl/business/3984820> (reporting guilty pleas to charges of price manipulation by three traders charged with reporting fictitious prices to the industry newsletter Inside FERC in an attempt to skew published price indexes and an earlier plea to a similar charge by another trader before another court); Tom Fowler, *Former Energy Trader Gets Nearly Five Years Sentenced for False Reporting*, HOUS. CHRON., Mar. 15, 2006, WLNR 4297700 (reporting that former trader for Reliant Energy was sentenced to four years and nine months in prison after pleading guilty to submitting false information about natural gas trades to an industry publication in violation of section 9(a)(2) of the Commodity Exchange Act, 7 U.S.C. § 13(a)(2) (2000), reportedly the first sentence for violating that law prohibiting reporting of false data on commodities); Press Release, DOJ, U.S. Attorney’s Office, S.D. Tex., *Former Reliant Trader Sentenced to Max Guideline Prison Term* (Mar. 15, 2006), http://www.usdoj.gov/usao/txs/releases/index_March2006.htm. Traders have also been charged with violating the federal wire fraud statute, 18 U.S.C. § 1343 (2000). Jeffrey Ryser, *As Time Runs out for Filing More Charges, Several Trials Loom in Misrepresenting Cases*, INSIDE F.E.R.C. GAS MKT. REP., Apr. 7, 2006, at 7.

148. 18 U.S.C. § 1001(a) (2000): “Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, knowingly and willfully --

(1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact;

(2) makes any materially false, fictitious, or fraudulent statement or representation; or

(3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry; shall be fined under this title, imprisoned not more than 5 years or, if the offense involves international or domestic terrorism (as defined in section 2331), imprisoned not more than 8 years, or both.”

See, e.g., *Brogan v. United States*, 522 U.S. 398 (1998) (affirming convictions for false statement to federal investigator). To cite one notable example, Martha Stewart was successfully prosecuted under this statute for lying to staff members of the SEC, among others, during interviews. *United States v. Stewart*, 433 F.3d 273 (2d

III. THE INTERPRETATION AND APPLICATION OF THE FERC'S NEW ANTI-MANIPULATION AND ANTI-DECEPTION RULES – THE APPLICATION TO THE ENERGY MARKETS OF THE LAW DEVELOPED UNDER SEC RULE 10B-5

The EAct 2005 specified that in adopting anti-manipulation and anti-deception rules, certain key terms be interpreted as they have been under section 10(b) of the Securities Exchange Act.¹⁵⁰ Rule 10b-5 is a broad rule implementing section 10(b).¹⁵¹ Accordingly, the FERC turned to rule 10b-5 as its model in adopting rules to implement its new authority under the Federal Power Act and the Natural Gas Act. The new rules are to be interpreted in light of Securities Exchange Act precedent, except to the extent the FERC adopts a different interpretation tailored to the energy markets.¹⁵²

While both the EAct 2005 and the FERC's new rules expressly preclude private suits based on a violation of these new rules,¹⁵³ much of the extensive case law applying rule 10b-5 in private actions, as well as in the SEC enforcement and criminal contexts,¹⁵⁴ provides indispensable guidance for understanding the new FERC rules.¹⁵⁵ This part of this Article presents what the FERC has said about how the new rules will be interpreted and examines how they might be interpreted by applying rule 10b-5 precedent.

The FERC cut a wide swath in crafting the new rules. The rules prohibit manipulative and deceptive conduct by “any entity”—directly or indirectly—“in connection with” [any] jurisdictional transaction”¹⁵⁶ In other words, while the conduct must affect a *regulated* transaction in natural gas or electric energy (including transportation or transmission),¹⁵⁷ the rules reach such conduct by “any entity,” including a natural person, *whether or not* that entity itself is regulated by the FERC in other respects.¹⁵⁸ Thus, for example, the new rules

Cir. 2006). It is not uncommon for someone involved in an SEC investigation to be charged with criminal conduct in connection with the investigation even though he is never charged with a substantive securities law offense. KIRKPATRICK & LOCKHART LLP, *THE SECURITIES ENFORCEMENT MANUAL TACTICS AND STRATEGIES* 324-30 (1997).

149. 18 U.S.C. § 371 (2000), which provides in pertinent part: “If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.” This was also one of the charges in *United States v. Stewart*, *supra* note 148.

150. *See supra* text accompanying notes 44-45.

151. *See supra* note 143.

152. Order 670, *supra* note 52, at PP 30-31, 42.

153. *See supra* text accompanying notes 53 at § 1(c)(1)(b) and 54 at § 1.(c)(2)(b).

154. The rule 10b-5 jurisprudence is vast. For example, Westlaw identifies more than 400 cases that referred to rule 10b-5 in 2005 and the annotations to officially reported court decisions under rule 10b-5 occupy over 600 pages in the United States Code Annotated.

155. Because most SEC enforcement cases are settled (KIRKPATRICK & LOCKHART LLP, *THE SECURITIES ENFORCEMENT MANUAL TACTICS AND STRATEGIES* 181 (1997)) and criminal cases have generally not presented novel legal issues (DONNA M. NAGY ET AL., *SECURITIES LITIGATION AND ENFORCEMENT CASES AND MATERIALS* 833 (2003)) a substantial proportion of the relevant law under rule 10b-5 is found in decisions arising out of private civil damage claims.

156. Order 670, *supra* note 52, at P 16. *See also supra* note 45.

157. Thus, the rules do not reach behavior affecting only “first sales” of natural gas at the wellhead or retail sales. Order 670, *supra* note 52, at P 20.

158. *Id.* at P 18.

apply to prohibited conduct engaged in by local distribution companies and municipally owned utilities—notwithstanding that the activities of those entities are not generally subject to FERC jurisdiction. Moreover—while this may not be free from doubt—it appears that the rules also extend to activities in the financial markets, such as by hedge funds, financial institutions, and energy trading affiliates of a regulated utility—so long as the transaction meets the “in connection with” test; for example, the transaction in the financial markets was intended to affect a FERC-jurisdictional transaction.¹⁵⁹ The FERC has made clear that these rules “will permit the commission to police all forms of fraud and manipulation that affect natural gas and electric energy transactions and activities [the FERC] is charged with protecting.”¹⁶⁰

In crafting rules to prohibit deception and manipulation, the FERC took into account the fact that rule 10b-5 prohibits only action taken with scienter.¹⁶¹ The FERC recognized that “scienter” has been interpreted, in the context of rule 10b-5, to encompass both intentional and reckless conduct.¹⁶² Securities law precedent establishes that in this context recklessness means, “highly unreasonable [conduct] involving . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”¹⁶³

The FERC added the gloss that to violate the new rules, an entity “must have intended to affect, or have acted recklessly to affect, a jurisdictional transaction.”¹⁶⁴ There is no similar specific intent requirement under rule 10b-5; almost anything uttered by a public company is deemed to be “in connection with” the market for its securities, whether or not the action was intended to affect that market.¹⁶⁵ One might, therefore, be justified in ignoring the broad

159. See *infra* text accompanying notes 164-67

160. Order 670, *supra* note 52, at P 25.

161. *Id.* at P 52. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-201, 212-14 (1976), the Supreme Court held that section 10(b) of the Securities Exchange Act, pursuant to which rule 10b-5 was promulgated, reached only conduct reflecting scienter. The SEC may not promulgate a rule that exceeds its power under the authorizing statute. *Id.* at 213-14.

162. Order 670, *supra* note 52, at P 53. In rescinding Market Behavior Rule 2 (see *supra* text accompanying notes 55-56), the FERC noted that it would be inconsistent to retain that anti-manipulation rule with its negligence-based foreseeability test: “To avoid the potential for uneven application of regulatory requirements based on whether an entity is a public utility under the FPA and a “non-jurisdictional” entity, or whether an entity is a public utility selling under market-based rate authority or selling at cost-based rates, the same standard of proof should apply to all entities and all jurisdictional sales for purposes of determining whether market manipulation occurred. It is not appropriate, as some commenters suggest, for the Commission to maintain a lesser standard of proof for only certain market participants or certain types of sales.” *Investigation of Market-Based Rate Authorizations*, *supra* note 58, at P 21. The FERC’s comparison of former rule 2 and the new anti-manipulation rules is at <http://www.ferc.gov/legal/majo-ord-reg/landdocs/orders/670/comp-chart.asp>.

163. *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977), cited by the FERC in Order 670, *supra* note 52, at P 53 n.109. See also *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 113 F.E.R.C. ¶ 61,190 at P 15 n.15 (2005) (quoting the *Sundstrand* definition of “recklessness” with approval).

164. Order 670, *supra* note 52, at P 22.

165. See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860-62 (2d Cir. 1968) (en banc): “Congress when it used the phrase ‘in connection with the purchase or sale of any security’ intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in

interpretation given to rule 10b-5¹⁶⁶ because the FERC has stated that a FERC interpretation of its rules, such as the one just quoted, supersedes how rule 10b-5 has been applied.¹⁶⁷ Even if the FERC rules are interpreted narrowly, it is critical to take into account that the rules apply to any transaction “in connection with” a FERC jurisdictional transaction. Because the conduct need not be “in” a jurisdictional transaction, it is at least arguable that a transaction in the financial markets that intentionally or recklessly affects a jurisdictional market is within the scope of the new FERC rules.

A comprehensive discussion of what constitutes scienter within the meaning of rule 10b-5 is beyond the scope of this Article. One point should be addressed, however. One commentator has suggested that in enforcement actions under the new rules the FERC should apply the heightened pleading requirement for alleging scienter that applies in suits brought by private parties under rule 10b-5, which was added by the Private Securities Litigation Reform Act of 1995 (PSLRA),¹⁶⁸ as reflected in what is now section 21D (b) (2) of the Securities Exchange Act.¹⁶⁹ That section provides in its entirety as follows:

In any private action arising under [the Securities Exchange Act] in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this [title], state with particularity facts giving rise to a strong inference that the defendant acted with the required stated of mind.

Much judicial ink has been devoted to interpreting that provision.¹⁷⁰ The commentator proposed that the “FERC should apply the entire body of securities case law, including cases under the PSLRA, strong-inference-of-scienter standard, to energy market manipulations.”¹⁷¹

This suggestion ignores the narrow application of section 21D(b)(2) in two respects. First, the pleading requirement imposed by section 21D(b)(2) did not

connection therewith, so relying, cause them to purchase or sell a corporation’s securities. There is no indication that Congress intended that the corporations or persons responsible for the issuance of a misleading statement would not violate the section unless they . . . acted with wrongful motives Accordingly, we hold that Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media, . . . if such assertions are false or misleading or are so incomplete as to mislead” (Internal citation omitted) Thus, for example, materially false statements made in an advertisement in a trade publication not directly targeted to the investing public may violate rule 10b-5 because they are “of a sort” that would cause reasonable investors to rely. *See, e.g., In re Carter-Wallace Sec. Litig.*, 150 F.3d 153, 156-57 (2d Cir. 1998).

166. Nevertheless, the concept of acting “recklessly to affect” a transaction, encompassed by the FERC rules, does *not* appear to entail a conscious malicious intent (Order 670, *supra* note 52, at PP 31, 42), just as actionable reckless conduct does not require *conscious* awareness of the danger of misleading others. If affecting a market recklessly, that is, not deliberately, is in fact within the scope of the new FERC rules, then following the rule 10b-5 jurisprudence that reaches many actors who arguably did not intend their actions to affect the securities market will pose a significant risk for those who trade in the energy markets, especially those who trade in large volumes that could be expected to move the market price. An “effect” test rather than an “intent” test presents a much greater regulatory risk for a market participant. It thus remains to be seen how different the scope of rule 10b-5 and the scope of the FERC rules really are in this respect.

167. Order 670, *supra* note 52, at PP 31, 42.

168. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

169. 15 U.S.C. § 78u-4(b)(2) (2000).

170. For a summary of appellate analyses of this section, *see* Florida State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 654-60 (8th Cir. 2001).

171. J. Michael Marcoux, *Proving Intent to Manipulate Markets*, PUB. UT. FORT., May 2006, at 23.

itself change the *substantive* interpretation of the scienter element of rule 10b-5.¹⁷² Second, the pleading standard imposed by that section by its terms—“[i]n any private action”—applies *only* to litigation commenced by a *private* party. Consistent with that language, the courts have held that to the extent the section imposes a greater requirement than, for example, rule 9(b) of the Federal Rules of Civil Procedure,¹⁷³ it does not apply to a civil action brought by the SEC.¹⁷⁴ There is, therefore, no basis to expand the EAct 2005 language directing that the FERC look to section 10(b) of the Securities Exchange Act¹⁷⁵ so that it also encompasses section 21D(b)(2) of the latter statute.

There is no “good faith” defense to a charge of violating the new FERC rules.¹⁷⁶ However, “in all cases, the intent behind and rationale for actions taken by an entity will be examined and taken into consideration as part of determining whether the actions were manipulative behavior.”¹⁷⁷ This is consistent with the statutory mandate that, when assessing a civil monetary penalty, the FERC shall take into consideration the “seriousness of the violation.”¹⁷⁸

The new rules do not impose a regime of affirmative disclosure obligations akin to the SEC’s extensive program of periodic and other reports that must be filed by public companies.¹⁷⁹ At the same time, the rules do not abrogate or displace any disclosure requirement that is in a tariff or is otherwise imposed by the FERC.¹⁸⁰ What the FERC rules certainly *do* require is accurate material disclosure when a party chooses to speak in connection with a jurisdictional transaction. This means that one who speaks—orally or in writing—cannot leave out some fact that is necessary to make what was said not materially misleading. For example, the FERC Market Rules prohibit knowingly reporting a false price to a trade publication.¹⁸¹ As explained by the FERC, “where an entity voluntarily provides information [or makes a disclosure required by a tariff, rule or regulation] and the entity then misrepresents *or omits* a material fact such that the information provided is materially misleading,” the rule has been violated.¹⁸²

172. *Florida State Bd. of Admin.*, 270 F.3d at 653 n.7.

173. That rule provides: “In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.”

174. *See, e.g.*, *SEC v. Lucent Tech., Inc.*, 363 F. Supp. 2d 708, 717 (D. N.J. 2005).

175. *Supra* text accompanying notes 44-45.

176. This is consistent with the law under rule 10b-5, inasmuch as good faith is inherently inconsistent with an intent to deceive or reckless conduct. *S.E.C. v. Infinity Group Co.*, 212 F.3d 180, 192 (3d Cir. 2000) (holding that good faith, without more, does not necessarily preclude a finding of recklessness).

177. *Investigation of Market-Based Rate Authorizations*, *supra* note 58, at P 29.

178. 16 U.S.C. § 825o-1(b) (2000); *see also supra* note 49 and accompanying text.

179. Order 670, *supra* note 52, at PP 35-36. For a brief summary of the SEC’s requirements for regular disclosure by public companies, see JAMES D. COX ET AL., *SECURITIES REGULATION CASES AND MATERIALS* 548-51 (5th ed. 2006). The detailed disclosure requirements imposed on public companies are not rooted in section 10(b) in any event.

180. Order 670, *supra* note 52, at P 36.

181. Former Market Behavior Rule No. 4, to be codified at 18 C.F.R. § 35.37(c), expressly requires accurate price reporting. Order 674, *supra* note 59, at P 8.

182. Order 670, *supra* note 52, at P 41 (emphasis added).

The FERC recognized¹⁸³ the long-standing principle under rule 10b-5 that silence is not wrongful unless there is a duty to speak.¹⁸⁴ Thus, as the FERC noted, rule 10b-5 does *not* impose an independent obligation to make disclosure “absent a relationship of trust and confidence,” such as a fiduciary relationship.¹⁸⁵ Some who commented on the proposed rules were concerned that they would impose additional disclosure obligations.¹⁸⁶ The FERC responded that “[n]othing in the Final Rule requires disclosure of sensitive information that would only function to weaken an entity’s bargaining position in arm’s-length, bilateral negotiations.”¹⁸⁷ It also said that “in the arm’s-length, bilateral negotiations that are typical in wholesale energy markets, absent some tariff requirement or Commission directive mandating disclosure, the Final Rule imposes no *new* affirmative duty of disclosure.”¹⁸⁸ This appears to mean that in the ordinary transaction one need not disclose proprietary information, such as one’s own assessment of the relevant energy or transportation market or of future weather.¹⁸⁹ At the same time, one is not free to affirmatively misrepresent an internal analysis.¹⁹⁰

Nothing suggests, however, that the FERC rejected the rule 10b-5 concept that when there is some pre-existing fiduciary or other relationship of trust and confidence between parties to a transaction, then silence—the failure to make a material disclosure—would violate the new rule when the other elements of the rule are satisfied.¹⁹¹ It is not readily apparent how this concept will apply in the energy context. The case law applying rule 10b-5, which draws on common law

183. Order 670, *supra* note 52, at P 35.

184. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) (“Silence, absent a duty to disclose, is not misleading under Rule 10b-5.”).

185. Order 670, *supra* note 52, at P 35. *See also* *United States v. O’Hagan*, 521 U.S. 642, 651-53 (1997) (applying rule 10b-5).

186. Order 670, *supra* note 52, at P 34 (summarizing comments).

187. *Id.* at P 36.

188. Order 670, *supra* note 52, at P 35 (emphasis added).

189. Similarly, under rule 10b-5 a company selling its own securities has no duty to disclose its internal forecasts. *In re Verifone Sec. Litig.*, 11 F.3d 865, 869 (9th Cir. 1993); *see also In re Compaq Sec. Litig.*, 848 F. Supp. 1307, 1314-15 (S.D. Tex. 1993) (holding that the securities market does not ordinarily rely on management’s disclosure of general economic conditions).

190. Under rule 10b-5, *see generally* *Schwartz v. Sys. Software*, 813 F. Supp. 1364, 1367 (N.D. Ill. 1993) (holding that failure to disclose internal earnings forecasts that were inconsistent with company’s publicly disclosed estimates could be actionable).

191. In the context of rule 10b-5, this concept arises frequently in the law of insider trading. For example, under the misappropriation theory of unlawful insider trading a “fiduciary’s undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company’s stock [as under the “classical theory” of unlawful insider trading], the misappropriation theory premises liability on a fiduciary-turned-trader’s deception of those who entrusted him with access to confidential information.” *United States v. O’Hagan*, 521 U.S. 642, 652 (1997). This theory extends beyond the traditional fiduciary relationship, reaching any relationship of trust and confidence. *Id.* *See, e.g., SEC v. Falbo*, 14 F. Supp. 2d 508, 523 (S.D.N.Y. 1998) (holding contractor was in a position of trust and confidence that was the “functional equivalent of a fiduciary relationship,” which he violated when he used information obtained in that relationship for personal benefit in trading securities).

principles to identify relationships of trust and confidence,¹⁹² should provide guidance to those who need to know if they have some affirmative obligation to make disclosure in connection with a transaction within the FERC's jurisdiction. The FERC may be driven to provide further clarity here, as the SEC has done.¹⁹³

To give some idea of the scope of rule 10b-5 and how it *might* be applied in the energy context, note that if, to trade in securities, a person uses information obtained in a relationship of trust and confidence that he was not supposed to use for his own purposes, and he fails to disclose to the source of the information that he intends to trade, that is deception in violation of rule 10b-5.¹⁹⁴ If this concept of deception is applied under the new FERC rules, then, for example, if an employee of an electric utility operating in a region not covered by an organized market learns in confidence as a result of his employment that the utility is about to take a large unit off line for unplanned maintenance and he discloses that fact to someone who then trades in the spot market for electricity in that region, both the employee and the trader would have engaged in unlawful deceptive conduct.¹⁹⁵ Because the FERC rules reach a natural person as well as any entity, whether or not the entity is itself regulated directly by the FERC,¹⁹⁶ this example demonstrates how the application of rule 10b-5 concepts provides the FERC with a broad regulatory reach to penalize deception and manipulation.

The rules cover only *material* deception. What is material is a fact-specific issue¹⁹⁷ often determined in practice—improperly it would seem—with the benefit of hindsight.¹⁹⁸ Following rule 10b-5 precedent, the FERC defined a material fact where “there is a substantial likelihood that a reasonable market participant would consider . . . in making its decision to transact because the material fact significantly altered the total mix of information available.”¹⁹⁹ This summary conflates several different but presumably consistent formulations expressed by the Supreme Court under rule 10b-5. To parse it out, a misrepresented fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell. The fact in question need not have been outcome determinative—the test is

192. Most notably, see the seminal decision *In re Cady, Roberts & Co.*, Securities and Exchange Act of 1934 Release No. 6668, 40 SEC Docket 907 (Nov. 8, 1961) (presenting the common law origin of what became known as the classical theory of insider trading); see also *United States v. Chestman*, 947 F.2d 551, 566-70 (2d Cir. 1991) (en banc) (delineating the relationship of trust and confidence among family members drawing on common law precedents).

193. Rule 10b5-2, 17 C.F.R. § 240.10b5-2 (2006) (“provid[ing] a non-exclusive definition of circumstances in which a person has a duty of trust [and] confidence for purposes of the ‘misappropriation’ theory” Discussed *supra* note 191).

194. *United States v. O’Hagan*, 521 U.S. 642 (1997).

195. The FERC rules would be violated only if the employee and his tippee intended to affect or recklessly affected a jurisdictional market, as explained by the FERC when promulgating the rules. See *supra* text accompanying notes 164-67. At the same time, issues of intent are often determined based on circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983) (noting that circumstantial evidence can be “more than sufficient” to prove scienter).

196. See *supra* text accompanying notes 156-60.

197. *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988) (holding that determination of materiality is a “fact-specific inquiry”).

198. Mitu Gulati et al., *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 796-813 (2004) (discussing fraud by hindsight in decisions applying rule 10b-5).

199. Order 670, *supra* note 52, at P 51.

not whether the investor would have changed its decision had the full truth been told, only that it is substantially likely it would have been considered important. It must have assumed actual significance in the deliberations of the party who was deceived.²⁰⁰ Here, too, there is a vast body of rule 10b-5 learning that will help gauge what is material, such as what is meant by the “total mix of information.”²⁰¹

“Puffery” is a remark that is so vague or hyperbolic that it would not be considered in making a decision.²⁰² Consistent with rule 10b-5 precedent,²⁰³ the FERC did not prohibit puffery in negotiations.²⁰⁴

The new rules reach manipulation, even though no form of that word appears in the rules (nor for that matter does it appear in rule 10b-5, though it does in section 10(b)).²⁰⁵ The FERC “defines fraud . . . to include any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market,” thus encompassing manipulation.²⁰⁶ These rules supplant rescinded Market Behavior Rule 2, which prohibited manipulative conduct.²⁰⁷ Specifically, “wash trades, transactions predicated on submitting

200. *Basic Inc.*, 485 U.S. at 232; *see also TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

201. The “total mix” takes into account information already publicly known and general business conditions. *See, e.g., In re Convergent Tech. Sec. Litig.*, 948 F.2d 507, 513 (9th Cir. 1991) (taking into account securities analysts’ reports); *Phillips v. LCI Int’l Inc.*, 190 F.3d 609, 615-20 (4th Cir. 1999) (taking into account public awareness of developments in the industry).

202. *Eisenstadt v. Centel Corp.*, 113 F.3d 738, 745-46 (7th Cir. 1997).

203. *E.g., Raab v. Gen. Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993).

204. Order 670, *supra* note 52, at P 42.

205. Rule 10b-5, which by its express terms prohibits deception and has been construed to reach manipulative conduct in the securities markets. *Edward J. Mawod & Co. v. SEC*, 591 F.2d 588, 595 (10th Cir. 1979). Section 10(b), and thus rule 10b-5 itself, reach only “intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). The FERC’s rules likewise are to be interpreted as requiring an intent to affect the market. *See infra* text accompanying notes 161-175. It has been argued that manipulation is actionable in violation of rule 10b-5 only if it also includes an element of deception, relying upon, *e.g.*, *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 12 (1985) (holding that “the term ‘manipulative’ as used in § 14(e) [of the Securities Exchange Act, 15 U.S.C. § 78n(e)] requires misrepresentation or nondisclosure”), and *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476-77 (1977) (“Section 10(b)’s general prohibition of practices deemed by the SEC to be ‘manipulative’ [-] in this technical sense of artificially affecting market activity in order to mislead investors [-] is fully consistent with the fundamental purpose of the [Securities Exchange] Act ‘to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*’ Indeed, nondisclosure is usually essential to the success of a manipulative scheme.”) (internal citation omitted).

206. Order 60, *supra* note 52, at P 50. *See also Investigation of Market-Based Rate Authorizations*, *supra* note 58, at P 22 (“it is the act of manipulation -- perpetrating a fraud or deceit of some kind -- that is the violation of [Market Behavior] Rule 2 or of the new anti-manipulation rule”). Two commentators made the following observation with regard to this aspect of the new rules: “It is not clear under the Manipulation Rule whether conduct that impairs or obstructs a ‘well functioning market’ also must create an ‘unjust and unreasonable’ or ‘artificial’ price in order to constitute a violation. . . . [A statement made by the FERC in another context] suggests that the FERC will rely on the Manipulation Rule to prosecute fraudulent conduct and that the creation of an unjust and unreasonable price may not be an essential element of a violation of the Manipulation Rule.” Doron F. Ezickson & Paul J. Pantano, Jr., *FERC’s New Anti-Manipulation Regime for Electricity and Natural Gas Transactions: Mixing Apples and Oranges*, 26 *FUT. & DERIV. L. REP.*, Mar. 2006, at 1, 3-4 (footnote omitted). This is different from the approach under the Commodity Exchange Act, where the ability to influence prices and creation of an artificial price are elements of a violation. *See supra* text accompanying note 87.

207. *Investigation of Market-Based Rate Authorizations*, *supra* note 58, at PP 1, 22.

false information, transactions creating and relieving artificial congestion, and collusion for the purpose of market manipulation” are all prohibited by the new rules.²⁰⁸ As stated earlier, although rule 2 was rescinded, most of the other Market Behavior Rules have been formally codified.²⁰⁹ The FERC will not bring duplicate charges where the now codified Market Behavior Rules and the new anti-manipulation/anti-deception rules overlap.²¹⁰ The fact that there will not be duplicate penalties in this respect should not, however, mask that a violation of some *other* FERC rule may also be a violation of the new rules. “In other contexts [i.e., apart from overlap with the codified Market Behavior Rules], violations of more than one statute, order, rule, or regulation may result in separate penalties.”²¹¹ For example, withholding pipeline capacity from the market in violation of the open access requirement,²¹² if done to manipulate the price that someone could pay for capacity, would likely subject the withholding pipeline to penalties under the new rule.

In light of the manner in which rule 10b-5 has grown to become the dominant anti-deception regulation under the securities laws, it is reasonable to expect the new FERC rules to have a similar impact, especially since the current chairman of the FERC was a strong advocate for those rules.²¹³

IV. THE POTENTIAL FOR MULTI-AGENCY ACTION ARISING OUT OF A SINGLE COURSE OF CONDUCT

A. *Prior Multi-Agency Action involving Energy Transactions*

The same conduct may be subject to both civil and criminal proceedings as well as civil proceedings by more than one agency.²¹⁴ As summarized by one court: “[I]t is well established that more than one governmental agency may investigate the same conduct simultaneously and bring simultaneous civil and criminal actions based on such conduct so long as the respective remedies are

208. Order 670, *supra* note 52, at P 59.

209. *See supra* text accompanying notes 58-59.

210. Order 670, *supra* note 52, at P 59; *see also Enforcement Policy Statement, supra* note 145, at P 14. While FERC itself will not bring duplicate charges, other agencies may seek to punish the same conduct if it violated a statute or rule that the other agency enforces. *See infra* Part IV.

211. *Enforcement Policy Statement, supra* note 145, at P 14.

212. On the concept of open access generally, *see* 18 C.F.R. § 284.10 (2006) (addressing manner in which open access rates are developed), and *Northern Natural Gas Co.*, 110 F.E.R.C. ¶ 61,361 at P 10 (2005) (stating that pipelines must make available for sale all firm capacity at rates no higher than recourse rates).

213. *See supra* text accompanying note 41.

214. *Standard Sanitary Mfg. Co. v. United States*, 226 U.S. 20, 52 (1912) (recognizing that a course of conduct or transaction could give rise to both criminal and government civil suits under the Sherman Act); *United States v. Kordel*, 397 U.S. 1, 11 (1970) (recognizing parallel criminal and civil proceedings in connection with possible violations of the Federal Food, Drug, and Cosmetic Act). This is a frequent occurrence under the Securities Exchange Act. *E.g.*, *Chiarella v. United States*, 445 U.S. 222, 224 (1980) (involving criminal prosecution for unlawful insider trading, where criminal defendant had settled parallel civil proceeding initiated by the SEC); *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368 (D.C. Cir. 1980) (en banc) (involving parallel SEC and grand jury investigations of the same conduct). At the same time, the conduct of the parallel proceedings must comport with basic notions of due process and proper standards of the administration of justice. *United States v. Stringer*, 408 F. Supp. 2d 1083, 1092 (D. Or. 2006) (dismissing indictment where DOJ, in a duplicitous manner, used an SEC investigation to develop facts to provide the basis for a criminal prosecution).

not mutually exclusive and there is an otherwise rational basis for their individual proceedings.”²¹⁵

Multiple agencies have acted under these respective statutory authorities to address misconduct in the energy markets. One notable example involved American Electric Power Company (AEP). As a result of the investigation of the western markets,²¹⁶ and after several companies, including AEP, admitted that their employees provided false data to trade press entities that published gas price indexes, the FERC ordered each of these companies to show that the employees who participated in the manipulations or attempted manipulations had been disciplined, that the company has a clear code of conduct in place for reporting price information, that all trade data reporting is done by an entity within the company that does not have a financial interest in the published index and that the company is cooperating fully with any government agency investigating its past price reporting practices.²¹⁷

The CFTC also sued AEP and an affiliate, based on the same conduct, alleging repeated and deliberate reporting of false natural gas trading information to firms that compile natural gas price indexes.²¹⁸ The CFTC case was settled; a subsidiary of AEP acknowledged responsibility for the knowing submission of false data, AEP and the subsidiary agreed to pay a civil penalty of \$30 million and the court ordered full and expeditious cooperation by the defendants with the CFTC.²¹⁹ The AEP subsidiary also entered into a deferred prosecution agreement with the DOJ in which it agreed to pay an *additional* \$30 million criminal penalty to resolve an investigation into the entity’s false reporting of natural gas trades.²²⁰

Both the CFTC and the FERC also addressed misconduct by Coral Energy Resources, L.P. (Coral), a natural gas marketer. Before the CFTC, Coral consented to the entry of findings that its employees had knowingly delivered false, misleading, or knowingly inaccurate market information concerning natural gas transactions that affected or tended to affect the price of natural gas and could affect or tend to affect the price of natural gas futures traded on

215. SEC v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 828 (E.D. Wis. 1978). As noted earlier, however, it is only the DOJ, and not an administrative agency, that can pursue federal criminal charges. *Supra* text accompanying notes 144-146.

216. See *supra* text accompanying notes 29-32.

217. *American Elec. Power Co.*, 103 F.E.R.C. ¶ 61,089 (2003).

218. U.S. Commodity Futures Trading Commission v. Am. Elec. Power Co., Inc., No. C2 03 891 (Sept. 30, 2003), available at <http://www.cftc.gov/files/enf/03orders/enfaep-complaint.pdf>. Dynegy, Inc., which was another respondent that settled the case in which AEP was involved (*supra* text accompanying note 217), was also the subject of a CFTC proceeding, which it settled. *In re Dynegy Mktg. & Trade and W. Coast Power LLC*, [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,262 (CFTC Dec. 18, 2002), *supra* text accompanying notes 101-105.

219. Press Release, CFTC, U.S. Commodity Futures Trading Comm’n Settles Lawsuit with Am. Elec. Power Co. and AEP Energy Servs., Inc. for False Reporting and Attempted Manipulation in Natural Gas Mkts. (Jan. 26, 2005), <http://www.cftc.gov/opa/enf05/opa5041-05.htm>.

220. *Id.* AEP and several affiliates also agreed to pay a further civil penalty of \$21,000,000 to the FERC to settle unrelated charges; see also Press Release, FERC, Comm’n Accepts \$21 Million Civil Penalty to Settle Investigation of AEP’s Natural Gas Activities (Jan. 26, 2005), <http://www.ferc.gov/press-room/press-releases/2005/2005-1/01-26-05-aep.asp>.

NYMEX and attempted to manipulate the price of natural gas for future delivery, all in violation of section 9(a)(2) of the Commodity Exchange Act.²²¹

Before the CFTC, Coral agreed to a settlement providing that it cease and desist from further violations, pay a \$30 million civil penalty and cooperate in future proceedings.²²² Before the FERC, Coral was another subject of the remedial order described above regarding AEP.²²³ Coral also later settled a charge that, in the FERC's investigation of possible manipulation of energy prices in the West in 2000 and 2001, Coral failed to produce certain documents that were requested by the FERC staff. In the settlement Coral agreed, among other things, to "continue to strengthen and improve its policies and procedures to ensure that it is conducting [price] reporting activities in a manner consistent with the Commission's regulations and orders," to "implement a Task Force to develop and implement a 'best in class' model for regulatory compliance" and to make a "voluntary payment" of \$3.5 million to an organization providing assistance to low-income energy consumers.²²⁴

B. Recent Developments in Interagency Cooperation

When Congress expressly preserved the jurisdiction of the CFTC in energy-related matters,²²⁵ Congress also directed the FERC and the CFTC to enter into a memorandum of understanding "relating to information sharing, which shall include, among other things, provisions ensuring that information requests to markets within the respective jurisdiction of each agency are properly coordinated to minimize duplicative information requests, and provisions regarding the treatment of proprietary trading information."²²⁶ On October 12,

221. 7 U.S.C. § 13(a)(2) (2000).

222. *In re Coral Energy Resources, L.P.*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,815 (CFTC July 28, 2004) (basing sanctions on findings of violations of 7 U.S.C. § 13(a)(2) (2000)). The CFTC made the following findings and conclusions, among others, pertinent to the interrelationship between the prices of the physical commodity and derivatives: "[R]eporting firms' [such as Natural Gas Intelligence and Inside FERC] price indexes are widely used by natural gas market participants for various purposes, including the pricing and settlement of natural gas transactions in interstate commerce. Moreover, natural gas futures and options traders refer to the indexes for price discovery and for assessing price risks. For instance, an increase in prices at a natural gas trading hub signals either stronger demand or weakened supply, and futures traders take account of both price movements and changes in the supply/demand balance when conducting their futures trading.

'Consequently, because market participants use the natural gas price indexes in the natural gas spot, over-the-counter derivatives, futures, and options markets, the price and volume data reported by natural gas traders to reporting firms is market information that affects or tends to affect the price of natural gas in interstate commerce, and could affect or tend to affect the natural gas futures and options contracts traded on the NYMEX.'" *In re Coral Energy Resources, L.P.*, at 56,397. The CFTC found that employees of Coral reported information about trades that in fact never occurred and reported false data about trades that did occur "with the intent to affect the price of natural gas in interstate commerce or for future delivery." *Id.*

223. *American Electric Power Co.*, *supra* note 217 and accompanying text. Coral was not, however, identified as one of the companies that admitted misconduct by its employees. *Id.* at PP 2, 10.

224. *Coral Energy Res., L.P.*, 110 F.E.R.C. ¶ 61,205 at PP 12-14 (2005). The proceeding grew out of information provided by the CFTC to the FERC that suggested that Coral's responses to the FERC were not sufficient. *Id.* at P 8.

225. *Supra* text accompanying note 73.

226. Energy Policy Act of 2005 § 316 (adding new section 23(c)(1) to the Natural Gas Act, 119 Stat. 594, to be codified at 15 U.S.C. § 717t-2(c)(1)); Energy Policy Act § 1281 (adding new section 220(c)(1) to the Federal Power Act, 119 Stat. 594, to be codified at 16 U.S.C. § 824t(c)(1)).

2005, just two months after the EPAct 2005 became law, the two agencies entered into the mandated memorandum of understanding (MOU).²²⁷ The MOU provides for each agency to request information from the other.²²⁸ The MOU also provides that the agencies will:

coordinate on a regular basis oversight, investigative, and enforcement activities of mutual interest. To facilitate this coordination, the respective oversight and enforcement staffs of the FERC and CFTC are authorized to share information concerning ongoing oversight, investigative, and enforcement activities to determine whether and when they have a mutual interest in matters.²²⁹

As directed by Congress, the MOU also addresses the protection of proprietary information that is shared by the agencies.²³⁰

The Antitrust Division of the DOJ and the FTC have long had an arrangement for cooperation to avoid overlapping investigations where each has potential jurisdiction over a matter. These were most recently revised early in 2002.²³¹ Under their agreement, which speaks principally to merger clearance matters but also encompasses antitrust investigations, the two agencies allocated different industries to each. The DOJ is designated for the “commodity markets” while the FTC is principally responsible for “energy.”²³²

C. Energy and Energy-Related Transactions Vulnerable to Enforcement Action by Multiple Agencies

The actual or alleged transactions that were the subject of decided or settled cases described in Parts II.A.1, II.B, II.C, and IV.A of this Article present only a sample of the kind of energy-related conduct that comes within the enforcement power of one or more federal agency. The possibility for multi-agency action where there has been manipulation or deception in the physical or financial

227. Memorandum from FERC and CFTC Regarding Information Sharing and Treatment of Proprietary Trading and Other Information (Oct. 15, 2005), <http://www.ferc.gov/press-room/press-releases/2005/2005-4/10-12-05.asp> [hereinafter Proprietary Trading]. See also Press Release, CFTC, CFTC Chairman Jeffrey and FERC Chairman Kelliher Sign MOU on Information Sharing, Confidentiality (Oct. 15, 2005), www.cftc.gov/opa/press05/opa5127-05.htm.

228. Proprietary Trading, *supra* note 227, at ¶¶ 1, 3. The requests between the staffs of the agencies are to be in writing. *Id.* at ¶¶ 1, 3, 13.

229. Proprietary Trading, *supra* note 227, at ¶ 6; see also *Id.* at ¶ 13 (“The Parties agree that no further authorizations are necessary for their respective staffs to undertake an . . . exchange of oversight, investigation, and enforcement interests; [or] discussion among staff of mutual interests . . .”).

230. Proprietary Trading, *supra* note 227, at ¶¶ 2, 4, 8-10. The concept of interagency cooperation is not something new. For example, in *AEP* and *Coral* (*supra* text accompanying notes 216-224), the FERC, the CFTC, the SEC, and the DOJ cooperated in the investigations. *American Elec. Power Co.*, 103 F.E.R.C. ¶ 61,089 at P 8 (2003); Press Release, FERC, Comm’n Accepts \$21 Million Civil Penalty to Settle Investigation of AEP’s Natural Gas Activities (Jan. 26, 2005), <http://www.ferc.gov/press-room/press-releases/2005/2005-1/01-26-05-aep.asp>; Press Release, CFTC, U.S. Commodity Futures Trading Comm’n Settles Lawsuit with Am. Elec. Power Co. and AEP Energy Svcs., Inc. for False Reporting and Attempted Manipulation in Natural Gas Markets (Jan. 26, 2005), <http://www.cftc.gov/opa/enf05/opa5041-05.htm>.

231. Press Release, DOJ, DOJ and FTC Announce New Clearance Procedures for Antitrust Matters, (Mar. 5, 2002), www.usdoj.gov/atr/public/press_releases/2002/10171.wpd; see also 3 THE DEPARTMENT OF JUSTICE MANUAL TIT. 7 at 353-57 (ANTITRUST) (2d ed. 2006) (describing history and procedures regarding coordination between the DOJ and FTC).

232. Press Release, DOJ, DOJ and FTC Announce New Clearance Procedures for Antitrust Matters, at 3-4 (Mar. 5, 2002), www.usdoj.gov/atr/public/press_releases/2002/10171.wpd.

energy markets is substantially enhanced with the adoption of the new FERC rules. The discussion that follows describes the kind of behavior that can be reached under more than one of the regulatory regimes addressed here.

It bears emphasis that many of these activities that were *not* within the purview of the FERC prior to the EAct 2005 may now be encompassed by the broadened FERC enforcement authority. As the exposure to federal agency regulatory action increases, so do the potential implications for market participants that are public companies.²³³ Moreover, because resolving a matter with one agency can have consequences in a proceeding brought by another agency, any party faced with an initial investigation must develop a strategy that takes into account the possibility of later action by a second, or even third agency.²³⁴ As explained earlier, energy transactions of utilities and others that were outside the jurisdiction of the FERC are now within the scope of the FERC's enforcement power.²³⁵

For example, a municipal electric utility with gas-fired generation whose peak electric load exceeds its generating capacity is likely to be active in the market for power. Until the EAct 2005, that utility would have been entirely unconcerned about the FERC. Now, however, if it trades in an organized market, such as in California, because its transactions impact a *market* that is within the FERC's jurisdiction—the wholesale electric energy market—its trading activities and power purchases are potentially subject to the FERC's expanded enforcement powers. Transactions in the market for physical energy that have no legitimate economic substance or purpose, such as improper wash trades or false reporting of transactions, can be reached by both the FERC and the CFTC.²³⁶

Under the new FERC rules, for example, trading in the market for energy derivatives that has the (intended) effect of manipulating the FERC jurisdictional market for physical energy may be within the compass of the FERC's new rules. Thus, someone active only in the financial markets must be mindful not only of the CFTC oversight that they have always had but also the potential for action by the FERC, either independent of or in cooperation with the CFTC—as well as the DOJ if the action is deemed sufficiently nefarious to merit criminal prosecution. Under the new FERC rules, deceptive energy trading in an organized market can bring penalties where there is an intended effect on a FERC jurisdictional market. Manipulation of the market for physical energy by engaging in extraordinary transactions with a manipulative purpose to affect the financial markets runs afoul of the Commodity Exchange Act.²³⁷ The same conduct—where the affected energy transaction is one over which the FERC otherwise has jurisdiction—is now vulnerable to an enforcement action brought by the FERC. An effort to fix prices in the energy markets would violate the antitrust laws.²³⁸ If that behavior had the (intended) effect of manipulating the

233. See Part VI of this Article.

234. See *supra* Part V.B.

235. *Supra* text accompanying notes 156-60.

236. *Supra* text accompanying notes 30-33 and 90-105.

237. *Supra* text accompanying notes 86-87 and 94-100.

238. *Supra* text accompanying notes 122-27.

market price for energy—and it is difficult to envision how price fixing would not be manipulative—then the FERC’s new rules would also reach the conduct, as would the CFTC’s enforcement power to address market manipulation. If this manipulation of the regulated commodity markets affects the physical market, *e.g.*, the interstate forward market in the energy, the new FERC rules appear to give the FERC enforcement arm the power to act, so long as all of the other elements of the new rules are satisfied.

The new rules also affect a broad range of conduct. Significant buying by an energy trader, either in the physical market or possibly in the derivatives market for electricity, that comes shortly before a supply shortage appears, with the trader benefiting from the price spike that results from the shortage, could expose that trader to scrutiny by the FERC and the CFTC. On these facts, there was no malicious intent. The point is that in a skeptical atmosphere, some regulatory inquiries may be unavoidable—coincidence often results in the innocent becoming enmeshed in a costly investigation—but no market participant relishes the prospect of a federal regulator inquiring into its affairs, when an examination of a lawful transaction may lead to unearthing activity that was not so blameless.

Possible scenarios are limited only by the bounds of one’s imagination. The point, however, is a simple one—now that the FERC has significantly enhanced authority, anyone involved in transactions that could impact a FERC jurisdictional transaction must be aware that the FERC Office of Enforcement could come calling, and that other agencies, most notably the CFTC but also the DOJ, could be interested as well. As a result of the EPAct 2005, there is at least the potential for enforcement action by the FERC far beyond anything that predated the EPAct 2005.

V. SPECIAL ISSUES THAT ARISE IN DEALING WITH ENFORCEMENT ACTIONS BY MULTIPLE REGULATORS

The foregoing discussion establishes that the same action or course of conduct is subject to civil sanctions under multiple regulatory regimes enforced by different federal agencies, as well as to criminal prosecution. In developing a strategy to deal with an enforcement inquiry, anyone faced with the potential of actions by multiple agencies must take into account that there may be few limits on multiple penalties and must recognize the consequences of concurrent or overlapping proceedings. This part of this Article deals briefly with these topics.

A. *Constitutional Limitations on Multi-Agency Actions*

A potential enforcement target must be mindful of the real risk of multiple sanctions, as well as possible arguments to fend them off. The potential for enforcement action by multiple regulators presents the questions whether the imposition of both a civil monetary sanction and a criminal penalty for the same act violates the Due Process Clause of the United States Constitution²³⁹ and whether it is constitutionally permissible to assess multiple civil penalties. It

239. The Double Jeopardy Clause provides that no “person [shall] be subject for the same offense to be twice put in jeopardy of life or limb.” U.S. CONST. amend. V.

cannot be overemphasized that in this regulatory atmosphere, making peace with one regulator does not necessarily foreclose action by another.

A defendant who has been assessed a *civil* penalty is not protected by the Double Jeopardy Clause from a subsequent criminal prosecution for the same conduct.²⁴⁰ Similarly, when the defendant has been prosecuted criminally the Double Jeopardy Clause does not preclude later assessment of a *civil* penalty.²⁴¹ This begs the question of what penalties are “civil.” The Supreme Court’s most recent pronouncement on this subject bears quoting at length:

Whether a particular punishment is criminal or civil is, at least initially, a matter of statutory construction. A court must first ask whether the legislature, “in establishing the penalizing mechanism, indicated either expressly or impliedly a preference for one label or the other.” Even in those cases where the legislature “has indicated an intention to establish a civil penalty, we have inquired further whether the statutory scheme was so punitive either in purpose or effect,” as to “transform what was clearly intended as a civil remedy into a criminal penalty.”

In making this latter determination, the factors listed in *Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 168-169 (1963), provide useful guideposts, including: (1) “whether the sanction involves an affirmative disability or restraint”; (2) “whether it has historically been regarded as a punishment”; (3) “whether it comes into play only on a finding of *scienter*”; (4) “whether its operation will promote the traditional aims of punishment—retribution and deterrence”; (5) “whether the behavior to which it applies is already a crime”; (6) “whether an alternative purpose to which it may rationally be connected is assignable for it”; and (7) “whether it appears excessive in relation to the alternative purpose assigned.” It is important to note, however, that “these factors must be considered in relation to the statute on its face,” *id.*, and “only the clearest proof” will suffice to override legislative intent and transform what has been denominated a civil remedy into a criminal penalty.²⁴²

Applying *Hudson*, lower courts have consistently held that the civil monetary sanctions imposed by courts or by an agency such as the SEC and CFTC do not raise double jeopardy concerns vis-à-vis a criminal prosecution for the same act, or vice versa.²⁴³ While one of the factors specified in *Kennedy v. Mendoza-Martinez*, cited in *Hudson*,²⁴⁴ for determining whether a penalty is “criminal” is whether the underlying wrong requires a showing of *scienter*, the

240. *Hudson v. United States*, 522 U.S. 93, 95-96 (1997).

241. *E.g.*, *SEC v. Palmisano*, 135 F.3d 860 (2d Cir. 1998) (rejecting double jeopardy challenge to civil penalty under the federal securities laws where defendant had earlier been convicted in criminal proceeding for the same conduct and was sentenced to prison, and then ordered to pay restitution and a civil penalty). The discussion in the text focuses on monetary penalties. The same principles have been applied where the civil sanction takes a different form, such as barring one from certain activities or requiring a forfeiture. *Id.* at 863-64, 866 (holding that disgorgement, to the extent it did not duplicate the criminal sanction of restitution, was a civil penalty that did not contravene the Double Jeopardy Clause); *see also Cox v. CFTC*, 138 F.3d 268, 272-74 (7th Cir. 1998) (holding that a permanent ban on commodity market trading and revocation of floor broker registration under the Commodity Exchange Act were civil remedies that did not implicate the Double Jeopardy Clause); *United States v. Usery*, 518 U.S. 267 (1996) (holding that an *in rem* civil forfeiture was not a “punishment” within the meaning of the Double Jeopardy Clause).

242. *Hudson*, 522 U.S. at 99-100 (internal citations omitted).

243. *E.g.*, *Palmisano*, 135 F.3d at 864-66. *See generally* Ken Veileux, *Assertion of Double Jeopardy Defense Based on Sanction Sought or Imposed during Civil or Administrative Proceeding Initiated by Securities and Exchange Commission or National Securities Organization or Exchange*, 147 A.L.R. FED. 585 (1998) (collecting cases under the Commodity Exchange Act as well as the Securities Exchange Act).

244. *Supra* text accompanying note 242.

fact that, for example, a civil penalty for a violation of rule 10b-5 requires proof of scienter has not been sufficient, in and of itself, to result in rulings to the effect that a civil penalty for a violation of rule 10b-5 is sufficiently criminal in nature to invoke the protection of the Double Jeopardy Clause.²⁴⁵

Following the lead of *Hudson* and the cases on which it relied,²⁴⁶ lower courts have also upheld concurrent penalties imposed by, on the one hand, a self-regulatory organization (SRO) operating under the statutory scheme of the securities or commodities laws and, on the other, the umbrella federal agency.²⁴⁷ It follows ineluctably that if parallel penalties by a self-regulatory organization whose determinations are reviewable by a federal agency²⁴⁸ do not offend the Double Jeopardy Clause, then parallel penalties imposed by, or at the instance of, two or more federal agencies with jurisdiction over the same conduct do not offend the Double Jeopardy Clause.

This does not, however, address whether some other provision of the Constitution is implicated. As stated in *Hudson*, “[t]he Due Process and Equal Protection Clauses already protect individuals from sanctions which are downright irrational,”²⁴⁹ and “[t]he Eighth Amendment protects against excessive civil fines, including forfeitures.”²⁵⁰ Inasmuch as it has been only a few years since the Supreme Court determined that the Eighth Amendment applied to sanctions imposed in civil proceedings,²⁵¹ the case law in the area is in its relative infancy, and cases addressing whether a civil remedy is excessive deal with forfeitures, not monetary penalties.²⁵² Some courts have held that so long as the civil penalty is within the limit prescribed by the statute, the fine is not “excessive.”²⁵³ Other courts have engaged in a more refined inquiry. For

245. *Palmisano*, 135 F.3d at 866 (“Although disgorgement and the . . . fines apply to conduct that may also be prosecuted under a criminal statute, and they possess some characteristics common to criminal laws, such as requiring scienter and effecting deterrence [citation omitted], neither disgorgement nor money penalties have historically been viewed as punishment.”) *Id.*

246. Most notably *United States v. Halper*, 490 U.S. 435 (1989), which was disapproved of in part by *Hudson* insofar as *Halper* truncated the multi-faceted approach applied in *Kennedy v. Mendoza-Martinez*. *Hudson*, 522 U.S. at 101-102.

247. *E.g.*, *Jones v. SEC*, 115 F.3d 1173, 1182-83 (4th Cir. 1997) (rejecting double jeopardy challenge to imposition of sanctions in SEC administrative proceeding that followed sanctions by the National Association of Securities Dealers for the same conduct); *Grossfeld v. CFTC*, 137 F.3d 1300, 1302-04 (11th Cir. 1998) (rejecting double jeopardy challenge to sanctions by the CFTC following sanctions by the National Futures Association for the same conduct).

248. Sanctions imposed by, for example, the National Association of Securities Dealers are subject to review by the SEC pursuant to section 19(d)(2) of the Securities Exchange Act, 15 U.S.C. § 78s(d)(2) (2000). Sanctions imposed by the National Futures Association are subject to review by the CFTC pursuant to section 17(i) of the Commodity Exchange Act, 7 U.S.C. § 21(i) (2000).

249. *Hudson*, 522 U.S. at 103 (referring to U.S. CONST. amend. V and XIV) (citing *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483 (1955)). These clauses protect entities as well as individuals. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 881 n.9 (1985) (“It is well established that a corporation is a ‘person’ within the meaning of the Fourteenth Amendment.”).

250. *Hudson*, 522 U.S. at 103 (citing *Alexander v. United States*, 509 U.S. 544 (1993), and *Austin v. United States*, 509 U.S. 602 (1993)).

251. *Austin*, 509 U.S. at 621-22; *Hudson*, 522 U.S. at 103.

252. *See, e.g.*, cases collected in the West Digests under Fines, headnote 1.3.

253. *E.g.*, *Newell Recycling Co. v. EPA.*, 231 F.3d 204, 210 (5th Cir. 2000) (upholding administratively imposed penalty of \$1,345,000, citing *Pharaon v. Bd. of Governors of Fed. Reserve Sys.*, 135 F.3d 148, 155-57 (D.C. Cir. 1998) (finding no Eighth Amendment violation where penalty was within statutory limits).

example, one court addressed whether a statutory, per-violation penalty was “so grossly disproportionate to the gravity of [the defendant’s] violation as to violate the Eighth Amendment.”²⁵⁴ After further proceedings in that case the penalty was upheld on the ground that the size of the penalty was “not grossly disproportional to [the defendant’s] level of culpability and the harm he caused.”²⁵⁵ Thus, the “excessive fine” analysis in each case turns on an assessment of the conduct of the defendant or respondent and the legislative judgment underlying the statutory authorization to impose the penalty.

While the reported cases address the constitutionality of a monetary penalty under a single statutory scheme, it is reasonable to conclude that a similar analysis would be applied if the same party were subjected to multiple civil sanctions under two or more regulatory regimes. That is, even if a civil monetary penalty under, for example, the FERC’s new rules were not excessive, that would not be dispositive of whether an *additional* penalty imposed under the Commodity Exchange Act for the *same* conduct did not *in combination* exceed the constitutional limit.²⁵⁶

*B. The Collateral Estoppel Implications of Multi-Agency Enforcement Actions*²⁵⁷

One who has litigated an issue with one party and lost on that issue may be collaterally estopped from relitigating that same issue with a *different* party.²⁵⁸ The application of so-called “offensive” non-mutual collateral estoppel in this situation is discretionary with the tribunal that hears the second case and depends

254. *United States v. Mackby*, 261 F.3d 821, 830 (9th Cir. 2001) (remanding for further proceedings analysis of civil penalty of \$5,000 per patient in proceeding under False Claims Act for submission of false Medicare claims). The court also remanded the lower court’s determination to award treble damages under the False Claims Act, recognizing that the two penalties – the civil penalty and the treble damage award – “need not be considered in isolation as if the other did not exist.” *Id.* at 831.

255. *United States v. Mackby*, 339 F.3d 1013, 1017 (9th Cir. 2003). The actual penalty imposed, as well as the treble damage remedy, was far less than the maximum allowed by statute. *Id.* at 1017-18.

256. This is consistent with the analysis in *Mackby*, *supra* note 254, requiring that two remedies under the *same* statutory scheme not be evaluated in isolation.

257. “Modern usage calls for the descriptive term, ‘issue preclusion,’ in place of ‘collateral estoppel.’” *Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145, 2157 n.14 (2006). The older term is used here because most of the cases cited used that term.

258. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979) (upholding offensive use of collateral estoppel by a private party in subsequent suit where defendant litigated and lost on the issue in an action brought by the SEC). *See also* 18A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE 2D § 4464 (2002) (comprehensive discussion of this subject). The general rule is that if the government has lost on an issue in an action against a particular party it is precluded from litigating that issue again with the *same* party. *United States v. Stauffer Chem. Co.*, 464 U.S. 165 (1984). This principle generally applies to successive actions between the same party and different governmental agencies. *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 402-03 (1940). *See also United States v. Rogers*, 960 F.2d 1501 (9th Cir. 1992) (holding that government was estopped from criminal prosecution for securities fraud where defendant had prevailed in civil action brought by the SEC for securities fraud). Thus, when faced with charges by more than one regulatory agency, a respondent or defendant may seek to accelerate litigation in the case that he thinks he has the best chance of winning, so that success will bar the other enforcement proceeding. A private litigant cannot, however, assert *non-mutual* offensive estoppel against the government. That is, when the government has litigated an issue and lost it is not precluded from litigating that issue with *other* parties. *United States v. Mendoza*, 464 U.S. 154 (1984). For a discussion of non-mutual estoppel against the government, *see* 18A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE 2D § 4465.4 (2002).

upon a variety of factors.²⁵⁹ This principle can be applied even if the first action was one where the defendant was not entitled to a jury trial and the second one was a case where the defendant had that right.²⁶⁰ Moreover, this concept can be applied where the first proceeding was before an administrative agency.²⁶¹ Thus, a defendant or respondent in an action brought by one agency may be bound by an adverse adjudication of an issue when a second agency seeks relief from that same party arising out of the same facts, subject to consideration of the *Parklane Hosiery* criteria. Finally, a defendant in a civil case, such as one brought by the SEC, is precluded from relitigating an issue that was fully and fairly decided against that defendant in a criminal case.²⁶² This concept is applied whether the defendant pled guilty or was convicted after a trial.²⁶³

Thus, when an individual or entity is confronted with an enforcement proceeding—administrative, civil judicial or criminal—it must assess the wisdom of fighting the charge, taking into account that suffering a defeat on the merits could have a domino effect in the event that other regulators choose to initiate proceedings with the advantage of the collateral estoppel effect of findings on specific issues in the first proceeding.²⁶⁴

VI. COLLATERAL OR RELATED CONSEQUENCES UNDER THE SECURITIES EXCHANGE ACT FOR VIOLATIONS OF RULES PROHIBITING MANIPULATION OR DECEPTION IN THE ENERGY MARKET

A full discussion of the consequences under the federal securities laws of a violation of the FERC or other anti-manipulation rules is beyond the scope of this Article. Nevertheless, because there *are* such consequences for a public company, a brief treatment of the issue is appropriate. There are a number of provisions of the Securities Exchange Act and the SEC's rules that are triggered by wrong doing or investigations under the substantive energy commodities and antitrust law provisions discussed throughout this Article.²⁶⁵

259. *Parklane Hosiery*, 439 U.S. at 331-33. The factors identified include whether the party seeking to take advantage of estoppel could easily have joined in the earlier action or for other reasons application of estoppel would be unfair to the defendant; whether the defendant had an adequate incentive fully and vigorously to litigate the issue in the prior case; and whether there are procedural opportunities available to the defendant in the second case that were not available in the first case that might lead to a different result.

260. *Id.* at 333-35.

261. *United States v. Utah Constr.*, 384 U.S. 394, 421-22 (1966) (setting forth criteria for applying collateral estoppel to an agency determination), which was followed in *University of Tenn. v. Elliott*, 478 U.S. 788, 797-98 (1986) (applying preclusive effect of prior state administrative proceeding to certain claims but not to those statutory claims where the statutory language reflected an intent to preclude the application of estoppel). See generally David A. Brown, *Collateral Estoppel Effects of Administrative Agency Determinations: Where Should Federal Courts Draw the Line?*, 73 *CORN. L. REV.* 817 (1988) (discussing law of estoppel based on the outcome in administrative proceedings).

262. *SEC v. Grossman*, 887 F. Supp. 649, 659 (S.D.N.Y. 1995), *aff'd*, 101 F.3d 109 (2d Cir. 1996).

263. *SEC v. Palmisano*, 135 F.3d 860 (2d Cir. 1998).

264. *KIRKPATRICK & LOCKHART LLP, THE SECURITIES ENFORCEMENT MANUAL TACTICS AND STRATEGIES* 309-10 (1997) (Richard M. Phillips ed., A.B.A. Section of Business Law) (discussing strategic considerations in addressing possible parallel proceedings under the securities laws).

265. This is not to suggest that the *only* secondary consequences are under the Securities Exchange Act. For example, a violation of certain laws may provide a basis to disqualify an entity from bidding on certain government contracts. A contractor can be debarred by a contracting official for a conviction or civil judgment for "[c]ommission of any . . . offense indicating a lack of business integrity or business honesty that seriously and

The most important issues arise under the Securities Exchange Act.²⁶⁶ If the offending entity is a public company,²⁶⁷ liability may result for the failure to disclose the true nature of transactions, if they would affect investors.²⁶⁸ Notably—as it was the first case of its kind, according to the SEC—Dynergy Inc. settled an enforcement case with the SEC in which it was charged with, among other things, misleading investors about the level of the company's energy trading activity. Dynergy Inc. was charged with negligently failing to disclose that the company's publicly released financial results were inflated by including sham round-trip or wash trades.²⁶⁹ As described by the SEC:

Dynergy issued materially misleading information to the investing public about the amount of trading on its electronic trading platform, *Dynergydirect*. On November 15, 2001, Dynergy entered into two massive "round-trip" electricity transactions. In a January 2002 press release, Dynergy included the notional trading value (multiple of volume, price and term) from one of these trades in a discussion of an increase in trading traffic on *Dynergydirect*. In an April 2002 press release, Dynergy included the results of these trades in its reported energy trading volume and in its first quarter 2002 revenues and cost of sales.

In both releases, Dynergy negligently failed to disclose that the resulting increases in energy trading volume, revenue and notional trading value were materially attributable to the round-trip trades. The contents of the press releases were also used in the offer and sale of securities. Because the round-trip trades lacked economic substance, Dynergy's statements were materially misleading to the investing public. This case is the first enforcement action resulting from an energy

directly affects the present responsibility of a Government contractor or subcontractor." 48 C.F.R. § 9.406-2(a)(5) (2005). A comprehensive discussion of this issue and of all of the potential secondary consequences of violating the substantive statutes discussed here is beyond the scope of this Article.

266. Part VI does not discuss every potential impact under the Securities Exchange Act of a violation or possible violation of laws regarding energy or energy derivatives. Among other potential consequences under the Securities Exchange Act, if a public company is required to restate its published financial statements because, as a result of misconduct, the original statements were materially false by reason of misreporting transactions that were in violation of an energy-related law (*see, e.g., infra* text accompanying notes 269-271 for discussion of a case where a company's financial reports were misleading in this regard), the chief executive officer and chief financial officer of the company must reimburse the company for any bonus or other incentive-based compensation received during the twelve month period following the first public issuance of the incorrect financial information, as well as any profits realized from the sale of company stock in that period. Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 778 (2002) (codified at 15 U.S.C. § 7243 (SUPP. III 2003)). For discussions of this potentially far-reaching provision, *see* John Patrick Kelsh, *Section 304 of the Sarbanes-Oxley Act of 2002: The Case for a Personal Culpability Requirement*, 59 BUS. LAW. 1005 (2004); 2 JOHN T. BOSTELMAN, *THE SARBANES-OXLEY DESKBOOK* § 26:4 (Practicing Law Institute) (2006).

267. *See supra* note 179.

268. In addition to the exposure of a public company itself, senior management of a public company have very specific responsibilities for the company's disclosures and extensive potential exposure to both civil and criminal sanctions when the company issues materially misleading or incomplete financial or other information. 1 JOHN T. BOSTELMAN, *THE SARBANES-OXLEY DESKBOOK* ch. 4 (Practicing Law Institute) (2006) (summarizing SEC rules regarding the requirement that the chief executive officer and chief financial officer of a public company certify to the accuracy of certain reports filed by the company with the SEC); LEWIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 514-17 (5th ed. 2004).

269. Press Release, SEC, Dynergy Settles Sec. Fraud Charges Involving SPEs, Round-Trip Energy Trades (Sept. 24, 2002), <http://www.sec.gov/news/press/2002-140.htm>; *see also In re Dynergy Inc., Accounting and Enforcement Release No. 1631, 78 S.E.C. Docket 1366* (Sept. 24, 2002). The case also included charges alleging improper accounting for a financing transaction involving special purpose entities. *Id.*

trading company's misleading disclosures regarding use of "round-trip" or "wash" trades.²⁷⁰

Without admitting or denying liability, Dynegey agreed to pay a \$3 million penalty in a federal civil suit and to the entry of a cease and desist order by the SEC.²⁷¹

The SEC requires that public companies make quarterly disclosures of material-pending proceedings.²⁷² Many companies disclose pending investigations as they become known, before any actual proceeding is commenced. Apparently they recognize that there is never anything wrongful about making an accurate disclosure even if it is not legally required, and, more importantly, that the failure to disclose the investigation may be a material omission in the context of other disclosures by the company, for example, if the investigation were to mature into formal charges or a significant settlement.²⁷³ The ultimate disposition of a charge by a government agency that entails a substantial monetary penalty or other material sanction is likely to be disclosed.²⁷⁴

270. Press Release, SEC, Dynegey Settles Sec. Fraud Charges Involving SPEs, Round-Trip Energy Trades (Sept. 24, 2002), <http://www.sec.gov/news/press/2002-140.htm>.

271. *Id.*; Dynegey Inc., Accounting and Enforcement Release No. 1631, 78 S.E.C. Docket 1366 (Sept. 24, 2002); Dynegey Inc. Litigation Release No. 1774, Accounting and Auditing Enforcement Release No. 1632, 78 SEC Docket 1493-89 (Sept. 25, 2002), <http://www.sec.gov/litigation/litreleases/lr17744.htm>; *see also* James G. Bohn, *Securities Litigation in the Utility Sector*, 26 ENERGY L.J. 473, 484-87 (2005) (discussing some of the private civil liability risks involved in an allegedly inaccurate description of transactions, such as those involved in the aforementioned cases).

272. SEC Regulation S-K, Item 103, 17 C.F.R. § 229.103 (2006) which is required to be addressed in a publicly traded company's annual report on Form 10-K (Part I, Item 3, <http://www.sec.gov/about/forms/form10-k.pdf>) and quarterly report on Form 10-Q (Part II, Item 1, <http://www.sec.gov/about/forms/form10-q.pdf>), provides for the disclosure of "material pending legal proceedings" but excuses disclosure "with respect to any proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets" of the company. (That regulation imposes different disclosure requirements for environmental matters.) The regulation explicitly requires disclosure of information regarding material "proceedings known to be contemplated by governmental authorities." *Id.*

273. *See, e.g., McKesson Discloses FTC Investigation*, N.Y. TIMES, May 5, 2004, at C4; *Saks Discloses Formal SEC Investigation*, N.Y. TIMES, March 29, 2005, at C4. This has become a frequent practice, notwithstanding that under rule 10b-5 total silence is not wrongful in the absence of an affirmative disclosure duty and unless the undisclosed fact is material. *Supra* text accompanying notes 184-91. The failure to disclose an investigation may render other statements materially misleading in violation of the federal securities laws. *See, e.g.,* RMED Int'l, Inc. v. Sloan's Supermarkets, Inc., 878 F. Supp. 16 (S.D.N.Y. 1995) (finding of material omission arising from failure to disclose existence of FTC investigation concerning illegal concentration of New York City supermarkets and discussions over possible divestiture of grocery stores when company made statements that it would continue to expand); *see also* SEC v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 829-30 (E.D. Wis. 1978) (sustaining complaint alleging that failure to disclose that a substantial portion of the defendant's business was at regulatory risk because it had made payments in violation of liquor laws was a material omission from reports filed with the SEC).

274. For example, Item 303(a)(3)(i) of SEC Regulation S-K requires annual disclosure by a public company of "any unusual or infrequent events . . . that materially affected the amount of reported income from continuing operations and, in each case, indicate the extent to which income was so affected." 17 C.F.R. § 229.303(a)(3)(i) (2006). Similarly, a material non-monetary sanction, such as a restriction on business activities imposed as a result of regulatory action, should be disclosed in response to Item 303(a)(3)(ii) of Regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii) (2006) ("Describe any known trends . . . that the registrant reasonably expects will have a material . . . unfavorable impact on net sales or revenues or income from continuing operations.").

There are some mandated disclosures of matters addressed in this Article. Most notably, Item 10 of the annual report on Form 10-K filed with the SEC by a public company requires disclosures regarding directors, nominees for director or an executive officer that are specified by Item 401 of SEC Regulation S-K.²⁷⁵ Item 401(f) requires the disclosure of certain events “that occurred during the past five years and that are material to an evaluation of the ability or integrity” of the person. These events include an injunction from acting in certain capacities in the commodities industry, an order barring or suspending the person from engaging in certain capacities in the commodities business, engaging in any activity in connection with the purchase or sale of any commodity, or in connection with any violation of the federal commodities laws; and a finding by a court or the CFTC that the person violated any federal commodities law.²⁷⁶

The Securities Exchange Act and the SEC’s rules also impose special disclosure requirements on both accountants and attorneys for public companies who learn of material violations of the law by their public company clients.²⁷⁷

VII. AVOIDING VIOLATIONS AND MITIGATING SANCTIONS

In order to develop a sound and adequate corporate compliance plan, one must take into account the agencies’ enforcement policies.²⁷⁸ This leads to an informed understanding of the appropriate procedures and policies for internal compliance, as well as the employee education that is required, and the monitoring that is necessary. When there is uncertainty whether a course of conduct is lawful, the compliance program should provide a means for obtaining internal or external guidance.

A. *Policies on the Imposition of Remedies*

1. The Federal Energy Regulatory Commission

In response to the enhanced penalty-imposing authority granted to the FERC by the EAct 2005, and concurrent with proposing what became the new anti-manipulation rules, the FERC issued a policy statement on enforcement.²⁷⁹ The FERC’s purpose was to “articulate how we intend to apply our new and expanded civil penalty authority, so as to assure the industry that we will temper strong enforcement measures with consideration of all relevant factors, including

275. SEC Regulation S-K, Item 401, 17 C.F.R. § 229.401 (2006) (Item 10 of the annual report on Form 10-K is available at <http://www.sec.gov/about/forms/form10-k.pdf>. The information may be incorporated by reference from the company’s proxy statement. *Id.* at item G.3.).

276. SEC Regulation S-K, Item 401(f), 17 C.F.R. § 229.401(f) (2006).

277. With respect to accountants, *see* The Securities Exchange Act § 10A(a)-(f), 15 U.S.C. § 78j-1(a)-(f) (2006), (enacted as section 301 of the PSLRA); *see also* John H. Eickemeyer, *SEC Actions Against Accountants under Section 10A of the Exchange Act*, 39 REV. SEC. & COM. REG. 53 (2006). With respect to attorneys, *see* 17 C.F.R. pt. 205 (2006) (promulgated by the SEC pursuant to section 307 of the Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 784 (2002), codified at 15 U.S.C. § 7245 (Supp. III 2003)).

278. A comprehensive statement of what constitutes an effective compliance program is beyond the scope of the Article. The agency policies and other guidelines discussed in this section of the Article, however, identify a number of important features of a sound compliance program.

279. *Enforcement Policy Statement*, *supra* note 145.

mitigating factors, in determining the appropriate remedies.”²⁸⁰ Penalties will be decided on a case-by-case basis without a specific formula, thereby giving the FERC “the discretion and flexibility to address each case on its merits, and to fashion remedies appropriate to the facts presented, including any mitigating factors.”²⁸¹

The ability to impose penalties does not abrogate whatever power the FERC has to require disgorgement of ill-gotten gains or impose other sanctions.

Our enhanced civil penalty authority will operate in tandem with our existing authority to require disgorgement of unjust profits obtained through misconduct and/or to condition, suspend, or revoke certificate authority or other authorizations, such as market-based rate authority for sellers of electric energy. This is similar to the ability of the SEC to require an accounting and disgorgement to investors for losses and also to impose penalties for the misconduct, or of the CFTC to order restitution or obtain disgorgement and also to impose fines for violations. In doing so, we intend to take the full range of possible remedies into account in determining whether a penalty should be imposed in addition to other remedies and, if so, the appropriate amount of the penalty. Entities faced with enforcement thus will be subject to the full array of possible enforcement tools, but we will exercise our discretion to apply remedies in a fair, reasonable, and appropriate manner.²⁸²

As required by statute, the FERC must consider the seriousness of the offense in determining the appropriate penalties.²⁸³ In applying this criterion the FERC will take into account, among other considerations, “what harm was caused by the violation;” how widespread the harm was; whether significant sums of money were involved; whether the violation was part of a broader scheme, such as acting in concert with others; whether the violation was a repeat offense; the length of time over which the misconduct occurred; whether “the wrongdoing related to actions of senior management” or the result of “pressure placed on employees by senior management;” whether “management engage[d] in a cover-up;” whether senior management resisted or ignored efforts to inquire into actions or otherwise impeded an inquiry into the violation; and “what the effect of penalties would be on the financial viability of the entity that committed the wrongdoing.”²⁸⁴

280. *Id.* at P 3. (the policy covers all persons, including individuals as well as corporate entities, covered by the applicable rules; this includes governmental entities and other market participants not generally under the jurisdiction of the FERC). *See Enforcement Policy Statement, supra* note 145, at n.2.

281. *Id.* at P 13.

282. *Enforcement Policy Statement, supra* note 145, at P 12 (footnotes omitted). *See also Id.* at P 19. Contrary to what may be implied in the quoted text, the SEC’s power to “require” monetary penalties or disgorgement is limited in comparison to that now granted to the FERC. Specifically, the SEC’s power actually to impose monetary penalties and disgorgement in an administrative proceeding applies only to certain specified violations, and does not extend to any and all violations of rule 10b-5. Securities Exchange Act §§ 21B(a), (e); 15 U.S.C. §§ 78u-2(a), (e) (2000). The SEC’s general administrative power to issue a cease and desist order does not provide for imposing monetary penalties or disgorgement. Securities Exchange Act § 21C, 15 U.S.C. § 78u-3 (2000).

283. Energy Policy Act of 2005, Pub. L. No. 109-58 § 314, 119 Stat. 594, 691 (to be codified at 15 U.S.C. § 717t-1) (adding new section 22 of the Natural Gas Act); Energy Policy Act of 2005 § 1284 (to be codified at 16 U.S.C. § 825o-1) (amending section 316A of the Federal Power Act).

284. Enforcement of Statutes, Orders, Rules, and Regulations, 113 F.E.R.C. ¶ 61,068 at P 20 (2005). The last item in this list is comparable to factors the SEC recently announced it would consider in determining the appropriate approach toward corporate penalties. *See infra* notes 324-325 and accompanying text.

On the other side of the ledger, credit will be given for a company's commitment to compliance. The following factors, among others, will be taken into account by the FERC in determining the credit to be given for that commitment:²⁸⁵

- Does the company have an established, formal program for internal compliance that is well documented and widely disseminated within the company and fully supported by senior management?
- Is the program supervised by a high ranking official, who reports to or has access to the chief executive officer or the board of directors?
- Are sufficient resources dedicated to the program?
- How frequently does the company review and modify the program?
- How frequently is training provided to the relevant employees and is that training sufficiently detailed and thorough?
- Does the company have a program for auditing compliance with the FERC's regulations?
- How has the company responded to prior wrongdoing, for example in imposing internal sanctions on violators?²⁸⁶

Another factor that militates in favor of the potential respondent is whether it reported its own violation to the FERC,²⁸⁷ a concept often referred to as "self-reporting." More than the mere act of self-reporting, however, is taken into account in determining the credit to be given. The following specific factors, among others, will be considered:

- Was the misconduct uncovered through a self-evaluation or internal audit?
- Did the company act immediately when it learned of the misconduct and did the company then notify the FERC immediately?
- Did the company take immediate steps to stop the misconduct and otherwise respond appropriately?
- Did the company arrange for individuals with full knowledge of the matter to meet with the FERC enforcement staff and present its findings to the FERC with all relevant evidence regarding the misconduct, including identifying the employees involved?²⁸⁸

The final major factor—in addition to the assessment of the company's compliance program and its self-reporting—is the degree of cooperation by the company with the FERC and its staff after the violation has come to the FERC's attention. Cooperation is expected, but the FERC will "give some consideration to exemplary cooperation, that is, cooperation which quickly ends wrongful conduct, determines the facts, and corrects a problem. Cooperation must come very early in the process, however, and must be in good faith, consistent, and continuing."²⁸⁹ In particular, there will be no credit for a company that "does no

285. These factors relate only to the amount of credit given when a penalty is being considered; they do not affect consideration of disgorgement of unjust profits. *Enforcement Policy Statement, supra* note 145, at P 23.

286. *Id.* at P 22.

287. *Enforcement Policy Statement, supra* note 145, at P 24.

288. *Id.*

289. *Enforcement Policy Statement, supra* note 145, at P 26.

more than the minimum, or delays cooperation, or purports to cooperate but actually engages in conduct that impedes the Commission's activities or consumes Commission resources unnecessarily."²⁹⁰

The factors taken into account when assessing cooperation include:

- Did the company volunteer to provide internal investigation or audit reports relating to the misconduct?

- Did the company retain an independent outside entity to assist in the internal investigation?

- Did senior management make clear to all employees that their cooperation has the full support and encouragement of management and the board of directors?

- Did the company facilitate the FERC's access to employees with knowledge bearing on the misconduct and encourage them to cooperate?

- Did the company identify culpable employees?²⁹¹

The FERC considers lack of cooperation seriously, and has declared that "[l]ack of cooperation is a serious matter and will be weighed in deciding appropriate remedies The manner in which a company approaches cooperation will be an important factor in determining whether, and how much, credit may be given for cooperation."²⁹²

There is considerable controversy over the policy issue of whether private parties should be expected to provide an investigating agency with the results of an internal investigation when doing so may result in waving the attorney-client privilege with respect to the materials developed in connection with that investigation.²⁹³ While the FERC did not address this issue directly in its policy statement on enforcement,²⁹⁴ it has been reported that the FERC will not expect the subject of an investigation to waive the attorney-client privilege in order to be deemed as having cooperated in the investigation.²⁹⁵ On the surface this may be reassuring to potential enforcement targets. However, since the fruits of internal investigations are often protected by the attorney-client privilege,²⁹⁶ it is

290. *Id.*

291. *Enforcement Policy Statement, supra* note 145, at P 26.

292. *Id.* at P 27.

293. *E.g.*, William W. Horton, *A Transactional Lawyer's Perspective on the Attorney-Client Privilege: A Jeremiad for Upjohn*, 61 *BUS. LAW.* 95, 115-27 (2005) (summarizing the current issues and arguments). However, an analysis of the wisdom of requiring this level of cooperation and the attorney-client privilege implications of providing the agency with the fruits of counsel's investigation is beyond the scope of this Article. For a recent decision addressing the issue of waiver in the context of governmental investigations, discussing federal and state case law, *see In re Qwest Communications Int'l Inc.*, 450 F.3d 1179 (10th Cir. 2006).

294. *See Enforcement Policy Statement, supra* note 145.

295. Audio tape: Statement of Robert Pease, Director of Investigations, FERC Office of Enforcement, speaking for himself and not on behalf of the FERC or its staff at Panel on New Market Behavior Rules: How They Impact Market Manipulation, and FERC's Expanded Penalty Authority, held by the Energy Bar Association (Apr. 27, 2006) (on file with author).

296. *E.g.*, Dennis J. Block & Nancy E. Barton, *Implications of the Attorney-Client Privilege and Work-Product Doctrine*, *INTERNAL CORPORATE INVESTIGATIONS* 18 (Brad D. Brian & Barry E. McNeil eds., 2d ed. 2003) ("The *goal of providing maximum protection of the investigative record* requires consideration of the elements of both the attorney-client privilege and the work-product doctrine . . . and *to comport the investigative process as closely as practicable to these requisites.*) (emphasis added, footnote omitted); DAN K.

difficult to reconcile a policy that does not require waiver of the attorney-client privilege with the announced policy of the FERC that an element of both self-reporting and cooperating is providing reports of internal investigations.²⁹⁷

2. The Commodity Futures Trading Commission

In enforcing the provisions of the Commodity Exchange Act against participants in the markets, the CFTC considers a variety of factors, although the only factor specified in the Commodity Exchange Act itself is the gravity of the offense.²⁹⁸ The CFTC published a policy statement in 1994 to specify additional factors it would consider.²⁹⁹ The CFTC Policy Statement is important both because of its own direct application to misconduct in the markets under its jurisdiction and also because the FERC referred to the CFTC's policies when articulating its own enforcement policy.³⁰⁰

The CFTC's guidelines are merely representative of the factors it considers in assessing penalties; the list is not meant to be exhaustive.³⁰¹ The CFTC reviews the specific facts of each case and considers any relevant and appropriate factors before assessing civil money penalties.³⁰² The CFTC's guidelines are not binding on the CFTC and they create no legal rights for respondents.³⁰³

In determining sanctions, the CFTC considers various factors for determining the gravity of the offense, including:³⁰⁴

- Whether the violation involves the core provisions of the [Commodity Exchange] Act, [including] fraud, [manipulative conduct], and other violations having an effect on market integrity and customer protection
- Whether the violator acted intentionally or willfully;
- Whether the violator acted in concert with others;
- The number of violations;
- The duration of the violations;
- Whether the violator benefited from the wrongdoing;
- Whether the violations resulted in harm to victims; and
- Whether the violator attempted to cure the violation, voluntarily disclosed the wrongdoing, or provided restitution.

WEBB ET AL., CORPORATE INTERNAL INVESTIGATIONS §§ 6.08-6.09 (2005) (explaining how to protect the attorney-client privilege when conducting an internal investigation).

297. *Enforcement Policy Statement*, *supra* note 145, at PP 24, 26.

298. 7 U.S.C. § 9a(1) (2000).

299. Policy Statement Relating to the Commission's Authority to Impose Civil Money Penalties and Futures Self-Regulatory Organizations' Authority to Impose Sanctions; Penalty Guidelines, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,265 (C.F.T.C. 1994) [hereinafter CFTC Policy Statement]. The CFTC Policy Statement followed the CFTC's study in the early 1990's of the penalties imposed by the agency and by futures SROs, in which the CFTC analyzed data concerning both SRO disciplinary actions and CFTC enforcement cases. A Study of CFTC and Futures Self-Regulatory Organization Penalties, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,264 (C.F.T.C. 1994).

300. *Enforcement Policy Statement*, *supra* note 145, at P 9.

301. CFTC Policy Statement, *supra* note 299, at *2.

302. *Id.* at *3.

303. CFTC Policy Statement, *supra* note 299, at *3.

304. *Id.*

In addition to the gravity of the offense, the CFTC Policy Statement also identified the following general factors as considerations in its assessment of civil money penalties:³⁰⁵

- Sanctions imposed in analogous cases;
- Sanctions imposed by self-regulatory organizations against the respondent in a parallel disciplinary action;³⁰⁶
- The total mix of sanctions available under the Commodity Exchange Act, including: the revocation or suspension of registration; trading prohibitions; cease and desist orders; restitution and other equitable relief, such as an injunction, rescission, or disgorgement available in federal district court actions;
- Double jeopardy;³⁰⁷
- Prior misconduct, including whether the respondent is a recidivist;
- The collectibility of a civil monetary penalty, including an assessment of the respondent's assets, liabilities, and overall financial condition;³⁰⁸
- The conservation of CFTC resources, specifically in the contexts of cooperation (i.e., whether the respondent is willing to cooperate in the prosecution of the Commission's action against the remaining respondents) and settlement (i.e., whether the respondent is willing to forego a full adjudication of the allegations in the complaint).

Just as the FERC gives credit for a company's commitment to compliance when evaluating the level of sanctions,³⁰⁹ the CFTC also gives credit for respondents' cooperative conduct when deciding on the appropriate sanctions to impose. The most recent formal statement of the CFTC's considerations was published in the "CFTC Cooperation Advisory."³¹⁰ The CFTC Cooperation Advisory identifies three broad categories of cooperation that the CFTC considers in determining whether there are mitigating factors to be weighed against the contemplated sanctions, along with additional factors that may lend weight or perspective to those factors.³¹¹ The three categories involve the company's good faith in investigating misconduct, cooperation with the CFTC, and efforts to prevent future violations.

The CFTC's evaluation of a company's good faith effort to uncover and investigate the violations will include whether the company:

305. CFTC Policy Statement, *supra* note 299, at *3.

306. For a discussion of the lawfulness of the imposition of sanctions by both an SRO and the umbrella federal regulatory agency, *see supra* text accompanying note 247.

307. Here the CFTC referred to the standard set under *United States v. Halper*, 490 U.S. 435 (1989), which was later disapproved of in part by *United States v. Hudson*, 522 U.S. 93, 101-02 (1997). *See supra* note 246.

308. Prior to 1992, the CFTC also was statutorily required to consider a person's overall financial condition in assessing an appropriate civil penalty. Futures Trading Practices Act, Pub. L. No. 102-546, § 209(a)(5), 106 Stat. 3590 (1993) (amending 7 U.S.C. § 9a (2000)). The CFTC Policy Statement identifies the respondent's net worth and its business viability as one appropriate consideration in assessing civil money penalties. CFTC Policy Statement, *supra* note 299, at *3.

309. *Supra* text accompanying note 285.

310. C.F.T.C., ENFORCEMENT ADVISORY: COOPERATION FACTORS IN ENFORCEMENT DIVISION SANCTION RECOMMENDATIONS (2004), available at <http://www.cftc.gov/files/enf/enfcooperation-advisory.pdf> [hereinafter CFTC COOPERATION ADVISORY].

311. *Id.* at 2, 3.

- Uncovered the misconduct itself, and through what means it was uncovered;

- Took immediate steps to address the misconduct and to implement an effective response to it;

- Quickly made appropriate disclosure of the misconduct; and

- Used an independent entity to investigate and report the misconduct.

Cooperation with the CFTC's staff in reporting the misconduct and the company's actions with respect to it includes the quality of the company's cooperation efforts and its management of the aftermath of the misconduct, including the following:

- After discovering the misconduct, whether the company promptly notified the CFTC;

- Whether a corporate officer met with the CFTC promptly to review and explain the known facts about the misconduct;

- Whether the company willingly waived the corporate attorney-client and work product protections for internal investigation reports and other corporate documents; willingly waived the corporate attorney-client privilege for employee testimony; made witnesses available in a timely manner; avoided entering into joint defense agreements with counsel for employees or other entities; and provided a financial analysis of its financial gains, if any, from the unlawful activities;³¹² and

- Whether the company outlined its findings and relevant evidence regarding the misconduct and produced a full and complete report of the internal investigation to the CFTC, including full disclosure of: the scope of the wrongdoing; the identity of the wrongdoers within the organization, including culpable senior executives, if applicable; the steps taken by the company upon learning of the misconduct; the processes followed to ferret out necessary information; the relevant communications between officers, directors, employees, and counsel; the documents evidencing the misconduct; and the measures taken to address and ameliorate the misconduct.

Efforts to prevent future violations include whether the company:

- Provided sufficient, credible assurances to the CFTC that the conduct would not recur;

- Implemented additional internal controls, procedures, and oversight, or took other reasonable steps to reduce the likelihood of recurrence;

- Reassigned supervisors overseeing the areas in which misconduct occurred; and

- Adequately addressed the employment of the persons responsible for the misconduct.

312. Following publication of the CFTC Cooperation Advisory, a member of the staff of the CFTC Division of Enforcement stated that the CFTC will *not* require a target to waive the attorney-client privilege in contrast to the policy and practice of other agencies, such as the SEC and the Department of Justice. Joan Manley, Deputy Dir. of Div. of Enforcement, Futures Industry Association Law & Compliance Division, Session on Crisis Management in Baltimore, Maryland (May 13, 2005). *See also supra* text accompanying notes 293-96 (discussing the waiver of the attorney-client privilege in this context); *supra* text accompanying notes 296-97 (discussing the possible anomaly of not requiring a waiver of the attorney-client privilege while at the same time expecting production of the results of an internal investigation).

The CFTC will also consider the respondent's corporate structure, the nature of the misconduct, and the harm caused by the violations.³¹³ Specifically, the CFTC will consider:

- At what level of the organization the misconduct occurred;
- Whether the misconduct arose because of pressure from superiors;
- The duration of the misconduct after supervisors first learned of it;
- Whether the company hired or designated adequate staff and resources to enable it to respond quickly to CFTC subpoenas; and
- Whether the company took available actions to mitigate any losses caused by the misconduct.

The CFTC reiterated that the presence of any cooperative factors will not prevent the CFTC from bringing an enforcement action against the wrongdoers. For example, certain corporate actions may limit or offset any cooperation credit to which the respondent would otherwise be entitled. Conduct deemed uncooperative, or action that serves to impede the CFTC's investigation, or to unnecessarily consume government resources, is strongly discouraged.³¹⁴ The CFTC identified the following as examples of uncooperative conduct:³¹⁵

- Failure to respond to subpoenas in a timely manner, or to produce documents and witnesses within a reasonable period;
- Misrepresenting the nature or extent of the company's misconduct;
- Claiming that records are unavailable when they are available;
- Directing company counsel to limit the CFTC's access to employees;
- Inappropriately directing employees or their counsel not to cooperate fully or openly with the investigation;
- Engaging in obstructive conduct during investigative testimony or interviews;
- Providing specious explanations for instances of misconduct that are uncovered;
- Issuing questionnaires to employees that offer suggestive responses;
- Failing to properly search computer hard drives for documents and electronic images; and
- Failing to provide documents organized in the way they are maintained in the normal course of business.

The CFTC Cooperation Advisory further specified that a company can be deemed uncooperative for turning a blind eye to warnings or indications that its employees were committing, or had committed, violations of the commodities rules, or for failing to report those warnings, after discovered, to the CFTC.³¹⁶ Likewise, the CFTC may view a company to have been uncooperative if it internally identifies signs of wrongdoing and then waits for a formal governmental inquiry before taking action to prevent further violations of the Commodity Exchange Act.³¹⁷

313. CFTC COOPERATION ADVISORY, *supra* note 310, at 2-3.

314. *Id.* at 4.

315. CFTC COOPERATION ADVISORY, *supra* note 310, at 4.

316. *Id.*

317. CFTC COOPERATION ADVISORY, *supra* note 310, at 4.

3. The Securities and Exchange Commission

As discussed earlier, in some instances, there may be SEC-related enforcement implications of enforcement action taken by the FERC, the CFTC, or the DOJ.³¹⁸ In addition, since the new FERC rules are patterned after the SEC's principal anti-deception and anti-manipulation rule, the FERC is likely to be guided in some measure by the SEC's approach toward enforcement. Moreover, in its policy statement, the FERC made specific reference to the SEC's most noteworthy pronouncement on the subject.³¹⁹

The principal enforcement policy statement of the SEC is known as the Seaboard Report.³²⁰ In that matter the SEC determined not to seek sanctions from a corporation, which had filed inaccurate reports with the SEC, because of the level of cooperation by the corporation. As explained by the SEC:

Within a week of learning about the apparent misconduct, the company's internal auditors had conducted a preliminary review and had advised company management who, in turn, advised the Board's audit committee, that Meredith had caused the company's books and records to be inaccurate and its financial reports to be misstated. The full Board was advised and authorized the company to hire an outside law firm to conduct a thorough inquiry. Four days later, Meredith was dismissed, as were two other employees who, in the company's view, had inadequately supervised Meredith; a day later, the company disclosed publicly and to us that its financial statements would be restated. The price of the company's shares did not decline after the announcement or after the restatement was published. The company pledged and gave complete cooperation to our staff. It provided the staff with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of Meredith and others; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.³²¹

The SEC took that occasion to expound on:

some of the criteria we will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation [-] from the extraordinary step of taking no enforcement action to bringing reduced charges,

318. *Supra* text accompanying notes 272-77.

319. *Enforcement Policy Statement*, *supra* note 145, at P 7 (referring to the SEC report discussed *infra* text accompanying notes 320-23).

320. Report of Investigation Pursuant to Section 21(A) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969, 76 SEC Docket 220 (Oct. 23, 2001) [hereinafter Seaboard Report]. It is known as "the Seaboard Report" because the subject of the report was a division of the Seaboard Corporation, albeit that company is never named in the report. The underlying facts, as found by the SEC, are set forth in the companion release reporting on a settlement with an individual found by the SEC to be a wrongdoer. *In re* Gisela de Leon-Meredith, Exchange Act Release No. 44,970, 76 SEC Docket 223 (Oct. 23, 2001).

321. Seaboard Report, *supra* note 320, at 1. For a recent example of alleged corporate misconduct where no monetary penalty was imposed in a settlement because the entity cooperated, see *In re* Tribune Company, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, Exchange Act Release No. 53,882, 2006 WL 1469703 (May 30, 2006) (providing for settlement of charges that Tribune Company issued false financial information based on inflated publication circulation figures, with no assessment of a financial penalty in view of "remedial acts promptly undertaken by Tribune and the cooperation that Tribune afforded the [SEC] staff").

seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.³²²

Following are some of the factors noted by the SEC in respect of these considerations:

2. How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?

3. Where in the organization did the misconduct occur? How high up in the chain of command was knowledge of, or participation in, the misconduct? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Is it symptomatic of the way the entity does business, or was it isolated?

4. How long did the misconduct last? Was it a one-quarter, or one-time, event, or did it last several years? . . .

6. How was the misconduct detected and who uncovered it?

7. How long after discovery of the misconduct did it take to implement an effective response?

8. What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for any misconduct still with the company? If so, are they still in the same positions? Did the company promptly, completely and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies? Did the company identify what additional related misconduct is likely to have occurred? . . . Did the company appropriately recompense those adversely affected by the conduct?

9. What processes did the company follow to resolve many of these issues and ferret out necessary information? Were the Audit Committee and the Board of Directors fully informed? If so, when?

10. Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior? Did management, the Board or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?

11. Did the company promptly make available to [the SEC] staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information [the SEC] staff did not directly request and otherwise might not have uncovered? Did the

322. Seaboard Report, *supra* note 320, at 2.

company ask its employees to cooperate with [the SEC] staff and make all reasonable efforts to secure such cooperation?

12. What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company provide [the SEC] staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?³²³

More recently, the SEC separately addressed when it is appropriate to impose a monetary penalty on a corporate entity.³²⁴ While many of the factors are more directly pertinent to whether to impose a penalty for a violation of the securities laws—and thus directly relevant to a sanction under the provisions discussed in Part VI of this Article—some of the factors are ones that the FERC might also choose to consider in determining whether to impose, or to seek, a corporate penalty in addition to sanctions against individual wrongdoers.

The principal considerations identified by the SEC regarding seeking or imposing a corporate monetary penalty are “the presence or absence of a direct benefit to the corporation as a result of the violation[, and] the degree to which the penalty will recompense or[, on the other hand,] further harm the injured shareholders.”³²⁵ Additional factors are:

[(1)] The need to deter the particular type of offense . . . [(2)] The extent of the injury to innocent parties . . . [(3)] Whether complicity in the violation is widespread throughout the corporation . . . [(4)] The level of intent on the part of the perpetrators . . . [(5)] The degree of difficulty in detecting the particular type of offense . . . (6) [The] [p]resence or lack of remedial steps by the corporation . . . and [(7)] [The] [e]xtent of cooperation with [the SEC] and other law enforcement [bodies].³²⁶

4. The Department of Justice

The most notable expression by the DOJ of its policy on charging business organizations with crimes is the “Thompson Memorandum,” named for its author, Larry D. Thompson, Deputy Attorney General at the time the memorandum was issued to heads of DOJ components and United States attorneys.³²⁷ The lawfulness of some aspects of this memorandum have come into question in light of the recent ruling that the Justice Department acted improperly in pressuring a company not to pay legal fees for its employees who were under investigation.³²⁸ Nevertheless, this memorandum remains important

323. *Id.* at 2-4 (footnote omitted).

324. Press Release, SEC, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), <http://www.sec.gov/news/press/2006-4.htm>.

325. *Id.* at 3.

326. Press Release, SEC, Statement of the Securities and Exchange Commission Concerning Financial Penalties, *supra* note 324, at 4.

327. Larry D. Thompson, Deputy Attorney General, U. S. Department of Justice, Memorandum re Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm [hereinafter Thompson Memorandum].

328. *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (finding that Thompson Memorandum provision that payment of an employee's attorney's fees would be considered a lack of cooperation by the employer in determining whether to indict the employer interfered with the employees' constitutional rights to

not only because of the guidance it provides on what steps an entity can take to avoid criminal prosecution for a violation of the Federal Power Act, the Natural Gas Act, the Commodity Exchange Act, the Securities Exchange Act, and the Sherman Act, but also because some of its discussion might serve as an indication of factors that the FERC may consider in determining whether to proceed against an organization and, if so, what penalty to impose or to seek.³²⁹ The focus in the following discussion is on the insight that the memorandum provides on what an entity can do either before wrongdoing occurs or after wrongdoing has been discovered that bears on the judgments that will be exercised by the DOJ.

Charging a corporation with a crime may be appropriate even if the wrongdoing was “minor misconduct” where “the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation”³³⁰ “On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, *particularly one with a compliance program in place*, under a strict respondeat superior theory for the single isolated act of a rogue employee.”³³¹

As with the other agencies, self-reporting is very important in the criminal prosecutorial decision-making process.

In determining whether to charge a corporation, that corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government’s investigation may be relevant factors. In gauging the extent of the corporation’s cooperation, the prosecutor may consider the corporation’s willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.³³²

The memorandum notes that complete disclosure of the fruits of an internal investigation is “often critical in enabling the government to evaluate the completeness of a corporation’s voluntary disclosure and cooperation.”³³³ Waiver of the attorney-client privilege and work product protections, however, are not “an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation’s cooperation.”³³⁴ Protecting culpable employees is frowned upon.

[A] corporation’s promise of support to culpable employees and agents, either through advancing of attorneys [sic] fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement, may be

a fair trial and to the effective assistance of counsel and ordering that the government shall abide by its representation to the court that the employer’s payment of employee defense costs will not be considered in determining whether the employer has complied with a deferred prosecution agreement between the employer and the government).

329. *Enforcement Policy Statement*, *supra* note 145, at P 8.

330. Thompson Memorandum, *supra* note 327, at Section IV.

331. *Id.* (emphasis added).

332. Thompson Memorandum, *supra* note 327, at Section VI.

333. *Id.*

334. Thompson Memorandum, *supra* note 327, at Section VI.

considered by the prosecutor in weighing the extent and value of a corporation's cooperation.³³⁵

Compliance programs are also important in the DOJ's decision on whether to prosecute. The existence of such a program, however, is not enough to protect an entity from prosecution. "Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program."³³⁶

The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs. Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonable designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law.³³⁷

Establishing or upgrading a compliance program after the wrongdoing has been discovered is also a factor in the potential defendant's favor in determining whether to charge the entity.³³⁸

The decision whether to bring criminal charges should also take into account whether non-criminal alternatives are adequate in terms of deterrence, punishment, and rehabilitation.³³⁹ This takes into account regulatory enforcement actions that might be taken, which is dependent upon "the strength of the regulatory authority's interest [and] the regulatory authority's ability and willingness to take effective enforcement action" as well as the "probable sanction if the regulatory authority's enforcement action is upheld"³⁴⁰

335. *Id.* (footnote omitted). Providing legal fees to employees when that is mandated by state law, however, "should not be considered a failure to cooperate." Thompson Memorandum, *supra* note 327, at n.4. *See also* United States v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (addressing propriety of prosecutorial pressure on a prospective corporate defendant not to advance fees for the legal defense of company personnel).

336. Thompson Memorandum, *supra* note 327, at Section VII.

337. *Id.* (footnote omitted).

338. Thompson Memorandum, *supra* note 327, at Section VIII.

339. *Id.* at Section X.

340. Thompson Memorandum, *supra* note 327, at Section X.

The DOJ has not published guidelines that reflect a general policy on when to bring a civil or criminal antitrust enforcement action.³⁴¹ The DOJ has, however, published policies regarding granting leniency to corporations and to individuals when considering bringing criminal antitrust charges.³⁴² In this context, “leniency” means not bringing criminal charges for the activity that is reported.³⁴³ Most notably, leniency will be granted to a corporation that reports illegal activity *before an investigation has begun* if the following six conditions have been met:

1. At the time the corporation comes forward to report the illegal activity, the [Antitrust] Division has not [sic] [received] information about the illegal activity being reported from any other source;
2. The corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity;
3. The corporation reports the wrongdoing with candor and completeness and provides full, continuing, and complete cooperation to the Division throughout the investigation;
4. The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials;
5. Where possible, the corporation makes restitution to injured parties; and
6. The corporation did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of, the activity.³⁴⁴

Leniency may also be granted even if an investigation has begun, using a seven part test, including the criterion that the corporation is the first one to come forward and qualify for leniency.³⁴⁵

341. For a general discussion of the factors considered by the Department of Justice in deciding whether to commence a preliminary antitrust inquiry, *see* 3 DEPARTMENT OF JUSTICE MANUAL 7-153 (ANTITRUST) (2d ed. 2006). The procedures for recommending commencement of a civil or criminal action are found *id.* at 7-236-242.

342. The Department of Justice Antitrust Division Corporate Leniency Policy (Aug. 10, 1993), *available at* <http://www.usdoj.gov/atr/public/guidelines/0091.pdf>; The Department of Justice Antitrust Division Leniency Policy for Individuals (Aug. 10, 1994), *available at* <http://www.usdoj.gov/atr/public/guidelines/0092.pdf>.

343. The Department of Justice Antitrust Division Leniency Policy for Individuals (Aug. 10, 1994), *available at* <http://www.usdoj.gov/atr/public/guidelines/0092.pdf>.

344. The Department of Justice Corporate Leniency Policy (Aug. 10, 1994), *available at* <http://www.usdoj.gov/atr/public/guidelines/0091.pdf> at 1-2. If a corporation qualifies for leniency under these criteria, “all directors, officers, and employees of the corporation who admit their involvement in the illegal antitrust activity as part of the corporate confession will receive leniency, in the form of not being charged criminally for the illegal activity, if they admit their wrongdoing with candor and completeness and continue to assist the Division throughout the investigation.” *Id.* at 4. There are three criteria for leniency for an individual under the separate leniency policy for individuals: “1. At the time the individual comes forward to report the illegal activity, the Division has not received information about the illegal activity being reported from any other source; 2. The individual reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division throughout the investigation; and 3. The individual did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of, the activity.” The Department of Justice Antitrust Division Leniency Policy for Individuals (Aug. 10, 1994), <http://www.usdoj.gov/atr/public/guidelines/0092.pdf> at 1-2.

345. The Department of Justice Corporate Leniency Policy (Aug. 10, 1994), <http://www.usdoj.gov/atr/public/guidelines/0091.pdf> at 2-3. There is no separate provision under the Leniency Policy for Individuals,

5. The Federal Sentencing Guidelines

The Federal Sentencing Guidelines are the benchmark for determining the appropriate punishment of a defendant who has been convicted of a crime after trial or upon a guilty plea.³⁴⁶ These provisions are also important, however, in providing guidance to an organization regarding the contours of an effective compliance program so as to minimize any sanctions if a violation occurs, as well as penalty-reducing steps that should be taken if the organization discovers that company personnel have violated the law, such as the FERC rules discussed in this Article. The guidelines devote an entire chapter to sentencing of organizations,³⁴⁷ and a part of that chapter to the significance of an effective compliance program.³⁴⁸ In formulating its policy on enforcement the FERC took these provisions into account.³⁴⁹ Several points are particularly noteworthy in evaluating a compliance program, self-reporting and entity cooperation, both vis-à-vis a criminal sentencing decision and a penalty assessment by the FERC.

If the offense occurred notwithstanding “an effective compliance and ethics program” at the time the offense, the culpability score under the guidelines is reduced.³⁵⁰ The guidelines set forth in some detail what constitutes “an effective compliance and ethics program.”³⁵¹ This credit is not available, however, if, “after becoming aware of an offense, the organization unreasonably delayed reporting the offense to appropriate governmental authorities.”³⁵² The culpability score is reduced if, prior to the imminent threat of disclosure or investigation and within a reasonably prompt time after becoming aware of the offense the entity reported the offense to appropriate governmental authorities, fully cooperated in the investigation, and clearly demonstrated recognition and

supra note 343, when the report is made *after* the investigation has begun. Moreover, the Leniency Policy for Individuals cannot be invoked if their corporation has attempted to qualify for leniency under the Corporate Leniency Policy. <http://www.usdoj.gov/atr/public/guidelines/0092.pdf> at 2. If the corporation does not qualify for leniency for having reported prior to commencement of an investigation or before the Antitrust Division has received information about illegal activity, however, the DOJ will consider granting immunity to an individual as if he had approached the DOJ individually. Corporate Leniency Policy, *available at* <http://www.usdoj.gov/atr/public/guidelines/0091.pdf> at 4; Leniency Policy for Individuals, *available at* <http://www.usdoj.gov/atr/public/guidelines/0092.htm> at 2.

346. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL (2005). The guidelines are not mandatory, but only advisory. *United States v. Booker*, 543 U.S. 220, 245-65 (2005) (Opinion of Breyer, J., writing for the Court on that issue).

347. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL ch. 8 (2005). A full discussion of the complex organizational sentencing guidelines is beyond the scope of this Article.

348. *Id.*

349. *Enforcement Policy Statement, supra* note 145, at P 8.

350. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8C2.5(f)(1) (2004). The “culpability score” is a factor that is applied to the base fine for the offense so that applying the culpability score to the base fine “will result in guideline fine ranges appropriate to deter organizational criminal conduct and to provide incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct.” *Id.* at § 8C2.4, cmt. (backg’d.).

351. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8B2.1 (2004).

352. *Id.* § 8C2.5(f)(2). The entity is allowed a reasonable period of time to conduct the internal investigation. Moreover, no reporting is required if the entity “reasonably concluded, based on the information then available, that no offense has been committed.” UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8C2.5(f)(2), cmt. (n.10) (2004).

acceptance of responsibility of the offense.³⁵³ Alternatively, in the absence of self-reporting, full cooperation and recognition and acceptance of responsibility will reduce the culpability score, but not as much as when the entity has self-reported.³⁵⁴

6. Summary – Basic Elements of an Effective Compliance Program

The array of policies and factors summarized above provides indispensable guidance for creating a compliance program to reduce to the extent possible the risk of violating one or more of the laws discussed in this Article and presents a set of guidelines on what to do if a violation is discovered—before the regulators begin an inquiry or even after that inquiry is received.

The most significant actions to take *before* a violation has occurred to develop an effective compliance program are:

- Establish a *documented* compliance program with active oversight that involves senior personnel in a meaningful supervisory role.
- Commit significant resources, including information technology, to the compliance program.
- Assure that there is always someone in a position of responsibility in the compliance program available to be consulted regarding the propriety of any proposed conduct or transaction. (Often this should *not* be an attorney, given the reluctance of some business people to consult counsel in these situations, although there should always be an attorney knowledgeable in these matters available for consultation, either inside or outside the entity.)
- Provide initial and refresher training to all relevant personnel that clearly explains the legal restrictions on their activities.
- Develop and foster a culture of compliance, not a culture of pushing the envelope.
- Encourage personnel to report any concerns about non-compliance, with an assurance that there will be no retaliation for reporting. Encourage personnel who are uncertain about the legality of conduct in which they are about to engage to confer with someone senior to them.
- Provide access to senior management, such as through an anonymous hotline, for communicating any concern.
- Audit the effectiveness of the compliance program by reviewing a sufficient sample of transactions and communications with counterparties.
- Comply with all applicable document retention requirements so that documents pertinent to trading activities that might be requested in any investigation are not destroyed, even inadvertently.

353. *Id.* at § 8C2.5(g)(1).

354. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8C2.5(g)(2) (2005). Effective November 1, 2006, unless Congress has acted, the U.S. Sentencing Commission has removed the commentary at *id.* § 8C2.5(g)(1)-(2) (n. 12) that provides that waiver of the attorney-client privilege and of the work product protections is not a prerequisite to a reduction in culpability “unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.” In other words, waiver of the privilege will no longer be a prerequisite to a reduced culpability score. 74 U.S.L.W. 2598 (Apr. 11, 2006).

• If any doubt about the legality of a proposed course of conduct or transaction remains, consider obtaining guidance from the FERC, as discussed in the next section of this Article.

B. The Opportunity to Obtain Agency Guidance on a Proposed Course of Conduct

If there is uncertainty about whether a particular course of conduct would violate a statute or rule administered by an agency it would, of course, be useful for the actor to get some appraisal of the conduct before acting. The SEC, for example, has long had a “no-action letter” process at the staff level.

Under this procedure, one in need of a concrete interpretation of the securities laws can submit, through an attorney, a statement of the relevant facts to the [SEC’s] staff, with the attorney’s opinion and reasons as to why a particular course of action does not constitute a violation of the securities laws. *Without committing the [SEC] to its viewpoint*, the staff, if it does not disagree with the opinion expressed by counsel, may advise the transmitting party that assuming the facts set forth are correct, “we will not recommend that the Commission take any action” if the proposed course of action is taken. If the staff disagrees or has substantial doubts concerning the view expressed by counsel, it will express its disagreement or otherwise decline to give a no-action recommendation.³⁵⁵

In express recognition of the success of the SEC’s process, the FERC recently instituted a no-action letter process of limited scope, so that parties can seek advice whether a proposed practice will run afoul of certain FERC rules.³⁵⁶ The FERC stated that the new procedure:

may be used to request and obtain staff “no-action” letters . . . with respect to whether the staff will recommend that the Commission take no enforcement action with respect to specific proposed transactions, practices or situations that may raise issues under the Commission’s regulations relating to the Standards of Conduct for Transmission Providers, Market Behavior Rules and, when a final rule is effective, the Commission’s proposed Prohibition of Energy Market Manipulation Rules.³⁵⁷

A no-action request to the FERC:

must describe in writing the proposed transaction, practice, situation or other matter in complete detail, including identifying to the extent possible each of the corporate

355. 3 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES AND FEDERAL CORPORATE LAW* § 1.122, at 1-156 (2d ed. 2005) (emphasis added). The CFTC also has a no-action letter process. 17 C.F.R. § 140.99 (2006). It is useful to consider the CFTC’s description of its process for an understanding of the scope and limits of the agency staff response: “No-action letter means a written statement issued by the staff of a Division of the Commission or of the Office of the General Counsel that it will not recommend enforcement action to the Commission for failure to comply with a specific provision of the Act or of a Commission rule, regulation or order if a proposed transaction is completed or a proposed activity is conducted by the Beneficiary. A no-action letter represents the position only of the Division that issued it, or the Office of the General Counsel if issued thereby. A no-action letter binds only the issuing Division or the Office of the General Counsel, as applicable, and not the Commission or other Commission staff. Only the Beneficiary may rely upon the no-action letter.” 17 C.F.R. § 140.99(a)(2) (2006).

356. Informal Staff Advice on Regulatory Requirements, 113 F.E.R.C. ¶ 61,174 (2005). The process for making a request is set forth in Informal Staff Advice on Regulatory Requirements, 71 Fed. Reg. 116 (Jan. 3, 2006).

357. Informal Staff Advice on Regulatory Requirements, *supra* note 356, 113 F.E.R.C. ¶ 61,174 at P 1 (footnotes omitted). At the outset, no-action requests will be limited to the specific topics referred to in the quoted passage. *Id.* at P 8. As with the SEC and CFTC, the views expressed in the response to the request are those of the staff of the agency and not the agency itself.

entities, counterparties or other persons that would be involved, the purpose of the matter, the requester's role in the proposed matter and the regulatory issues that the matter poses [T]he General Counsel or designee will not respond to no-action requests that raise purely hypothetical inquiries.³⁵⁸

It is questionable whether this process will be useful when the question is whether conduct is manipulative or deceptive in violation of the FERC's new rules,³⁵⁹ although it may be useful for consideration of the permissibility of a general trading program. In particular, the procedure has no utility in addressing whether a specific *immediate* transaction will violate the law, because there is no time to submit a request and obtain a response from the FERC General Counsel.³⁶⁰ It is also questionable whether parties will be able to frame meaningful requests in any gray area of coverage of the market manipulation rules, particularly because the requesting party must attest that to the best of its knowledge and belief "the request is accurate and complete and does not contain any untrue statement of a material fact [and] that there is no omission of a material fact in the request,"³⁶¹ and any defect in the request in reciting the complete facts would vitiate the utility of any favorable response.

VIII. CONCLUSION

Anyone who engages in transactions in the markets for energy is exposed to an increasing arsenal of federal enforcement weapons. In this context "anyone" includes not only regulated utilities but also unregulated market participants, all manner of intermediaries in the physical markets, and possibly even those who trade only on CFTC regulated commodities exchanges—to name just a few of those who must be concerned about the laws discussed here. A public company that violates the laws and regulations discussed in the Article is not only vulnerable to enforcement for violations but also must be mindful of related disclosure and enforcement issues arising under the Securities Exchange Act. The professionals—accountants and lawyers—who advise public companies must know the substantive law pertaining to transactions in the physical and financial markets for energy because of the special obligations imposed by law on those professionals.

The law in this area is in the early stages of development. The legal theories used by federal enforcement agencies in reaction to the debacle in the western markets are largely untested in the courts. Private litigation, especially under state antitrust laws, has not been resolved. Criminal prosecution is a new

358. *Id.* at P 10.

359. A Westlaw search of no-action letters issued by the SEC staff suggests that the no-action letter process is very seldom used, if at all, to seek guidance on whether a proposed transaction is deceptive or manipulative. This may be due in part to the fact that the requests—as is to be the case with the FERC no-action letter process—must relate to actual transactions and not hypothetical situations.

360. The FERC enforcement hotline may also be used to seek an "informal staff opinion[]" that is "not binding on the General Counsel or the Commission." 18 C.F.R. § 1b.21 (2006). *See also* Press Release, F.E.R.C., Commission Enforcement Hotline Has New Toll-Free Telephone Number (Nov. 18, 2002) ("Market participants, jurisdictional entities and members of the public also may ask the Hotline for help or information about any matters within the Commission's jurisdiction."). It also seems unlikely that advice through the hotline is a realistic vehicle for obtaining guidance in navigating the new anti-deception and anti-manipulation rules.

361. Informal Staff Advice on Regulatory Requirements, *supra* note 356, 113 F.E.R.C. ¶ 61,174 at P 11.

development in this realm. Because so many of the enforcement and private cases have been settled or arbitrated, there have been few reports of decided cases. Now come the new FERC rules. While patterned after a rule under the securities laws that has an enormous judicial gloss, it is uncertain how those precedents will be applied by FERC or by the courts. Beyond the substantive issues lie procedural and strategic considerations that any participant in the energy markets who becomes the subject of an enforcement inquiry must take into account.

This Article has presented the issues and suggested how some of them may be resolved. Definitive answers will come only after more experience in applying these laws and regulations to the evolving energy markets.