THE NEW FERC ENFORCEMENT: DUE PROCESS ISSUES IN THE POST-EPACT 2005 ENFORCEMENT CASES

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Synopsis: The Energy Policy Act of 2005 radically increased the potential penalties for alleged violations of the statutes administered by the Federal Energy Regulatory Commission and prompted a sea-change in the agency's enforcement techniques and procedures. This increased exposure to the regulated community was not, however, accompanied by a corresponding attention to due process concerns as FERC vigorously exercised its newly expanded authority. Indeed, many of these due process issues, including the most serious ones, were not readily identifiable until the Commission was compelled to litigate its allegations in trial-type hearings by enforcement targets who chose to fight, rather than submit to the agency's charges. This article summarizes the lessons learned from the first litigated FERC enforcement cases in the post-EPAct 2005 era—Energy Transfer Partners, Oasis Pipeline, Amaranth, and Hunter. It is intended to provide guidance to practitioners and regulated entities who may run afoul of the FERC enforcement process as well as to recommend appropriate policies the FERC should implement in future proceedings, some of which were formally adopted by the agency as this article went to press.

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I. INTRODUCTION

For thirty years, the Federal Energy Regulatory Commission (FERC or Commission) enforcement process has been part of ensuring that the Nation's energy markets continue to function properly. Stronger enforcement powers have been granted to the FERC as recent concerns of market manipulation, fraud and abuse, and speculation have increased. Whether the recent volatility in commodities prices are the result of nefarious activities or the normal workings of supply and demand, a well-functioning enforcement process with the ability to assess penalties has become part of the process that has emerged to ensure the continued vibrancy and effectiveness of the Nation's energy markets. However, just as the ability to impose substantial—and substantiated—penalties is important, it is equally important that the protections of due process continue to ensure that the Commission exercises its enforcement powers impartially and even-handedly.

The Commission has concluded, or shortly will conclude, the first two enforcement cases set for hearing under its enhanced penalty authority granted by the Energy Policy Act of 2005 (EPAct 2005). By examining those first enforcement cases, we will provide an overview of what is going right and wrong with the FERC's enforcement process and suggest issues that entities subject to the Commission's jurisdiction and practitioners should consider for the future. We begin with a brief history of the evolution of the Commission's enforcement process, including the changes wrought by EPAct 2005 and an introduction to the first enforcement cases set for hearing after EPAct 2005. We will then describe a series of due process protections that were implicated in those first cases, including the right to *de novo* judicial review under the Natural Gas Act (NGA), whether *Brady v. Maryland* should be applied to Commission enforcement actions, the role of the federal rules of evidence in the FERC enforcement proceedings, *ex parte* communications and the separation of functions among Commission staff, and the Commission's Rule 1b.19 Wells Process. We conclude by identifying issues for future consideration, including suggestions for the improvement of the Commission's enforcement process.

II. ENFORCEMENT OF MARKETS

A. A Brief History of FERC Enforcement

The FERC was created by § 401 of the Department of Energy Organization Act of 1977.[1] On September 30, 1977 the Federal Power Commission (FPC) ceased to exist, and the DOE Act transferred virtually all of the FPC's regulatory

1. Pub. L. No. 95-91, § 2-1002, 91 Stat. 565 (1977) (amended 1978) [hereinafter *DOE Act*].

powers and responsibilities under the Federal Power Act (FPA)[2] and the NGA[3] to the newly-formed FERC.[4] Shortly thereafter, in December 1977, the Commission announced the creation of the Office of Enforcement to assist in implementing the FERC's regulatory goals.[5] Just a few years later, Marilyn Doria, a former FERC Assistant General Counsel, and Gary Lord observed that "Enforcement at the Commission has come of age and has demonstrated its effectiveness," but cautioned that "the Commission must insist more than ever upon the integrity of its processes."[6] That sentiment was prescient.

The Commission's original enforcement focus was on making sure that utilities adhered to their tariffs and to Commission regulations. As the Nation's energy markets evolved, the focus shifted to market manipulation. At the turn of the century, attempts at deregulation caused significant problems for energy production and transmission in the western states, particularly in California. This would become known as the California Energy Crisis. The California Energy Crisis prompted a sea-change at the FERC, creating greater concern over the impact of market manipulation. This eventually led to significant reforms of the FERC's enforcement powers and greatly increased the size of the FERC's Investigatory and Enforcement Staff. In his December 2, 2009 testimony before the House Subcommittee on Energy and Commerce, Chairman Wellinghoff stated that:

> FERC's efforts on market oversight and enforcement have increased greatly in recent years. At the start of this decade, FERC investigatory staff consisted of 14 attorneys and a few support personnel within its Office of General Counsel. Today, staff in FERC's Office of Enforcement (including market oversight, investigations, audits and financial regulation) numbers over 180, including 40 attorneys in its Division of Investigations.[7]

In 2002, the Commission established the Office of Market Oversight and Investigations (OMOI) to ensure effective regulation of the nation's energy markets and to "help the Commission improve its understanding of energy market operations and ensure vigilant and fair oversight of those areas under Commission jurisdiction."[8] In its March 2005 report on Energy Market Oversight and Enforcement,[9] the Commission referred to OMOI as its "cop on the beat" and praised its ongoing efforts in the area of enforcement. However, in

2. Federal Power Act, 16 U.S.C. §§ 791a-825r (2006).

3. Natural Gas Act, 15 U.S.C. §§ 717-717w (2006).

4. *See generally* Clark Byse, *The Department of Energy Organization Act: Structure and Procedure*, 30 ADMIN. L. REV. 193 (1977).

5. Phillip Marston, *A Review and Assessment of the FERC Natural Gas Enforcement Program*, 16 HOUS. L. REV. 1105, 1115 (1979).

6. Marilyn Doria & Gary Lloyd, *Enforcement at the Federal Energy Regulatory Commission: Considerations for the Practitioner*, 4 ENERGY L.J. 39, 59 (1983).

7. *Impacts of H.R. 3795, the Over-the-Counter Derivatives Markets Act of 2009, on Energy Markets: Hearing Before the Subcomm. on Energy and the Environment of the H. Comm. on Energy and Commerce*, 111th Cong. ___ (2009) (testimony of Chairman Jon Wellinghoff, Federal Energy Regulatory Commission) (Dec. 2, 2009), *available at* http://www.ferc.gov/EventCalendar/Files/20091202135547-wellinghoff-09-12-02-testimony.pdf.

8. Press Release, FERC (Apr. 10, 2002), *available at* http://www.ferc.gov/news/news-releases/2002/2002-2/newofficedir.pdf.

9. FERC, ENERGY MARKET OVERSIGHT AND ENFORCEMENT: ACCOMPLISHMENTS AND PROPOSAL FOR ENHANCED PENALTY AUTHORITY (Mar. 2005) [hereinafter *2005 Report*].

the 2005 Report, the Commission also claimed that it had "few remedies to address misconduct by market participants."[10] The Commission argued that without enhanced penalty authority "violative conduct [by market participants] might go unpunished."[11] To that end, the 2005 Report recommended that Congress increase the Commission's penalty authority.[12] The 2005 Report did not suggest or recommend any additions or improvements to the protections offered to entities subject to the Commission's jurisdiction.

On August 8, 2005, then-President Bush signed into law EPAct 2005[13] which, among other things, granted the Commission enhanced enforcement and civil penalty authority for violations of the FPA[14] and the Natural Gas Policy Act (NGPA),[15] and created for the first time, civil penalty authority under the NGA.[16] EPAct 2005 increased the maximum amount of civil penalties the Commission could assess for violations of these three statutes, or any rule, regulation or order issued under them, to $1,000,000 per violation for each day that the violation continues.[17] In addition, EPAct 2005 also amended the FPA and NGA to make it unlawful for any entity to directly or indirectly use or employ, "in connection with" the purchase or sale of electric energy, electric transmission services subject to FERC jurisdiction, natural gas or natural gas transportation services subject to FERC jurisdiction any "manipulative or deceptive device or contrivance," as those terms were used in Section 10(b) of the Securities Exchange Act of 1934.[18] These changes drastically widened the Commission's oversight of the energy markets and increased its enforcement authority.

The FERC's October 20, 2005 Policy Statement on Enforcement[19] sought to provide guidance regarding changes to the FERC's enforcement process as a result of EPAct 2005. The Policy Statement explained the aggravating factors that the Commission would take into account in assessing penalties for

10. *Id.* at 1. Former Chairman Kelliher contemporaneously argued that FERC's enforcement powers at the time were "insufficient" to properly chastise wrongdoers. Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 22 (Apr. 2005).

11. *2005 Report*, *supra* note 9, at 2.

12. *2005 Report*, *supra* note 9.

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

14. EPAct of 2005 § 1284(e)(2) (amending FPA § 316, 16 U.S.C. § 825o-1 (2006)). The statute did not, however, change the Commission's civil penalty authority in the regulation of hydroelectric facilities under Part I of the FPA. *See* FPA § 316, 16 U.S.C. § 823b(c)-(d) (2006) (permitting civil penalties of $10,000 per day per violation. Fines and terms of imprisonment for criminal violations of both FPA Part I and Part II were also increased). *See also* 16 U.S.C. § 825o (2006) (defining criminal penalties).

15. EPAct of 2005 § 314 (b)(2) (amending NGPA § 504(b)(6)(A), 15 U.S.C. § 3414(b)(6)(A) (2006)). The NGPA, enacted in 1978 after FERC was created, is codified as amended at 15 U.S.C. §§ 3301 to 3432 (2006).

16. EPAct of 2005 § 314(b)(1) (inserting new NGA § 22, 15 U.S.C. §§717t-1 (2006), and transferring the previous NGA § 22, 15 U.S.C. 717u (2006), to NGA § 24).

17. *See generally* notes 14-16. This increase in civil penalty authority gave FERC similar authority to that of its sister agencies, including the Securities and Exchange Commission (SEC), the Commodities Futures Trading Commission (CFTC), and the Federal Trade Commission (FTC).

18. EPAct of 2005 § 315 (creating NGA § 4A, 15 U.S.C. § 717c-1 (2006); EPAct of 2005 § 1283, creating FPA§ 222, 16 U.S.C. § 824v (2006)). Section 10(b) of the Securities Exchange Act is codified at 15 U.S.C. § 78j(b) (2006).

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

violations, as well as the mitigating factors which would reduce those penalties. In particular, the Commission emphasized that it sought to "provide firm but fair enforcement of [its] rules and regulations and to place entities subject to [its] jurisdiction on notice of the consequences of violating the statutes, orders, rules and regulations [that it] enforce[s]."[20] In addition, because "EPAct 2005 is silent with respect to procedures [to assess civil penalties] under the NGA," the Commission explained in the Policy Statement its intent to "provide companies with hearing procedures before an administrative law judge" when it issues civil penalty notices.[21]

On January 19, 2006, the Commission issued its final rule on the Prohibition of Energy Market Manipulation. This prohibition "permit[s] the Commission to police all forms of fraud and manipulation that affect natural gas and electric energy transactions and activities the Commission is charged with protecting."[22] Departing from its original position in the notice of proposed rulemaking,[23] the FERC determined that "a wholesale overlay of the securities laws onto the energy market is overly simplistic."[24] At the same time, however, the agency opined that "it would be illogical to simply ignore decades of useful guidance that securities law precedent can offer, especially considering that Congress deliberately modeled [portions of the EPAct 2005] on section 10(b) of the Exchange Act."[25] Therefore, much of the case law amassed over the past few decades by the SEC can be looked to for guidance, if not binding authority.

Most recently, on May 15, 2008, as part of a series of reforms (May 2008 Reforms) of its enforcement processes, the Commission issued a Revised Policy Statement on Enforcement.[26] The Revised Statement was a response to "the many expressions of concern" that the Commission received in response to its application of its enhanced penalty authority.[27] In addition to setting forth the factors the Commission takes into account when assessing a penalty in greater detail than that provided in the October 20, 2005 Policy Statement, the Revised Statement also was an attempt to "give the industry a fuller picture as to how [the Commission's] investigative process works."[28] Most encouragingly, the Commission stated that:

> [a]t the outset, however, we emphasize that we are committed to ensuring the fairness of our investigatory process[es] from the commencement of an investigation until the time it is completed. We will continue to hold Enforcement

20. *Id*. at P 1.

21. *Id.* at P 16.

22. *Prohibition of Energy Mkt. Manipulation*, Order No. 670, 114 F.E.R.C. ¶ 61,047 at P 25 (2006) [hereinafter *Order No. 670*]. *Order No. 670* added a new part 1c to the Commission's regulations. *See* 18 C.F.R. § 1c.1-2 (2006) (defining and prohibiting market manipulation in the energy and natural gas markets).

23. *Prohibition of Energy Mkt. Manipulation*, 113 F.E.R.C. ¶ 61,067 at P 14 (2005).

24. *Order No. 670*, *supra* note 22, at P 31.

25. *Id.* at P 31.

26. *Enforcement of Statutes, Regulations and Orders*, 123 F.E.R.C. ¶ 61,156 (2008) [hereinafter *Revised Statement*] (detailing the factors considered by the Commission in assessing a civil penalty); *see also Compliance with Statutes, Regulations, and Orders*, 125 F.E.R.C. ¶ 61,058 at P 2 (2008) (providing additional commentary on four specific factors: "(1) the role of senior management in fostering compliance; (2) effective preventive measures to ensure compliance; (3) prompt detection, cessation, and reporting of violations; and (4) remediation efforts").

27. *Revised Statement*, *supra* note 26, at P 4.

28. *Id.* at P 5.

> staff to the highest ethical standards throughout the process and we are clarifying certain of our procedures *to ensure that the subjects of an investigation receive due process both in perception and reality*.[29]

It is against this backdrop that we can explore whether the Commission's commitment to due process has been met in its first post-EPAct 2005 enforcement cases.

B. Enforcement Can Cause More Harm Than Good

Legitimate regulatory oversight is critical to ensure that markets are free from fraud and manipulation. Indeed, attempts at deregulation have sometimes caused more serious and deeper problems than were caused by poorly run regulatory schemes—an error that some commentators maintain was the cause of the California Electricity Crisis at the turn of the century.[30] However, the need for regulation and enforcement of those regulations must be tempered with caution. An ill-advised enforcement action can cause more damage than was caused by the alleged acts. Even where a corporation has engaged in potential wrongdoing, such damaging enforcement actions are akin to throwing the baby out with the bath water. The *Arthur Andersen* case is a classic example of the damage an indictment or enforcement action can have on a company—practically overnight the Big 5 accounting firm virtually evaporated as a result of an indictment of the company that only alleged misconduct by several employees. Like Humpty Dumpty, the Supreme Court's later reversal of the firm's conviction could not repair the damage done by the indictment.[31]

Ill-advised or misguided enforcement actions can also cause damage to the markets themselves by chilling legitimate conduct. Entities that might otherwise act in a rational manner may change their behavior as a result of enforcement actions which may later prove to have been mistakes. It is critical that market participants operate free from fear that previously tolerated or approved conduct may suddenly, without proper notice, become the subject of a resource-consuming enforcement action.[32] Likewise, the public may also be damaged by the high cost of enforcement actions. In its first enforcement cases, the Commission deployed dozens of attorneys and outside consultants at a not-insubstantial cost. Indeed, it is very likely that the cost of prosecuting those cases far outweighed any financial penalties that the Commission was able to assess.

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29. *Id.* at P 21 (emphasis added) (citations omitted).

30. *See generally* JAMES L. SWEENEY, THE CALIFORNIA ELECTRICITY CRISIS 17-25 (Hoover Inst. Press 2002).

31. Arthur Andersen, L.L.P. v. U.S., 544 U.S. 696 (2005) [hereinafter *Arthur Andersen*].

32. Commissioners Moeller and Spitzer have been particularly vigilant on this score, stressing that "[t]hose who are subject to Commission penalties need to know, in advance, what they need to do to avoid a penalty." *Florida Blackout*, 129 F.E.R.C. ¶ 61,016 (2009) (Moeller, Comm'r, concurring) (quoting his emphasis on this position in earlier policy statements and enforcement orders); *id.* (Spitzer, Comm'r, concurring) ("[B]y failing to identify with any specificity the Reliability Standards that FPL is alleged to have violated . . . the Commission fails to provide clarity or transparency to the industry as to what is expected under the relevant Reliability Standards."). For example, both Commissioners dissented from the Commission's enforcement actions in *Seminole Energy Services, L.L.C.*, 126 F.E.R.C. ¶ 61,041 (2009) and *National Fuel Marketing Co., L.L.C.*, 126 F.E.R.C. ¶ 61,042 (2009).

C. Post EPAct 2005 Enforcement Cases

The first anti-manipulation enforcement actions scheduled for hearing under the FERC's enhanced penalty provisions have either concluded or will be concluded shortly. *Amaranth*,[33] and *Energy Transfer Partners (ETP)*[34] (collectively, Cases) reveal the workings of the new FERC Enforcement regime, and provide insights into what is going right, and what is going wrong.[35]

Amaranth was initiated by an Order to Show Cause and Notice of Proposed Penalties on July 26, 2007.[36] The Commission sought approximately $300 million in civil penalties and disgorgement for alleged manipulation of the NYMEX natural gas markets.[37] The matter was set for hearing, but, on August 12, 2009 the Commission approved a Stipulation and Consent Agreement settling the *Amaranth Advisors, L.L.C.* proceeding with all parties but Brian Hunter, formerly Amaranth's head natural gas trader.[38] In the settlement, Amaranth agreed, among other things, to pay $7.5 million in civil penalties.[39] A previous attempted settlement by all of the *Amaranth* defendants, including Mr. Hunter, was rejected by the Commission on February 12, 2009.[40] The terms of the rejected settlement are not public. Following the submission of the *Amaranth* stipulation and consent agreement, the Commission severed the cases of the settling parties from that of Mr. Hunter.[41] Mr. Hunter's hearing before an Administrative Law Judge began on August 18, 2009 and finished September 2, 2009. An Initial Decision was issued on January 22, 2010 finding that Hunter engaged in manipulation.[42] Appeals are expected.

Similarly, *ETP* began as a single proceeding following an Order to Show Cause and Notice of Proposed Penalties (*ETP* SCO) on July 26, 2007.[43] The Commission alleged that Energy Transfer Partners (ETP) and its affiliates had engaged in actions which manipulated the natural gas markets at the Houston Ship Channel (HSC) and that ETP's affiliate, Oasis Pipeline (Oasis), had discriminated against some customers in its transportation business between the Waha, Texas and HSC trading hubs.[44] The Commission sought nearly $100

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33. *Amaranth Advisors, L.L.C.*, Docket No. IN07-26 [hereinafter *Amaranth*].

34. *Energy Transfer Partners, L.P.*, Docket No. IN06-3-003 [hereinafter *ETP*].

35. Each of the Cases have extensive procedural histories which can be reviewed in the public pleadings available in each docket.

36. *Amaranth Advisors L.L.C.*, 120 F.E.R.C. ¶ 61,085 (2007) [hereinafter *Amaranth SCO*]. In addition to the FERC enforcement, and like *ETP*, the CFTC also initiated a tandem investigation and enforcement process.

37. *See Amaranth SCO*, *supra* note 36, at P 1. The *Amaranth* SCO did not seek disgorgement of alleged ill-gotten gains because, by this time, Amaranth was bankrupt as a result of nearly $6 billion in losses.

38. *Amaranth Advisors, L.L.C.*, 128 F.E.R.C. ¶ 61,154 (2009). The *Amaranth* defendants, again without Mr. Hunter, also entered into a settlement agreement with the CFTC. *See, e.g.*, *CFTC v. Amaranth Advisors, L.L.P.*, 07 Civ. 6682 ECF at 3-6 (S.D.N.Y. Aug. 12, 2009).

39. *Amaranth Advisors, L.L.C.*, 128 F.E.R.C. ¶ 61,154 (2009).

40. *Amaranth Advisors, L.L.C.*, 126 F.E.R.C. ¶ 61,112 (2009).

41. *Amaranth Advisors, L.L.C.*, 128 F.E.R.C. ¶ 61,081 (2009); *see also Hunter v. FERC*, 130 F.E.R.C. ¶ 63,004 (2010) [hereinafter *Hunter*].

42. *Id*.

43. *Energy Transfer Partners, L.P.*, 120 F.E.R.C. ¶ 61,086 (2007).

44. *Id.* In addition to the FERC enforcement process, the CFTC also initiated an investigation alleging attempted manipulation of natural gas prices at HSC. The CFTC investigation was settled early in the process

million in civil penalties and another $85 million in disgorgement. This would later be raised to a combined total of more than $225 million following an expansion of the allegations by Enforcement Staff and its expert witnesses.[45] Furthermore, a number of claimants, seeking to capitalize on the Commission's enforcement process filed civil actions against ETP alleging damages for the same conduct alleged in the *ETP* SCO. On May 15, 2008 the Commission set the matters alleged in the *ETP* SCO for hearing. [46] Shortly thereafter, the Chief Judge determined to divide the NGA and NGPA allegations into two separate proceedings.[47]

Over the following year, Oasis and ETP both engaged in extensive discovery and motions practice leading up to their respective trials—*Oasis* was scheduled to go first in the winter of 2008, followed by *ETP* in the spring of 2009. However, neither case made it to trial. On October 29, 2008, Oasis filed a motion for partial summary disposition challenging the lion's share of the Commission's claims which the presiding ALJ granted in a November 18, 2008 order.[48] Subsequently, on the eve of that trial, the Oasis and Enforcement Staff filed a joint Stipulation and Consent Agreement which the Commission approved by letter order on February 27, 2009.[49] The *Oasis* settlement required only that Oasis agree to certain monitoring requirements consistent with those in Docket No. RM09-2 and in accordance with any rehearing or judicial challenge of Order 720.[50] Likewise, and also on the eve of trial, a Stipulation and Consent Agreement resolving all matters related to the *ETP* case was approved by the Commission on September 21, 2009.[51] In the *ETP* settlement, ETP agreed to pay a mere $5 million in civil penalties and to create a $25 million fund to be used for settlement of pending civil claims against ETP and any other claims which may arise during the settlement period.[52]

III. DUE PROCESS CONCERNS IN FERC ENFORCEMENT CASES

The "right to be heard before being condemned to suffer grievous loss of any kind, even though it may not involve the stigma and hardships of a criminal conviction, is a principle basic to our society."[53] As the D.C. Circuit has explained, "an administrative hearing must be attended, not only with every element of fairness *but with the very appearance of complete fairness* . . . ."[54] Indeed, in the Revised Statement, the Commission emphasized that, in

before it could be set for hearing. *See generally* CFTC v. Energy Transfer Partners, L.P., 3:07-cv-01301 (N.D. TX) (Mar. 17, 2008).

45. *See* Section II D.

46. *Energy Transfer Partners, L.P.*, 123 F.E.R.C. ¶ 61,168 (2008).

47 *Energy Transfer Partners, L.P.*, Docket No. IN06-3-003, Order of Chief Judge Establishing Separate Hearings (May 19, 2008) (creating a new docket to examine the NGPA allegations in Oasis Pipeline, L.P., Docket No. IN06-3-004).

48. *Oasis Pipeline L.P.*, 125 F.E.R.C. ¶ 63,019 (2009).

49. *Oasis Pipeline L.P.*, 126 F.E.R.C. ¶ 61,188 (2009).

50. *Id.* at P 15.

51. *Energy Transfer Partners, L.P.*, 128 F.E.R.C. ¶ 61,269 (2009).

52. *Id.* at PP 10-12.

53. Mathews v. Eldridge, 424 U.S. 319, 333 (1976) (citations and internal quotations omitted).

54. Cinderella Career & Finishing Sch., Inc. v. FTC, 425 F.2d 583, 591 (D.C. Cir. 1970) (citation and internal quotations omitted).

enforcement proceedings, Enforcement Staff must be held "to the highest ethical standards throughout the process" and that "subjects of an investigation" must "receive due process both in perception and reality."[55]

The Cases exposed several due process problems in the FERC's enforcement process. While the FERC has recognized some of the issues and taken steps to resolve them, some of these due process concerns remain today and must be dealt with if targets of the FERC enforcement process (and investigations) are to "receive due process both in perception and in reality." Five of the most prominent due process concerns raised by the Cases are: a) the right to *de novo* review under the NGA; b) the application of *Brady v. Maryland*; c) the use of the Federal Rules of Evidence in regards to expert witnesses; d) *ex parte* communications and the separation of functions between decisional and non-decisional Staff; and e) the need for a robust Wells Process.

A. The Right to De Novo Review Under the NGA

In the post-EPAct 2005 era, the FERC has the authority to impose civil penalties under the NGA, FPA, and NGPA of up to $1 million per violation for every day that the violation continues.[56] Federal law expressly provides for *de novo* review in a federal district court of any civil penalty assessed under the FPA[57] or the NGPA,[58] but the correct procedure to be followed for civil penalties sought under the NGA requires an exercise in statutory interpretation.

Following the EPAct 2005 amendments, the FERC issued a statement of administrative policy in its *Process for Assessing Civil Penalties*.[59] With regard to the NGA, the FERC decided that it was required to provide only "notice and opportunity for public hearing."[60] The FERC declared that "unlike the FPA and NGPA, Congress did not establish a *de novo* court review under the NGA,"[61] and that it was free to assess civil penalties through "a paper hearing or a hearing before an ALJ."[62] The FERC concluded that its orders were subject to judicial

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55. *Revised Statement*, *supra* note 26, at P 21.

56. *See generally* notes 14-16.

57. FPA § 316A(b), 16 U.S.C. § 825o-1(b) (2006), requires the FERC to employ the civil penalty procedures set out in FPA § 31(d), 16 U.S.C. § 823b(d) (2006). FPA section 31(d) permits the target of a civil penalty assessment to choose between a hearing before an ALJ or a *de novo* hearing in federal district court, both of which are reviewable in the United States Court of Appeals. *Id.*

58. Unlike the FPA, the NGPA does not allow a choice: the NGPA requires *de novo* review in federal district court. NGPA § 504(b)(6)(E) requires the FERC to provide an alleged violator with "notice of the proposed penalty." 15 U.S.C. § 3414(b)(6)(E) (2006). "Following receipt of notice of the proposed penalty by [the FERC's target], the Commission shall, by order, assess such penalty." *Id.* If the penalty the FERC assesses is not paid within 60 days, the "Commission *shall* institute an action in the appropriate district court of the United States for an order affirming the assessment of the civil penalty." *Id.* § 3414(b)(6)(F) (emphasis added). The district court reviews both the facts and the law *de novo*, and may enforce, modify, or set aside FERC's assessment. *Id.* In a later section, the NGPA further reinforces the jurisdiction of federal district courts to try civil penalty cases by expressly accepting civil penalty proceedings from the otherwise applicable litigation cycle of an agency hearing and then an agency rehearing followed by judicial review in the United States Court of Appeals. *See* NGPA § 506, 15 U.S.C. § 3416(a) (2006).

59. 117 F.E.R.C. ¶ 61,317 (2006).

60. *Id.* at P 6.

61. *Id.* at P 8.

62. *Id.* at P 7(2). Compared to a paper hearing—where each side would have the opportunity to state their cases—a hearing before an ALJ is more resource and time intensive. In essence, the Commission's

review in a federal court of appeals under NGA § 19(a) and not *de novo* review by a federal district court.[63]

In *ETP*, once the FERC stated its intent to hold an administrative hearing with respect to the violations alleged under the NGA, ETP requested rehearing of that decision arguing that the NGA, like the FPA and NGPA, required that ETP's civil penalty liability be adjudicated in federal district court even though the statute did not expressly provide for such review.[64] The Commission rejected ETP's interpretation of the NGA, stating that "the interplay between NGA sections 19, 22 and 24 clearly delineates Congress' intention that the Commission's assessment of NGA section 22 civil penalties should be reviewed by a court of appeals rather than a federal district court."[65] The FERC also reasoned that NGA § 19(b) exclusively governs review of NGA civil penalty assessments.[66] The FERC later reiterated its conclusion in its 2007 Rehearing Order that NGA § 24 does not confer federal district courts with exclusive jurisdiction to adjudicate NGA civil penalty assessments.[67]

The FERC contended that NGA § 24 merely governs "collection" actions, claiming that only the agency itself has authority to determine "violations."[68] In its 2008 Rehearing Order, the FERC recast its interpretation, stating that NGA § 24 "*provides a vehicle* for the Commission or other parties to bring an action in district court to enjoin violations of the Act, or to enforce liabilities for duties created under the Act (such as civil penalty liability created by a Commission order finding a violation)."[69]

The FERC's conclusion—that the NGA uniquely departs from the other statutes the FERC administers by depriving federal district courts of de novo jurisdiction to adjudicate civil penalty liability—is an unreasonable reading of the statute that does not survive scrutiny. The express jurisdictional grant in NGA § 24, and the operative language used in NGA § 22, viewed in light of its established meaning under pre-existing parallel provisions of the NGPA and FPA, and the structure of the statute as a whole (including its interplay with other statutes), must be read to require de novo district court adjudication of civil penalties. Unfortunately, there are at least four issues raised by the FERC's interpretation of the NGA.

First, NGA § 24 expressly bestows federal district courts with "exclusive jurisdiction" over "violations of" and "any liability . . . created by" that statute.[70]

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finding now requires participants to engage in a complete trial-type proceeding and then, if the Commission is wrong about *de novo* review, to do so again when, and if, the case moves to a federal district court.

63. *Id.* at P 7(5)-(6). However, it is important to note that FERC's determinations were never reviewed because policy statements are *per se* non-reviewable.

64. *See* NGA § 24, 15 U.S.C. § 717u (2006); NGPA § 504(b)(6)(E)-(F), 15 U.S.C. § 3414(b)(6)(E)-(F) (2006).

65. *Energy Transfer Partners, L.P.*, 121 F.E.R.C. ¶ 61,282 at P 66 (2007) [hereinafter *2007 Rehearing Order*].

66. *Id.* at PP 58-66

67. *Energy Transfer Partners, L.P.*, 124 F.E.R.C. ¶ 61,149 at PP 15-16 (2008) [hereinafter *2008 Rehearing Order*].

68. *2007 Rehearing Order*, *supra* note 64, at P 58 [R. 243-44].

69. *2008 Rehearing Order*, *supra* note 66, at PP 15-16.

70. 15 U.S.C. § 717u (2006).

This is exactly the same language used in FPA § 317.[71] The FERC reads the grant of jurisdiction in NGA § 24 to encompass only the collection phase of a civil penalty proceeding, and thus renders as mere "surplussage" the grant of jurisdiction over "violations." Moreover, the FERC's reading of the statute runs counter to the express wording of the statute and its natural reading. The FERC attempts to avoid the plain meaning of NGA § 24 by asserting instead that NGA § 22 is ambiguous, since, unlike the civil penalty provisions in the FPA and NGPA, NGA § 22 does not buttress NGA § 24 with an express commitment of civil penalty authority to federal district courts. That shell game is not consistent with statutory analysis under *Chevron*: the FERC should not resort to such a comparison unless the NGA is ambiguous on its face, and it is not.[72]

Second, the civil penalty provision in NGA § 22 is almost identical to parallel language in the FPA and tracks relevant language in the NGPA. In NGA § 22 Congress stated that: "[t]he penalty shall be assessed by the Commission after notice and opportunity for public hearing." Both the NGPA and the FPA civil penalty provisions pre-date NGA § 22.[73] As a result, when Congress enacted NGA § 22, it already had created terms of art regarding what it means for the FERC to "assess" a civil penalty and to provide a "notice and opportunity for a public hearing." Congress used this identical language in FPA § 31(c), and again in FPA § 316A (with a cross-reference back to the assessment process in FPA § 31(d)).[74] Likewise, in NGPA § 504(E), entitled "Assessed by Commission," Congress gave the FERC authority to "assess" a civil penalty as a precursor to federal district court *de novo* adjudication.[75] When Congress used those same terms again in the NGA, the only reasonable conclusion under traditional canons of statutory interpretation is that Congress intended to impart the same meaning as in the other statutes.[76]

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71. 16 U.S.C. § 825p (2006).

72. Judicial review of an agency's interpretation of a statute it administers is typically governed by the familiar two-step analysis established in Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984). Under step one, if "Congress has directly spoken to the precise question at issue," then courts "must give effect to the unambiguously expressed intent of Congress" and may not defer to a contrary agency interpretation. *Id.* at 842-43. Under step two, if the statute is "silent or ambiguous with respect to the specific issue," courts determine "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843. Courts have long held that no *Chevron* deference is afforded to an agency's views where the matter at issue is "the scope of the judicial power vested by the statute." Adams Fruit Co. v. Barrett, 494 U.S. 638, 650 (1990); United States v. Mead Corp., 533 U.S. 218, 232 n.14 (2001) (citing *Adams Fruit*, 494 U.S. 649-50 for the proposition that "the Secretary's interpretation of [statutory] enforcement provisions is not entitled to *Chevron* deference"); *see generally*, Fox Television Stations, Inc. v. FCC, 280 F.3d 1027, 1038-39 (D.C. Cir. 2002) ("Nor is an agency's interpretation of a statutory provision defining the jurisdiction of the court entitled to our deference under *Chevron*"), *modified on other grounds*, 293 F.3d 537 (2002).

73. 15 U.S.C. § 717t-1(b) (2006).

74. *Compare* 15 U.S.C. § 717t-1(b) (2006) *with* 16 U.S.C. § 823b(c) (2006) *and* 16 U.S.C. § 825o-1(b) (2006).

75. 15 U.S.C. § 3414(b)(6)(E) (2006).

76. "A new statute of a fragmentary nature"—for example, NGA § 22—"must be construed as intended to fit harmoniously into the existing system, unless a contrary legislative purpose is plainly indicated." U.S. v. Fixico, 115 F.2d 389, 393 (10th Cir. 1940). Moreover, it "well settled that the comparable provisions of the [NGA] and the [FPA]"—as, we submit, the civil penalty provisions at issue here—"are to be construed *in pari materia*." Ky. Utils. Co. v. FERC, 760 F.2d 1321, 1325 n.6 (D.C. Cir. 1985) (citing Union Elec. Co. v. FERC, 668 F.2d 389, 392 n.1 (8th Cir. 1981); Mun. Light Bds. v. FPC, 450 F.2d 1341, 1347 (D.C. Cir. 1971)); *accord, e.g.*, Ark. La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981) (quoting FPC v. Sierra Pac. Power Co., 350 U.S. 348, 353 (1956) and citing Permian Basin Area Rate Cases, 390 U.S. 747, 820-21 (1968)).

Third, FERC's assertion that NGA § 19(b) is the only judicial review provision governing civil penalties under NGA simply makes no sense. The FPA contains a judicial review provision, FPA § 313(b),[77] that is identical to NGA § 19(b). It therefore follows that the specific language in NGA § 19(b) cannot, as the FERC contends, prohibit de novo district court adjudication of civil penalty liability. If it did, then the same language in FPA § 313(b) would have the same effect under that statute, which everyone agrees is not the case. Moreover, NGA § 19(b), like FPA § 313(b), provides for judicial review of the FERC orders under a substantial evidence standard.[78] Taken literally, the FERC's position would allow the agency to impose hundreds of millions of dollars in civil penalties simply by founding its case on "more than a mere scintilla" of evidence,[79] even if the respondent, by any measure, had proved a stronger case. This stands in sharp contrast to *de novo* review.[80] It also stands in sharp contrast to this nation's long-established approach to the imposition of civil penalties. "From the earliest history of the government, the jurisdiction over actions to recover penalties and forfeitures has been placed in the district court."[81] Where "a statute imposes a penalty and forfeiture, jurisdiction of an action therefor[e] . . . vest[s] in the District Court, unless it is *in express terms* placed exclusively elsewhere."[82] As the FERC's entire argument rests on an asserted ambiguity, the agency can hardly claim to have been provided the express authority to conduct civil penalty proceedings that the Supreme Court expects.

Fourth, the FERC has never explained why, uniquely among the statutes administered by the Commission, Congress would have chosen to commit NGA civil penalty hearings to the FERC, rather than to a federal district court. The FERC's interpretation also creates perverse outcomes. Because the NGA and NGPA both involve natural gas regulation, a single civil penalty case can implicate both statutes. That is exactly what happened in *ETP* and *Oasis*. According to the FERC, however, NGA civil penalties must remain at the agency for adjudication, subject to appellate review under a substantial evidence standard, while the NGPA civil penalty issues ultimately will be adjudicated *de novo* in federal district court. This chaotic outcome—where a single show cause order fractures in two at the judicial review stage, going before two different levels of the federal court system under two significantly different standards of review—creates great confusion and must be remedied. Indeed, the Fifth Circuit

77. 16 U.S.C. § 825*l*(b) (2006).

78. 15 U.S.C. § 717r(b) (2006).

79. Consolidated Edison Co. v. NLRB, 305 U.S. 197, 229 (1938); *see also* Columbia Gas Transmission Corp. v. FERC, 448 F.3d 382, 385 (D.C. Cir. 2006) (explaining that the substantial evidence standard means "more than a scintilla, but . . . less than a preponderance of the evidence") (quoting FPL Energy Maine Hydro, L.L.C. v. FERC, 287 F.3d 1151, 1160 (D.C. Cir. 2002)).

80. "[W]hen FERC brings an action in district court to enforce a civil penalty assessment [under the FPA], the court must make a *de novo* review of the assessment [and] will give no deference to FERC's decision. Instead, [it] will make 'a fresh, independent determination of 'the matter' at stake.'" FERC v. MacDonald, 862 F. Supp. 667, 672 (D.N.H. 1994) (*aff'g* civil penalty under FPA Part I) (*quoting* Doe v. United States, 821 F.2d 694, 697-98 (D.C. Cir. 1987)).

81. Lees v. U.S., 150 U.S. 476, 478 (1893).

82. *Id.* at 479 (emphasis added); *see also*, Athlone Indus., Inc. v. Consumer Prod. Safety Comm'n, 707 F.2d 1485, 1492 (D.C. Cir. 1983) ("Congress' decision to limit the Commission to a prosecutorial role in civil penalty actions is not unique.").

recently pointed out that "the NGA's statutory scheme [with respect to appellate review] is far from clear. Congressional action to chart with clarity the desired course of proceedings in this regard would not be unwelcome."[83]

B. The Application of Brady v. Maryland *in FERC Enforcement Proceedings*

One of the bedrock principles of due process is that an accused must be provided not only with a statement of the charges against him, but also with the evidence in the government's possession that implicates him. In *Brady v. Maryland*,[84] the U.S. Supreme Court created the corollary to that principle and held that government prosecutors also have a constitutional obligation to disclose all evidence that is "favorable to an accused" or that "would tend to exculpate him or reduce the penalty."[85] This obligation was based on the due process clause of the U.S. Constitution.[86] As Justice Douglas stated for the Court:

> Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly. An inscription on the walls of the Department of Justice states the proposition candidly for the federal domain: 'The United States wins its point whenever justice is done its citizens in the courts.'[87]

Although *Brady* was a criminal case, the disclosure obligations in *Brady* have been determined to apply in administrative enforcement proceedings[88] before the CFTC[89] and the SEC. SEC regulations prohibit the Division of Enforcement from "withhold[ing], contrary to the doctrine of *Brady v. Maryland*, documents that contain material exculpatory evidence."[90] The due process clause and the right to a fair hearing apply equally to administrative enforcement proceedings as they do in criminal proceedings. The CFTC held in *First Guaranty*:

> [t]he *Brady* rule is not a discovery rule rather it is a rule of fairness and minimum prosecutorial obligation. Since *Brady* is premised upon due process grounds *we hold that its principles are applicable to administrative enforcement actions such as this which, while strongly remedial in nature, may yield substantial sanctions.*[91]

During the discovery phase of *ETP*, ETP requested that Enforcement Litigation Staff produce any "exculpatory" materials in its possession per the

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83. Energy Transfer Partners, L.P. v. FERC, 567 F.3d 134, 146 (5th Cir. Apr. 28, 2009). The Fifth Circuit requested Congressional action to clarify the NGA because the Court itself did not reach the merits of ETP's petition for review; rather, the court determined that it was compelled to deny ETP's appeal as unripe. *See generally id.* at 140-42 (relying heavily on FTC v. Standard Oil Co. of California, 449 U.S. 232 (1980)).

84. 373 U.S. 83 (1963).

85. *Id.* at 87-88.

86. *Id*.

87. *Id.* at 87.

88. The Supreme Court, in *Lees v. U.S.*, explained the similarities between criminal actions and administrative civil penalties: "[a]lthough the recovery of a penalty is a proceeding criminal in it's nature, yet in this class of cases it may be enforced in a civil action, and in the same manner that debts are recovered in the ordinary civil courts." 150 U.S. 476, 478-79 (1893).

89. *See, e.g.*, *In re* Bilello, No. 93-5, 1997 CFTC LEXIS 244 (Oct. 10, 1997); *In re* Schiller, No. 96-4, 2002 CFTC LEXIS 115 (Sept. 3, 2002); *In re* First Guaranty Metals, Co., Nos. 79-55, *et al.*, 1980 CFTC LEXIS 141 (July 2, 1980).

90. 17 C.F.R. § 201.230(b)(2) (2005).

91. *In re* First Guaranty Metals, Co., *supra* note 88, at *27 (emphasis added; citations omitted).

requirements of *Brady*. Despite the broad reach of *Brady*, Enforcement Litigation Staff refused to turn over any materials in its possession, claiming on the one hand that it was not aware of any exculpatory materials and citing multiple privileges on the other hand. ETP moved to compel production in what was a first impression case at the Commission with respect to *Brady*. ETP sought materials which it believed contained a potential treasure trove of exculpatory data, including witness interviews, discussions with expert and testifying witnesses and data from third party sources. In addition, ETP also asserted that compilations of data prepared by Enforcement Staff that contradicted Enforcement Staff's position would also be producible under *Brady*.[92]

Judge McCartney specifically declined to "bind" the Commission with respect to whether or not *Brady* applied at FERC but nonetheless "assume[d] *arguendo* that *Brady* applies."[93] Judge McCartney ordered Staff to produce certain documents, but because it had previously been determined that those documents were protected by a Commission privilege, Judge McCartney certified the issue to the Commission under Rule 714.[94] At the same time, ETP sought the Commission's permission for an interlocutory appeal of Judge McCartney's decision, but the Commission denied ETP's request to appeal and failed to respond to Judge McCartney's Rule 714 Certified Question.[95] Shortly thereafter, ETP and Enforcement Staff began settlement discussions and all proceedings in *ETP* were suspended. As a result, the *Brady* issues in *ETP* died on the vine without ever being subject to review by the Commission.

But the issue didn't die with *ETP*. On December 17, 2009, the Commission issued a Policy Statement on Disclosure of Exculpatory Materials which applies *Brady* to Section 1b investigations and enforcement actions under Section 385 of the Commission's Rules of Practice and Procedure.[96] Through this Policy, the Commission will require that Enforcement Staff provide the subject of an investigation with exculpatory materials that Enforcement Staff acquires that are not already in the possession of the subject of the investigation. Perhaps even more importantly, the Commission acknowledged that certain exculpatory materials may also be subject to various Commission privileges. In such cases, the presiding ALJ must certify the potential release of such materials to the Commission under Rule 410.[97]

This new policy, if it faithfully applies the *Brady* doctrine in practice, is a good (albeit not complete) first step in ensuring the due process rights of the subjects of FERC enforcement actions.

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92. *Energy Transfer Partners, L.P.*, Docket No. IN06-3-003, Motion to Compel Responses to Thirteenth Set of Data Requests (May 20, 2009).

93. *Energy Transfer Partners, L.P.*, Docket No. IN06-3-003, Order Confirming Rulings at Hearing, at 3 (June 9, 2009).

94. *Id.*

95. *Energy Transfer Partners, L.P.*, Docket No. IN06-3-003, Notice of Determination by the Chairman (July 1, 2009).

96. *See, e.g.*, 129 F.E.R.C. ¶ 61,248, at P 7. Interestingly, the Commission claimed that it has long been its policy "to provide to the subjects of its investigations such evidence." *Id.* at P 1. However, the authors, who have taken part in many of the most high-profile enforcement actions of the last two decades, cannot recall ever receiving such a production of exculpatory materials from Commission Enforcement Staff.

97. *Id*. at P 13.

C. Expert Witnesses and the Federal Rules of Evidence

It has long been the case at the FERC that the Federal Rules of Evidence (FRE) do not apply, particularly when it comes to determining the admissibility of expert testimony.[98] While Rule 702 of the Federal Rules requires an expert's testimony to pass a rather stringent test prior to being admissible, FERC Rule 509 is significantly broader and more permissive. Rule 509 permits the FERC Administrative Law Judges to admit evidence which would be inadmissible in federal court. While such a result may be permissible when *de novo* review by a federal court is available after a penalty is assessed[99] it raises a significant due process concern when considered in the context of the FERC's position on *de novo* review under the NGA. If the FERC's interpretation of the NGA is correct, then, in the FERC's view, it is permissible to base a case on scientifically unreliable testimony that would be inadmissible in federal court.

Indeed, the difference between FRE 702 and FERC Rule 509 is readily apparent. FRE 702 states that:

> [i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.[100]

On the other hand, FERC Rule 509(a) provides that: [t]he presiding officer should exclude from evidence any irrelevant, immaterial or unduly repetitious material . . . which the presiding officer determines is not of the kind which would affect reasonable and fair minded persons in the conduct of their daily affairs.[101]

In order to admit expert testimony under Rule 702, the Judge must not only determine that the witness is "qualified as an expert by knowledge, skill, experience, training, or education," but he must also determine that the testimony is "based upon sufficient facts or data" and is the "product of reliable principles and methods."[102] If a purported expert lacks the qualifications to testify as an expert or if he has not based his conclusions on sufficient facts or data or reliable principles and methods, then the testimony should not be admissible under Rule 702 of the FRE. Likewise, the same should hold true under Rule 509(a) of this Commission's rules. This is because statements made by unqualified experts or purported experts that have not developed sufficient facts or applied reliable principles are not evidence that would "affect reasonable and fair-minded persons in the conduct of their daily affairs."[103]

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98. 15 U.S.C. § 717n(f) (2006) ("All hearings, investigations, and proceedings under this chapter shall be governed by rules of practice and procedure to be adopted by the Commission, and *in the conduct thereof the technical rules of evidence need not be applied*") (emphasis added).

99. Section II A, *supra* (discussion of NGPA and FPA *de novo* language).

100. FED. R. EVID. 702.

101. 18 C.F.R. § 385.509 (2006).

102. FED. R. EVID. 702.

103. *See, e.g., Sacramento Mun. Util. Dist.*, 41 F.E.R.C. ¶ 63,022 at P 65,159 (1987) (a reasonable and fair-minded person would not give credence to the testimony of an unqualified expert).

When the *ETP* SCO issued, it quickly became apparent that the theory under which the Commission was proceeding was completely novel. Because of that novelty, ETP sought from the Commission the right to challenge the FERC's expert witness under FRE 702 and *Daubert*.[104] The Commission rejected ETP's request, reasoning that:

> [T]he ALJ must rule on the admissibility of evidence pursuant to Rule 509 of the Commission's Rules of Practice and Procedure. The Commission's rule for the admissibility of evidence differs from, and is broader than, Rule 702 of the Federal Rules of Evidence, which encompasses the principles of *Daubert.* Rule 509 reflects the administrative nature of the Commission's trial-type proceedings and the presence of a fact finder who can afford appropriate weight to the relevant evidence that is submitted.[105]

Rule 509 is a more lenient standard because it assumes that a Commission ALJ can assess an expert witness's testimony and grant it the "appropriate weight." However, one of the purposes of *Daubert* and FRE 702 is to prevent "junk science" from being admitted into the record. If a party to a FERC proceeding wants to utilize untested methodologies, it is reasonable to use the rules set forth by *Daubert* and FRE 702 as a measuring stick to determine if it is "junk science." If it is, then it likely should be afforded very little or no weight by the ALJ.

Even though it is technically permissible, applying the lesser standard of Rule 509 in place of FRE 702 in administrative proceedings causes grave concerns. For instance, a hearing at the FERC may include testimony admissible under Rule 509 that is not admissible under FRE 702 in a federal court. Assuming *de novo* review is available in such a case, the target of an investigation may be forced to participate in lengthy, expensive litigation disputing evidence that could not be used to substantiate the Commission's claims on judicial review in a federal district court. Because of the likelihood that the subject of a FERC enforcement proceeding will seek judicial review, evidentiary decisions regarding the admissibility of expert testimony should be made under FRE 702 rather than the far less stringent standard of Rule 509. The FERC should remedy this issue by adopting the Federal Rules if it truly believes that "subjects of an investigation" must "receive due process both in perception and reality."[106]

D. Ex Parte Communications and the Separation of Functions

In a context where a single entity is the prosecutor, judge, and jury—as the FERC has made itself out to be—there are significant due process concerns regarding *ex parte* communications and the dividing line between decisional and non-decisional Staff. *Ex parte* and separation of function rules protect due process rights and ensure the integrity of litigated proceedings by limiting off-the-record contacts between persons involved in litigating a matter and the FERC's decisional employees. At the time of the initiation of *ETP* and *Amaranth*, the Commission's position had been that its rules respecting separation of functions and *ex parte* contacts—embodied in Rules 2201 and

104. Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993).

105. *2008 Rehearing Order*, *supra* note 66, at P 17.

106. *Revised Statement*, *supra* note 26, at P 21.

2202 of the Commission rules of practice—did not apply to Part 1b investigations.[107] Specifically, the Commission had taken the position that, until an investigation was set for a trial-type evidentiary hearing, members of the investigative team remained free at all times to discuss the investigation with the Commission.[108] Further, once the case was set for a trial-type hearing, it was permissible for the members of the investigatory team to become trial staff.[109] Only at that late stage did the Commission subject its investigatory team, prospectively, to the separation of functions and *ex parte* rules, precluding them from continuing to advise the Commission on the matters at issue.[110]

Prior to the passage of EPAct 2005, when the Commission's ability to assess civil penalties was limited both as to scope and amount, this approach may have been viewed as a reasonable way to harmonize the dictates of due process with the Commission's administrative considerations. It may also have appeared reasonable in a context where the Commission simply noted the existence of Staff allegations and set those allegations for hearing.[111] But, in an era where the Commission can assess penalties amounting to hundreds of millions of dollars, the due process concerns are particularly heightened.

ETP raised the issue of the FERC's investigative staff's communications with the Commission in its 2007 Rehearing Request. In the 2007 Rehearing Order, FERC addressed the issue by "mak[ing] nondecisional all Office of Enforcement investigative staff that [were] assigned to participate in the remainder of" the *ETP* proceeding.[112] Furthermore, the Commission pledged that:

> [t]o provide additional due process in all future civil penalty cases under the FPA, NGPA, and NGA, at the time Office of Enforcement investigative staff completes its investigation, it will transmit to the Commission a report with recommended findings and conclusions of fact and law and the Commission will attach the report to a show cause order to respond to the recommended findings. The Commission will not make any findings, preliminary or otherwise, at least until it has considered the response. In addition, at the point Office of Enforcement investigative staff submits a report to the Commission, designated Office of Enforcement investigative staff will become nondecisional employees for purposes of participating in the remainder of that enforcement proceeding, including any hearing or other procedures used by the Commission to resolve the proceeding.
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> * * *
>
> We believe these steps, although not required as a matter of law, will provide additional due process and eliminate any perception of unfairness or prejudgment, while allowing the Commission to benefit from the expertise of its Office of Enforcement staff and have the ability to timely pursue enforcement actions.[113]

Interestingly, the Commission believed that these additional provisions would "eliminate any perception of unfairness or prejudgment" in "all future

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107. *See generally Statement of Admin. Policy on Separation of Functions*, 101 F.E.R.C. ¶ 61,340 at P 26 (2002); *see also* 18 C.F.R. §§ 385.2201, 2202 (2006).

108. *Id.* at P 27.

109. *Id.* at P 28.

110. *Id*.

111. *See, e.g.*, *Northwest Pipeline Corp.*, 61 F.E.R.C. ¶ 61,012 (1992); *Clifton Power Corp.*, 25 F.E.R.C. ¶ 61,225 (1983).

112. *2007 Rehearing Order*, *supra* note 64, at P 88.

113. *Id.* at PP 89-90.

civil penalty cases," but did not, apparently, believe that such a perception existed in *ETP*.

Shortly thereafter, on May 15, 2008, the FERC issued a Notice Of Proposed Rulemaking (NOPR) seeking comments on a proposal to revise its separation of functions and *ex parte* "off-the-record" communications rules for Part 1b investigations to conform them to the procedures adopted in *ETP*.[114] As proposed, Rule 2202's separation of function restrictions would apply once the FERC issued a show cause order.[115] Once a show cause order was issued, the FERC would determine which of its Enforcement Staff would be considered "decisional" for the purposes of the proceeding.[116] With respect to Rule 2201's *ex parte* restrictions, the FERC's proposed policy would limit communications between either the subject of an investigation or the investigatory staff with the commissioners and their personal staffs to written communications during investigations.[117]

In response to the NOPR, some commenters supported the proposed revisions to the Commission's *ex parte* and separation of functions rules.[118] Indeed, those same commenters suggested that in addition to providing "equal treatment of investigative staff and subjects of an investigation subsequent to a show cause order," "the Commission should extend the proposal to include the early stages of the investigation."[119] It suggested that "allowing Commission investigative staff unrestricted access to decisional employees, while allowing the subject of an investigation only written communication, puts the subject of an investigation at a disadvantage in making its case to the Commission."[120]

The Commission rejected these additional suggestions and instead adopted only the proposed revisions to its rules.[121] While this move was a small step in the right direction, there are still significant due process concerns in the crossover among Enforcement Staff prior to the issuance of a show cause order. As the commenters to the NOPR pointed out, the subject of an investigation will continue to be at a distinct disadvantage so long as the Enforcement Staff is permitted unfettered access to the Commission while the subject of an investigation is limited to written communications.[122] The Commission should adopt *ex parte* and separation of function rules that come into play as soon as the Commission authorizes Enforcement Staff to conduct an investigation. Without

114. *Ex Parte Contacts and Separation of Functions*, 123 F.E.R.C. ¶ 61,158 (2008); 18 C.F.R. §§ 385.214, 385.2201 (2006).

115. 123 F.E.R.C. ¶ 61,158 at P 7-8.

116. *Id.*

117. *Id.* at P 11. However, just as with a Wells submission, it is imperative that the subject of an investigation carefully consider the pros and cons of conveying information, unasked for, to the Commission. *See* CFTC v. Energy Transfer Partners, L.P., *supra* note 44.

118. *Ex Parte Contacts and Separation of Functions*, Order No. 718, 125 F.E.R.C. ¶ 61,063 at P 21 (2008).

119. *Id.*

120. *Id.*

121. *Id.* at P 23.

122. This is particularly key given the Commission's position vis-à-vis *de novo* review under the NGA; *see* Section II A, *supra*.

such provisions, litigants will not "receive due process both in perception and reality."[123]

E. The Need For A Robust "Wells Process"

In 1972, the Securities and Exchange Commission (SEC) formed an advisory committee led by John Wells and several former SEC chairmen. Its task was to broadly consider the SEC's enforcement policies and practices. While not all of its recommendations were accepted or put into practice, one of its recommendations has stood the test of time-the "Wells Process." Indeed, in 2007 former SEC Commissioner Paul Atkins said that "the Wells Process remains the SEC's central due process mechanism in enforcement matters.[124]

The Wells Process, as utilized by the SEC, gives parties under investigation the opportunity to present their side of the story, and to argue against charges, for reduced charges or to propose a settlement before the SEC decides whether to charge the party with violations. Enforcement Staff may notify the subject of an investigation of its findings and what, if any, recommendation Staff intends to make to that particular Agency's Commissioners.[125] The entity then has the right, if it so chooses, [126] to submit a written statement which will be appended to the Enforcement Staff's report when it is presented to the Commissioners. As the SEC stated in its recently released enforcement manual,

> [t]he objective of the Wells notice [for the Commission] is, . . . 'not only to be informed of the findings made by its staff but also, where practicable and appropriate, to have before it the position of persons under investigation at the time it is asked to consider enforcement action.'[127]

In addition, once the Wells notice has been given, the SEC process also provides for the potential disclosure of non-privileged portions of Enforcement Staff's investigative file to the subject of the investigation.[128]

As explained above, an indictment, show cause order, or any other administrative enforcement action can have deleterious effects on the subject of

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123. On December 17, 2009, the Commission adopted a policy statement authorizing the Secretary, at the direction of the Head of the Office of Enforcement, to issue Preliminary Notices of Violations prior to the issuance of an Order to Show Cause by the Commission. *See generally Order Authorizing Secretary to Issue Preliminary Notices of Violations*, 129 F.E.R.C. ¶ 61,247 (2009). If this policy statement remains in effect, the separation of functions and *ex parte* rules should, at a minimum, apply no later than the issuance of the Preliminary Notice if not at the commencement of an investigation.

124. Paul S. Atkins, Comm'r, U.S. Securities and Exchange Commission, Remarks Before the Security Traders Association of New York 71st Annual Conference (Apr. 19, 2007), *available at* http://www.sec.gov/news/speech/2007/spch041907psa.htm.

125. In some instances the SEC has determined that a Wells notice may permit additional harm and has made provisions whereby the Wells Process can be sidestepped. Such instances include those where the harm is on-going and the delay involved in submitting a Wells notice and waiting for a response will cause additional investors to be harmed, and situations where a Wells notice will give the target of an investigation sufficient notice it may avoid a pending asset freeze.

126. The choice to make a Wells submission must be weighed carefully. There is significant risk in voluntarily providing information to an administrative agency that has already begun an investigation. Before deciding to participate in the Wells Process it is imperative that the consequences of participation are thoroughly evaluated and that strategies are developed to minimize any legal risk implicit in that participation.

127. SEC, Office of Chief Counsel, *SEC Enforcement Manual* (Jan. 13, 2010) at 23, *available at* http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

128. *Id.*

the action. Like in *Arthur Andersen*, the effects could be profound enough to cause the entity to cease to function. Other effects may be a chilling of legitimate activity and damage to the public good due to the high cost of unsuccessful enforcement actions. In addition, stock and share prices of a targeted entity may be adversely impacted by an enforcement action, which in turn may affect the entity's credit rating and ability to fund its ongoing operations. A robust Wells Process can protect against ill-advised enforcement actions and inadvertent damage to the subject of an investigation or to the public.

In addition to the obvious benefits of providing both sides of the story to the administrative decision-makers, the Wells Process also allows Enforcement Staff to determine whether the evidence it has collected truly supports its allegations. If the entity's Wells submission is unpersuasive in that regard, then Enforcement Staff can be more confident in its conclusions. On the other hand, if the Wells submission is persuasive it may convince Staff to rethink its case. Furthermore, the Wells Process offers the parties an opportunity to engage in settlement negotiations before the investigation is made public.

For many years, the FERC offered what could be termed "Wells lite"—a lesser version of the Wells Process that offered somewhat less effective procedural safeguards to the subject of an investigation. The FERC's longstanding rules relating to investigations, at 18 C.F.R. § 1b.18, and § 1b.19, expressly provided for a Wells Process and was intended to be "similar to rules relating to investigations used by other Federal agencies with regulatory mandates similar to those of the Commission."[129] At the time, the provisions read as follows:

> § 1b.18 *Right to submit statements.* Any person may, at any time during the course of an investigation, submit documents, statements of facts or memoranda of law for the purpose of explaining said person's position or furnishing evidence which said person considers relevant regarding the matters under investigation.
> § 1b.19 *Submissions.* When the Investigating Officer determines it is appropriate in the interest of the proper administration of the law, he may inform any person that a recommendation may be made to the Commission that said person be a defendant in a civil action to be brought by the Commission. In such case, said person may submit a statement of fact, argument, and/or memorandum of law, with such supporting documentation as said person chooses showing why said person should not be a defendant in any civil action brought by the Commission. The Investigating Officer shall inform said potential defendant of the date by which such statement may be submitted to said officer, and if such statement is submitted by such date, it shall be presented to the Commission together with any recommendation for enforcement action by the office responsible for the investigation.[130]

Compared to the SEC Wells Process, the FERC's then-existing process permitted great discretion on the part of the Investigating Officer into whether to permit a Wells submission, and the relevant rules also did not require the same information relating to the allegations and recommendations being made to the Commission to be relayed to the subject of an investigation. These differences prompted some commentators to suggest that:

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129. Rules Relating to Investigations, 43 Fed. Reg. 27,174, 27,175 (June 23, 1978) (codified at 18 C.F.R. pt. 1b (2006)).

130. 18 C.F.R. §§ 1b-18, -19 (2007).

> [the] FERC should adopt a 'Wells submission' rule like that of the SEC. That process, set out in SEC regulation 5(c), 17 C.F.R. 202.5(c), generally entitles persons who are the subject of an SEC investigation to receive from the enforcement staff at the conclusion of an investigation notice of any charges and enforcement action the SEC staff intends to recommend to the SEC Commissioners for authorization and provides such persons an opportunity to submit written statements and materials explaining why enforcement action or a particular charge is unwarranted. Such Wells submissions then are forwarded to the Commissioners with the staff's enforcement recommendation. This process should help to avoid unwarranted enforcement actions and often provides a basis for both sides to better understand the facts and issues and resolve them without litigation.[131]

The FERC responded:

> [it] already has a regulation in place that provides a company under investigation with an opportunity to present its views, and staff's existing practice is to present the company's views to the Commission as part of any report or recommendation made by staff following an investigation . . . [and that] no new process need be adopted.[132]

The events surrounding the *ETP* and *Amaranth* demonstrate why a complete and robust Wells Process similar to that of the SEC's is important in the enforcement context. Both the *ETP* and *Amaranth* Orders to Show Cause were highly unusual and unlike any other Show Cause Orders in recent memory. Both Orders to Show Cause read like final orders, packed with detailed factual conclusions. For instance, the *ETP* SCO, at over eighty pages, included many instances where the Commission stated, without any qualification whatsoever, that ETP and Oasis "manipulated" prices, acted "knowingly" or "unduly discriminated." In the entire eighty page *ETP* SCO, there was not a *single* instance in which the Commission qualified those characterizations by using terms like "alleged" or "apparent." Indeed, the express language of the Orders to Show Cause suggested that the FERC had already concluded that ETP and Amaranth were guilty. Just as alarming, in several contemporaneous press accounts, the FERC Chairman, stated that the investigation found that ETP violated the relevant rules and dismissed ETP and Oasis's arguments as "laughable."[133]

While the FERC chairman may have dismissed ETP's counterarguments as "laughable," a more robust Wells Process than the then-existing process under § 1b.19 would have helped to mitigate the perception that the Commission's prejudged the case. The Commission has since taken steps to adopt a more fulsome Wells Process. In early 2008, the FERC held a Conference on Enforcement Policy to review the FERC's enforcement program and to seek suggestions on potential changes. The Office of Enforcement prepared a "Report on Enforcement" which reflected a commitment to a Wells Process beyond what § 1b.19 provided for at the time. Enforcement Staff stated that its current practice embodied a Wells Process:

> [i]f staff reaches the conclusion that a violation occurred, staff shares its views, including both the relevant facts and its legal theories, with the company . . . where [the Division of Investigations] staff reaches a conclusion that a violation has occurred but the company continues to maintain that there is no violation, the

131. *Order No. 670*, *supra* note 22, at P 74.

132. *Id.*

133. *See generally* notes 36-41, *supra* (citing FERC press releases and published interviews).

> company *may* be given the opportunity to make a submission directly to the Commission prior to action being taken against the company. Only after completing a full exchange of facts and views with the company does staff recommend that the Commission issue an order to show cause.[134]

While Enforcement Staff's practice may have been more fulsome than Rule § 1b.19 required, it still left significant discretion to the Staff: a "company *may* be given the opportunity to make a submission." By not clarifying the circumstances under which a company would be denied the right to make a submission, the process was still inadequate.

Shortly thereafter, on May 15, 2008, the FERC adopted revisions to 18 C.F.R. § 1b.19 providing the subjects of investigations, in all but extraordinary circumstances, the right to be informed of Staff's intent to recommend action to the Commission and the opportunity to provide a written nonpublic response to the Staff's recommendations.[135] In line with the SEC's Wells Process, the revised § 1b.19 requires that Staff's notification to the subject of an investigation must provide sufficient information and facts to enable the entity to prepare its response.[136] Before making any decision, the Commission will then consider both the Staff's recommendation and the entity's response before deciding whether to take further action.[137] However, because "extraordinary circumstances" remains vague, the current revisions to § 1b.19 still present due process concerns and should be fixed.

IV. A GUIDE FOR FERC JURISDICTIONAL ENTITIES AND PRACTITIONERS

Entities subject to the Commission's jurisdiction, particularly those who are the subjects of investigations or enforcement actions, and the FERC practitioners should carefully consider each of the above due process issues in any current or future FERC proceedings. In addition, it is also important to consider such issues as the length of time that these cases took to move through the FERC's enforcement process, the use of privilege by the Commission Staff to prevent discovery, and the question of which agency, the FERC, the CFTC, or the DOJ, has jurisdiction over the alleged violations.[138] And, perhaps most importantly of all, it is important to consider whether these issues and the substantial monetary penalties under the FERC's enhanced powers make it wiser to fight the allegations or to seek an early settlement.

A. The Due Process Issues

The FERC's adoption during the May 2008 Reforms of a Wells Process similar to that of the SEC added another useful tool for responding to

134. FERC, REPORT ON ENFORCEMENT (Nov. 14, 2007) at 18-21 (footnotes omitted) (emphasis added).

135. *Submissions to the FERC Upon Staff Intention to Seek an Order to Show Cause*, 123 F.E.R.C. ¶ 61,159 at PP 3-5 (2008) (citing 18 C.F.R. § 1b.19 (2006)).

136. *Id.*

137. *Id.*

138. Multi-jurisdictional enforcement actions, particularly in the energy-market manipulation context are becoming increasingly common. The interaction between the agencies creates peculiar questions that may have answers that are not necessarily intuitive. *See, e.g.*, Allan Horwich, *Warnings to the Unwary: Multi-Jurisdictional Federal Enforcement of Manipulation and Deception in the Energy Markets After the Energy Policy Act of 2005*, 27 ENERGY L.J. 363 (2006).

allegations.[139] However, just as with a criminal defendant who has the opportunity to voluntarily provide information to a prosecutor, or a grand jury, it is important to consider whether it might be wiser to say nothing at all. On the other hand, no harm can come from requesting *Brady* materials. Because *Brady* requires disclosure of evidence that may not be disclosed as part of the Wells Process, it is imperative that practitioners seek out such information. Now that the Commission has adopted a *Brady* policy similar to that of the SEC and CFTC, the enforcement of that policy must be carefully watched to ensure that it upholds the spirit of *Brady*.[140]

It is also important to consider the appellate stance of an enforcement proceeding early in the process. If *de novo* review is available, strategic decisions should be very different than if it is not. The same holds true for considerations of the FERC's expert witnesses under the Federal Rules. The Commission should adopt the Federal Rules to ensure that all expert testimony in FERC proceedings is sufficiently credible. Even if the FERC continues to permit expert witnesses to testify under the less stringent standards of Rule 509, it will nonetheless have to satisfy FRE 702 when, and if, actions under the FPA and NGPA are reviewed *de novo* by a federal court. On the other hand, if *de novo* review is not available in actions under the NGA, the strategic concerns of how to deal with experts must necessarily change.

Finally it is important to recognize that the subject of a FERC enforcement proceeding is at a disadvantage from the very beginning. The current *ex parte* rules permit the Enforcement Staff unfettered communication with the Commission and its advisory Staff regarding the merits of a case prior to the issuance of an order to show cause.[141] However, the subject of an investigation is limited to written communications with the Commission.[142] This places Enforcement Staff in a powerful position, allowing it to narrowly craft its arguments so that it hits the issues that most appeal to the Commission, while the subject of an investigation must use a more "shotgun" approach. Only after the issuance of an Order to Show Cause does the playing field level, but even then, the damage to an entity's due process rights is already done.

B. Other Issues to Consider

ETP and *Amaranth* each took about two years from the time the Orders to Show Cause were issued until they reached settlements. *Oasis* took a year and a half, and an initial decision in *Hunter* took more than two and a half years after the *Amaranth* SCO. In addition, the investigation phases in *ETP* and *Oasis* took almost a year and a half before the Commission issued the *ETP* SCO. On top of that, none of these cases reached an appellate stage with *de novo* review, but that would surely have come if settlements had not been reached. Given the length of time involved—four years or longer from start to finish—it is necessary to consider issues such as witness retention and document preservation.

Also at issue is Enforcement Staff's heavy-handed reliance on privilege in attempting to shield information from discovery. While the Commission's *ex*

139. *See* Section II E *supra*.

140. *See* Section II B *supra*.

141. *See* Section II D *supra*.

142. *Id.*

parte rules permit Enforcement Staff to communicate with the Commission prior to the issuance of an order to show cause, Enforcement Staff has taken the position that those communications, and any information , the Commission has even taken the position that communications with third parties—if done as part of the investigation—are privileged. Such broad claims under the new FERC Enforcement process have yet to be tested in a federal court, and may not be sustained.

Another key issue to consider is jurisdiction. In *Amaranth* and *ETP*, the CFTC conducted a parallel investigation with the FERC. In *ETP* it became a non-issue as that investigation was settled relatively early, but in *Amaranth* the issue became contested. Indeed, the CFTC actually went so far as to intervene on behalf of Brian Hunter in his bid to enjoin the FERC from conducting an enforcement proceeding with him as a target.[143] Because of the crossover between the energy markets and the commodities markets, such confrontations may be more common in the future, and the rift between these two agencies may be useful as part of a litigation strategy.

C. Fight or Flight

Finally, it is important to consider the costs and benefits of contesting or settling a FERC investigation or enforcement proceeding. Given the greatly enhanced civil penalty authority that the FERC was granted under EPAct 2005, it is increasingly clear that the cost of acquiescence to FERC enforcement actions might exceed the benefits. In other words, it might often be wiser to fight Enforcement Staff's allegations.

Contesting a proceeding may increase the likelihood of a positive settlement. For instance, the FERC sought civil penalties in *Amaranth*,[144] *ETP*,[145] and *Oasis* of approximately $200 million, $115 million, and $15 million, respectively. ETP agreed to civil penalties of less than 4.5% of what the FERC sought. *Amaranth*, which lost nearly $6 billion, managed to settle for $7.5 million in civil penalties—a mere 3.75% of the amount that the FERC sought in penalties. Oasis settled the claims against it without paying a cent. These figures suggest that even a modest investment in contesting the allegations may return huge returns in terms of avoided cost.

But the picture is not completely rosy. Government attorneys are subject to the same flaws and temptations as other mortals, including vindictiveness and prideful blindness to the weaknesses of our own arguments. In *ETP*, for example, the FERC's Enforcement Litigation Staff continued to add new allegations of wrongdoing throughout the hearing process—alleging manipulation in ten months at the start, only to expand those allegations to seventeen months through its expert testimony. While the expanded months

143. *See generally* Hunter v. FERC, No. 08-5380, Intervener for Appellant Brief (D.C. Cir. Nov. 3, 2008); Hunter v. FERC, No. 08-5380, Intervener for Appellant Reply Brief (D.C. Cir. Dec. 18, 2008).

144. The FERC also sought approximately $60 million in unjust profits from Amaranth.

145. The FERC also sought approximately $100 million in unjust profits from ETP. As part of the ETP settlement, ETP agreed to pay $25 million into a fund which would be used in part to settle certain of the civil suits against ETP and to make payments to other parties who make claims during the settlement period. In order to participate, fund claimants were required to submit data to substantiate any claims that were made. Final decisions as to any amounts to be paid from the fund will be made by a Fund Administrator appointed by the Commission.

were far less significant in terms of financial exposure than the original ten, it remains a cautionary tale. Even though it did not impact the final outcome in *ETP*, contesting the proceeding could potentially increase the subject's financial exposure.

The best case scenario occurred in *Oasis*. By aggressively contesting the proceeding, *Oasis* was able to move for summary disposition and managed to dismiss more than ninety-eight percent of the civil penalties and disgorgement that the FERC sought. *Oasis* was then able to settle for no monetary payment.[146] On the other hand, the worst case scenario would be a loss to the FERC in an administrative hearing. However, with claims under the FPA and the NGPA the subject of an enforcement action will get another bite at the apple as a result of *de novo* review, and to a lesser extent will still have some appellate options if the allegations were under the NGA.

V. CONCLUSION

While the FERC has made some good strides in protecting the rights of entities subject to the Commission's jurisdiction, particularly through the May 2008 Reforms, there are still additional and significant due process protections that the Commission should address, especially if it truly wants to "ensure that the subjects of an investigation receive due process both in perception and reality."[147]

146. *See* Section I C *supra*.

147. *Revised Statement*, *supra* note 26, at P 21.