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Panel

Deciding Market Manipulation Cases:
FERC processes, Role of Judiciary, and Policy Coherence
Historical Perspective on How FERC Has Evolved on Enforcement Issues and Why

Remarks of Susan J. Court, Principal, SJC Energy Consultants, LLC

My task this afternoon is to give you an historical perspective on the FERC enforcement process.

I wish I could start by saying that the current process is coherent and seamless.

Indeed, for a process to be due – and that's what we're talking about here, due process – it must be coherent and treat the accused fairly and ensure that the accused has an opportunity to defend itself timely.

Notwithstanding the Commission's efforts over the last ten years to be fair to respondents and make the process transparent, the current process is: cobbled together and cumbersome accordingly.

Partly, the reason for the current structure is that, following the enactment of the Energy Policy Act of 2005, we built on what we had in place.

In retrospect, we probably should have stepped back and built a structure from outside in, and not inside out, given the significant changes to the Commission's mission from that Act. Of course, hindsight is always the best sight.

In our defense, we did not truly appreciate the complexity of the dueling statutory schemes. But I'm getting ahead of myself.

When FERC became an enforcement agency in 2005, with its new authority to impose million-dollar a day penalties, there were three sets of FERC regulations that defined the process for conducting enforcement investigations.

- First, and foremost, Part 1b set out the procedures for the *CONDUCT OF INVESTIGATIONS*. These regulations were put in place in 1978.

The 1b regulations provide, for example, that investigations:

(1) will be confidential,

(2) limit participation (no interventions allowed), and

(3) outline the procedures for submitting materials.

Before 2005, the 1b process was sufficient, mainly because most enforcement investigations settled.

- Second, Rules 2201 and 2202, found in Part 385 of the Commission's regulations, contain the ex parte and separation of function rules.

    - The Commission issued a statement of administrative policy in 2002 to advise participants in FERC proceedings about "who may talk to whom when." Here's what FERC said,

      Unless an investigator is assigned to serve as a litigator, she may freely speak to persons inside the Commission about an investigation.

      Accordingly, the investigator may speak to decision makers and their advisors throughout her investigation (up to the point where she may be assigned to be a litigator), providing them with details of the investigation, seeking their input on how to proceed, and discussing settlement with them.

      Proceeding in this way does not compromise the Commission's decision making process, because [as the Supreme Court explained] the "mere exposure to evidence presented in non-adversary investigative procedures is insufficient in itself to impugn the fairness of the [decision makers] at a later adversary hearing."

Before 2005, these rules as interpreted in 2002, worked well.

- Again, most enforcement actions settled.
- If there was any litigation, it was before an ALJ -- thus the separation of function rule kicked in and the investigative trial staff was walled off from the Commission and its advisors.

So, here's how it worked, and still works in large part today.

- The enforcement staff would initiate an investigation, perhaps because of
    - a call to the enforcement hot line
    - (and later), a self-report
    - a report from an ISO or RTO market monitor, or
    - a referral from the FERC market oversight staff.

- The staff would investigate, with depositions, interrogatories, and interviews, from which it crafted a recommendation embodied in a memorandum to the Commission.

- If that recommendation claimed there was a violation of the law, the Commission would issue a show cause order, attaching the staff's memorandum.

- The respondent would respond, and the Commission would issue an order setting out the next step, *e.g.*, setting the matter before a FERC ALJ. (Hold that thought for now.)

After 2005, the Commission tweaked the relevant regulations and added a few steps in the name of transparency and fairness. And I mean, tweaked.

For example,

- Re Part 1b: two actions
  - First, in May 2008, the Commission issued Order No. 711, which amended Rule 1b.19. Accordingly,

    - The enforcement staff must notify the respondent that they intend to recommend a show cause order to the Commission.

    - The notification must include information and facts sufficient to enable the respondent to prepare a written response to staff's view of the case.

    - The staff must give the respondent at least 30 days to prepare that response.

    - Staff then must give the Commission the respondent's response at the same time it gives their recommendation to the Commission.

    - *The order states that the codification of the staff's practice would give respondents a "fuller opportunity to present their positions to the Commission."*

- Second, in December 2009, the Commission issued a Policy Statement on Disclosure of Exculpatory Materials, which reinforced what staff had done as a matter of practice.

    - Thus, during a 1b investigation, Enforcement staff will scrutinize materials it receives from sources other than the respondents for material that should be disclosed.

    - Any such materials or information that are not known to be in the respondent's possession must be provided to the it.

    - *The Commission hoped that the policy would promote "administrative efficiency and certainty, and contribute to its goal of open and fair investigations and enforcement proceedings."*

- Re ex parte and separation of functions: three actions

    - FIRST, in 2007, the Commission issued a NOTICE, in an *Energy Transfer Partner* docket, that designated certain enforcement personnel as non-decisional and certain ones as decisional.

        - The Commission's goal was to *provide respondents greater assurance that the Commissioners would not be unduly influenced by the staff who worked on the investigation.*

        - As a practical matter, there was no way to figure out who those people were, because over the course of an investigation, staff come and go. A person, *e.g.,* could be pulled into a discussion for a single issue. Ten minutes of his time. Never involved again.

        - And, at the time the Commission issued the ETP order, there were probably 150 people in the Enforcement Office. The possible candidates numbered less than 40, but we couldn't be sure.

        - So, we decided to make the entire enforcement staff non-decisional – that is, no contact between staff and the Commission and its advisors from the issuance of a show cause order to the end of the proceeding at the agency.

        - There was one problem with that approach, however.

- The Commission still might need the expertise of enforcement personnel.

- So, in the notice that accompanied the ETP order, the Commission carved out five people – me and my four division directors, including the Director of Investigations.

- This approach is still followed by the Commission today. The Commission issues the notice at the same time it issues a show cause order.

- SECOND, in October 2008, the Commission issued Order No. 718, which codified what the Commission had said in 2002: the *ex parte* and separation of function rules are triggered when the Commission establishes – and only when the Commission establishes -- a trial-type hearing for litigating a matter arising out of an enforcement investigation.

    - *However, a significant amount of communication takes place before a case is set for a trial type hearing before a FERC ALJ.*

    - *And, more important, not all enforcement litigation takes place before an ALJ! Indeed, only about 25% of the market manipulation cases so far have followed or are about to follow that route. So, for 75% of the cases in litigation to date, Order No. 718 is irrelevant.*

    - And, as a practical matter, the ETP-type notices kick in before a matter is set for a trial-type hearing.

- FINALLY, in a 2008 Revised Policy Statement on Enforcement, the Commission stated that as a matter of policy Commissioners and their personal staffs will no longer accept oral communications about pending investigations from respondents. Such communications would have to be in writing.
    - But this statement is lopsided.
    - It does nothing to cabin what FERC staff says to the Commissioners.
    - Also, as former ethics officer of the agency, I can tell you, it is an unenforceable sentiment.

Now I want to return to my original point – the FERC enforcement process is not coherent or seamless.

- There are two primary reasons, both grounded in the statutes:

  (1) the difference between the process for assessing penalties in the Natural Gas Act and the process in the Federal Power Act, and

  (2) the convoluted approach found in the Federal Power Act.

  - Differences between the Two Acts

    - By way of background – the historical perspective, as is my responsibility today – in December 2006, the Commission issued a statement of administrative policy regarding the assessment of penalties under the Gas Act and the Power Act, as well as the Natural Gas Policy Act.

    - The main issue – as relevant to market manipulation – was (and is) whether respondents in an investigation can have their cases tried *de novo* in a U.S. District Court OR have them heard at the agency before a FERC ALJ.

    - In 2006, the Commission read the Natural Gas Act to say, *no way*, and the Power Act to say, *either way*.

    - *With respect to the NGA, the Commission reasoned that Congress did not establish a de novo court review, and the Commission could not provide what can only be provided by Congressional action.*

    - Therefore, respondents in Natural Gas Act investigations could have their cases tried only at the agency, following the traditional five-prong approach of (1) setting the matter for hearing before an ALJ, (2) who would issue an initial decision, (3) on which the Commission would opine in an order, (4) subject to rehearing and an order on rehearing (5) which would be reviewed by a U.S. Court of Appeals.

    - *With respect to the Power Act, the Commission recognized that the statute specifically refers to a process already in place for violations of Part I (hydropower licensing) and applied that process to violations of Part II (wherein lie the market manipulation provisions).*

- Therefore, respondents in Federal Power Act investigations could have their cases tried EITHER by an agency ALJ (with judicial review by a U.S. Court of Appeals) OR in a U.S. District Court (with eventual judicial review by a U.S. Court of Appeals).

- No one – I repeat, no one, no company, no law firm, no trade association, no state commission, no former General Counsel, no one – sought rehearing of the policy statement. In other words, no one challenged the Commission's reading of the Gas Act and the Power Act.

- The dichotomy between the Commission's approaches to the enforcement of its market manipulation rules – which are basically the same for gas and electric -- has significant ramifications.

    - Obviously, a trial conducted by a different type of judge with a different mandate – will likely lead to a difference in the development of the law on manipulation, even though that law should be the same.

        - For gas, a FERC ALJ will understandably be inclined to give great deference to what the Commission has already said.

            - That's what FERC ALJ's are supposed to do – rule considering what the Commission has already said.

            - Moreover, once the Commission has addressed the case in a final opinion on an ALJ initial decision, under the Gas Act, a U.S. Court of Appeals must give deference to the Commission if its decision is based on "substantial evidence in the record." That's statutory!

            - Lastly, up to the time a gas case goes to the Court of Appeals, the Commission controls the timing. It can decide when to set a matter for hearing, when it issues an opinion on an ID, when it acts on rehearing.

            - However, the respondent will control WHICH court of appeals the case is heard.

- For electric, a U.S. District Court judge would be expected to approach the case based on what is presented. *I.e.*, a district judge does not have the same obligation to the Commission as a Commission ALJ does.

    - Granted, his or her decision would be appealable to a U.S. Court of Appeals, but that Court does not owe the Commission the same deference as it would if the case had evolved under the judicial review provisions of the Act.

    - Once the case goes to a District Court, the Commission loses control over the timing of how it proceeds.

    - However, the Commission controls WHICH district court the case is filed in the first instance.

- So, is your head spinning by now?

- Unfortunately, it is not rocket science to see how the law regarding the manipulation of the natural gas versus the electric energy markets could develop differently over time. Talk about confusing! And a disservice to the markets the law is intended to protect.

- The second reason that the current FERC enforcement process is not coherent is the convoluted approach to litigation in the Federal Power Act.

    - To be frank, none of us involved in the development of the 2006 administrative policy statement foresaw the tension in language, tension that immediately triggers due process concerns.

    - For a respondent in an electric case to get to the District Court, the Commission must first assess a penalty, which the respondent refuses to pay, and the Commission takes the respondent to court to get its money. Like, going to court to collect on a judgment.

    - Here's the rub: The judgment is the Commission's decision assessing penalties, based on a written record, rendered after the Commission has issued a show cause order and received responses to that order.

- However, the record developed from that point forward (and for sure, the record compiled previously) has not been tested to ensure its validity. The respondent has no opportunity to subpoena records or depose or cross-examine witnesses.

- To be sure, the Commission frequently "hears" cases "on paper." In fact, the Commission has routinely been upheld by the Courts of Appeals when it has proceeded that way in many, many cases.

- However, the Commission itself has always foregone "paper hearings" when the "demeanor of a witness" is important to a proper resolution of the issues.

- And, market manipulation cases clearly fall into that category.

- So, as a practical matter, once a respondent in an electric market manipulation case has chosen the "district court" route – and they all have – it can expect the Commission to issue promptly its decision on whether and to what extent to assess a penalty for violations of the law.

- No time for anything resembling a hearing.

- This is the part that I find convoluted. It puts a respondent between a rock and a hard place. And truthfully, I didn't see it until it started to play out for real after I left.

- But, then I thought, well, it won't be so bad, since the respondents will be getting a de novo trial at the district court, not simply a summary review of the Commission's action.

- The Commission had said, in the 2002 statement, investigations are NOT adversarial proceedings.

- No one was more surprised than I was when the enforcement staff started to describe, last year in court pleadings, that the agency proceedings were adversarial (at least after the issuance of a show cause order) and that the courts should simply review the FERC action and not conduct a trial de novo.

- It was like … describing the FERC proceeding as "adversarial" to the Court magically turned it into the functional equivalent of a trial.

- Trust me, none of us in 2006 – my staff and I, as well as the General Counsel and his staff, and I think it's fair to say, the Commissioners themselves -- viewed de novo the way the enforcement staff recently did. I gave speeches on the topic.

- And, what was surprising – and incredibly disappointing – was the Commission's endorsement of the staff's position in the *Coaltrain* order.

- I'll leave to my fellow-panelists how the courts have reacted to the revisionist version of history, among other things.

THANK YOU.