To Our Clients and Friends

Memorandum

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FERC Enforcement at the Crossroads: An Emboldened Program Surges Forward as Congress Expresses Skepticism

Introduction

The Federal Energy Regulatory Commission ("FERC" or, the "Commission") has successfully and aggressively advanced the breadth of its enforcement activities and, as the Commission approaches the tenth anniversary of the Energy Policy Act of 2005 ("EPAct 2005"),[1] recent developments present an opportunity for reflection upon FERC's enforcement process and procedures. This reflection has most recently displayed itself on Capitol Hill, where a number of members of Congress have met FERC's recent enforcement successes with a range of skepticism and support, with recent hearings demonstrating continued infighting over efforts to shape the future of FERC's enforcement program.

Chief among recent critics has been U.S. Representative Ed Whitfield (R-Kentucky), the Chairman of the House Subcommittee on Energy and Power who, in prepared testimony before a June 3, 2015 hearing titled "Discussion Draft on Accountability and Department of Energy Perspectives on Title IV: Energy Efficiency," remarked that some have raised concerns about the "fairness, consistency, transparency, and due process" afforded by FERC's Office of Enforcement, and asked "whether FERC enforcement actions are counterproductive and actually impede the proper functioning of electricity markets."[2] While Fred Upton (R-Michigan), the Chairman of the House Committee on Energy and Commerce, was more circumspect in similar prepared statements (Rep. Upton stated that the draft bill intended to maintain "FERC's enforcement and oversight role"), he too noted that "the provisions in the 2005 energy bill expanding FERC's enforcement authority" had "created a number of unintended consequences for electricity markets and have not kept up with some of the changes in the industry."[3] Supporters of

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1 The Energy Policy Act of 2005, Pub. L. 109-58, was signed into law on August 8, 2005.

2 *See* Opening Statement of the Honorable Ed Whitfield, Subcommittee on Energy and Power, Hearing on "Discussion Draft on Accountability and Department of Energy Perspectives on Title IV: Energy Efficiency" ("Title IV Hearing") (June 3, 2015), *available at* http://energycommerce.house.gov/sites/republicans.energycommerce.house.gov/files/114/Hearings/EP/20150603/HHRG-114-IF03-MState-W000413-20150603.pdf. A complete listing of prepared witness testimony and audio-visual of the two day hearings is *available at* http://energycommerce.house.gov/hearing/discussion-draft-accountability-and-department-energy-perspectives-title-iv-energy.

3 *See* Opening Statement of the Honorable Fred Upton, Subcommittee on Energy and Power, Title IV Hearing (June 3, 2015), *available at* http://energycommerce.house.gov/sites/republicans.energycommerce.house.gov/files/114/Hearings/EP/20150603/HHRG-114-IF03-MState-U000031-20150603.pdf.

FERC's recent efforts include Sue Kelly, President and CEO of American Public Power Association, who testified that "[t]he public has to rely on the Commission's enforcement staff to protect its interests as electric consumers," and that any new legislation must "not adversely impact enforcement staffs' ability to protect the public from market manipulation."[4]

Irrespective of whether the proponents for change prevail, the existence of this debate itself indicates how far FERC has come in building up a flexible enforcement program. This article reviews some important FERC developments which, in turn, shed light on the current debate over proposed legislation that could have a significant impact on FERC enforcement efforts in the future.

Recent FERC Enforcement Program Developments

The recent hearings held by the House Subcommittee on Energy and Power came in the wake of developments in two important market manipulation proceedings brought by FERC, against Barclays Bank PLC ("Barclays") and Powhatan Energy Fund ("Powhatan"), respectively. These developments reflect the evolving nature of FERC's personal and subject matter jurisdiction.

Barclays' Motion to Dismiss FERC's Petition to Affirm Civil Penalties

In the Barclays proceeding, FERC has alleged that Barclays and four of its traders (the "Barclays Defendants") violated Federal Power Act ("FPA") § 222 and FERC's anti-manipulation rule (18 C.F.R. § 1c.2) through trading in Commission-regulated physical markets with "the fraudulent purpose of moving the [physical] Index price at a particular point so that Barclays' financial swap positions at that same trading point would benefit."[5] FERC's allegations in the Barclays proceeding were first noted in an April 5, 2012 Notice of Alleged Violations,[6] followed by an October 31, 2012 Order to Show Cause and Notice of Proposed Penalty.[7] Upon issuance of the Order to Show Cause, the Barclays Defendants had the option to proceed with an administrative hearing before an Administrative Law Judge, but instead elected to seek the issuance of the Commission's penalty assessment, which they could then proceed to challenge in federal court.[8] After additional briefing before FERC, the Commission issued its penalty assessment on July 16, 2013, in which it agreed with the positions previously advanced by FERC Enforcement Staff, finding that Barclays should be assessed $435 million in civil penalties and forced to disgorge $34.9 million in unjust profits.[9]

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4 See Testimony of Sue Kelly, President and CEO of American Public Power Association before Subcommittee on Energy and Power, Title IV Hearing (June 4, 2015), available at http://docs.house.gov/meetings/IF/IF03/20150603/103551/HHRG-114-IF03-20150603-SD999.pdf.

5 *Barclays Bank PLC, et al.,* 144 FERC ¶ 61,041 (Order Assessing Civil Penalties) (Jul. 16, 2013) at 3.

6 *Barclays Bank PLC, et al.,* Staff Notice of Alleged Violations (Apr. 5, 2012).

7 *Barclays Bank PLC, et al.,* 144 FERC ¶ 61,084 (Order to Show Cause and Notice of Proposed Penalty) (Oct. 31, 2012).

8 Section 31(d)(3)(B) of the Federal Power Act permits the Commission to institute an action in federal court for an order affirming its assessment of a civil penalty if it has not been paid within 60 calendar days after assessment by FERC, but also gives the court authority "to review *de novo* the law and the facts involved . . . ." 16 U.S.C. § 823b(d)(3)(B).

9 144 FERC ¶ 61,041, Order Assessing Civil Penalties at 7. The Commission also found that one of the Barclays traders should be assessed $35 million in civil penalties, and that the remaining three traders should each be assessed a $1 million civil penalty.

Barclays continued to dispute FERC's allegations and refused to pay the civil penalty. On October 9, 2013, after the statutorily defined 60-day waiting period, FERC petitioned the U.S. District Court for the Eastern District of California to affirm its penalty assessment, with the Barclays Defendants thereafter exercising their right to obtain *de novo* review, filing a motion to dismiss on December 16, 2013.[10] While the Barclays Defendants advanced a number of arguments in their motion to dismiss, the motion was watched for a decision on arguments addressing the scope of FERC's jurisdiction and the scope of its anti-manipulation authority.

- *Trading Activity in Futures vs. Physical*

Among these was an argument advanced by the Barclays Defendants that, because the allegedly manipulative scheme "encompassed transactions 'involving' futures contracts," *i.e.*, Barclays' swap positions, the trading at issue fell within the exclusive jurisdiction of the Commodity Futures Trading Commission (the "CFTC"). In advancing this argument, the Barclays Defendants relied on a decision of the Court of Appeals for the D.C. Circuit in *Hunter v. FERC,* in which the Court found that where "a scheme, such as manipulation, involves buying or selling commodity futures contracts, [Commodity Exchange Act] section 2(a)(1)(A) vests the CFTC with jurisdiction to the exclusion of other agencies."[11] FERC, in turn, distinguished *Hunter* by arguing that the jurisdictional question hinged on the locus of the allegedly manipulative trades, which in *Barclays* meant the physical wholesale electricity market, a FERC jurisdictional market.

On May 19, 2015, U.S. District Judge Troy L. Nunley issued an order denying the Barclays Defendants' motion to dismiss and adopting FERC's jurisdictional argument.[12] As summarized by Judge Nunley for purposes of the motion to dismiss, "FERC determined that [the Barclays Defendants'] manipulative scheme involved three parts: (1) setting up a financial position; (2) building a physical position that was in the opposite direction to the financial position; and (3) flattening the physical position through trading [day-ahead fixed-price physical energy] to benefit the financial position."[13] Based on this formulation, Judge Nunley adopted the jurisdictional arguments advanced by FERC, stating that the Barclays Defendants had "not shown why swaps, as the benefiting position, are relevant to jurisdiction, as opposed to the trades involving physical products, from which the swaps were priced. FERC's allegation is that the manipulation occurred in the physical market and the swaps benefited, not the converse."[14]

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10 *FERC v. Barclays Bank PLC, et al.,* Case No. 2:13-cv-02093-TLN-DAD (E.D. Cal. Oct. 9, 2013) (Petition to Affirm Civil Penalties); *FERC v. Barclays Bank PLC, et al.,* Case No. 2:13-cv-02093-TLN-DAD (E.D. Cal. Dec. 16, 2013) (Motion to Dismiss).

11 Motion to Dismiss at 23, *citing Hunter v. FERC*, 711 F.3d 155, 159 (D.C. Cir. 2013). The *Hunter* decision itself created consternation among members of Congress regarding the proper scope of FERC's jurisdiction and the extent of its cooperation with the CFTC where there are perceived overlaps in regulatory oversight. For additional background on the *Hunter* case and Congressional reaction to that case *see* Daniel A. Mullen and Nathan M. Erickson, *Political Pressure May Push FERC, CFTC Closer Together* (Oct. 24, 2014), available at http://www.law360.com/articles/590135/political-pressure-may-push-ferc-cftc-closer-together.

12 *FERC v. Barclays Bank PLC, et al.,* Case No. 2:13-cv-02093-TLN-DAD (E.D. Cal. May 19, 2015) (Order on Motion to Dismiss).

13 Order on Motion to Dismiss at 6.

14 Order on Motion to Dismiss at 26. Judge Nunley separately stated that the Barclays Defendants had not, based on the hearing or their moving papers, "explain[ed] how the swaps actually were futures as plainly defined," though, based on his decision, this finding would not have been dispositive in his analysis. *Id*.

While Judge Nunley's decision reflects only a ruling on a motion to dismiss, and Barclays is yet to have its day in court on the substance of FERC's allegations, the decision is a significant one, as it is the first to address the revised jurisdictional position advanced by FERC in the wake of the *Hunter* decision. Unless and until another federal court takes a contrary position, Judge Nunley's decision will remain the guidepost for future line drawing between FERC and CFTC jurisdictional questions. Going forward, jurisdictional questions in manipulation proceedings involving both physical trading and futures contracts will be resolved by looking to the locus of the allegedly manipulative trades.

- *Meaning of "Entity" Under FPA § 222*

Judge Nunley's decision in the *Barclays* case is also of significance for being the first to address the issue of whether the term "entity," as used in the anti-manipulation statute found at FPA § 222 ("It shall be unlawful for any entity . . ."), encompasses individuals. The Barclays Defendants argued, as have other respondents in recent FERC proceedings, that the term "entity" was meant to address non-persons and does not encompass natural persons. In rejecting these arguments, Judge Nunley found that "a meaning of 'entity' that includes natural persons appears more consistent with the goals of FPA § 222 and the surrounding statutory scheme," and that it would be anomalous to model an anti-manipulation statue on the Securities Exchange Act of 1934, but "preclude enforcement against persons who engaged in manipulative trading."[15]

- *De Novo Review*

The Barclays Defendants continue to fight FERC's allegations and filed answers and a jury demand in response to FERC's petition on June 17, 2015. In its Answer, Barclays advanced the position that:

> "any purported findings, conclusions or determinations asserted in the Complaint by FERC are not based upon an evidentiary record developed in a contested proceeding before an objective trier of fact, are irrelevant and prejudicial, and should not be considered by the Court as part of its *de novo* adjudication of the law and facts. Under the plain language of the [FPA], the Federal Rules of Civil Procedure, and fundamental principles of fairness and due process, Barclays is entitled to full discovery and adjudication of the law and facts by this Court."[16]

This statement is meant to stake out the position of the Barclays Defendants on the scope of the federal court's *de novo* review, which stands in opposition to FERC's position that a federal court need not hold a trial *de novo* but instead merely rest its decision on the administrative record developed before the Commission. Judge Nunley has ordered the parties to address the scope of the proceeding called for pursuant to FPA § 31(d)(3)(B) in their joint discovery plan, and to outline a briefing schedule on this issue.[17] Going forward, it appears that the Barclays case will again present a first impression on this

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[15] *Id*. at 32. The Barclays Defendants separately advanced argument that "trades which involve willing counterparties made on the open market cannot be actionable under Section 10(b)." Judge Nunley found that, "as a blanket statement, this is not supportable," and is controverted by a number of precedents in the securities and commodities fraud context.

[16] *FERC v. Barclays Bank PLC, et al.,* Case No. 2:13-cv-02093-TLN-DAD (E.D. Cal. June 17, 2015) (Barclays Answer to FERC Petition to Affirm Civil Penalties) at 1.

[17] *FERC v. Barclays Bank PLC, et al.,* Case No. 2:13-cv-02093-TLN-DAD (E.D. Cal. June 2, 2015) (Stipulation and Order on Briefing Schedule).

issue in the federal courts and potentially provide significant guidance on the meaning of *de novo* review in this context.

FERC's Powhatan Proceeding

Ten days after Judge Nunley issued his order on the Barclays Defendants' motion to dismiss, FERC issued an Order Assessing Civil Penalties against Powhatan Energy Fund, LLC ("Powhatan"), Dr. Houlihan Chen, and two funds owned by Dr. Chen (collectively, the "Powhatan Defendants").[18] As in the Barclays proceeding, FERC's Order alleged that the Powhatan Defendants had violated FPA § 222 and the Commission's anti-manipulation rule at 18 C.F.R. § 1c.2 "through a scheme to engage in fraudulent Up-To Congestion (UTC) transactions in PJM Interconnection L.L.C.'s (PJM) energy markets to garner excessive amounts of certain credit payments to transmission customers."[19] The UTC payments at issue were built into the PJM market as a type of spread trade with the objective of allowing "market participants to arbitrage the difference between day-ahead and real-time congestion prices at two different locations."[20]

At the time of the trades at issue, PJM required market participants engaging in UTC payments to reserve transmission service, the reservation of which entitled UTC traders to become eligible for transmission credits known as Marginal Loss Surplus Allocation ("MLSA") payments. According to FERC's allegations, the Powhatan Defendants' scheme involved the placement of "a high-volume of 'round-trip' UTC trades that canceled each other out by placing the first leg of the trade from locations A to B, and simultaneously placing a second leg of equal volume from locations B to A."[21] FERC's Order assessed civil penalties of $16,800,000 against Powhatan, $1,000,000 against Dr. Chen and $10,080,000 and $1,920,000, respectively, against the funds controlled by Dr. Chen. Powhatan and the funds controlled by Dr. Chen were separately directed to disgorge unjust profits and applicable interest in the amounts of $3,465,108, $1,080,576 and $173,100, respectively.

As in the Barclays proceeding, the Powhatan Order Assessing Civil Penalties was preceded by an Order to Show Cause, with the Powhatan Defendants similarly electing to invoke their right to a prompt assessment by the Commission of a civil penalty amount, followed by *de novo* review of that penalty in federal district court.[22] The Powhatan Defendants have waged a vociferous and vocal public relations campaign against FERC's allegations in this matter and it is expected that, like the Barclays Defendants, they will pursue their remedies forcefully in federal district court. The Powhatan Defendants asserted as much in their Notice of *De Novo* Election, in which they noted their objection and opposition to FERC's "mangled view" of the statutory review scheme, under which they assert that FERC enforcement staff believes *de novo* review amounts to little more than a "perfunctory review" of the administrative record,

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18 *Powhatan Energy Fund, LLC, et al.*, 151 FERC ¶ 61,179 (Order Assessing Civil Penalties) (May 29, 2015).

19 Powhatan Energy Fund, LLC, et al., 151 FERC ¶ 61,179 at ¶ 2.

20 *Id. at* ¶ 3. FERC noted that, "[w]hen used appropriately, UTC trades in PJM permit financial traders to profit by arbitraging market prices between two locations in the day-ahead and real-time market; these transactions can benefit PJM's market by encouraging convergence between day-ahead and real-time market prices." *Id. at* ¶ 4.

21 *Id.* at ¶ 3.

22 *Powhatan Energy Fund, LLC, et al.*, Docket No. IN15-3-000 (Jan. 12, 2015) (Notice of De Novo Election).

"defined as the materials provided to the Commission, with no discovery or any of the adjudicative rights provided by the Federal Rules of Civil Procedure."[23]

If the Powhatan proceeding moves toward a full blown adjudication in federal district court, that case can be expected to provide additional guidance on the circumstances under which trading strategies that do not accord with the purpose behind established market structures, but instead seek to exploit "loopholes," constitute manipulation or fraud under FERC's regulatory scheme. While the Powhatan Defendants have not conceded that their strategy was designed to expose loopholes in PJM's market structure, their position before FERC has been that "even if they were exploiting a loophole, such behavior is neither fraudulent nor illegal," with Powhatan arguing that the process of exploiting loopholes is a "time-honored tradition" that serves to benefit the market and rule makers by exposing market inefficiencies.[24] In opposition, FERC has used the Powhatan case to further stake out its position that "[a]n entity need not violate a tariff, rule or regulation to commit fraud" and that trading carried out without regard for the market purpose of a product (here, in the case of UTC arbitrage trading, "to encourage convergence between the day-ahead and real-time markets") is inherently deceptive.[25]

Congressional Debate over the Future of FERC's Enforcement Program

The process-oriented arguments advanced by the Powhatan Defendants, and likely soon to be litigated by the Barclays Defendants, were recently the subject of letters sent to Gregory H. Friedman, the Inspector General for the Department of Energy ("DOE"), by U.S. Senators Susan M. Collins (R-Maine) and John Barrasso, M.D. (R-Wyoming) and U.S. Senator Robert P. Casey, Jr. (D-Pennsylvania). In the first of these letters, sent on July 18, 2014, Senator Casey wrote to "ensure that FERC is properly and fairly conducting investigations and taking enforcement actions," and to ask DOE's Inspector General to examine a number of policies and answer a series of questions regarding the transparency of FERC's enforcement process.[26] Among the questions presented by Senator Casey included inquiries suggesting concern about whether FERC-regulated entities were on appropriate notice regarding the types of conduct that FERC found to be violative. For example, Senator Casey asked Inspector General Friedman to determine if FERC has "appropriate authority to investigate instances of alleged market manipulation that may not be expressly or impliedly prohibited at the time they occurred," and whether FERC has ever "pursued enforcement actions against entities that were not in violation of then-current applicable laws and regulations."

Senator Casey's letter was followed by separate correspondence from Senators Collins and Barrasso on September 12, 2014 in which they wrote to address "questions and allegations" that had been raised

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[23] *Id*. The Powhatan Defendants went on to note that, "[i]n several recent court cases, Enforcement has contended that the Commission's show cause order process constitutes an adjudication, that a penalty assessment order constitutes an agency determination that violations occurred as well as a determination of sanctions, and that, as a result, there is no need for federal district court adjudication of anything." *Id*.

[24] Powhatan Energy Fund, LLC, et al., 151 FERC ¶ 61,179 at ¶ 56.

[25] *Id.* at ¶ 94 – 95. FERC separately noted in its Order Assessing Civil Penalties that it has been long-standing policy at the Commission that "wash trades are inherently manipulative" and that the "very nature of a wash trade is to conceal the purpose of the trade," which in Powhatan's case was to conceal the fact that UTC trades were used "to obtain transmission service reservations and thereby collect MLSA payments." *Id.* at ¶ 107.

[26] July 18, 2014 Letter from Senator Robert P. Casey, Jr. to DOE Inspector General Gregory H. Friedman, *available at* http://ferclitigation.com/wp-content/uploads/Letter-to-DOE-FERC-IG-07-18-14-1.pdf.

about "the fairness and transparency of FERC's enforcement program," including "allegations that the public, including FERC-regulated entities and their employees, are not being given actionable notice by FERC of the conduct, which under current law, FERC precedent, and applicable tariffs constitutes market manipulation."[27] Senators Collins and Barrasso sought detailed information on a number of issues related to FERC enforcement, including the willingness of FERC staff to share exculpatory materials with the targets of FERC investigations, and whether such targets are afforded the ability to secure *de novo* federal court review of enforcement proceedings in a way that is consistent with the Federal Power Act and FERC precedent. In response to this Congressional Interest, Inspector General Friedman notified Senator Barrasso that his office had made a determination to undertake "a review of aspects of FERC's enforcement program."[28]

While Inspector General Friedman has yet to release the results of his investigation, some members of Congress have shown an unwillingness to wait for additional feedback, and have instead worked to craft draft legislation that seeks to address the animating concerns found in the aforementioned Congressional correspondence.[29] The draft legislation includes two principle sections addressing FERC's enforcement function.

Section 4211 – FERC Office of Compliance Assistance

The first, Section 4211, is intended to address the perceived concern that FERC has not provided clear guidance to market participants on what is permissible under FERC regulations. Section 4211 proposes to establish within FERC an Office of Compliance Assistance that would be tasked with improving compliance with Commission rules and orders by, among other tasks, making recommendations to the Commission regarding consumer protection, market integrity and the development of responsible market behavior, and "the application of Commission rules and orders in a manner that ensure markets are not impaired and consumers are not damaged by inconsistent application."[30] The Office of Compliance Assistance would also allow regulated entities "the opportunity to obtain timely, including real-time, compliance guidance."[31] This guidance would be in addition to "outreach, publications, and where appropriate, direct communication with entities regulated by the Commission."[32]

During the recent House Energy and Power Subcommittee hearings on the proposed Title IV legislation, J. Arnold Quinn, Director of FERC's Office of Energy Policy and Innovation, testified that the Commission and Commission staff are already performing much of the work envisioned by Section 4211, and supplementing those efforts may prove to be not only duplicative, but could impede the Commission's

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27 September 12, 2014 Letter from Senators Susan M. Collins and John Barrasso, M.D. to DOE Inspector General Gregory H. Friedman, *available at* http://ferclitigation.com/wp-content/uploads/09-12-14-Collins-Barrasso-to-DOE-IG-with-attachments.pdf.

28 October 23, 2014 Letter from DOE Inspector General Gregory H. Friedman to Senator John Barrasso, M.D., *available at http://eelegal.org/wp-content/uploads/2015/04/DoE-OIG-FERC-Ltr-to-Sens-Barrasso-Collins.pdf.*

29 *See* Discussion Draft, Title IV – Energy Efficiency and Accountability, Subtitle B – Accountability, Chapter 1 – Market Manipulation, Enforcement and Compliance ("Title IV Draft") (May 20, 2015).

30 *See* Title IV Draft Section 4211(2)(b)(1)(A).

31 *See* Title IV Draft Section 4211(2)(b)(1)(B).

32 *See* Title IV Draft Section 4211(2)(b)(3).

ability to fulfill its mission.[33] Director Quinn noted that the Commission utilizes a detailed notice and comment process in connection with its pending cases, and elicits and thoroughly considers public comment in response to Commission or staff actions. Director Quinn reserved his strongest opposition to Section 4211's mechanism for providing real-time guidance on regulatory questions to market participants. Director Quinn noted that such guidance is already provided through no-action letters, legal opinions from FERC's Office of General Counsel, and interpretative letters issued by FERC's Chief Accountant.[34] While Director Quinn indicated FERC opposition to Section 4211, this criticism was largely based on process-oriented grounds and the need to maintain efficient operations at the Commission. In contrast, FERC reserved its more vocal criticism – presented during the House committee hearing by FERC Office of Enforcement Director Larry R. Parkinson[35] – for Section 4212, which proposes to alter FERC's investigative process.

Section 4212 – Improving Transparency in FERC Investigations

Section 4212 would require the Commission to issue a rulemaking concerning investigations (or any proceedings in which the Commission may assess a civil penalty) addressing four key issues relating to (1) the disclosure of exculpatory materials, (2) access to Commission transcripts, (3) the documentation of communications between advisory staff and investigatory staff, and (4) open communications channels between the subjects of investigations and the Commissioners regarding issues relevant to settlement.[36] During the Subcommittee's hearings, FERC Enforcement Director Parkinson lodged a number of objections to the draft bill. While Director Parkinson issued a number of unique objections, he noted that FERC is an outlier among federal agencies not for providing less process, but for providing what he described as "an enormous amount of process to investigative subjects during the investigative phase."[37] The draft Sections at issue, and Director Parkinson's specific objections to them, are as follows:

First, Section 4212(1) would require the Commission, not later than 7 days after the issuance of a preliminary findings letter, to "disclose to any entity or person subject to such investigation or proceeding any exculpatory materials, potentially exculpatory materials, or materials helpful or potentially helpful to the defense of such entity or person, including by ensuring disclosure of materials in the possession of other Federal or State agencies or non-governmental entities (including State regulatory authorities,

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33 *See* Testimonial Statement of J. Arnold Quinn, Director, Office of Energy Policy and Innovation, Federal Energy Regulatory Commission, Before the Committee on Energy and Commerce, Subcommittee on Energy and Power, U.S. House of Representatives (June 3, 2015), *available at* http://www.ferc.gov/CalendarFiles/20150603142502-Quinn-Testimony-06-03-2015.pdf.

34 *Id.* Director Quinn also observed that in 1978, the FPA was amended to contain a provision providing for a FERC Office of Public Participation, but noted that Congress has never authorized funding for such an office.

35 *See* Testimonial Statement of Larry R. Parkinson, Director, Office of Enforcement, Federal Energy Regulatory Commission, Before the Committee on Energy and Commerce, Subcommittee on Energy and Power, U.S. House of Representatives (June 3, 2015) ("Parkinson Statement"), *available at http://www.ferc.gov/CalendarFiles/20150603142526-Parkinson-Testimony-06-03-2015.pdf*.

36 *See* Title IV Draft Section 4212(1) – (4).

37 *See* Testimony of Larry R. Parkinson, Director, Office of Enforcement, Committee on Energy and Commerce Subcommittee on Energy and Power (June 3, 2015), *available at* http://www.ferc.gov/media/videos/staff/060315-parkinson.pdf.

Commission-approved regional transmission entities, and market monitors) assisting the Commission in such investigation or proceeding."[38]

Director Parkinson testified that, despite having no obligation to do so, FERC, more than five years ago, voluntarily adopted a policy requiring mandatory disclosure to the subject of an investigation any materials that a criminal prosecutor would have to provide to a defendant pursuant to the U.S. Supreme Court's decision in *Brady v. Maryland*. Director Parkinson stated that, under the *Brady* doctrine, subjects of investigations receive exculpatory evidence that is "material to guilt or punishment." Director Quinn testified that there is no Constitutional requirement to apply the *Brady* Doctrine in a civil, agency adjudication context, and objected strongly to the fact that the House's proposed revisions would go well beyond the requirements of the *Brady* Doctrine, and require not only the production of materials that are merely helpful or even *potentially* helpful, but compel the Commission to ensure that other, third-party agencies are also complying with the proposed rule. Director Parkinson characterized this requirement as "unprecedented in federal enforcement," and as a development that would likely cause "extraordinary delay" to FERC investigations.[39]

Second, Section 4212(2) proposes to require the Commission to "provide any entity or person subject to such an investigation or proceeding access to the official transcripts of any deposition involving such entity or person within a reasonable period of time after the conclusion of such deposition." [40]

Although Commission regulations already permit FERC witnesses to obtain a copy of their testimony transcripts, Director Parkinson acknowledged that this right currently comes with the caveat that the Commission can deny such requests whenever there is "good cause" to do so. Director Parkinson asserted in his prepared testimony that the Commission has delayed access to transcripts "only in the rare instance where there is a threat to the integrity of the fact-finding process."[41] By way of example, Director Parkinson expressed concern that the proposal to force FERC to release to witnesses "transcripts of *any* deposition involving such entity or person" could be used to force the identification of third-party witnesses, including, potentially, whistleblowers.[42]

Third, Section 4212(3) proposes to require the Commission, in any such investigation or proceeding, to document, in writing, "all communications regarding the merits of the investigation or proceeding between the investigatory staff of the Commission and the advisory staff of the Commission," and to place such written communications "in the formal record of the investigation or proceeding."[43]

Director Parkinson's perhaps most forceful protest to the proposed bill came in response to this section, which he called a "dramatic change to existing practice" that would "seriously undermine the Commission's ability to administer its enforcement function." Director Parkinson stated that, during the investigatory stage (and prior to adjudication), the Commissioners and their staff need the ability to have

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38 *See* Title IV Draft Section 4212(1).

39 *See* Parkinson Statement at 8.

40 *See* Title IV Draft Section 4212(2).

41 *See* Parkinson Statement at 8 – 9.

42 *See id*. at 9.

43 *See* Title IV Draft Section 4212(3).

open and candid attorney-client communications with the investigatory staff, whose activities the Commission is responsible for directing. Director Parkinson asserted that requiring such communications on the record, particularly without allowing for the protection of privileged communications, would place FERC's enforcement staff in an operational silo and "seriously impede the ability of the Commission to make informed decisions about enforcement matters and enforcement policy."[44]

Finally, Section 4212(4) proposes to permit "an entity or person subject to such an investigation or proceeding to communicate with the Commissioners regarding the substance of settlement considerations to the same extent as such communications occur between the Commissioners and the investigatory staff of the Commission." [45]

If Director Parkinson's objections to Section 4212(4) were slightly more muted than those to Section 4212(3), it is perhaps owing to his position that the subsection, as drafted, does not clearly state an objective and "fails to recognize that the attorneys in the Office of Enforcement act as *counsel to the Commission* and, as such, have an obligation to provide candid advice to the Commissioners regarding settlement considerations during the investigative stage."[46] Director Parkinson noted that practitioners have the ability to submit papers to the Commission during an investigation, and that any attempt to elevate investigative subjects to the same level as the Enforcement staff during the investigative stage would ignore the attorney-client relationship held by Enforcement staff and the Commission during an investigation.

Criticism for the draft House bill has not been limited to FERC's Office of Enforcement. Shortly after the recent House subcommittee hearings, Senator Maria Cantwell (D-Washington), a top-ranking Democrat on the Senate Energy and Natural Resources Committee, criticized the House bill, praising FERC's enforcement efforts and noting that, while it is important to assess the extent to which agencies have set the right priorities, "some in the House are more motivated to help Wall Street banks and their attorneys, who have complained that FERC is just being too tough on them."[47] Senator Cantwell also has been pushing legislation that could lead to the reform of FERC's enforcement process, though her proposals currently appear likely to lead to more, and not less, regulation. Senator Cantwell's bill, S.1420, the Energy Markets Act, proposes the creation of a Working Group on Energy Markets, comprised of the heads of a number of agencies, including FERC.[48] Among the responsibilities of the Working Group would be the conducting of a number of studies, including "an examination of the degree to which changes in energy market transparency, liquidity, and structure have influenced or driven abuse, manipulation, excessive speculation, or inefficient price formation."[49]

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44 *See* Parkinson Statement at 10 – 12.

45 *See* Title IV Draft Section 4212(4).

46 *See* Parkinson Statement at 12.

47 Statement of Senator Maria Cantwell (D-Washington) before the U.S. Senate Committee on Energy and Natural Resources (Jun. 9, 2015), *available at* http://www.energy.senate.gov/public/index.cfm/2015/6/cantwell-reform-shouldn-t-prioritize-wall-street-over-consumer-and-environmental-protections.

48 S. 1420 (114th Congress), Energy Markets Act of 2015, *available at* http://www.energy.senate.gov/public/index.cfm/files/serve?File_id=67d88717-063d-4967-be9e-07065df7546a.

49 S. 1420, Sec.4(b)(3).

Conclusion

The recent and heated debate over the future direction of FERC's Office of Enforcement is likely to continue as partisan factions, both in Congress and among market participants, come to grips with this burgeoning area of regulatory activity. FERC's modern enforcement function is a relative newcomer and, with only ten years of experience since the passage of EPAct 2005, participants in FERC-regulated markets should pay close attention to regulatory developments in this area. While there have been recent signals that lawmakers are interested in tweaking the current regulatory structure, it is important to realize that the current rumblings may not be the watershed moment for dialing back enforcement's strength, but a predictable reaction to a regulatory arm that is moving ever slowly forward.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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