



JONES DAY
COMMENTARY

FERC'S ENFORCEMENT PROGRAM— INCREMENTAL UPDATES

The Energy Policy Act of 2005¹ (“EPAAct 2005”) authorized the Federal Energy Regulatory Commission (“FERC”) to assess civil penalties up to \$1 million per day per violation of the Natural Gas Act (“NGA”), the Natural Gas Policy Act (“NGPA”), and Part II of the Federal Power Act (“FPA”).² EPAAct 2005 also gave FERC express authority over market manipulation in the natural gas and electricity markets. In addition, FERC also has the authority to order disgorgement of unjust profits and the ability to condition, suspend, or revoke market-based rate authority, certificate authority, or blanket certificate authority.

Since EPAAct 2005, FERC has issued several orders developing an energy enforcement program and laying out how it planned to operate under that program. FERC also has approved 17 enforcement settlements (assessing civil penalties and/or disgorgement of \$300,000 to more than \$12 million each) and issued two orders to show cause regarding alleged manipulation of the natural gas markets (together recom-

mending civil penalties and disgorgement of nearly \$500 million).

On May 15, 2008, FERC issued a package of orders intended to strengthen its enforcement program. The package of orders included: (a) a Revised Policy Statement on Enforcement; (b) an Interpretative Order that revises FERC's no-action letter process; (c) a Final Rule that sets out the rights of parties once FERC's Office of Enforcement decides to seek a show cause order; and (d) a Notice of Proposed Rulemaking proposing updates to FERC's *ex parte* policy and separation of functions and intervention rules in the context of enforcement investigations. These orders enhance existing policy, codify existing practice, and propose additional procedural safeguards.

On May 19, 2008, FERC issued an order approving an enforcement settlement among Edison Mission Energy, Edison Mission Marketing & Trading, Inc., and Midwest Generation LLC (collectively “Edison Mission”)

and FERC's Office of Enforcement. To settle allegations that it had misled FERC during an investigation, Edison Mission agreed to pay \$7 million in civil penalties and to assess and strengthen its current compliance programs at a cost estimated at an additional \$2 million.

This *Commentary* reviews the history of FERC's existing energy enforcement program, summarizes the orders described above, and describes how they might affect a company or individual subject to a FERC investigation.

REVISED POLICY STATEMENT

On October 20, 2005, shortly after EPCRA 2005, FERC issued its first Policy Statement on Enforcement (2005 Policy Statement).³ That initial policy statement set out the remedies available to FERC and explained how FERC would determine the appropriate remedy for a violation.

On May 15, 2008, FERC issued a Revised Policy Statement that reflects FERC's recent enforcement experiences, industry comment, and the need for more transparency.⁴ The Revised Policy Statement provides an overview describing how FERC conducts audits and investigations, and how FERC determines appropriate remedies for violations. It supersedes FERC's 2005 Policy Statement.⁵ It affirms and restates FERC's existing policies and adds to FERC's enforcement policies where needed.⁶

The Revised Policy Statement describes FERC Staff's investigation process.⁷ When faced with a possible violation, FERC's Staff will perform an informal review. After its informal review, Staff can either open an investigation (formal or informal) or close the review without further action.⁸ FERC's 2005 Policy Statement did not identify the factors that FERC's Staff would consider when deciding whether to open an investigation. The Revised Policy Statement fills that gap and explains that in deciding whether to open an investigation, FERC's Staff will consider: (a) the nature and seriousness of the alleged violation; (b) the nature and extent of the harm, if any; (c) the efforts made to remedy the alleged violation; (d) whether the alleged violations were widespread or isolated; (e) whether the alleged violations were willful or inadvertent; (f) the importance of documenting and remedying the potential violations to advance FERC policy objectives; (g) the likelihood of the

conduct recurring; (h) the amount of detail in the allegation or suspicion of wrongdoing; (i) the likelihood that Staff could assemble a legally and factually sufficient case; (j) the compliance history of the alleged wrongdoer; and (k) the Staff resources.⁹ The Revised Policy Statement also describes limitations on communications with the commissioners during the investigation process, the discovery process, the options at the end of an investigation, and the procedures applicable to settlement negotiations and show cause orders.¹⁰

The Revised Policy Statement describes in more detail the remedies available to FERC (*i.e.*, disgorgement, compliance plans, non-monetary measures, and civil penalties).¹¹ When determining the appropriate remedy, FERC will consider the seriousness of the violation, the company's culture of compliance, and the level of cooperation. The Revised Policy Statement identifies six *new* factors for evaluating the seriousness of a violation:

- What, if any, harm was there to the efficient and transparent functioning of the market?
- What are the earnings, revenues, and market share of the part of the company that is under investigation?
- What penalty amount best discourages improper conduct while not excessively discouraging beneficial market participation?
- What was the motivation of those accused of improper conduct?
- Was the integrity of the regulatory process impaired?
- Was there a risk of serious harm, even if the actual harm was slight or nonexistent?¹²

The Revised Policy Statement clarifies the factors that FERC will consider in analyzing whether a company has a strong culture of compliance and notes that FERC will hold periodic workshops to discuss the elements of a vigorous compliance program.¹³ In addition to readopting the compliance program evaluation factors set out in the 2005 Policy Statement, the Revised Policy Statement provides specific guidance regarding the development of compliance programs. FERC suggests that companies: (a) prepare an inventory of compliance risks and practices; (b) create an independent compliance officer reporting directly to the CEO and the board of directors; (c) provide sufficient funding for the compliance program; (d) identify measurable compliance targets;

(e) tie compliance to personnel assessment and compensation; (f) provide for disciplinary consequences for infractions; (g) provide frequent, mandatory training programs; (h) implement an internal “hotline” for anonymously reporting compliance issues; and (i) implement a comprehensive compliance audit program.¹⁴

The 2005 Policy Statement identified “self-report” and “cooperation” factors that FERC will consider when determining the proper remedy for a violation. The Revised Policy Statement specifically reaffirms and readopts those factors.¹⁵ The Revised Policy Statement states that FERC also will consider whether the company reasonably relied, in good faith, on guidance received from Staff through the No-Action Letter process or other FERC guidance.¹⁶ The level of credit will depend on the circumstances and could be negative if the company disregarded the Staff’s guidance.¹⁷

In late 2007, FERC Staff issued its Report on Enforcement.¹⁸ In that report, FERC Staff statistically reviewed FERC’s enforcement actions since EAct 2005. With the Revised Policy Statement, FERC directs its Staff to prepare a similar statistical report around September 30 of each year summarizing the enforcement activities for the preceding fiscal year. Finally, the Revised Policy Statement describes the audit process followed by FERC’s Division of Audits (a part of FERC’s Office of Enforcement).¹⁹ This division audits jurisdictional entities to ensure compliance with FERC’s statutes, regulations, and orders. The Division of Audits publicly discloses the initiation of an audit with a commencement letter that describes the purpose and scope of the audit.²⁰ While the information gathered during the audit is treated as nonpublic, the final audit report and the company’s response are released to the public.²¹ The final audit report will describe the audit’s methodology, findings, and recommendations.²²

The Revised Policy Statement is the core of FERC’s May 15, 2008 orders and lays out the key elements of FERC’s enforcement program. With it, companies subject to FERC’s enforcement authority should have a better idea of FERC’s procedures and considerations. Even so, the Revised Policy Statement represents more of an incremental update to the 2005 Policy Statement than a new enforcement program. It makes FERC’s existing enforcement practices more transparent rather than adding new practices or procedures.

OBTAINING FERC GUIDANCE

Regulated entities have several options for obtaining formal or informal guidance from FERC and its Staff regarding compliance with the agency’s statutes, rules, regulations, orders, and tariffs. These options include seeking declaratory orders, no-action letters, general counsel opinion letters, and accounting interpretations as well as calls to the enforcement hotline and other less formal contacts with Staff (such as meetings with Staff and calls to the compliance help desk).²³ Selecting an option will depend on a number of factors, including the subject matter, the urgency, the amount of reliance desired, and the level of confidentiality needed.²⁴ The procedures for receiving formal (*i.e.*, more binding) guidance require more time and are less confidential than the procedures for obtaining less formal (*i.e.*, less binding) guidance. FERC provides its most definitive interpretations in orders that result from pleadings subject to public review and comment.

FERC initially adopted the no-action letter (or “NAL”) process shortly after EAct 2005. Under that process, a company could obtain written advice from FERC’s Staff regarding whether the Staff would recommend that FERC take “no action” with respect to specifically proposed transactions, practices, or situations.²⁵ A company could seek a no-action letter only with respect to the following subjects: standards of conduct for transmission providers, affiliate restrictions for electric sellers, code of conduct for natural gas sellers, market behavior rules, and energy market manipulation rules.²⁶

On May 15, 2008, FERC issued a new Interpretive Order modifying the NAL process to make it more useful to the regulated community (the “NAL Interpretive Order”).²⁷ The NAL process now includes *everything* within the area of FERC’s energy markets jurisdiction except for issues relating to the licensing of hydroelectric projects, certification of natural gas pipelines, operation of LNG terminals, and enforcement of mandatory reliability standards.²⁸ Thus, a company may seek a no-action letter for any issue within FERC’s jurisdiction unless the issue arises under Part I of the FPA; Sections 215 and 216 of the FPA; Sections 2, 7, and 15 of the NGA; or Section 311 of the NGPA.²⁹

In the past, FERC allowed requestors to withdraw their NAL requests before the Staff responded. This sometimes

occurred when the requestor believed it would receive a negative response from the Staff. Under the NAL Interpretive Order, however, requestors no longer can withdraw a NAL request unless the requestor sought temporary nonpublic treatment of the NAL request and response but the Staff disagreed with the need for nonpublic treatment.³⁰ FERC eliminated the generally available withdrawal option because it felt negative NAL responses would be as instructive to other market participants as positive NAL responses.

Although the NAL Interpretive Order makes the NAL process available for a broader range of topics, it does not fundamentally change the procedures for seeking FERC guidance. That said, the no-action letters are a viable, low-cost³¹ process for receiving FERC Staff's guidance. That can be particularly important under the Revised Policy Statement where good-faith reliance on Staff's advice is a favorable factor in the level of penalty calculus.

RIGHT TO RESPOND *BEFORE* STAFF RECOMMENDS A SHOW CAUSE ORDER

Under FERC's previous rules, FERC's Staff only needed to tell the subject of an investigation under 18 C.F.R. Part 1b (the "Subject") of the Staff's intent to seek a show cause order if the Staff determined that the disclosure would be appropriate in the interest of proper administration of the law.³² The Staff's practice in most cases, however, had been to advise the Subject of the Staff's intent.³³

On May 15, 2008, FERC adopted revisions to 18 C.F.R. § 1b.19 codifying the Staff's current practice to provide that the Subject shall have, in all but extraordinary circumstances, the right to be informed of Staff's intent and the opportunity to provide FERC with a written nonpublic response to the Staff's recommendation if the Staff intends to recommend to FERC that it either: (a) initiate a proceeding governed by 18 C.F.R. Part 385 (e.g., a show cause order) against a Subject; or (b) make the Subject a defendant in a civil action to be brought by FERC.³⁴

The Staff's notification to the Subject must provide sufficient information and facts to enable the Subject to prepare its response.³⁵ The Subject will have 30 days to respond.³⁶ The Staff will submit its recommendation and the Subject's timely

response to FERC.³⁷ FERC will consider both the Staff's recommendation and the Subject's response when deciding whether to take further action.³⁸

These rules provide important rights to companies under investigation. Having the ability to submit a formal legal memorandum to FERC before it issues a show cause order provides the company with a valuable tool. This response option gives a company the opportunity to provide legal or factual analysis to support the validity of its activities or otherwise counterbalance the Staff's position.

***EX PARTE* COMMUNICATIONS AND SEPARATION OF FUNCTIONS DURING AN INVESTIGATION**

On May 15, 2008, FERC issued a Notice of Proposed Rulemaking ("NOPR") seeking comment on its proposal to revise its separation of functions rule³⁹ and intervention rule⁴⁰ as they apply to investigations under 18 C.F.R. Part 1b.⁴¹ The NOPR also proposed a new policy regarding the application of FERC's *ex parte* "off-the-record" communications rule⁴² during an investigation. The *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 FERC's decisional employees.

FERC proposed to revise Rule 2202 (FERC's separation of function rule) to bring it more in line with the procedures adopted in the Energy Transfer Partners enforcement proceeding.⁴³ As proposed, Rule 2202's separation of function restrictions would apply only once FERC issues a show cause order.⁴⁴ At that time, FERC would designate which of its Enforcement Staff would be considered "decisional" for the purposes of the proceeding.⁴⁵

Currently, FERC's *ex parte* rule, Rule 2201, does not apply to investigations under Part 1b.⁴⁶ Hence, a party under investigation is free to contact a FERC commissioner to discuss the investigation.⁴⁷ With the NOPR, FERC is proposing to establish a new policy that the commissioners and their personal staffs accept only *written* communications during the pendency of an investigation.⁴⁸ In-person and telephonic communications would not be accepted. The subject of an investigation may still contact decisional Staff (other than

commissioners and their personal staffs) about the investigation and may speak to commissioners and their personal staffs about other matters.⁴⁹

Finally, FERC proposes clarifying language in Rule 214 (FERC's intervention rule) as it applies to the proceedings resulting from an investigation.⁵⁰ The intervention rule currently states that interventions are not appropriate in an investigation.⁵¹ That rule, however, does not address whether interventions are appropriate in the enforcement proceedings that arise from investigations.⁵² In this NOPR, FERC proposes to revise its intervention rule to state specifically that intervention is not permitted as a matter of right in enforcement proceedings arising from Part 1b investigations.⁵³ The revision generally would prohibit interventions in enforcement proceedings, but would leave open the possibility that intervention may be appropriate in some circumstances.⁵⁴

The proposed rules and policies provide important procedural rights to companies under investigation. The proposals seek to limit inappropriate communications during the investigation process. The NOPR highlights that a company under investigation is permitted to communicate in writing with the commissioners and their personal staffs regarding the substance of the investigation during its pendency. Like the right to submit a formal response to FERC Staff's recommendation for a show cause order, companies under investigation should consider this procedural opportunity if they feel they might benefit from direct communications to the commissioners or their personal staff.

DUTY OF CANDOR DURING INVESTIGATION

Section 35.41(b) of FERC's regulations requires sellers authorized to engage in sales for resale of electric energy at market-based rates to provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with FERC.⁵⁵ On May 19, 2008, FERC approved a settlement between Edison Mission and FERC's Office of Enforcement.⁵⁶ The settlement resolved matters related to Edison Mission's conduct during an investigation. That conduct caused FERC's Staff to be misled prior to and during the investigation.⁵⁷ Edison Mission admitted to violating Section 35.41(b) of FERC's reg-

ulations and agreed to pay a \$7 million civil penalty and to assess and strengthen its current compliance programs at a cost estimated at an additional \$2 million.⁵⁸

The enforcement settlement with Edison Mission is unique because the civil penalty and compliance program do not relate to a substantive requirement regulated by FERC. Instead, it addresses actions taken by Edison Mission during the investigation process that caused FERC's investigation Staff to be misled.⁵⁹

Edison Mission's violations took place over a three-and-a-half-year period. Examples of Edison Mission's conduct include: omitting key facts in statements to FERC; providing inaccurate statements to FERC; recharacterizing facts when previous characterizations proved inaccurate; and failing to suspend its automatic email deletion program after a preservation order was issued (with Staff concerned about potential "selective" preservation of documents).⁶⁰ FERC noted that its Staff wasted significant time and resources analyzing different explanations offered by Edison Mission and that the violations were severe and not the types of data errors or omissions that might occur in an investigation involving large data production.⁶¹ Instead, Edison Mission's activities "were protracted, related to the core issues under investigation, and caused extensive misallocation of resources."⁶²

The Edison Mission settlement shows that FERC can and will strongly penalize a company if it fails to cooperate in an investigation. Edison Mission agreed to pay \$7 million for its violation of Section 35.41(b) and may spend an additional \$2 million on a mandated compliance effort. This \$7 million penalty and the \$2 million commitment constitute one of the largest assessments by FERC thus far.

Although 18 C.F.R. § 35.41(b) does not apply to all activities subject to FERC's enforcement authority, each of the NGA, NGPA, and FPA require regulated entities to respond to FERC's requests for information in the course of investigations, audits, and other inquiries.⁶³ FERC has concluded that engaging in obstructionist behaviors (like misrepresentation, delayed responses to data requests, or frivolous objections to information requests) may be viewed as an aggravating factor in determining the amount of a civil penalty.⁶⁴

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ENDNOTES

- 1 Energy Policy Act of 2005, P.L. No. 109-58, 119 Stat. 594 (2005).
- 2 See NGA § 22(a); NGPA § 504(b)(6)(A) and (C); FPA § 316A(b). Prior to EAct 2005, FERC only had authority to assess up to \$11,000 per day per violation under FPA Part II §§ 211-214 and up to \$5,500 per day per violation under the NGPA. FERC had no civil penalty authority under the other parts of FPA Part II or any part of the NGA. EAct 2005 did not change FERC's \$11,000 per day per violation civil penalty cap under FPA Part I.
- 3 *Enforcement of Statutes, Orders, Rules and Regulations*, 113 FERC ¶ 61,068 (2005).
- 4 *Enforcement of Statutes, Regulations and Orders*, 123 FERC ¶ 61,156 (2008).
- 5 Revised Policy Statement at P 13.
- 6 *Id.*
- 7 *Id.* at P 23-26.
- 8 *Id.* at P 24.
- 9 *Id.* at P 25.
- 10 *Id.* at P 28-40.
- 11 *Id.* at P 41-54.
- 12 *Id.* at P 55-56.
- 13 *Id.* at P 57-60.
- 14 FERC has scheduled a Compliance Workshop for July 8, 2008, that will focus on the elements of a sound compliance program. For more information, see the following web site: www.ferc.gov/enforcement/investigations.asp.
- 15 Revised Policy Statement at P 61-68.
- 16 *Id.* at P 69-71.
- 17 *Id.* at P 71.
- 18 *Conference on Enforcement Policy, Report on Enforcement*, FERC Docket No. AD07-13 (issued Nov. 14, 2007).
- 19 Revised Policy Statement at P 14-19. For more information on the Division of Audits audit process, see the "audits" tab under the "enforcement" tab on www.ferc.gov.
- 20 *Id.* at P 15.
- 21 *Id.* at P 15, 17.
- 22 *Id.* at P 17.
- 23 *Obtaining Guidance on Regulatory Requirements*, 123 FERC ¶ 61,157, at P 14-34 (2008).
- 24 *Id.* at P 15.
- 25 See *Interpretative Order Regarding No-Action Letter Process*, 113 FERC ¶ 61,174 (2005); *Interpretative Order Modifying No-Action Letter Process*, 117 FERC ¶ 61,069 (2006).
- 26 See *id.* at P 7.
- 27 See, generally, NAL Interpretive Order.
- 28 *Id.*
- 29 *Id.*
- 30 *Id.* at P 10.
- 31 Unlike a Petition for Declaratory Order, FERC does not charge a filing fee for a no-action letter request. NAL Interpretive Order at P 13.
- 32 *Submissions to the FERC upon Staff Intention to Seek an Order to Show Cause*, 123 FERC ¶ 61,159, at P 3 (2008) (citing 18 C.F.R. § 1b.19).
- 33 *Id.*
- 34 *Id.* at P 4-5.
- 35 *Id.*
- 36 *Id.*
- 37 *Id.*
- 38 *Id.*
- 39 18 C.F.R. § 385.2202.
- 40 18 C.F.R. § 385.214.
- 41 *Ex Parte Contacts and Separation of Functions*, 123 FERC ¶ 61,158 (2008) (comments due July 21, 2008).
- 42 18 C.F.R. § 385.2201.
- 43 See *Energy Transfer Partners, L.P.*, 121 FERC ¶ 61,282, at P 89 (2007).
- 44 *Ex Parte Contacts and Separation of Functions*, 123 FERC ¶ 61,158, at P 7-8 (2008).
- 45 *Id.*
- 46 See *id.* at P 9.
- 47 *Id.*
- 48 *Id.* at P 11.
- 49 *Id.*
- 50 *Id.* at P 14-17.
- 51 *Id.* at P 15.
- 52 *Id.*
- 53 *Id.* at P 16.
- 54 *Id.*
- 55 See *In re. Edison Mission*, 123 FERC ¶ 61,170, at P 2 (2008) (citing 18 C.F.R. § 35.41(b)).
- 56 *In re. Edison Mission*, 123 FERC ¶ 61,170 (2008).
- 57 Edison Mission had been under investigation regarding its bidding practices in the PJM power markets.
- 58 *Id.* at P 1.
- 59 *Id.* at P 10. The settlement agreement states that it resolves the investigation, Edison Mission's bidding strategy, and Edison Mission's representations to FERC's Enforcement Staff regarding bidding strategy. *Id.* (introduction to Article III of Stipulation and Consent Agreement). But, FERC's order states that the agreement makes "[n]o finding with respect to" Edison Mission's bidding strategy. *Id.* at P 10.
- 60 *Id.* at P 5.
- 61 *Id.* at P 2.
- 62 *Id.* at P 9.
- 63 FPA § 301(b); NGA § 8(b); NGPA § 304(a).
- 64 Revised Policy Statement at P 68.

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