

# The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms

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June 3, 2014

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Foundation of the  
Energy Law Journal



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The FERC Enforcement Process:  
Time for Structural Due Process  
and Substantive Reforms

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## Due Process is a Fundamental Right

The Government’s “interest is not that it will win its case, but that justice shall be done.” *Berger v. United States*, 295 U.S. 78, 86 (1935).

“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.’” *Brady v. Maryland*, 373 U.S. 83 (1963).

FERC’s stated goal is to “ensure that the subjects of an investigation receive due process both in perception and reality.” *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156 (May 15, 2008)



# Energy Law Journal Article Overview

- Background
- The FERC Enforcement Process
- Due Process Concerns and Suggested Procedural Reforms
- Substantive Issues and Suggested Reforms
- Next Steps

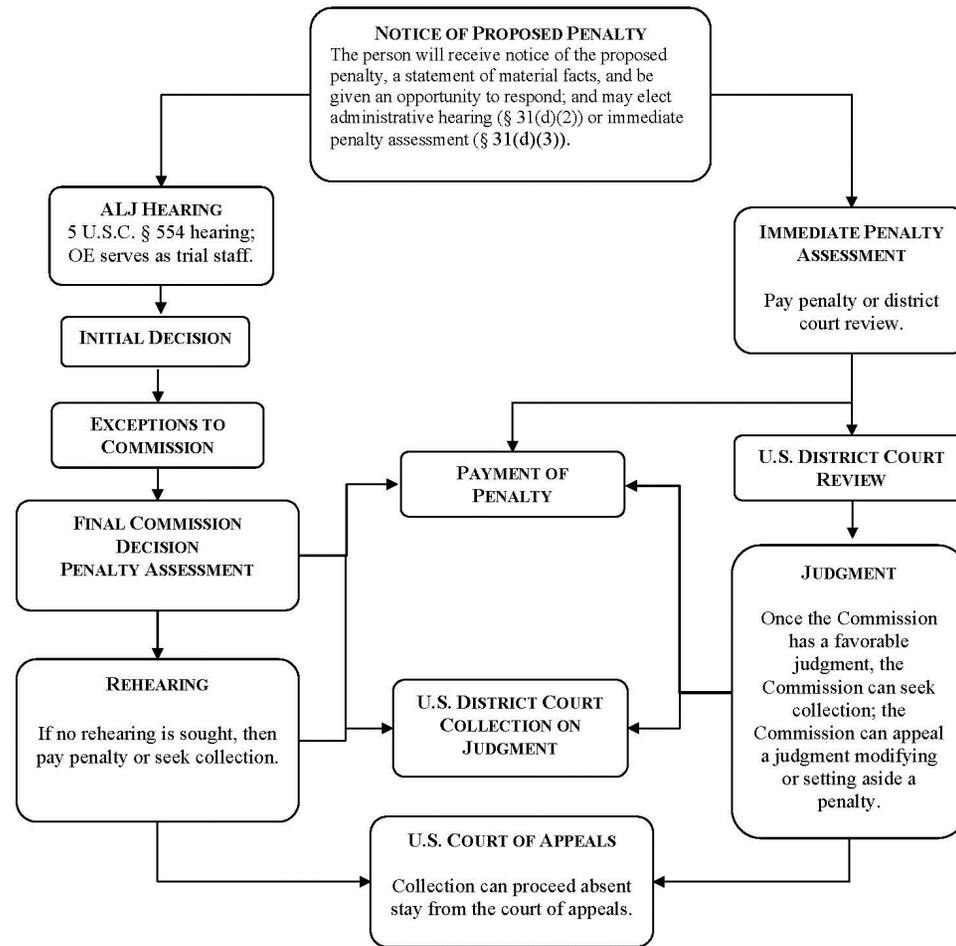
## Background

- Bill Scherman – Chair, Energy, Regulation & Litigation Group, Gibson Dunn & Crutcher, Former General Counsel and Chief of Staff of FERC
- Brandon Johnson – Of Counsel, Gibson Dunn & Crutcher, Former member of FERC Enforcement Staff
- Jason Fleischer – Senior Associate, Gibson Dunn & Crutcher
- 2010 *Energy Law Journal* Article: The New FERC Enforcement: Due Process Issues in the Post-EPA Act 2005 Enforcement Cases
- Some changes in FERC Enforcement, both good and bad
- 2014 *Energy Law Journal* Article: The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms

# FERC Enforcement Process

- FERC Investigations under Part 1b
  - Data Requests
  - Depositions
  - Third-Party Discovery
- FERC Section 1b.19 Process vs. SEC “Wells” Process
  - Preliminary Findings and Recommendation of Enforcement Action
  - Notice of Alleged Violations
- Settlement Discussions
- Show Cause Order and Notice of Proposed Penalty
- Civil Penalty Assessment Process

**PROCESS FOR FPA PART II PENALTY ASSESSMENT**



# Due Process Concerns and Suggested Procedural Reforms

- FERC Section 1b.19 Process v. SEC “Wells” Process
  - Provide a full and fair opportunities to raise defenses to Staff and Commissioners
  - “Such notice shall provide sufficient information and facts to enable the entity to provide a response.” 18 C.F.R. § 1b.19.
  - However, Enforcement Staff is “under no obligation to provide any response” to “legal and factual arguments.” Barclays Bank PLC, 144 FERC ¶ 61,041 at P 18 (2013)
- *Ex Parte* Communications and Separation of Functions
  - Rules should be triggered far earlier (*i.e.*, at conclusion of investigation)
  - Permit subjects to present case to Commissioners on equal terms as Staff
  - Enable Commissioners to act as impartial decision makers
- Disclosure of Exculpatory Evidence Required under *Brady*
  - Follow SEC approach of disclosing full investigative file
  - Reasonable sanctions for failure to disclose

# Due Process Concerns and Suggested Procedural Reforms

- Settlement Discussions
  - Part 385 protections do not apply to Part 1b. 18 C.F.R. § 385.101(b)(1).
  - In practice, everyone applies Part 385 Rule 602 , even Enforcement Staff
  - Amend Part 1b to provide Similar Protections, including Settlement Privilege and Right to Sever
- Penalty Calculations and Application of Penalty Guideline Factors
  - Transparency
  - Transparency
  - Transparency
- Part 1b Discovery Should Terminate when 1b Investigation Concludes
  - Barclays Discovery Order was inconsistent with the standards set forth in the Notice of Alleged Violations Order and should be reversed

# Due Process Concerns and Suggested Procedural Reforms

- Provide Subjects Reasonable Discovery Rights
  - Subjects have no access to testimony or documents from third parties
  - Issue would be solved simply by following SEC approach
- Adopt Reasonable Limitations on Staff Discovery
  - Currently no limits Staff discovery
  - Cost of discovery and defending depositions frequently exceed potential penalties
  - Soft Limits on sliding scale based on scope of investigation
- Adopt Mechanism to Resolve Discovery Disputes
  - Currently discovery disputes must be taken to the Commission or the District Courts
  - Appoint ALJ as Discovery Master for disputes in non-public proceedings
- Subjects Should be Granted Timely Access to Transcripts
  - Access to transcripts required under 1b.12 and 555(c) of the APA
  - Due process violation compounded by threat of prosecution for perjury, false statements

# Due Process Concerns and Suggested Procedural Reforms

- *De Novo* Review under FPA Section 31(d)
  - *De Novo* Standard of Review: No Deference to FERC
  - *De Novo* Scope of Review: Not limited to review of FERC “record”
  - Subject may elect to have liability adjudicated before FERC ALJ or U.S. District Court
- FERC Litigation Positions in Recent District Court Proceedings
  - FERC claims show cause proceeding is an adjudicative proceeding
  - No need for discovery or disclosure of full administrative “record” considered by FERC
  - District Court should “affirm” FERC determination based on review of FERC orders and materials presented to FERC in show cause proceeding
- FERC Investigations and Civil Penalty Proceedings
  - FERC proceeding is prosecutorial rather than adjudicatory
  - Subjects have no access to third-party materials considered by Staff or Commissioners
  - District Court proceeding is first and only opportunity to have full and fair hearing, and FERC position would deny subjects of *any* opportunity to adjudicate claims against them

# Substantive Concerns and Suggested Reforms

- FERC Does Not Provide Constitutionally Required Fair Notice
- FERC Applies Anti-Manipulation Rule to:
  - Lawful, non-fraudulent conduct
  - Conduct permitted by tariff or ISO/RTO market rules
  - Conduct previously found lawful
- FERC Must Revise Rule to Provide Fair Notice
  - Abandon interference with “well-functioning market” theory and instead show fraud
  - Adopt “safe harbor” for conduct permitted by tariff or ISO/RTO market rules
- FERC Must Clarify Scope of False Statement Rules
  - Adopt a clear intent requirement given potential criminal liability
  - Staff’s disagreement with a statement not sufficient for violation
- FERC Cannot Treat Settlements as Precedent
  - “Black box” settlements provide insufficient guidance for treating conduct as unlawful
  - Settlement should detail conduct, subject’s defenses, and FERC’s responses thereto

## Next Steps

- Technical Conferences Are Needed
  - Procedural Reforms
  - Structural Reforms
- Notice of Proposed Rulemaking on Substantive Issues
  - Adopt a Definition of Conduct Prohibited by Anti-Manipulation Rule, but the Definition MUST Comply With the Statute – Fraud Means Fraud
  - Eliminate the “impairing, obstructing or defeating a well-functioning market” definition of fraud
  - Reinstate the Safe Harbor in Order No. 670 and Adopt Other Safe Harbors
  - Clarify Rules Applicable to False Statements
- Notice of Proposed Rulemaking on Procedural Issues
  - Amend Rules on 1b.19 “Wells” Process
  - Amend Rules on *Ex Parte* Communications and Separation of Functions
  - Adopt SEC Rules regarding Access to Investigatory File & *Brady* Materials
  - Amend Part 1b Requirements regarding Discovery & Discovery Disputes
  - Amend Part 1b Requirements to Add Settlement Privilege



Questions?



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William S. Scherman is a partner in the Washington, D.C. office of Gibson, Dunn & Crutcher and Chairs the Energy, Regulation and Litigation Practice Group. Mr. Scherman has served as general counsel for the Federal Energy Regulatory Commission and was chief of staff and senior legal and policy advisor for the FERC beginning in 1987. He advises companies on litigation, commercial, regulatory and legislative matters relating to the U.S. and international energy markets. He has litigated high-profile energy investigation and enforcement matters before the FERC and in the federal courts and represents large electric utilities before the FERC and state regulators.

Before joining Gibson Dunn, Mr. Scherman was a partner at Skadden Arps. Before that, he served as the General Counsel of the FERC from 1990 to 1993 and as the Chief of Staff from 1987 to 1993. During his tenure at the FERC, he played a key role in major policy initiatives, including the Energy Policy Act of 1992 and Order No. 636, which reformed the natural gas pipeline industry. As FERC's chief legal officer, he was responsible for the agency's litigation strategy before federal appellate courts.

During the last several years, Mr. Scherman has been heavily involved in very high-profile trials before the FERC. He utilizes his experience in market power issues in advising companies on mergers and acquisitions. Mr. Scherman has defended clients in extended trials addressing cutting-edge issues. This includes a six-month trial before the FERC regarding whether certain affiliated company power supply arrangements are in the best interest of the utilities customers.

Mr. Scherman is a frequent speaker on energy issues at various industry and government conferences. He is a member of the Keystone Energy Board, a prominent non-profit think tank that seeks bipartisan policy consensus on key energy and environmental issues, and regularly participates in the Harvard Electricity Policy Group. He is recognized as a leading practitioner in energy law in various publications including *The Best Lawyers in America*®, *Chambers Global*, and *Chambers USA: America's Leading Lawyers for Business*.

Mr. Scherman received his Juris Doctor degree from the University of Louisville School of Law where he was an Articles Editor of the *Law Review*. He received his B.A. degree from George Washington University in 1980. Mr. Scherman is admitted to District of Columbia bar.



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Brandon Johnson is Of Counsel in the Washington D.C. office of Gibson, Dunn & Crutcher, and a member of the firm's Energy Regulatory practice and the firm's Energy and Infrastructure Practice Group. Mr. Johnson's practice focuses on energy regulatory matters and the regulatory aspects of energy transactions, and he has represented clients in numerous proceedings before the Federal Energy Regulatory Commission (FERC).

Over the course of his career, Mr. Johnson has represented and advised independent power producers, electric power and natural gas marketers, merchant transmission developers, interstate pipelines, local distribution companies and trade associations in connection with a wide range of regulatory, administrative litigation and transactional matters arising under various federal and state laws, including the Federal Power Act, the Public Utility Regulatory Policies Act of 1978, the Natural Gas Act, the Natural Gas Policy Act of 1978, the Public Utility Holding Company Act of 2005, and the Energy Policy Act of 2005. In this capacity, he has advised clients on negotiating agreements and structuring transactions to satisfy regulatory requirements, including interconnection agreements, electric power and natural gas contracts, transmission service agreements, pipeline leases, and mergers and acquisitions. In addition, he has represented independent power producers and power marketers in merger and other antitrust investigations conducted by the U.S. Department of Justice.

Before joining the firm, Mr. Johnson was an associate in the Washington, D.C. offices of King & Spalding and Kirkland & Ellis. Prior to entering private practice, he was a staff attorney in FERC's Office of the General Counsel and Office of Enforcement from 2004 to 2007, where he conducted investigations of electric and natural gas market manipulation and other violations of FERC rules, including responsibility for depositions, document productions and federal court briefs, and drafting FERC orders and federal court briefs and motions. He also drafted orders and rules on mergers, market-based rates, ISO/RTO rules, and implementation of the Energy Policy Act of 2005. From 2000 to 2003, he practiced U.S. antitrust and European Union (EU) competition and energy regulatory law at leading international firms in Brussels, Belgium.

Mr. Johnson received his Juris Doctor, *cum laude*, from The University of Michigan Law School in 2001. In addition to his law degree, he earned a Bachelor of Arts, with highest distinction, in philosophy from the University of Kansas in 1996, an LL.M., *cum laude*, in EU law from Katholieke Universiteit Leuven in 2001, and a Masters of Arts in Economics from George Mason University in 2008. Mr. Johnson is a member of the New York and District of Columbia Bars, and is admitted to practice before the U.S. Court of Appeals for the District of Columbia Circuit and the U.S. District Court for the District of Columbia.



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Jason J. Fleischer is a senior associate in the Washington, D.C. office of Gibson Dunn whose practice focuses primarily on energy litigation, regulatory and transactional matters before the Federal Energy Regulatory Commission, the Commodities Futures Trading Commission, other federal agencies and the federal courts.

Mr. Fleischer has represented a wide variety of electric utilities, investment banks, power marketers and natural gas companies and pipelines in agency investigations and enforcement matters including alleged market manipulation, market power, and reliability matters, and transactional matters including mergers and acquisitions. In addition, he has assisted clients with crisis management, strategic planning, internal corporate investigations and Congressional investigations.

Mr. Fleischer's recent representations include:

- two investment banks and several electric utilities, energy marketers, natural gas pipelines and private individuals in FERC and CFTC enforcement investigations relating to alleged market manipulation;
- companies involved in the San Diego and Texas Power Outage reliability investigations and several other companies in FERC-initiated reliability audits and investigations;
- two natural gas pipelines in FERC-initiated FPA Section 205 rate proceedings;
- companies in Congressional investigations relating to the practice of hydraulic fracturing (i.e. "fracking");
- several electric utilities and natural gas pipeline companies in mergers and acquisitions and development projects; and

Mr. Fleischer graduated *magna cum laude* from American University Washington College of Law in 2006 where he was a member of the Order of the Coif and the American University Law Review. He received his undergraduate degree from the University of Maryland, Baltimore County where he graduated *cum laude* and was a member of Phi Beta Kappa.

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