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FERC's electric enforcement process is a procedural quagmire in need of reform

After repeated losses, FERC may consider changing its electric enforcement procedures, but poorly conceived reforms could lead to an existential crisis in Federal Power Act enforcement.

By Wesley J. Heath

The following is a viewpoint from Wesley J. Heath, of counsel at Steptoe & Johnson LLP in the Energy and Financial Services practices.

In its electric enforcement program, the Federal Energy Regulatory Commission (FERC) through its Office of Enforcement has been fighting an unsuccessful war to convince courts to allow substantial fines through a summary procedure rather than through conventional fact-finding trials.

Since 2013, FERC has exercised the enforcement authority it received following the 2000-01 Western Power Crisis to bring electric cases seeking fines and disgorgement of profits against alleged manipulators and other violators. FERC's procedural process in electric enforcement cases is complicated but generally involves the agency issuing an administrative order assessing penalties, based on paper submissions rather than a trial-type proceeding, followed by a subsequent lawsuit in federal court.

Once in federal court, FERC has argued that the Federal Power Act (FPA) does not entitle defendants to normal civil process and a trial on the merits but instead permits courts to use a summary procedure to review FERC's prior work in assessing penalties. As a practical matter, FERC's position has invited courts to defer to FERC's administrative findings, a potential outcome that would make fighting FERC in court much less appealing.

All seven courts to consider FERC's argument have rejected it. The conventional wisdom is that FERC will now drop its summary procedure argument and streamline its elaborate and time-consuming penalty assessment processes to which courts have refused to defer. The agency may decide to adopt that approach. But we would do well to keep in mind that sometimes, as Dr. Laurence J. Peter memorably put it, **"[b]ureaucracy defends the status quo long past the time when the quo has lost its status."**

Rather than streamlining, FERC may instead consider expanding its pre-court penalty assessment process in the hope that a future court will defer to its findings. Although the latter approach makes sense if FERC's goal is to attempt to maximize its authority, an unintended consequence could be the creation of an existential issue for effective FPA enforcement.

A brief history of FERC's electric enforcement procedural quagmire

In response to alleged manipulation during the 2000-01 Western Power Crisis, Congress passed the Energy Policy Act of 2005, updating the FPA to provide FERC with **anti-manipulation** authority and **penalties** up to a million dollars per violation.

While these provisions were new, Congress mandated that FERC's electric penalty process, although not its natural gas one, follow an earlier 1986 FPA amendment for hydroelectric dam regulation penalties. Under that **provision**, the Commission provides notice of the proposed penalty, and the defendant elects either a FERC administrative hearing or litigation in federal court.

The **administrative hearing option** involves a trial-type proceeding before an administrative law judge (ALJ) with Commission review of the ALJ's findings, followed by judicial review in a federal appellate court. If a defendant elects the federal court option, **"the Commission shall promptly assess such penalty, by order."**

Although a few other virtually unused statutory penalty provisions, like those in the **Atomic Energy** and **Power Plant and Industrial Fuel Use Acts**, pose a similar choice between administrative and court procedures, Congress did not explain its intent in providing this choice when it amended the FPA in 1986.

The FPA also contrasts with court enforcement provisions involving the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) that do not require an administrative order assessing a penalty before a lawsuit but rather authorize the agencies to file cases directly in federal court.

Most FERC investigations close with no action or settle prior to litigation. However, for those electric investigations that go to litigation, FERC implements its unique penalty assessment process by issuing a lengthy and detailed "order to show cause" to which defendants file answers and FERC's Office of Enforcement files a reply.

If defendants elect the federal court process, FERC writes a lengthy assessment order, deciding the merits of the case and assessing penalties based on its findings. If FERC assesses penalties, the Office of Enforcement, after a mandatory 60-day waiting period, files a **federal court lawsuit** to enforce those penalties.

The FPA provides that in the federal court lawsuit, **"[t]he court shall have authority to review de novo the law and the facts involved."** "De novo" is Latin for **"anew."** Prior to filing these cases in the last five years, the agency had stated that the FPA provided for a **"trial de novo,"** i.e., a full civil process culminating in a trial.

In these cases, FERC changed its position, arguing instead that the courts could and should conduct "reviews" of FERC's detailed factual findings and legal conclusions in assessing the penalty and should not allow defendants to use standard civil discovery to obtain evidence.

In FERC's new view, the FPA guarantees a defendant a trial only if it elects the FERC ALJ hearing option. Although to date no appellate courts have weighed in, the federal district courts where FERC brought these cases (listed at the end of this article) have unanimously rejected FERC's argument. A number of them found FERC's position that a court could order substantial penalties without additional civil process or a trial raised serious constitutional concerns.

Premature rumors of death for FERC's summary procedure argument

FERC now faces the questions of whether to abandon its summary procedure argument in future court proceedings and whether to change its penalty assessment process that takes place before court. One Commissioner has emphasized the need to arrive at a **"fair and legally defensible"** process.

Conventional wisdom has been that FERC will likely abandon its summary procedure argument and streamline its assessment and other internal processes.

Changing its lengthy internal processes would get FERC to court quicker and help avoid statute of limitations challenges. FERC has faced those challenges as its internal processes, both during the penalty assessment and investigation, have arguably resulted in it failing to file some cases in court within five years under the relevant **statute of limitations**.

One court found that FERC must file a case in court within five years of the actual behavior that allegedly caused a violation. **Another** held that FERC has five years after its penalty assessment to file in court. A third court is considering the issue. Streamlining FERC's electric enforcement procedures seems prudent and arguably necessary to avoid having future cases dismissed.

Nevertheless, FERC may consider the opposite approach — adding to the pre-court administrative process in an attempt to rescue its summary procedure argument. If FERC were to adopt this course, its hope would be that a new and improved process could obtain the deference for FERC's assessment findings that courts previously rejected.

When viewed from the standpoint of maximizing deference, adding procedure and trying the summary procedure argument on a new court could be appealing. Continuing a process that allows FERC to decide the merits of electric enforcement cases via penalty assessments might also seem more normal from the agency's perspective as the majority of FERC's workload is adjudicating rate disputes.

Adding additional process could take a variety of formats.

Allowing defendants discovery during the assessment process at FERC is an option that could consist of authorizing document requests to the Office of Enforcement and third parties as well as providing defendants an opportunity to take some depositions. Going further, FERC could even attempt to institute a full ALJ trial-type hearing before issuing an assessment.

A full hearing pre-assessment option is likely to be very burdensome for both the Office of Enforcement and defendants. However, FERC ordered a full agency **hearing** as a precursor to a later federal court proceeding once before in a 2007 case involving the Natural Gas Policy Act, a statute also providing for federal court **"de novo" review** although not providing the alternative, stand-alone agency hearing option contained in the FPA.

More recently, in June, FERC initiated its first FPA **penalty assessment** since repeatedly losing its summary procedure argument. FERC did not change its assessment process at all or indicate that it would stop advocating for courts to use a summary procedure.

Interestingly, **statute of limitations** was an issue in the case. Although the Office of Enforcement has moved to **withdraw** the case for other reasons, FERC's commencement of a new assessment without announcing any changes suggests that FERC is willing, at a minimum, to continue its battle over the meaning of its process for statute of limitations purposes and that procedural reform is not an immediate priority.

It also further calls into question the prospect that FERC will streamline its processes and abandon its summary procedure argument, raising the likelihood that any forthcoming reform could provide more rather than less process at FERC.

A potential existential crisis and some possible solutions

If reform adds administrative process, FERC would effectively be seeking to transform its current informal assessment process conducted on paper submissions into something that seems a bit more like traditional agency formal adjudication.

Formal adjudication is the process under the **Administrative Procedure Act** with an agency ALJ hearing that has document discovery, cross-examination of witnesses and other procedural protections similar to a court trial.

A full pre-court hearing seems unlikely.

A more probable route could be establishing limited and defined discovery rights during the FPA penalty assessment. However, this course could potentially result in the worst of all possible outcomes — expanding an already lengthy and expensive penalty assessment process for defendants and for FERC itself while not solving the fundamental problem identified by the courts.

The resource expenditure for FERC would entail not just having its Office of Enforcement litigate the inevitable discovery disputes but also having the Commission decide them. More important, adding additional process would not meet the courts' primary objection that the FPA requires FERC to prove its case in a federal court trial.

FERC investing further in its cumbersome penalty assessment process could have dire consequences for its electric enforcement program.

Although few investigations result in litigation, those that do establish the law on manipulation and other violations, provide the procedures for deciding cases and set the program's tone. Therefore, FERC's success or failure in litigated cases plays an outsized role in its program's viability.

Adding procedure to the assessment process will further delay FERC getting to court, potentially rendering statute of limitations fatal for many electric enforcement cases.

Even if FERC were to overcome statute of limitations arguments, it would still be stuck litigating, and likely trying, cases many years removed from the underlying activity. The unanticipated consequence of FERC adding additional pre-court procedure could be an impairment of its ability to enforce the FPA, creating a potential existential issue for its electric enforcement program.

But FERC has options other than adding process.

The Commission could abandon its summary procedure argument and truncate its assessment process as many expect.

Another option would be for FERC to retain its current process but agree that the FPA provides for the federal court to employ standard civil procedure including a trial to resolve factual disputes. This may have some appeal to FERC because the agency would still decide cases even if its conclusions receive no deference from the courts.

Congress alternatively could eliminate FERC's penalty assessment process and require filing of electric enforcement cases directly in federal court like the SEC and CFTC do in many enforcement cases. This would have the apparent advantages of clarifying FERC's role by delineating it as an enforcer and not an adjudicator in enforcement cases and of eliminating an inefficient and burdensome penalty assessment process.

On the other hand, FERC could instead propose Congress eliminate the federal court option and provide for an agency hearing in all enforcement cases, an option likely to be highly controversial.

Congress also has other options.

For example, Congress could assign certain classes of FPA enforcement cases arguably benefiting from FERC's technical expertise, such as electric tariff and system reliability requirements, to the FERC administrative hearing process.

Other cases, like market manipulation, could go to federal court, a forum that has extensive experience handling financial fraud. Congress would have to decide whether FERC or a federal court handles cases that have both tariff and manipulation charges.

Another approach would be to allow defendants or even FERC to choose between FERC administrative or federal court adjudication while providing that for court cases, no FERC penalty assessment occurs.

As a **judge** recently noted, the FPA's "atypicality" has "confounded a series of courts," and "[i]t would seem advisable for Congress or FERC to clarify the expected procedure."

The current statute and lengthy FERC process are standing in the way of getting to court where court decisions, settlements or trials can resolve contentious cases. Anecdotal evidence supports this conclusion as four out of seven cases FERC brought settled after reaching court.

A clearer process could allow better use of FERC resources while protecting defendants' legitimate right to be judged only after a full civil process, including a trial if necessary. Industry could also benefit from a system that resolves enforcement cases more efficiently and provides legal decisions around which it can adjust behavior and assess risk.

The current quagmire benefits no one except the lawyers.

Cases rejecting FERC's proposed summary procedure under the FPA:

FERC v. Coaltrain Energy, L.P., 2:16-cv-00732-MHW-KAJ, slip op. at 7-8 (S.D. Ohio Mar. 30, 2018);

FERC v. Powhattan Energy Fund, LLC, 286 F. Supp. 3d 751,757-71 (E.D. Va. 2017);

FERC v. Barclays Bank PLC, 247 F. Supp. 3d 1118, 1123-38 (E.D. Cal. 2017);

FERC v. Etracom LLC, No. 2:16-cv-01945-SB, 2017 U.S. Dist. LEXIS 33430, at *2-10 (E.D. Cal. Mar. 7, 2017);

FERC v. Silkman, 233 F. Supp. 3d 201, 218-28 (D. Me. 2017);

FERC v. City Power Mktg., LLC, 199 F. Supp. 3d 218, 230-32 (D.D.C. 2016);

FERC v. Maxim Power Corp., 196 F. Supp. 3d 181, 188-97 (D. Mass. 2016).