



**IMPLEMENTATION OF THE
FEDERAL ENERGY REGULATORY COMMISSION'S
ENFORCEMENT AUTHORITY**

A WHITE PAPER

Submitted on Behalf of

**American Gas Association
Edison Electric Institute
Electric Power Supply Association
Independent Petroleum Association of America
Interstate Natural Gas Association of America
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This White Paper expresses the collective views of a broad range of energy trade associations regarding current enforcement policy and activities of the Federal Energy Regulatory Commission (“FERC” or the “Commission”).¹ These energy associations broadly span the various segments of both the gas and electric industries and offer this constructive analysis to support the Commission’s use of its enforcement authority to foster a culture of compliance by market participants. The Commission must deter those who might be inclined to choose a different path, facilitate self-reporting, ensure that the assessment of civil penalties fits the violation, and avoid chilling legitimate market behavior.

Executive Summary

FERC’s enhanced civil penalty authority should be one of many tools that it uses to achieve its long-term policy goals of developing energy infrastructure, nurturing competitive markets, ensuring reliability, and protecting consumers. While the Commission’s current enforcement policy provides a solid initial framework for achieving these goals, it must evolve to respond to the challenges raised by the dynamic markets it regulates. It is essential that the Commission remain committed to firm but fair enforcement and increase its efforts to promote a culture of compliance. At the same time, if the Commission’s policy goals are to be achieved, it is important that market participants also remain committed to cooperation and compliance.

¹ This White Paper addresses issues raised by the Commission’s enforcement program as a whole. It does not, however, deal directly with particular issues raised by new mandatory reliability rules being implemented by the Commission and the Electric Reliability Organization under section 215 of the Federal Power Act.

Market participants want to comply with the law and the Commission's regulations for a good reason -- it is the right way to operate. In addition, they value their commercial reputations, want to maintain competitive market environments, seek to provide innovative and market-responsive services, strongly support industry reliability, and understand the costs of non-compliance.

However, certain FERC regulations and various aspects of FERC's enforcement policies and actions lack clarity. Lack of clarity sows confusion, creates unnecessary risk, and chills legitimate market behavior. Some market participants that thought they were in compliance are now discovering that this may not be the case.

Market participants who desire to take the steps necessary to achieve full compliance need assistance from the Commission to develop a better compliance "road map." Because FERC and market participants have the same goals -- to support the development of necessary energy infrastructure, ensure a reliable energy supply, promote competitive markets, and protect consumers -- market participants urge FERC to take further steps to promote and facilitate compliance with the energy laws and regulations it administers.

There are a number of immediate steps FERC can take to promote compliance by market participants. Many of these steps are drawn from the enforcement policies of other federal agencies. The steps recommended by market participants include:

- clarifying, simplifying, and codifying (where appropriate) certain Commission policies and rules, thereby reducing regulatory uncertainty
- increasing efforts to educate market participants about Commission policies and rules and to provide guidance they can rely on
 - broadening the scope of the no-action letter program
 - establishing a Help Desk to supplement the no-action letter process
 - educating market participants about FERC's policies and rules
 - holding public workshops to provide guidance on what steps market participants can take to achieve compliance
 - publishing questions and answers to commonly asked questions that market participants can rely on
- encouraging self-reporting
 - providing additional information about the Commission's process for crediting market participants for self-reporting, and promptly issuing closing letters at the conclusion of investigations of self-reported violations
 - providing mitigation of penalties when market participants make good faith efforts to comply with rules
 - offering amnesty under appropriate circumstances to encourage self-reporting
- providing more clarity about the levels of civil penalties the Commission will assess, and establishing gradations of civil penalties that better match the severity of the violation
- ensuring that the processes used to implement enforcement policy reinforce long-term policy goals and promote due process
 - developing a more transparent compliance audit process (along with a guidebook and audit questions), and promptly issuing closing letters at the conclusion of audits
 - incorporating letters of warning or reprimand into FERC's enforcement process
 - expanding the use of mediation

- determining whether it is in the public interest for the Commission to be both “prosecutor and judge” in adjudicating civil penalty liability under the Natural Gas Act
- reviewing and modifying, as appropriate, its Separation of Functions Policy Statement with respect to Enforcement Staff
- inviting an expert panel to regularly review FERC’s enforcement policies and actions
- developing measurements of success that tie enforcement actions to long-term policy goals and that measure industry compliance

In the long run, consumers will reap the benefits of the market-wide culture of compliance that FERC and market participants work together to build, and market participants will have much greater confidence in the clarity, balance, and overall fairness of the Commission’s enforcement policy. Overall, true compliance must be fostered through cooperation and the joint efforts of FERC and market participants.

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I. FERC Should Implement Its Enforcement Policies in a Firm but Fair Manner, Intensify Its Efforts to Promote a Culture of Compliance by Working Cooperatively with Market Participants, and Build Upon Its Enforcement Policy Statement So Improvements Can Be Made

The Energy Policy Act of 2005 (“EPAAct 2005”)² ushered in a new era of enforcement at FERC.³ Most significantly, it granted the Commission broad power to enforce Part II of the Federal Power Act (“FPA”) and all substantive provisions of the Natural Gas Act (“NGA”) and the Natural Gas Policy Act (“NGPA”) by levying civil penalties of up to \$1 million per day per violation.⁴ While the strength and breadth of this enhanced civil penalty authority is well recognized, achieving the Commission’s policy goals ultimately will depend on how the Commission fleshes out the day-to-day meaning of firm but fair enforcement policies and coordinates joint efforts with entities that are subject to FERC enforcement actions⁵ to ensure a market-wide culture of compliance.

The Commission’s Policy Statement on Enforcement specifically states that its aim is to “provide firm but fair enforcement of [the Commission’s] rules and regulations.”⁶ Armed with its broad new civil penalty authority, the Commission has demonstrated that it can be firm. The bigger challenge, however, may be how to balance

² Pub. L. No. 109-58, 119 Stat. 594 (2005).

³ Enforcement of Statutes, Orders, Rules and Regulations, 113 FERC ¶ 61,068 at P 4 (2005) [hereinafter “Policy Statement on Enforcement”].

⁴ FPA § 316A(b), 16 U.S.C. § 825o-1 (2000 & Supp. 2005); NGA § 22(a), 15 U.S.C. § 717t-1 (2000 & Supp. 2005); NGPA § 504(b)(6)(A), 15 U.S.C. § 3414 (2000 & Supp. 2005); Policy Statement on Enforcement, *supra* note 3, at P 5.

⁵ Under EPAAct 2005, the Commission has enforcement authority over many entities traditionally not subject to its jurisdiction with respect to market manipulation and electric reliability standards.

⁶ Policy Statement on Enforcement, *supra* note 3, at P 1.

firmness with fairness. Instead of prescribing specific penalties and formulas for different violations, the Policy Statement allows FERC to “retain the discretion and flexibility to address each case on its merits, and to fashion remedies appropriate to the facts presented, including any mitigating factors.”⁷ Certainly, discretion and flexibility are necessary for fair enforcement, particularly when they facilitate the Commission’s reasonable mitigation of penalties for comparatively minor violations that cause no significant harm to consumers or the market, or when compliance efforts by market participants⁸ otherwise warrant penalty mitigation. However, maintaining regulatory flexibility can inadvertently create the appearance of inequitable enforcement if the Commission does not provide a sufficient explanation when setting forth its rationale for the results reached in individual cases.

Another positive element of the Policy Statement is that it explicitly “place[s] a high value on internal compliance, self-reporting, and cooperation.”⁹ But this statement does not provide sufficiently unambiguous guidance to market participants on the effect these factors will have in enforcement actions. Specifically, market participants would like to have greater comfort that strong compliance programs, self-reporting, and cooperation will be meaningful and influential considerations in civil penalty determinations. Additionally, the relationship between these factors and the seriousness of a violation, on the one hand, and the appropriate penalty level, on the other hand, should be clarified. Although market participants fully respect that a precise calibration cannot be specified in a policy

⁷ *Id.* at P 13.

⁸ As used in this White Paper, the term “market participants” refers to the members of the associations for whom this White Paper was prepared.

⁹ Policy Statement on Enforcement, *supra* note 3, at P 29.

statement, they are closely scrutinizing the Commission's actual exercise of its enhanced civil penalty authority to gain clarity and reassurance. Cooperation and self-reporting are significantly enhanced when market participants trust that they will be treated fairly. Therefore, it is critical that day-to-day implementation of the Commission's enforcement policy confirms the value of compliance, self-reporting and cooperation.

II. FERC's Enforcement Policies and Actions Should Also Be Consistent with Achieving Its Other Long-Term Policy Goals

FERC's enforcement actions should be carried out with the Commission's policy goals in mind. FERC and market participants agree that building a strong energy infrastructure, ensuring reliable electricity supplies, nurturing competitive markets, and protecting consumers are long-term policy goals that must be achieved. Better infrastructure ultimately increases reliability and promotes competition, leading to lower prices and more choices for consumers.

The Commission must eliminate regulatory barriers so that the nation's energy infrastructure can keep pace with the growing demands placed upon it. Moreover, it must provide clarity and unambiguous guidance to promote competitive markets. Recently, the Commission stated that "efficient and competitive markets are possible only if market participants have confidence in the institutions and rules that govern those markets."¹⁰ Indeed, Commission policies should serve to reduce barriers to the functioning of liquid, transparent, and competitive transportation and commodity markets. To facilitate market liquidity, transparency and competitiveness, the Commission must provide market

¹⁰ FERC Press Release, Commission Acts to Assure Independence of PJM Market Monitoring (Sept. 20, 2007).

participants with clear and timely policy guidance, encourage innovation, and facilitate appropriate risk taking, such as market-driven speculation¹¹ and hedging. Uncertainty, inconsistent application, or a lack of due process can deter these appropriate and lawful forms of risk taking and hinder innovation, thus raising costs to consumers.

Firm but fair enforcement is important because it allows market participants to structure transactions around clear, predictable rules. Further, it facilitates innovative and appropriate risk taking, which is a necessary and desirable component of a highly liquid market. Highly liquid markets, in turn, deliver cost savings to consumers who are the ultimate beneficiaries of FERC's enforcement actions. To continue to deliver cost savings to consumers, market participants must clearly understand how to comply with the Commission's policies and rules. It is not enough, therefore, to punish violators. Instead, the Commission should strive to foster the type of compliance that prevents violations from occurring in the first place so that market participants seeking to comply can do so, and those who choose a different path can be easily identified.¹² Ultimately, compliance

¹¹ The Commission recently noted that “[d]espite the sometimes pejorative connotation of the term, speculation is a normal and necessary part of all markets A robust market depends on a wide variety of conflicting perspectives about current and future market conditions to reach workably competitive levels. Otherwise, there is no basis for trading. For example, buyers and sellers would largely lose the benefits of hedging if there were no speculators willing to assume the risks that hedgers want to lay off.” FERC, 2006 State of the Markets Report at 44, *available at* <http://www.ferc.gov/market-oversight/st-mkt-ovr/som-rpt-2006.pdf>.

¹² FERC should use its enforcement power to provide the assistance market participants need. The General Accounting Office (“GAO”) recognized in 1994 the value of the Commission's effective monitoring and enforcement program in connection with its evaluation of efforts to enforce safety and environmental requirements in the hydroelectric area. In a review of FERC's enforcement activities after Congress granted FERC civil penalty authority under Part I of the FPA, GAO found that FERC's compliance, education, and other enforcement actions led to a reduced number of violations. GAO, *Electricity* (continued...)

requires a relationship of trust and understanding between FERC and market participants. Market participants need consistency and transparency in enforcement actions as they enter into transactions that provide economic value for themselves and their counterparties, that in turn ensure that energy markets remain liquid, that electricity supply is reliable, and that our nation's energy infrastructure continues to grow.

III. FERC's Enforcement Actions Have Created Some Unintended Consequences that Impact the Integrity of, and Confidence in, Energy Markets and May Have Dampened Vibrant Market Participation

FERC should carry out its enforcement actions so as to avoid chilling legitimate market behavior. Unfortunately, policy and regulatory uncertainty and the looming threat of substantial civil penalties have combined to heighten business risk. As a result, some well-intentioned market participants may be increasingly risk adverse, thus limiting the innovation and appropriate risk taking that should thrive in well-functioning markets, and thereby increasing costs to consumers. Moreover, in such an environment, it becomes difficult to attract new capital investment to certain markets as the perceived risks of doing business increase from uncertainty regarding the Commission's enforcement policies, and in some cases, lack of clarity in the underlying rules themselves.

A. Unclear Policies and Rules in Certain Areas Are a Problem

Clear and simple rules are critical to the ability of market participants to function boldly yet prudently to aid in the achievement of FERC's policy goals. Market

Regulation FERC's Efforts to Monitor and Enforce Hydroelectric Requirements at 1-2, GAO/RCED-94-162, (May 24, 1994) [hereinafter "GAO Hydroelectric Enforcement Report"].

participants are eager to comply with FERC regulations. They are concerned, however, about those areas where policies and rules are not sufficiently clear.

Chairman Kelliher acknowledged a concern that market participants were “reading the tea leaves” when it came to enforcement.¹³ He has also said that “[t]here is somewhat of a natural instinct by regulators to have shades of gray in their rules because it maintains your discretion and keeps you flexible. But I don’t think shades of gray are fair when you are looking at a prospect of a \$1 million a day penalty.”¹⁴ He stated that the Commission has “a duty to be clear on what the rules are. Compliance should not be elusive, it should not be subjective; it should be objective to the greatest extent possible . . . in many instances, [FERC’s] rules are not perfectly clear and, in such instances, [FERC] must work with industry and the regulated community to resolve ambiguities.”¹⁵ Chairman Kelliher is to be commended for charting a course toward significantly greater clarity. Market participants agree that this is a fertile field for improvement.

Lack of clarity sows confusion, creates unnecessary risk, and chills legitimate market behavior because market participants are reticent to engage in certain types of transactions where the rules are unclear. Without clarity, transactions and operational

¹³ *Kelliher: Regulatory Certainty and Reforms Work in Tandem to Address Energy Needs*, INSIDE F.E.R.C., May 21, 2007 at 3.

¹⁴ *FERC Continues Exercising Civil Penalty Authority*, 25 GAS PROCESSORS REPT. No. 27, July 11, 2007.

¹⁵ Chairman Joseph T. Kelliher, Statement on Establishing a Clearer “No-Action” Letter Process (Nov. 17, 2005). *See also* FERC, Transcript of Technical Conference on Standards of Conduct (Apr. 7, 2006) at 6, 165-66, *available at* <http://www.ferc.gov/EventCalendar/Files/20060501140839-transcript.pdf> (commenting on rules regarding standards of conduct, Chairman Kelliher said, “I think we need to provide greater clarity to the regulated community and that will help them and help us.”).

changes that may reduce costs to consumers, but nevertheless produce unacceptable enforcement risk, are being deterred.

The rules regarding asset management transactions between local distribution companies (“LDCs”) and portfolio managers are a good example of this concern. In the wake of the Commission’s decision to unbundle pipeline capacity, these transactions have made a significant contribution to the efficient operation of the natural gas market by allowing LDCs to delegate to portfolio managers, who are often better equipped for the job, the tasks necessary to acquire gas. As the marketplace has matured, however, these transactions have become more complex, and market participants have sought clarification from the Commission on whether these more complex transactions comply with FERC rules. Specifically, market participants have asked whether and under what conditions prearranged releases of capacity can be made in association with gas supply and purchase agreements or on an aggregated basis, whether transaction fees may be charged without violating rate caps, and whether reservation charges will cause releases not to be biddable.¹⁶ Although these questions were submitted to the Commission more than a year ago, they have not been answered by the Commission. In the meantime, there has been a drop in the number of opportunities for asset management transactions. This drop has been accompanied by a marked decline in the quantity and quality of responses to requests for proposals. Given the uncertain enforcement climate, this is hardly surprising.¹⁷

¹⁶ Coral Energy Resources, L.P., et al., Petition for Clarification, Docket No. RM91-11 and RM98-10 (Oct. 20, 2006).

¹⁷ Although the Commission provided some helpful guidance with respect to asset management transactions in *In re BP Energy Co.*, when it clarified that an asset management (continued...)

In addition, more than 10 months have passed since the Commission issued a notice of proposed rulemaking classifying asset managers as “marketing affiliates” and requiring them to comply with the Commission’s standards of conduct. The Commission has not acted on the proposed rulemaking, and today it is unclear what standards govern transactions between asset managers and their affiliates or how to define an “asset manager.”¹⁸ Large civil penalties have been assessed in settlements pertaining to these types of transactions without the Commission ever making a finding that asset managers and their affiliates engaged in the type of undue discrimination that standards of conduct are designed to prevent.¹⁹

Moreover, the Commission has not issued a final regulation clarifying and codifying the scope of the application of standards of conduct to shared senior officers and directors.²⁰ Although standards of conduct ordinarily require transmission function

transaction “refers to an individual master (or base) agreement between BP and its customer,” this does not remove the uncertainty that market participants have with respect to various other aspects of asset management transactions. In re BP Energy Co., Order Approving Stipulation and Consent Agreement, 121 FERC ¶ 61,088 at n. 1 (Oct. 25, 2007).

¹⁸ Standards of Conduct for Transmission Providers, 118 FERC ¶ 61,031 at P 21, 72 Fed. Reg. 3958 (proposed Jan. 29, 2007) (to be codified at 18 CFR Part 358) [hereinafter “Standards of Conduct for Transmission Providers Proposed Rule”].

¹⁹ *Id.* When the Commission issued its Notice of Proposed Rulemaking (“NOPR”) proposing new standards of conduct regulations, it noted that staff investigations of transactions between asset managers and their affiliates led to a settlement imposing a \$21 million penalty on American Electric Power Company, Inc. *Id.* at P 21. When the NOPR was issued, this penalty was the largest in the Commission’s history. The Commission also referenced similar settlement payments made by Cleco Corporation as the largest civil penalty assessed under section 214 of the FPA. *Id.* For further description of various standards of conduct matters requiring clarification, see Edison Elec. Inst., Comments on Notice of Proposed Rulemaking for Standards of Conduct for Transmission Providers Attachment B, Docket No. RM07-1-000 (Mar. 30, 2007).

²⁰ Standards of Conduct for Transmission Providers Proposed Rule, *supra* note 18, at P 23.

employees to function independently of marketing affiliate employees, the Commission has permitted certain employees, including senior officers, to be shared between transmission providers and their marketing affiliates.²¹ Until the scope of this exception is formally clarified and codified, however, wary market participants may be forced to compromise the corporate governance and fiduciary responsibilities of senior officers and to forgo the cost savings that often accompany the sharing of certain senior officers.

The Commission has made significant efforts to assist market participants in complying with standards of conduct. These efforts have included technical conferences, the posting of “Frequently Asked Questions” on the Commission’s website, and a series of outreach meetings with market participants.²² While market participants welcome these efforts, they fall short of what is needed. Market participants want to be able to rely on the information these efforts generate. Any persisting uncertainty as to what the rules require or allow may tend to cast doubt on the fairness of the exercise of the Commission’s enhanced civil penalty authority for these and other areas subject to its jurisdiction.

B. At Times, There Appears to Be a Disconnect Between the Level of a Civil Penalty and Various Factors the Commission Takes into Account

The level of civil penalties assessed for technical violations, that may have been unintentional, with no finding of market harm, has raised concern that penalties seem higher than necessary to incent compliance and good behavior, taking into account internal compliance, self-reporting, and cooperation. The \$1 million penalty imposed on Bangor Gas Company earlier this year is a useful example. Bangor Gas Company violated the

²¹ *Id.*

²² *Id.* at P 32.

Commission’s “shipper-must-have-title” rules when it transported gas for nine customers along 1.5 miles of pipeline in Maine.²³ The company did not profit from the violation and the Commission found no evidence of harm to third parties.²⁴ Moreover, the company self-reported, exhibited what the Commission characterized as “exemplary cooperation,” and took prompt corrective actions to ensure future compliance.²⁵ Nevertheless, a \$1 million penalty was assessed on the basis that the Commission’s “shipper-must-have-title” rule was well-known and that senior management did not take steps to ensure its personnel complied with the rule prior to the violation.²⁶ There is no doubt that some violations did occur. What is concerning and not easily reconciled with the Commission’s enforcement policy, however, is the amount of the penalty in light of the absence of financial harm and the presence of self-reporting, exemplary cooperation and corrective action. Specifically, it is unclear how much credit was accorded for these mitigating factors.

The exercise of the full force of the Commission’s enhanced civil penalty authority for every violation would be inconsistent with the language of EPC Act 2005, which

²³ Press Release, FERC, Bangor Gas Agrees to Pay \$1 Million Penalty to Resolve Self-Reported Shipper-Must-Have-Title Violations (Mar. 7, 2007).

²⁴ *Id.*

²⁵ *In re Bangor Gas Co., LLC*, Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,186 at P 12 (Mar. 7, 2007). Other similar violations of shipper must have title rules that have resulted in the imposition of large penalties despite the absence of financial harm and the presence of self-reporting, cooperation and corrective action include *In re MGTC Inc.*, Order Approving Stipulation and Consent Agreement, 121 FERC ¶ 61,087 (Oct. 25, 2007), and *In re Calpine Energy Services, L.P.*, Order Approving Stipulation and Consent Agreement, 119 FERC ¶ 61,125 (May 9, 2007). Additionally, in *In re SCANA*, a significant fine was imposed despite the fact that the “identifiable harm was small” and SCANA self-reported. *In re SCANA Corp.*, Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,028 at P 7 (Jan. 18, 2007).

²⁶ *In re Bangor* at P 12.

said the Commission may impose civil penalties “of not more than” \$1 million per day per violation. The fact that EAct 2005 does not require the Commission to impose the maximum civil penalty for every violation means that the Commission has discretion to tailor the level of the penalty assessed to reflect the seriousness of the violation and mitigating factors. Chairman Kelliher has said with respect to reliability compliance that “[m]inor violations may be resolved without imposition of a civil penalty [and, that]. . . [m]aximum penalties will likely be reserved for those reliability violations that cause significant harm, or are especially egregious.”²⁷ Market participants welcome the guidance provided by the Chairman’s statement. They also appreciate, as Commissioner Kelly has said, that certain practices may “not have an easily quantifiable or significant impact on the market but they nevertheless can have a harmful effect on the market.”²⁸ Indeed, market participants urge the Commission to use the force of its enhanced civil penalty authority to punish and deter those whose harmful practices damage the reputation of our industries and frustrate our efforts to operate in robust competitive markets. Nevertheless, recent disconnects, such as in *Bangor* between the amount of civil penalties and various mitigating factors the Commission has said that it takes into account, threaten to dampen market participation.

²⁷ Chairman Joseph T. Kelliher, Statement on NorthWestern Corporation, SCANA Corporation, Entergy Services, Inc., PacifiCorp, and NRG Energy, Inc. (Jan. 18, 2007).

²⁸ Commissioner Suede G. Kelly, Statement on NorthWestern Corporation, SCANA Corporation, Entergy Services, Inc., PacifiCorp, and NRG Energy, Inc. (Jan. 18, 2007).

IV. Recommendations for FERC’s Evolving Enforcement Policies and Actions

Market participants want to work cooperatively with FERC to help the Commission achieve its long-term policy goals. There must be a clear linkage, however, between these goals and FERC’s enforcement actions. Currently, effective enforcement is one of the long-term policy goals established by the Commission in its Strategic Plan.²⁹ Although the Commission has recognized that in order to achieve this goal it needs to “ensure that utilities subject to its jurisdiction have effective internal monitoring and compliance programs in place,”³⁰ it should go a step further and make fostering a culture of compliance an explicit objective. Market participants need FERC to promote and facilitate their efforts to achieve full compliance with the Commission’s rules. Fortunately, as the Commission’s enforcement policy evolves, it has the potential to provide the assistance market participants need. Market participants offer the following recommendations, many of which are drawn from the enforcement policies of other federal agencies:

- A. FERC Should Clarify Policies and Rules to Provide a Better Compliance “Road Map”**
 - 1. Educate Market Participants on the Interpretation of Commission Policies and Rules Prior To Taking an Adversarial Approach**

As discussed earlier, uncertainty surrounds a number of the Commission’s important policies and rules. Market participants eager to achieve compliance would be greatly assisted by Commission efforts to eliminate this uncertainty.

²⁹ FERC, Strategic Plan FY 2006 - FY 2011 at 23-27 (Sept. 2006).

³⁰ *Id.* at 23.

FERC should increase its efforts to educate market participants. Recently, market participants learned of a proposal for FERC and the Commodity Futures Trading Commission (“CFTC”) to work together to “educate . . . utilities and others who use NYMEX settlement prices as benchmarks in pricing their energy products.”³¹ This effort is indeed welcomed by market participants and is an example of the type of outreach that will foster compliance by educating market participants so that they can prevent inadvertent violations from occurring in the first place.

Other agencies have found additional ways to coach market participants toward compliance by providing timely advice and notices prior to any adversarial approach. For example, the Securities and Exchange Commission (“SEC”) facilitates compliance as part of its CCO Outreach Program, which allows companies with compliance concerns about industry or individual practices to contact the agency’s CCO Outreach staff. The program offers the option of speaking anonymously.³² This provides companies seeking to comply with SEC rules an opportunity to obtain timely advice in a setting where they need not be afraid of repercussions. The program sponsors regional seminars to coach firms on effective compliance practices.³³

EPA sponsors a program to coach facilities toward compliance with the complex requirements of Toxics Release Inventory (“TRI”) reporting under section 313 of

³¹ CFTC, Report on the Oversight of Trading on Regulated Futures and Exchanges and Exempt Commercial Markets at 23 (Oct. 2007), *available at* http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf.

³² SEC, CCO Outreach Program, <http://www.sec.gov/info/iaicccoutreach.htm> [hereinafter “CCO Outreach Program”].

³³ SEC, CCO Outreach Program, <http://www.sec.gov/info/ccoutreach.htm>.

the Emergency Planning and Community Right-to-Know Act of 1986.³⁴ This program offers web-based courses and live workshops to educate those charged with preparing TRI reports.³⁵ After attending the program, participants can train others at their facilities to ensure that TRI reports are accurate. Finally, the Office of Pipeline Safety (“OPS”) also provides compliance guidance. It publishes inspection forms and protocols, rule interpretations, guidance manuals and advisory notices, frequently asked questions, and final orders on its website, in addition to holding public meetings and workshops.³⁶ Although FERC has taken some of these steps, market participants urge greater Commission activity in this area.

To achieve a market-wide culture of compliance, it is important that the Commission ensure that there is a wide range of information available about internal compliance programs. In various stipulation and consent agreements, the Commission has referenced different elements of effective programs. Clearly, while certain general principles apply to establishing corporate compliance programs, there is no “one-size-fits-all” approach. Because an individual market participant best understands the unique compliance challenges its organization faces, it is the most appropriate architect of its own compliance program. The Commission could provide valuable assistance to market

³⁴ EPA, TRI Training Registration Website, <http://envr.abtassoc.com/tritraining/TRIReg.exe>.

³⁵ *Id.*

³⁶ Office of Pipeline Safety, Stakeholder Communications, Regulation Enforcement, <http://primis.phmsa.dot.gov/comm/reports/enforce/Enforcement.html>.

participants designing their programs if it increased its efforts to make available a wide range of information about compliance programs.

2. Create More Clarity in the Process for Compliance Audits and Investigations

Effective internal compliance programs require constant review and modification to guard against new areas of noncompliance in dynamic and fast-moving energy markets. This “review and modification” is so important that the Commission’s Policy Statement lists it as a specific factor to consider when deciding how much credit a company receives for internal compliance programs. It is difficult, however, for market participants to respond to new compliance challenges without adequate information. In the current enforcement environment, market participants often have insufficient information to ensure that the substantive elements of their internal compliance programs are up-to-date. For example, FERC has not released its basic list of interrogatories and document requests issued for standards of conduct audits, despite repeated requests from market participants seeking to be prepared for Commission audits.

Market participants recommend that FERC increase the transparency of compliance audits and investigations.³⁷ Updates on generic audit findings to alert market participants to problem areas of compliance, like the SEC’s “*Compliance Alert*”³⁸ letters, will make it easier for individual market participants to prevent or correct deficiencies

³⁷ The Commission has clarified procedural issues surrounding its compliance audits of market participants. *See* Procedures for Disposition of Contested Audit Matters, 114 FERC ¶ 61,178 (Feb. 17, 2006). Although it is helpful for market participants to have the necessary clarity on the appeal process in connection with compliance audits, that is far different from educating market participants about issues that arise in compliance audits.

³⁸ SEC, Compliance Alert, <http://www.sec.gov/about/offices/ocie/complialert.htm>.

before they become market-wide problems that may cause harm to consumers. In addition, in order to remove uncertainty, FERC should institute the practice of providing timely closing letters in connection with audits and investigations where no violations are found. Finally, providing information about the matters auditors will be evaluating, as is done in the handbooks published by the Office of Thrift Supervision (“OTS”),³⁹ Nuclear Regulatory Commission (“NRC”),⁴⁰ Food and Drug Administration (“FDA”),⁴¹ and Federal Deposit Insurance Corporation (“FDIC”),⁴² would greatly assist the compliance efforts of market participants by providing a better compliance road map.

3. Broaden the Scope of the No-Action Letter Program, Ensure That Market Participants Can Rely on Staff Advice, and Establish a Help Desk to Supplement the No-Action Letter Program

In the context of dynamic energy markets, market participants have concerns regarding the scope of no-action letters. For example, the fact that the scope of the no-action letter program is limited to instances regarding specific proposed transactions or matters relating to standards of conduct for transmission providers, codes of conduct for both electric and natural gas sellers, codified Market Behavior Rules, and prohibitions on market manipulation, means that a significant number of FERC’s other rules cannot be

³⁹ OTS, Examination Handbook, *available at* <http://www.ots.treas.gov/da.cfm?catNumber=113&an=11>.

⁴⁰ NRC, Enforcement Guidance, <http://www.nrc.gov/about-nrc/regulatory/enforcement/guidance.html>.

⁴¹ FDA, FDA Compliance Policy Guides Manual Foreword, *available at* http://www.fda.gov/ora/compliance_ref/cpg/foreword.html.

⁴² FDIC, Compliance Examination Handbook, *available at* <http://www.fdic.gov/regulations/compliance/handbook/index.html>.

clarified through this process.⁴³ In addition, the fact that the Commission does not accept no-action letters setting forth hypothetical actions has discouraged market participants from using the process to determine whether their actions are consistent with the Commission's new market manipulation rules.⁴⁴ Finally, because only nine letters have been made publicly available, no-action letters have not been an adequate tool for educating market participants about FERC's understanding of its own rules.

Market participants encourage the Commission to consider appropriate ways to turn the no-action letter process into a more effective compliance tool. Specifically, the Commission should broaden the scope of the no-action letter program. This will provide market participants with greater opportunities to clarify ambiguities in all the rules that FERC enforces. Comprehensive guidance will facilitate the transactions that are necessary to promote competitive markets and benefit consumers. Further, including in the text of no-action letters the principles and standards the Commission relied upon to reach its

⁴³ Informal Staff Advice on Regulatory Requirements, Interpretive Order Modifying No-Action Letter Process, 117 FERC ¶ 61,069 (Oct. 19, 2006); Informal Staff Advice on Regulatory Requirements, Interpretive Order Regarding No-Action Letter Process, 113 FERC ¶ 61,174 at P 2 (Nov. 18, 2005).

⁴⁴ The Commission's new rules barring market manipulation are a significant source of confusion among market participants. Prohibition on Energy Market Manipulation (Final Rule), 114 FERC ¶ 61,047 (Jan. 19, 2006) (Order No. 670). Chief among their concerns is the Commission's decision to determine on a case-by-case basis whether it is appropriate to apply securities law precedents to specific energy industry facts, circumstances, or situations. The case-by-case application of such precedents creates uncertainty regarding the duties, standards, and obligations of market participants. This uncertainty will undermine responsible hedging and speculation activities that are broadly recognized as legitimate activities that mitigate risk, keep energy markets liquid, and bring benefits to consumers. Moreover, this approach to implementation of the market manipulation rules could make the situation worse because the continuation of appropriate speculation and hedging activities depends on consistent recognition of the presumption that these transactions that are explicitly contemplated in Commission-approved rules do not violate the prohibition on market manipulation.

conclusions, and allowing requests for advice on hypothetical actions, will also enhance their usefulness and increase transparency. Finally, to use the no-action letter process as a mechanism for providing reliable guidance to market participants, the Commission should specifically state that reliance on advice provided in no-action letters is a mitigating factor in enforcement actions.

Instituting a “Help Desk,” separate from the Office of Enforcement, for market participants to contact for informal guidance on a timely basis will provide yet another way to obtain the information needed to comply. As discussed earlier, the SEC has a similar program for obtaining compliance information as part of its CCO outreach program.⁴⁵ Again, the Commission should specifically state that relying on advice provided by the “Help Desk” is a mitigating factor in enforcement actions. This will make the “Help Desk” a valuable tool for providing reliable guidance to market participants.

B. FERC Enforcement Policies and Actions Should Encourage Self-Reporting

1. Continue To Clarify Expectations Regarding Self-Reporting

Although the Policy Statement on Enforcement places a high value on self-reporting, market participants are uncertain about how self-reporting will actually be credited in the course of enforcement actions. In nearly all of the settlements the Commission has publicly announced since implementing its new enforcement policy, the Commission has stated that it gave market participants credit for self-reporting without

⁴⁵ CCO outreach Program, *supra* note 32.

explaining how self-reporting mitigated the penalty.⁴⁶ Additionally, current enforcement policies do not appear to provide transparent criteria for when a self-report becomes worthy of further investigation.

In the face of this uncertainty, market participants respect the fact that Commissioners have attempted to provide some guidance on self-reporting. For instance, Commissioner Spitzer has provided some clarity by stating “[s]elf reporting is mitigation but . . . not absolution.”⁴⁷ Chairman Kelliher has said, “credit for self reporting will diminish if a regulated company does not make a strong commitment to develop a compliance culture. If a company self reports violations, does not develop a strong compliance culture, and continues to commit violations, I would expect the credit for self reporting would diminish over time, and civil penalties for violations would escalate.”⁴⁸

The Commission should continue to clarify its policy regarding self-reporting because persisting uncertainties are discouraging self-reporting by some market participants.

⁴⁶ In re BP Energy Co., Order Approving Stipulation and Consent Agreement, 121 FERC ¶ 61,088 (Oct. 25, 2007); In re MGTC Inc., Order Approving Stipulation and Consent Agreement, 121 FERC ¶ 61,087 (Oct. 25, 2007); In re Gexa Energy LLC, Order Approving Stipulation and Consent Agreement, 120 FERC ¶ 61,175 (Aug. 21, 2007); In re Cleco Power LLC, Order Approving Stipulation and Consent Agreement, 119 FERC ¶ 61,271 (Jun. 12, 2007); In re Calpine Energy Services LLC, Order Approving Stipulation and Consent Agreement, 119 FERC ¶ 61,125 (May 9, 2007); In re Bangor Gas Company LLC, Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,186 (Mar. 7, 2003); In re SCANA Corp., Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,028 (Jan. 18, 2007); In re PacifiCorp, Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,026 (Jan. 18, 2007); In re Entergy, Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,027 (Jan. 18, 2007); In re NRG Energy Inc., Order Approving Stipulation and Consent Agreement, 118 FERC ¶ 61,025 (Jan. 18, 2007).

⁴⁷ *In First Exercise of Civil Penalty Authority, FERC Hits Five Companies With a Total of \$22.5 Million In Fines*, FOSTER ELECTRIC REP., Jan. 24, 2007. Rpt No. 491, at 1.

⁴⁸ Chairman Joseph T. Kelliher, Statement on NorthWestern Corporation, SCANA Corporation, Entergy Services, Inc., PacifiCorp, and NRG Energy, Inc. (Jan. 18, 2007).

As discussed earlier in connection with *Bangor*, market participants need a better explanation of how self-reporting is weighted in determining penalties. It would be helpful to have a report from the Commission providing generic information about self-reports that resulted in enforcement action, without revealing the identity of the market participants who self-reported. Such a report will help market participants better understand how FERC exercises its discretion in enforcement actions. Further, market participants would like to know whether FERC will exercise its discretion not to pursue enforcement action against a party who self-reports where the rules are unclear. Finally, as set forth above, when FERC makes decisions not to pursue enforcement actions, market participants that do self-report would like to receive timely non-public closing letters from the Commission at the conclusion of the investigations.

2. Offer Amnesty Under Appropriate Circumstances To Encourage Self-Reporting

To further encourage self-reporting, FERC should offer amnesty under appropriate circumstances for certain types of violations. Appropriate circumstances could include, for example, situations in which rules are unclear, violations are technical, there is no harm to consumers or markets, or strong compliance programs have been put in place.

Amnesty programs have been used to promote compliance by other agencies and departments that FERC has used as models for its enforcement strategy. In particular, the SEC instituted a limited amnesty program for past violations of auditor independence rules in exchange for a commitment from accounting firms to prevent future violations.⁴⁹

⁴⁹ See Lynn E. Turner, *The Hallmark of the Profession, Serving the Public Interest*, available at <http://www.sec.gov/news/speech/spch437.htm>.

Moreover, at the NRC, the Commission directed staff to implement a short amnesty program as civil penalties increased.⁵⁰ These examples suggest that an amnesty program may be particularly appropriate for FERC in light of the importance of compliance and the legislative enactment of the Commission’s enhanced civil penalty authority. Amnesty may prove to be an effective way both to promote self-reporting and to save valuable staff resources for more serious violations.

Similarly, in the past, FERC established a safe harbor policy for data providers in connection with guidelines for reporting and developing price indices for natural gas and electric transmission transactions.⁵¹ Specifically, the Commission stated that if data providers could demonstrate that they adopted and followed the Commission’s standards, the Commission did “not intend to prosecute and/or penalize parties for inadvertent errors in reporting.”⁵² This kind of enforcement approach that provides significant mitigation of penalties or other remedies for inadvertent errors by well-intentioned market participants may be useful to replicate more broadly as the Commission’s enforcement program evolves.

⁵⁰ See NRC, Memorandum from William D. Travers, Executive Director of Operations, NRC, to Commissioners (May 15, 2000), *available at* <http://www.nrc.gov/reading-rm/doc-collections/commission/secys/2000/secy2000-0106/2000-0106scy.html#ATTACHMENT%203>.

⁵¹ Price Discovery in Natural Gas and Electric Markets, Order Further Clarifying Policy Statement on Natural Gas and Electric Price Indices, 112 FERC ¶ 61,040 at PP 10-11 (July 6, 2005); Price Discovery in Natural Gas and Electric Markets, Policy Statement on Natural Gas and Electric Price Indices, 104 FERC ¶ 61,121 at PP 37-38 (July 23, 2003) [hereinafter “Policy Statement on Natural Gas and Electric Price Indices”].

⁵² Policy Statement on Natural Gas and Electric Price Indices, *supra* note 51, at P 37.

C. FERC Should Provide More Clarity About The Levels of Civil Penalties It Will Assess

Another area that the Commission should clarify is how the agency determines the level of civil penalties in individual cases. The Commission should establish, and make publicly available, gradations of civil penalties based on the seriousness of the offense and the harm to the market.

This would be similar to the enforcement approach taken by the NRC. At the outset of its process, the NRC characterizes the violation it is sanctioning as a level I, II, III, or IV violation, with level I reserved for the most serious violations and level IV for the least serious.⁵³ No civil penalties are assessed for level IV violations. Whether a civil penalty is assessed for level I, II or III violations depends on whether the company can obtain credit for identifying the violation and taking corrective actions. If a company gets credit for identifying a violation and taking corrective actions, the NRC may choose to issue a notice of violation (“NOV”), rather than assess a penalty. These notices identify the violation a company committed. After receiving an NOV, a company is required to submit a written response. If, however, the NRC determines that it is appropriate to assess a civil penalty instead of issuing an NOV, the amount of that penalty is fixed at what the NRC calls a base level. Base level penalties vary according to the level (*i.e.*, seriousness) of the offense. For instance, the base level penalty for a level II violation is 80% of the penalty for a level I violation, and the base level penalty for a level III violation is 50% of that of level I for

⁵³ NRC, Enforcement Policy at 20-29, *available at* <http://www.nrc.gov/about-nrc/regulatory/enforcement/enforc-pol.pdf>.

various reactor, fuel cycle, and materials programs.⁵⁴ Once the base level penalty is determined, enforcement staff may use its discretion to adjust the amount of the penalty, but the Commission must be notified if the adjustment results in a penalty that is more than two times the base level. Moreover, this adjusted penalty may not exceed the statutory ceiling of \$130,000 per violation per day.⁵⁵

FERC should implement a policy similar to the NRC for assessing civil penalties, with gradations modified appropriately to fit FERC rules, regulations and expectations. Chairman Kelliher commented favorably on the idea of tiered violations when he said that the North American Electric Reliability Corporation (“NERC”) needed to move in the direction of the NRC. Specifically, he “cit[ed] a ‘great deal of concern’ that minor violations could receive maximum penalties.”⁵⁶ A tiered approach would provide needed consistency among penalties imposed for similar violations, and would give more thorough consideration to a range of factors, including the seriousness of the harm. In short, under this type of transparent and structured regime, the punishment would better reflect the nature and extent of the violation, and market participants would have a more objective understanding of potential penalties.

Another example of explicitly linking violations to the amount of harm they cause is the assignment of risk factors for violations of reliability standards that was recently

⁵⁴ *Id.* at 20-21.

⁵⁵ *Id.* at 31-32.

⁵⁶ *NERC Chief Says Certain Parts of the Grid Operating Near Their Limits Much of Time; FERC Clarifies Delegation Agreement Order*, FOSTER ELECT. REP., Sept. 25, 2007. *See also* *In re North Am. Elec. Reliability Corp.*, Order on Clarification, 120 FERC ¶ 61,239 at P 11 (Sept. 25, 2007).

approved by FERC.⁵⁷ These risk factors clarify the relationship between violations and their impact on reliability. Formally establishing this relationship creates clarity that market participants need regarding the Commission's enforcement actions. While the Commission is to be commended for approving this tiered approach for reliability standards, it should broaden the application of such an approach to other rules.

D. FERC Should Ensure That the Processes Used to Implement Its Enforcement Policy Reinforce Its Long-Term Policy Goals and Promote Due Process

As emphasized throughout this White Paper, market participants are eager to comply with FERC's rules because they share the Commission's policy goals and have an interest in bolstering the integrity of the markets in which they operate. They view the Commission as a partner in their efforts to protect their own reputations and public perception of the markets. Consistent and transparent enforcement which is observable by all market participants improves the public perception of markets, allows market participants to become active partners in the Commission's efforts to achieve its policy goals, and is necessary for due process.

1. Consider the Impact on the Reputation of Market Participants and the Integrity of Energy Markets

The energy industry understands it must work to improve the public perception of markets and market participants. The great bulk of market participants have integrity. They are eager to comply with FERC's rules but they need the Commission's support to improve public perceptions and fulfill the Commission's policy goals. FERC

⁵⁷ FERC, Press Release, Commission Approves NERC's Assignment of Violation Risk Factors Associated with Approved Reliability Standards (May 17, 2007).

should take care that its enforcement actions and resulting penalties do not inadvertently and unfairly impact the reputation of market participants that may have been acting in good faith to comply with unclear policies or rules. Market participants understand that flagrant violations which harm markets and consumers must be dealt with in a forceful manner. It is important for the Commission in its orders, public statements and press releases to be mindful of these concerns and the public's perception of markets and market participants.

2. Use Warning or Reprimand Letters

To ensure that penalties reflect the nature and extent of violations and that commercial reputations are not unnecessarily harmed, the Commission should consider the use of letters of warning or reprimand rather than upfront penalties if there is no harm to the market and market participants fully meet the standards set forth in the Policy Statement on Enforcement -- in other words, they self-report, demonstrate strong compliance, and fully cooperate.⁵⁸ The SEC has used letters of deficiency to accelerate the compliance process. After the SEC completes its examination of a regulated firm, either as part of an evaluation of a particular compliance risk area or in response to an investor complaint, examination staff has the option of sending the firm a deficiency letter. The letter describes issues identified, asks the firm to take corrective action and provide staff with a written response, and may request a conference with the firm.⁵⁹ Similarly, the NRC's NOV letters, as

⁵⁸ For an example of how FERC has already successfully used compliance orders, *i.e.*, directives to correct a deficiency, see GAO Hydroelectric Enforcement Report, *supra* note 12, at 2, 9.

⁵⁹ SEC, Examination Information For Broker-Dealers, Transfer Agents, Clearing Agencies, Investment Advisers, and Investment Companies, at 3, *available at* http://sec.gov/about/offices/ocie/ocie_exambrochure.pdf.

mentioned above, allow it to remedy violations without resorting to civil penalties.⁶⁰ Letters of warning or reprimand would promote a culture of compliance among market participants by giving them the guidance they need to promptly rectify inadvertent mistakes for less serious violations. Making such letters public without disclosing the identity of the recipient would recognize the reputational consequences that accompany such letters and the need to enhance transparency in enforcement actions.

3. Expand the Use of Mediation

FERC should incorporate mediation and other forms of non-binding dispute resolution procedures into its enforcement program to enhance communications between the agency and market participants. Mediation promotes communication and innovative solutions as parties work together to resolve a range of disputes.⁶¹ Notably, the SEC recognized the value of mediation in its enforcement matters in an April 2007 “Report for the President on the Use and Results of ADR in the Executive Branch of the Federal Government.”⁶² Specifically, it found “mediation routinely helps to streamline discovery and focus the parties on key issues so that they are able to reach settlement shortly after the mediation concludes.”⁶³ EPA has also identified benefits associated with the Agency’s use of ADR including “faster resolution of issues,’ ‘more creative satisfying and enduring

⁶⁰ NRC, Enforcement Policy at 20-29, *available at* <http://www.nrc.gov/about-nrc/regulatory/enforcement/enforce-pol.pdf>.

⁶¹ *See* Energy ADR Forum Report, Using ADR to Resolve Energy Industry Disputes: The Better Way (Oct. 2006), *available at* www.energyadrforum.com.

⁶² Federal Interagency Alternative Dispute Resolution Working Group Section and Steering Committee Report for the President on the Use and Results of Alternative Dispute Resolution in the Executive Branch of the Federal Government at 8 (Apr. 2007).

⁶³ *Id.*

solutions,’ ‘reduced transaction costs,’ ‘increased likelihood of compliance with environmental laws,’ ‘and better environmental outcomes.’”⁶⁴ These benefits could help FERC exercise its enforcement authority in new areas such as market manipulation.

The experience of the NRC is also illustrative of the benefits of ADR in the enforcement area. Between 2004 and 2006, the NRC established a successful pilot program for disputes between licensees and the agency. Under the program, NRC enforcement staff offered mediation as an option both before pre-decisional enforcement conferences and at the time when the order imposing a civil penalty was issued.⁶⁵ In all but one post-investigation ADR case, settlement came after one day of mediation.⁶⁶ Ultimately, mediation furthered the NRC’s goals of prompt identification and corrective action to deter non-compliance. Specifically, the report on the program found that “[p]ost-investigation ADR resulted in agreements that include broader and more comprehensive corrective actions than actions normally achieved in the traditional enforcement process.”⁶⁷

FERC should incorporate mediation and other forms of non-binding dispute resolution procedures formally into its enforcement program. This will foster compliance, free up agency resources to prevent violations, increase the perception of fairness, and

⁶⁴ Joseph A. Siegel, *Alternative Dispute Resolution in Environmental Enforcement Cases: A Call for Enhanced Assessment and Greater Use*, 24 PACE ENVTL. L. REV. 187, 194 (Apr. 2007).

⁶⁵ NRC, ADR Pilot Evaluation Report (May 2006), *available at* <http://www.nrc.gov/reading-rm/doc-collections/commission/secys/2006/secy2006-0102/enclosure.pdf>, p. 4.

⁶⁶ *Id.* at 5.

⁶⁷ *Id.* at 6.

enhance communication between the Commission and market participants by making sure all concerns are addressed before decisions are reached.⁶⁸

4. Review and Modify, as Appropriate, the Role of the Commission and Its Enforcement Staff in the Implementation of Enforcement Policy

FERC's enforcement policies and actions should ensure due process and the perception of fairness and impartiality. Thus, the Commission should determine whether it is appropriate for FERC, when adjudicating a civil penalty in a case brought under the NGA, to be both prosecutor and judge by first guiding the investigation of a matter, then sitting as a decision maker in a Commission proceeding to determine liability.⁶⁹

Under current Commission policies and rules, FERC Enforcement Staff members that perform an investigation where the Commission may assess civil penalties are not precluded from later serving as Trial Staff in any proceeding the Commission may establish before an administrative law judge ("ALJ"). Also, an Enforcement Staff member is permitted to discuss an investigation with the Commission up until the time that the

⁶⁸ FERC would have to expend minimal resources to reap the benefits of mediation because it already has many of the elements of an effective ADR program in place. For instance, one commentator recently noted that developing an infrastructure that provides training on the effective use of ADR, assists in identifying third party neutrals, and evaluates and reports on an agency's ADR program is critical to increasing the number of ADR enforcement cases and developing the research needed to assess the effectiveness of these programs. Siegel, *supra* note 64, at 192-93. FERC has already established the Dispute Resolution Service ("DRS") to promote mediation and assist in identifying neutral mediators and DRS has developed an evaluation form that assesses the effectiveness of ADR.

⁶⁹ See *e.g.*, Motion of the Interstate Natural Gas Association of America for Limited Intervention, Docket No. IN06-3-002 (Oct. 31, 2007) (raising a concern about whether civil penalty assessments under the NGA are entitled to *de novo* review in federal district court.).

Enforcement Staff member is assigned to be a litigator on the case.⁷⁰ If FERC Enforcement Staff members that performed an investigation later serve as Trial Staff, due process concerns arise when they are developing and advocating their position before an ALJ and in any briefs to the Commission, because they will benefit from having received the Commission's input during the investigation. In such a situation, market participants defending themselves in a proceeding to adjudicate civil penalty liability before an ALJ will be at an unfair disadvantage. Therefore, the Commission should review and modify, as appropriate, its Separation of Functions Policy Statement.

Reviewing and modifying, as appropriate, the Commission's role as prosecutor and judge in the adjudication of civil penalty liability under the NGA, as well as the Commission's separation of function policies, will help the Commission achieve the procedural fairness that is necessary to incent compliance and achieve its policy goals.

E. FERC Should Establish Measurements or Metrics of Success and a Periodic Process to Evaluate Its Success in Achieving These Measures

1. Invite An Expert Panel To Regularly Review FERC's Enforcement Policies and Actions

A static enforcement program will not effectively safeguard competitive markets or help market participants achieve compliance. An effective mechanism for evaluating the Commission's enforcement program would be the establishment of an expert

⁷⁰ Separation of Functions, Statement of Administrative Policy on Separations of Functions, 101 FERC ¶ 61,340 at PP 26-27 (2002) [hereinafter "Separation of Functions Policy Statement"].

panel which could review FERC's enforcement actions on a periodic basis.⁷¹ Such a panel could be made up of academics, former government officials, lawyers, economists and former government prosecutors with diverse perspectives and unique insights into the investigative process, energy markets, and the challenges the Commission and market participants face. An expert panel would help the Commission make sure that its enforcement program keeps pace with the dynamic markets it regulates and that its program facilitates the achievement of the Commission's policy goals.

2. Establish Measurements or Metrics of Success That Reflect the Commission's Policy Goals and Measure Industry Compliance

The Commission appears in part to measure the success of its enforcement program by indicating that it has approved 12 settlements and assessed civil penalties totaling \$39.8 million since the first exercise of its enhanced civil penalty authority.⁷² Other measurements used by the Commission to evaluate the effectiveness of its enforcement program have included the number of investigations completed within a year, the number of cases resolved within established timeframes, the timeliness of responses to regulated entities seeking clarification on compliance issues and of responses to no-action letters, the percentage of regulated entities audited to ensure that internal compliance programs are in place, and the degree of cooperation with other federal agencies.⁷³

⁷¹ GAO has recommended that other agencies institute expert panel review programs. GAO, *Commodity Futures Trading Commission Trends in Energy Derivatives Markets Raise Questions about CFTC's Oversight*, GAO-08-25, at 56 (Oct. 19, 2007).

⁷² FERC Press Release, *Commission Approves Two Settlements for \$7.3 Million; Civil Penalties Resolve Capacity Release, Shipper-Must-Have-Title Violations* (Oct. 25, 2007).

⁷³ FERC, *FY 2008 Congressional Performance Budget Request* at 148-59 (Feb. 2007). While FERC's budget request characterizes monthly reports compiled by the Office of (continued...)

Market participants are concerned that relying on these metrics alone is insufficient to further the Commission’s long-term policy goals. If a key measurement of success becomes the amount of penalty dollars collected, then the only way to achieve greater success is for the Commission to collect more penalties. Uncertainty regarding the imposition of potentially large civil penalties may have the unintended effect of discouraging legitimate market behavior, rather than deterring violations. Tallying penalties neither motivates FERC and market participants to work together to promote a culture of compliance, nor establishes a connection between the enforcement program and achieving the Commission’s broader policy goals.

Other agencies whose goals include protecting consumers and preserving competitive markets periodically evaluate the effectiveness of their enforcement actions with measurements that are tied to their policy goals. For instance, the Federal Trade Commission (“FTC”) measures the amount of money it saves consumers through its enforcement actions and the total volume of commerce that takes place in the markets it regulates.⁷⁴ Specific benchmarks used by the FTC include traffic on its website and the number of media articles discussing its consumer protection activities.⁷⁵ These benchmarks are similar to the SEC’s measurement of annual searches for online filings and the CFTC’s

Enforcement on issues raised by regulated entities as a measurement of its efforts to encourage self-reporting, it does not indicate whether these monthly reports are publicly available. *Id.* To the extent they are not publicly available, they do not further the Commission’s goal of encouraging self-reporting as effectively as they could.

⁷⁴ FTC, Federal Trade Commission Performance and Accountability Report: Fiscal Year 2006 at 5, *available at* <http://www.ftc.gov/opp/gpra/2006parreport.pdf> [hereinafter “FTC Performance Report”].

⁷⁵ *Id.* at 8, 23-53.

measurement of the percentage of requests for guidance to which it responds.⁷⁶ Using these kinds of benchmarks to measure success makes education a key component of the agency's enforcement strategy. Other benchmarks include the number of investigations and cases that resulted in "positive outcomes."⁷⁷ These measurements are similar to the CFTC's evaluation of the percentage growth in market volume, percentage increase in the number of products traded, and percentage decrease in consumers who lose funds due to disobedience.⁷⁸ By evaluating these factors, the CFTC indicates that the quality of enforcement actions is just as important as the quantity and ties its enforcement actions to policy goals.

FERC should, therefore, make sure that it emphasizes measurements of success that tie its enforcement actions to its long-term policy goals. For instance, the Commission's practice of determining the number of regulated entities audited to ensure that internal compliance programs are in place sends a signal to all audiences that compliance is a priority. Providing even more public information and detail about the successful compliance programs these market participants have in place could, however, send an even more powerful signal about the importance of compliance by demonstrating explicitly the Commission's concern about the quality of compliance programs. Quality is important

⁷⁶ SEC, United States Securities & Exchange Commission 2006 Performance and Accountability Report at 41-52, *available at* <http://www.sec.gov/about/secpar/secpar2006.pdf>; CFTC, Commodities Futures Trading Commission Performance and Accountability Report Fiscal Year 2006 at 14-25, 41-94, *available at* <http://www.cftc.gov/stellent/groups/public/@aboutcftc/documents/file/2006performaccreport.pdf> [hereinafter CFTC Performance Report].

⁷⁷ FTC Performance Report, *supra* note 74, at 8.

⁷⁸ CFTC Performance Report, *supra* note 76, at 14-25, 41-94.

because it is the content of these programs that ultimately determines whether the Commission's policy goals will be achieved.

In addition, detailing the number of new educational and other measures implemented by the Commission to help market participants in their efforts to comply would indicate to all observers that the Commission has assumed a more prominent role in promoting and facilitating compliance. Finally, a measurement that the Commission could use to bolster the perception of compliance and integrity in energy markets is to identify publicly the number of market participants found not to be in violation of the rules after investigation.

V. Conclusion

With its newly enhanced civil penalty authority, FERC has a unique opportunity to develop an enforcement policy and implement enforcement actions to foster a culture of compliance and move closer to achieving its long-term policy goals for infrastructure development, well-functioning markets, and reliability. Its Policy Statement on Enforcement provides a solid initial framework. However, the Commission's enforcement policy and actions must be as dynamic as the markets it regulates. As its enforcement policy evolves and matures, FERC should also ensure that it is implemented in a firm but fair manner, while increasing efforts to promote a culture of compliance, and helping to ensure that well-intended enforcement actions do not have unintended consequences impacting the public perception of, and confidence in, energy markets or dampening vibrant market participation. The Commission can do this by reaching out to market participants to educate them about the serious compliance issues facing their industry, providing a variety of resources for market participants to obtain advice from the

Commission without being afraid of repercussions, and tailoring enforcement actions to the seriousness of any violations. Working together, FERC and market participants can ensure the development of a culture of compliance, allowing consumers to reap the benefits of a strong energy infrastructure, a reliable energy supply, and well-functioning competitive markets for years to come.