

ENERGY & CLIMATE CHANGE

FERC Enforcement is (Kinda) Alive and Well

But a new commission will mean changes for the energy regulator

MCC INTERVIEW: David Applebaum / Akin Gump Strauss Hauer & Feld LLP

As an independent administrative agency, FERC is immune to fast change from a new administration – sort of. With three commission slots to be filled in 2017, including the agency chair, FERC will change, and likely so will some of its enforcement priorities. Akin partner David Applebaum, former Director of FERC’s Division of Investigations, here gives us his unique inside view of where this critical agency may be heading in 2017 and beyond. His remarks have been edited for length and style.

MCC: You joined Akin in June from the Federal Energy Regulatory Commission (FERC). Why did you leave the agency at this time, and how did you choose Akin? I imagine you had no shortage of choices given your background.

Applebaum: FERC was a great experience. I joined when the agency was in the early stages of developing its enforcement program after Congress gave it substantial new authority under the Energy Policy Act of 2005 (EPAAct). I had many interesting, challenging and important issues to work on, but I felt it was time for a new opportunity. Before FERC, I represented large corporations in complex litigation for 10 years. I enjoyed that work and knew I’d enjoy continuing it after FERC. I was attracted to Akin because it has a world-class energy practice, including a great FERC regulatory group based in D.C. and Houston. Some of the market manipulation cases, particularly on the electric side, can get very technical and complex. Being able to tap

into the firm’s FERC regulatory markets and policy experts helps me provide the best advice for clients on compliance and investigations. Akin also has many very talented enforcement counsel throughout the country, including former federal prosecutors, SEC attorneys, white collar defense counsel, complex civil litigators, congressional investigators and top-notch trial lawyers. The best outcome for any enforcement case is being able to persuade the government to close it without action, but sometimes that can’t be achieved. So you need a very strong litigation bench to help clients in that situation. We have that at Akin.

Also very important to me was that I knew several people who had joined Akin, including people I met at FERC and people I knew from private practice. I respected these folks professionally and personally. That they had chosen to come to Akin said something great about the firm. Being able to practice law with them and their colleagues across different practice groups was very appealing.

MCC: At FERC, you had a bird’s-eye view from your perch in the Division of Investigations of the transition of the agency into an active and vigorous enforcer. Tell us about that shift and your role in it.

Applebaum: FERC had to build an enforcement agency essentially from the ground up. It was more than simply getting the new legal and civil penalty authority from the Energy Policy Act. That was crucial, but FERC had to figure out things like how many staff to hire, what skills and knowledge those people should have, how to organize and manage the enforcement office, what divisions to create, how lawyers and analysts should work together,

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how FERC would even learn about potential violations, how it would obtain the data necessary to analyze potential violations and build cases, and a whole range of other policy, management, organizational, and logistical issues.

FERC has been around a long time. It always had a talented and dedicated staff. But before EPAAct, and even for several years after, it was not a staff focused on these kinds of enforcement issues. FERC learned from colleagues familiar with the SEC, the Department of Justice and U.S. Attorney offices, but FERC has unique aspects to it, including the difference in how electricity and natural gas are regulated compared with other commodities. We had a lot of choices to make that couldn’t just be taken off the shelf from other government offices. I was fortunate to be part of the team figuring out a number of these key policy and management issues. I started at FERC as a line attorney working cases. When



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I became Deputy Director and then Director of Investigations, I was involved in developing these new enforcement policies and working with staff throughout the agency to make sure they were implemented and managed effectively.

There are two things I'm especially proud to have assisted with at FERC. I helped instill an approach to cases that didn't just look at whether there was a colorful email that looked bad but could be overblown in its importance. Instead, I always tried to focus on whether the underlying data, market fundamentals and other facts actually supported the alleged violation. It's essential that government agencies take that approach so that they can avoid trying to obtain a settlement or bring an enforcement action where prosecutorial discretion would be better exercised by closing the investigation. Second, I was heavily involved in hiring attorneys in the Division of Investigation. We brought in some very talented and thoughtful people from government and private practice.

MCC: *Many lawyers dealing with regulatory and compliance matters in sectors such as healthcare and energy expect major changes from the Republican administration. Tell us how you are advising clients today given the current regulatory uncertainty. What do you tell them to expect under the new administration?*

Applebaum: FERC is an independent administrative agency. It is not subject to the more direct or dramatic shifts that can affect an executive branch department under a new administration. Its independence shelters it from immediate changes. In FERC's case, however, there will be a major shift in the composition of the agency in 2017. There are three commissioners now, all Democrats. President Trump will have two commissioners to nominate, and he'll also be able to pick the new chair. On top of that, one of the commissioner's terms expires in June. That means there will be a very new commission in 2017, and this likely will spill over into changes at the senior staff level, which in turn can affect how the agency does its work. I do not, however, expect there to be major changes in enforcement.

Since 2005, across two administrations, one Republican and one Democratic, there has been a significant degree of bipartisan consensus on the need for strong enforcement capabilities and on the specific enforcement policy issues and cases. The agency is now institutionally committed to enforcement. It has an office of 200 people, including staff that regularly scrutinizes and analyzes the markets for potential violations. The new

commissioners, whoever they are, will want that work to continue, and Congress will expect it to continue.

But there could be changes. One example is cases that FERC has been bringing dealing with so-called gaming in the electric markets. This is where a market participant allegedly engages in market manipulation by intending to extract some benefit from the market in a way that is intentionally contrary to the purpose of the market rules, even if it's not necessarily contrary to the precise letter of those rules. While FERC enforcement staff is committed to bringing those cases, I would expect the new commission to take a close look at when the agency wants to continue bringing them. I'm not suggesting there will necessarily be a dramatic shift in the agency's approach to gaming cases—but I do think the commission will take a closer look. As to more obvious cases of fraud, or clear-cut attempts to move prices to benefit a derivative position, in my view those are going to continue to be investigated and enforced without much change from past years.

Another potential change concerns the FERC enforcement process. The gist of the process issue is that for various institutional reasons, traditional agency practices and policies, as well as the specific wording of the Federal Power Act, there's a lot of process built into the life of investigations and enforcement actions. It takes a long time for a resolution at the agency, or in the case of electric matters, before they head to federal court. Based on industry concerns and some recent federal court decisions interpreting the FERC process, we could see changes in the way that FERC investigations proceed through the agency. These could be designed to make sure that if FERC wants to proceed with an enforcement action rather than close out the case or obtain a settlement, that case will get to federal court or an administrative law judge quicker than it does right now.

MCC: *You recently wrote a blog post about two important FERC white papers: one on energy trading compliance and the other on market manipulation. You called the papers notable for providing the first guidance from FERC staff since the EPAct on interpretation of the anti-manipulation rule and on shaping compliance programs to avoid violations. As a longtime FERC insider, give us your perspective on the evolution of the anti-manipulation rule and what the FERC guidance means for clients.*

Applebaum: The anti-manipulation rule paper is significant because it gathers together, at a high level, what the agency believes warrants

a market manipulation enforcement action. This is very useful for market participants. The positions have been stated in various briefs and orders over the past few years, but this guidance brings them together and summarizes settlements and orders in cases brought so far and puts them into three categories.

The first is outright fraud or misrepresentation, an example of which is where a market participant lies about its costs or the operating capabilities of a generation unit to extract some market payment it shouldn't get. Those cases are straightforward, and FERC is always going to bring them.

A second is called a cross-market or related position case. This is where a market participant attempts to move a physical natural gas or electric price for a purpose such as benefiting a derivative. Some of those cases are complex, and some are closer calls than they appear, but this guidance paper shows that FERC has been committed to these kinds of cases, and I think that staff will continue to be committed to them.

The third category is gaming electric markets. For the reason I mentioned earlier, there could be some changes in how the new commission views those cases.

The real story, however, is what's happening in federal courts. In the past year or so, the federal district courts for the first time have been weighing in on FERC's legal theories of manipulation, including the categories of cases just mentioned. These decisions have been on motions to dismiss rather than on the merits, so I don't want to overstate their importance, but some of these courts have gone out of their way to comment on FERC's view of market manipulation beyond simply denying the defendant's motion. By and large, these decisions have been favorable to FERC, and enforcement staff is likely to feel emboldened by them. Still, until there have been some final decisions on the merits, and appellate courts have weighed in, there will remain many undecided questions on the scope of FERC's anti-manipulation rule.

MCC: *What about the trading compliance white paper?*

Applebaum: That could be helpful to market participants because it goes beyond high-level generalities and offers specific ideas about compliance such as training employees and staffing compliance programs. This white paper also, while stating clearly that energy companies have flexibility in designing and implementing compliance programs, says there is no one-size-fits-all approach. The paper makes clear that FERC enforcement

expects energy trading companies, particularly large, sophisticated companies that trade both physically and financially, to have robust compliance programs.

MCC: *You will be bringing your insider perspective to the Akin annual energy briefing in January. To the extent we haven't already spoken about it, can you give us a preview of the key points you plan to make about FERC's top enforcement priorities in the years ahead?*

Applebaum: A key priority for the agency will be litigating what is going to be an active federal court docket. Also, depending on what the commission does with a pending natural gas manipulation case, there could be a complex trial before an ALJ. And there is yet another pending natural gas case that involves some interesting jurisdictional issues on appeal. For

the agency to figure out how to do all of that work with the same number of staff and then handle all the ongoing and new inquiries, investigations and self-reports is going to be a challenge and a key priority. I'll provide more thoughts during the annual briefing.

One thing that I'll talk about in more detail is that there are some specific enforcement policies and practices where market participants, counsel and other commentators on enforcement might be able to persuade the agency to change course and make some modifications that will help the investigative process and add additional protections for market participants. One particular area is FERC's Notice of Alleged Violations policy.

In a nutshell, FERC has an unusual policy among federal enforcement agencies of

publicizing the existence of otherwise nonpublic enforcement investigations. Most significantly, the agency identifies the company and subjects of the investigation and makes the information public before the matter has been resolved through settlement, or before FERC has decided to bring an enforcement action. We think that is a bad policy and should be rescinded. We are publishing an article in the *George Washington Journal of Energy and Environmental Law* early next year on this issue. We then expect to follow up with the agency about the policy. I'll talk about that, and some other potential changes to enforcement processes and policies, at our briefing.