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# FERC's Penalty Guidelines: A Costly Trap for the Unwary

An Emerging Trends Q&A from Pillsbury

Q&A

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While the Federal Energy Regulatory Commission (FERC) has long had regulatory jurisdiction over electric utilities and natural gas companies, as well as the energy markets in which they operate, it had only limited statutory authority to impose civil penalties on wrongdoers until the passage of the 2005 Energy Policy Act (EPAct 2005). Passed in the wake of the 2000-2001 California energy crisis, and in response to the widespread allegations of market misconduct involving Enron and other power sellers, EPAct 2005 significantly expanded FERC's penalty authority. In an effort to help industry participants that are subject to FERC's enforcement authority to determine a potential civil penalty range for such violations, FERC issued its *Revised Policy Statement on Penalty Guidelines* (Penalty Guidelines) in September 2010 in order to bring "clarity and transparency" to the civil penalty process. In this month's Q&A, we speak with Pillsbury partners Joe Fagan, a noted energy regulatory attorney, and Maria Galeno, one of the firm's most active corporate defense litigators about the potential impact of these new Penalty Guidelines.

Q. Why did FERC issue the Penalty Guidelines?

Fagan: The Penalty Guidelines represent FERC's ongoing effort to improve upon its exercise of the enhanced statutory civil penalty authority granted to it by EPAct 2005. Considering that those organizations can be penalized up to $1 million a day for every day they are found to be in violation of FERC rules, resulting in penalties worth hundreds of millions of dollars, it became increasingly clear that the process for determining such penalties required more certainty. By providing the public with an objective means to gauge the potential civil penalties—based on the seriousness of a violation, as well as mitigating factors such as compliance efforts and self reporting—the Penalty Guidelines afford the industry a degree of consistency and transparency that had not previously existed.

Q. How does FERC intend to apply the Penalty Guidelines?

Fagan: The Penalty Guidelines are actually a refinement of FERC's current practice, rather than a departure from how it has fashioned civil penalties over the past five years. The types of violations that

can draw enforcement scrutiny range from failure to comply with electric reliability standards to instances of fraud or manipulative conduct and/or false statements and misrepresentations to FERC. These latter types of violations will likely pose the greatest enforcement concerns to organizations, particularly those unaccustomed to dealing with FERC regulation, which is why FERC decided to provide more transparency, and thus more certainty, on how penalties are determined. Under the Penalty Guidelines, FERC will continue to consider the seriousness of the violation, as well as factors such as the organization's efforts to correct the violation, the involvement of senior representatives, prior history, and the overall level of cooperation with FERC enforcement staff during the course of the investigation, in making its determination. It's important to note, however, that FERC also clearly stipulates that it may depart from the Penalty Guidelines as it deems necessary.

Q. What do you mean by "organizations unaccustomed to dealing with FERC regulation?"

Fagan: People often wrongly assume that only heavily regulated companies, such as electric utilities and natural gas pipelines, need be concerned with FERC enforcement activity. In fact, the broad mandate of FERC's EPAct 2005 enforcement authority extends to nontraditional industry players, including firms whose primary business is not energy, but who engage in activities that may have an impact on the FERC-jurisdictional markets.

Q. Can you give an example of one of these organizations?

Fagan: Yes. FERC pursued an enforcement hearing under its expanded penalty authority against Amaranth, a hedge fund, that according to FERC, engaged in questionable trading of natural gas futures contracts. What was notable about this case was not only the fact that FERC initially sought almost $300 million in civil penalties and disgorgement for alleged manipulation of the NYMEX natural gas markets, but that the fund itself did not engage in physical trades of natural gas. Rather, it only traded natural gas futures contracts. FERC, however, asserted jurisdiction over Amaranth's activities by claiming that its futures contracts trading activity adversely affected prices in the physical natural gas market. While the case ultimately settled for a fraction of what FERC originally sought, it highlights the traps that may befall organizations that engage in activities that they mistakenly believe to be beyond the reach of FERC's enforcement authority.

Q. In 2005, the Supreme Court decision in *United States v. Booker* found that Federal Sentencing Guidelines violated the Sixth Amendment right to trial by jury. As a result, the Guidelines are no longer mandatory, but instead serve in an advisory capacity for judges and other justice officials. Given this change, do Sentencing Guidelines work?

Galeno: Having worked with the Federal Sentencing Guidelines as a federal prosecutor and now as a defense lawyer, I share the view of many that removing discretion from judges, prosecutors, and defense lawyers, as the Guidelines do, is generally not a good way to reach a just sentence on what are inevitably unique facts and circumstances. There are just too many variables. In the pre-Booker world, when the Sentencing Guidelines were mandatory, it was more difficult for the participants in the process to work around them, particularly in cases of securities fraud where the loss calculations literally put the applicable Guidelines ranges off the chart. Now that the Guidelines are advisory, they are more useful as one metric for judges, albeit one with considerable weight.

Q. How do the FERC Penalty Guidelines differ from those of the DOJ?

Galeno: The FERC Penalty Guidelines differ principally in their purpose: the stated central goal of the Penalty Guidelines is to achieve compliance. FERC has determined that partial credit will be given to organizations that have effective compliance programs but do not satisfy precisely all of the requirements set out in the Guidelines, and FERC has made it clear that it could decide that no penalty will be assessed in appropriate circumstances. The Federal Sentencing Guidelines are designed to achieve the primary goals of the criminal law: punishment, deterrence, and rehabilitation. The DOJ, through former Deputy Attorney General Mark Filip in his Memorandum dated August 28, 2008, has stated that the existence of a compliance program will not insulate a corporation from criminal charges.

Q. What are the biggest lessons companies should take away from the FERC Penalty Guidelines?

Fagan: Companies, particularly nontraditional energy companies, should determine as an initial matter if they are subject to FERC rules. If you are, strongly consider consulting with an experienced FERC attorney to do a compliance audit. Don't assume that just because your primary counsel offers excellent advice when it comes to SEC or CFTC compliance rules that they are fully up to speed on the requirements by other agencies such as FERC, particularly if providing a regulated utility service is not your primary line of business.

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