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Court Rules on Rights of Respondents in FERC Enforcement Actions

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On April 11, 2016, the United States District Court for the District of Massachusetts issued a ***procedural order*** denying motions to dismiss actions initiated by the Federal Energy Regulatory Commission ("FERC") seeking affirmance of two orders assessing civil penalties against Lincoln Paper and Tissue, LLC, Richard Silkman ("Silkman"), and Competitive Energy Services ("CES") (collectively, the "Respondents") for violating Section 222 of the Federal Power Act ("FPA") and FERC's Anti-Manipulation Rule. In the underlying orders, FERC found that the Respondents had engaged in market manipulation by participating in schemes to inflate the baseline level of electrical consumption used to measure the demand response performance of certain industrial facilities by curtailing their use of on-site generation. Although the district court did not rule on the merits of FERC's market manipulation claim, the district court's order provides important guidance on the substantive and procedural rights afforded to respondents in a FERC enforcement action. In particular, the court:

- Found that respondents must raise all defenses that they have to a claim of market manipulation at the time that they answer an Order to Show Cause or run the risk that the arguments will later be deemed to have been waived.
- Interpreted the statute of limitations applicable to FERC enforcement actions to give FERC five years to issue a show cause order.
- Agreed with the conclusion reached by the district court addressing FERC's action to enforce its civil penalty order against *Barclays*—the only other court to address the issue—that the prohibition on market manipulation applies to natural persons.
- Held that the void-for-vagueness doctrine should be interpreted narrowly in the context of an action for enforcement of civil penalties against a market participant.
- Concluded that the FPA does not provide FERC with authority to apply civil penalties against an entity that merely aids or abets a third party that engages in market manipulation.

A. Waiver of Defenses

As an initial matter, the district court concluded that those accused of violating the prohibition on market manipulation must raise all available defenses before FERC prior to FERC issuing an order assessing penalties and that failure to do so may be deemed a waiver of the defense. In their motions to dismiss, the Respondents argued that FERC's action was barred by the generally applicable 5-year statute of limitations set out in 28 U.S.C. § 2462 and that FERC lacks jurisdiction over demand response. FERC, however, argued that the Respondents' failure to raise these arguments in the underlying FERC proceeding prevented them from raising these claims in district court. In response, the Respondents argued that the courts have found that the "raise-or-waive" rule supported by FERC should only apply where expressly contemplated by the applicable statute or rule and that FERC's position was inconsistent with the right to *de novo* review of an order assessing civil penalties conferred on Respondents by the FPA.

In its order, the district court agreed with FERC that there is a "general rule . . . that a federal court reviewing an agency adjudicative decision is limited to those issues presented during the agency proceeding below." In support, the district court noted that Rule 213 of FERC's Rules of Practice and Procedure expressly requires that, any answer to an order to show cause must, "to the extent practicable . . . [s]et forth every defense relied on." While the district court acknowledged that the FPA contemplates *de novo* review of a FERC penalty assessment order, the district court found that this did not provide a basis for departing from the general rule that issues that are not raised may be deemed waived. While the court did not make an affirmative determination regarding the procedures required for *de novo* review, the district court's reasoning is predicated on a narrow view of a court's role in reviewing a penalty assessment under the FPA. Specifically, the district court stated that while a court has the option to consider evidence outside of the administrative record and to conduct trial-type hearings as part of a *de novo revie*w, this "does not change the fundamental nature of the court's task – which is to 'review' agency action and, as a corollary, it does alter the basic rule that an argument may be waived by the failure to raise it at an appropriate time – such as the time required by the agency's rules."

Notably, while the district court agreed with FERC's arguments in principle, the court found that the Respondents' failure to raise the statute of limitations and jurisdiction at the agency level did not prevent them from pursuing these claims in court. The district court found that applying such a rule to a statute of limitations claim would be impracticable, as it would require Respondents to raise defenses that may only have merit at some point in the future and before the claim had ripened. The district court also emphasized that courts have consistently held that objections to an agency's jurisdiction may be raised on appeal of an agency order, even if not urged before the agency itself.

B. Statute of Limitations

The district court also clarified the application of the 5-year statute of limitations to FERC enforcement actions. In particular, the district court endorsed FERC's position that the statute of limitations should be applied separately to an action for violation of the prohibition on market manipulation and an action for civil penalties. More specifically, the district court held that FERC has (1) 5 years from the occurrence of the allegedly manipulative conduct to issue an order to show cause; and (2) 5 years from a Respondent's refusal to pay a civil penalty assessed by FERC to bring an action in district court seeking enforcement of civil penalties.

While the Respondents argued that the precedent relied upon by FERC in support of its arguments required that court actions based on "prosecutorial determinations"—as opposed to adjudicatory administrative proceedings—be brought within 5 years of the underlying conduct, the district court rejected these arguments on the basis that the administrative proceeding underlying FERC's orders had involved an adjudication of the underlying violations. While acknowledging that "FERC's proceeding may have been less formal and offered fewer procedural protections than some adjudications under the [Administrative Procedure Act]," the district court emphasized that FERC had made "extensive findings of facts and applied the law to those facts." According to the district court, "[t]hat the statutory scheme makes the Commission's determinations only the first step in a legal process does not strip [FERC's] determinations of their content."

C. Application of the Prohibition on Market Manipulation to Natural Persons

The district court also agreed with FERC that Section 222 of the FPA and FERC's Anti-Manipulation Rule apply to natural persons. In support of its conclusion, the district court cited the May 2015 opinion issued by the U.S. District Court for the Eastern District of California in an action involving allegations of market manipulation against Barclays Bank, which found that the reference to "entity" in Section 222 of the FPA encompasses natural persons. Notably, the district court in this case added that, even if the question had not been resolved in *Barclays*, it would have afforded *Chevron* deference to FERC's reasonable interpretation of the term entity when promulgating the Anti-Manipulation Rule in Order No. 670. This represents a marked departure from the approach taken in the Barclays' case, where the court declined to afford *Chevron* deference to FERC's interpretation of the scope of the term entity.

D. Notice

The district court's order also takes a narrow view of the void-for-vagueness doctrine, which requires that offenses be defined with "sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement." While the Respondents had argued that FERC's Anti-Manipulation Rule failed to provide them with adequate notice and that FERC's case was based upon an after-the-fact interpretation of what constitutes appropriate conduct, the district court emphasized that the void-for-vagueness doctrine should be less rigidly applied in the context of a FERC enforcement action. More specifically, the district court emphasized that the doctrine will be applied more leniently in the context of economic regulation of sophisticated parties, particularly where there is an opportunity for parties to obtain official guidance before engaging in unlawful conduct, and where the statute or regulation at issue includes a scienter requirement.

Here, although the district court acknowledged that the ISO-NE tariff did not expressly state how a baseline should be set, the district court found that the Respondents should have known that their conduct was prohibited because ISO-NE had made clear to market participants that the demand response program was not intended to pay market participants for reductions in demand that would have occurred absent the program. The district court also relied heavily on a letter from Constellation New Energy, Inc., which had enrolled one of the Respondents in the demand response program, expressing concern that participants in the demand response program may have modified their energy usage in a manner inconsistent with the program's purpose and encouraging further discussions with Constellation and/or ISO-NE to the extent that participants had questions regarding the legality of their conduct – something which the Respondent declined to do.

E. Aider and Abettor Liability

Finally, the district court's order holds that Section 222 of the FPA and FERC's Anti-Manipulation Rule do not impose liability on those that only aid and abet the manipulative conduct of another party, but do not directly engage in manipulative conduct. In their motion to dismiss, CES and Silkman argued that they only acted as advisors and consultants to Rumford Paper Company, who was the owner of the industrial facility at issue and had entered into a separate settlement with FERC. The district court agreed that the prohibition on market manipulation does not authorize secondary liability and noted that the Supreme Court has held that Section 10(b) of the Securities Exchange Act and Rule 10b-5, on which Section 222 and the Anti-Manipulation Rule are modeled, do not reach those that merely aid and abet violations of securities laws. While the district court found that allegations "that an entity assisted or provided advice to another company in support of the latter's execution of a fraudulent scheme" would not be a sufficient basis for imposing liability, the district court declined to dismiss the action against CES and Silkman on the basis that there was evidence suggesting that these entities had participated directly in the execution of the manipulative scheme by communicating Rumford's availability to provide demand response to ISO-NE.