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Litigation/Global Energy & Infrastructure | Alert

July 2016

Action in Massachusetts District Court on FERC Manipulation Cases: Shifting Tide of Review *De Novo* under *Maxim Power* Favors Defendants

On July 21, 2016, the United Stated District Court (USDC), District of Massachusetts rejected the Federal Energy Commission's (FERC) effort to limit review *de novo* to the administrative record. Judge Mastroianni ruled in *Maxim Power*—a generation "burn as bid" manipulation case brought by FERC seeking $5 million in penalties—that not only did *de novo* review allow for discovery and fact finding, but defendants are entitled to a *full civil trial* including the possibility of a jury trial with all attendant protections and processes.[1] Recall that on April 11, 2016, the same court (albeit a different judge) issued an order on motions to dismiss in the *FERC v. Silkman and Competitive Energy Services, LLC* and the *FERC v. Lincoln Paper and Tissue, LLC* cases – two closely-aligned FERC enforcement cases stemming from alleged manipulative conduct by the defendants in ISO New England's electricity demand response market. Rejecting a statute of limitations defense, Judge Woodlock denied the motions and transferred the cases to the USDC for the District of Maine without definitively ruling on the *de novo* review issue.[2]

The *Maxim* Order is an important "first" in a FERC enforcement matter. With *Maxim*, the tide may be shifting toward defendants despite a series of court orders favorable to FERC enforcement in various manipulation cases.

[1] *Maxim* Order at 2. *FERC v. Maxim Power Corp., et al.*, Memorandum and Order Regarding Procedures Applicable to FERC's Petition and Respondents' Motion to Dismiss, Civil No. 15-30113-MGM at 8 (D. Mass. July 21, 2016) (*Maxim* Order).

[2] *FERC v. Silkman and Competitive Energy Services, LLC*, Memorandum and Order Regarding Motions to Dismiss, Civil Action No. 13-13054-DPW (D Mass. April 11, 2016) (*Silkman* Order).

The Lead Up: Previous Massachusetts District Court Ruling

In *Silkman and CES*, FERC alleged that Lincoln Paper, a Maine paper mill, intentionally manipulated its demand response baseline by curtailing its on-site generator and that Richard Silkman and his consulting company, Competitive Energy Services (CES), advised and encouraged another paper mill to do the same. After a 4-year investigation, in 2012, FERC issued Orders to Show Cause outlining allegations and penalties against Lincoln, Silkman, and CES.[3] As required by Federal Power Act sections 31(d)(2) and (3), parties could elect for an administrative hearing before a FERC Administrative Law Judge (ALJ), or the parties could elect for "an immediate penalty assessment" by the Commission and, if unpaid, FERC would commence an action in an USDC for an order affirming the penalty, where the district court would review *de novo* the penalty assessment. The parties elected for a penalty assessment and review *de novo*, and the matter ended up in Massachusetts District Court. By 2014, the defendants had filed motions to dismiss.[4] After a stay, Judge Woodlock then denied the motions to dismiss.[5]

In reaching his decision, Judge Woodlock held that the defendants had not waived their statute of limitation and jurisdiction defenses, but denied both of them. First, the court stated FERC's Order to Show Cause and penalty assessment constituted an "adjudication," so the statute of limitations had not run on the enforcement of the penalty.[6] In making the determination of an adjudication, the order noted that the penalty assessment was "significantly more than a prosecutorial determination" and that "[t]he Commission made extensive findings of facts and applied the law to those facts."[7] However, the court remained silent on the extent of due process provided by this purported adjudication.[8] In a similar manner, Judge Woodlock deflected the important *de novo* review issue as discussed below.

Changing Tide: Review *De Novo*

Court and FERC rulings in FERC enforcement matters have been trending in favor of enforcement and against defendants, including the rejection of adequate notice and open market defenses. FERC and courts continue to cite FERC enforcement orders currently under review by the courts as persuasive authority. This cross-pollination of pro-enforcement FERC precedent has presented near-term challenges for defendants. However, it also could represent a house of cards for FERC enforcement as the tide begins to shift toward defendants and against FERC's manipulation claims.

A critical example of the changing tide regards what constitutes review of the penalty assessment *de novo*. *Maxim Power* made the same election as the *Silkman* parties for review *de novo* and before the same court. Judge Woodlock in the *Silkman* order deflected the issue, stating only that a district court's review could "gain some procedural richness in the context of an action seeking enforcement of an administrative order" and that "*de novo* review may allow for the evaluation of evidence that was not a part of the agency administrative record and may or may not require other trial-like proceedings."[9] Thus, the *Silkman* court has not yet reached a determination on the pressing issue of the meaning of *de novo* review. However, the *Maxim* order did make such a determination.

FERC enforcement has consistently argued—and as rejected in *Maxim*—that this review "is not a typical civil action" and the court can review the existing administrative record without a trial. Defense advocates—as successfully argued in *Maxim*—firmly believe that by electing to contest the assessment in district court, enforcement targets are entitled to "an ordinary civil action that is governed entirely by the Federal Rules of Civil Procedure and culminates in a jury trial."[10] In

[3] *See Richard Silkman*, 140 FERC ¶ 61,033 (2012); *Competitive Energy Services*, 140 FERC ¶ 61,032 (2012); and *Lincoln Paper and Tissue, LLC*, 140 FERC ¶ 61,031 (2012).

[4] *See FERC v. Electric Power Supply Ass'n*, No. 14-840, 2016 WL 280888 (U.S. Jan. 25, 2016).

[5] After this order, Lincoln settled with FERC enforcement on June 1, 2016 for $5 million in civil penalties and approximately $380,000 in disgorgement. *See Lincoln Paper and Tissue, LLC*, 155 FERC ¶ 61,228 (2016).

[6] *Silkman* Order at 34.

[7] *Silkman* Order at 33.

[8] The judge also struck down the defendants' arguments and ruled that FERC pled its claim with sufficient particularity, that Silkman and CES far from being aiders and abettors were direct participants in the manipulative scheme, and that FERC's interpretation of "entity" including natural persons (such as Silkman) be afforded *Chevron* deference and thus only reversible if the interpretation was unreasonable.

[9] *Silkman* Order at 25 and n. 5.

[10] *Maxim* Order at 8.

another pending market manipulation enforcement matter, the Eastern District of California Court declined to issue a definitive ruling, but "[did] not find that the administrative process lacked the basic elements common to adversarial adjudication" and had not yet "conclusively determine[d] whether Defendants have the right to a jury trial or another means of fact-finding, to call witnesses, to offer evidence, to cross-examine FERC's witnesses, or have the right to discovery."

The USDC, Massachusetts District, through Judge Mastroianni in the *Maxim Power* matter, has now ruled for the first time in such FERC enforcement proceedings that not only did *de novo* review allow for discovery and fact finding, but in fact defendants are entitled to *a full civil trial* with all attendant protections and processes. The court looked to a similar *de novo* provision in the Natural Gas Policy Act and emphasized the fact that FERC's investigation and prompt penalty assessment may not ensure the defendant's due process including discovery rights. Specifically, the court held that a *de novo* penalty review "is to be treated as an ordinary civil action, but with limitations on the discovery process in order to promote an efficient resolution of the case."[11] This does not mean a limit on defendants' overall discovery rights, since defendants did not have discovery rights in the first place during the investigatory phase.

FERC has been citing its own orders for persuasive authority on various substantive enforcement litigation issues. Now, through the *Maxim* order, there is court precedent for the first time rejecting FERC's stance on *de novo* review of penalty assessments that can be relied upon by other defendants in FERC manipulation litigations from Massachusetts to California.

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[11] *Maxim* Order at 2.

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