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FERC's Proposed Expansion of Duty of Candor Could Increase Compliance Risk

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Can a seemingly innocuous requirement to tell the truth create unintended consequences? The Federal Energy Regulatory Commission ("FERC" or "Commission") raised this question when it issued its July 28, 2022 Notice of Proposed Rulemaking ("NOPR") seeking comment on a new, broadly applicable duty of candor. FERC's proposal, if adopted in its current form, would require companies and individuals to offer complete, "accurate, and factual information" in any "communication relate[d] to a matter subject to the jurisdiction of the Commission."¹

According to the NOPR, a new duty of candor is necessary because the Commission relies heavily on accurate self-reported information in order to monitor markets and ensure jurisdictional rates remain just, reasonable, and not unduly discriminatory. To remedy the perceived lack of an overarching truthfulness requirement, the Commission seeks to impose strict liability for any false or misleading communications (including material omissions) relating to any matter subject to the jurisdiction of the Commission, "unless the entity exercises due diligence to prevent such occurrences." However, it is not clear that this new duty is required to fill gaps, if any, in the Commission's current regulations, especially given the existence of numerous overlapping legal duties that are already in place. Nor is it clear that the proposed strict liability rule is appropriate under the circumstances. Absent further clarification, the proposed rule could subject even immaterial misstatements from unwitting parties to FERC enforcement actions, even if the communicating party did not know the recipient is a FERC-jurisdictional entity. While FERC seeks to use the recipients of communications—including Commission-jurisdictional market monitors and transmission providers—as its basis for asserting broad jurisdiction, the communicating entities that are actually targeted by the regulation extend far beyond FERC's existing jurisdictional line. We review first FERC's existing regulations imposing duties of candor, then analyze the proposed new rule and what it purports to fix, and finally discuss the proposed rule's broad implications.

I. Is the Proposed Duty of Candor Necessary?

FERC currently imposes candor requirements under numerous regulations derived from the Federal Power Act ("FPA"), the Natural Gas Act ("NGA"), the Interstate Commerce Act, the Natural Gas Policy Act of 1978, and the Department of Energy Organization Act, each of which prohibit inaccurate communications to the Commission in defined circumstances. These Commission-specific regulations are bolstered by federal law criminalizing the submission of intentionally false statements to any branch of the United States Government. Yet in spite of the impressive array of existing regulations summarized below, the Commission nevertheless believes there are notable gaps in its candor requirements that need to be addressed. Although the NOPR suggests that certain scenarios may not be covered under

the existing regulations,² FERC did not offer any real-life instances where it was unable to adequately enforce its candor requirements due to limitations within the existing regulatory framework.

A. Market Behavior Rules

The Commission's strictest duty of candor is found within its rules governing market behavior. A subpart of the regulation³ states:

A Seller must provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercises due diligence to prevent such occurrences.

The market behavior duty of candor is extremely broad both in scope and in obligations imposed. It applies to Sellers' communications not just with FERC itself, but also with most other FERC-jurisdictional transmission entities. There is no express limit on the types of communications covered by the duty of candor, and the rule imposes an affirmative obligation upon Sellers to exercise due diligence to ensure the accuracy of the information they communicate. Unlike many of FERC's other duties of candor, the market behavior rules do not require proof of intent—in essence, imposing strict liability on parties for even accidental misstatements of fact made without due diligence.

The market behavior duty of candor has been upheld judicially in light of multiple challenges. In 2013, the D.C. Circuit upheld the provision's constitutionality against a challenge alleging unconstitutional vagueness and lack of fair notice.⁴ The U.S. District Court for the Southern District of Ohio also issued a 2018 opinion both upholding FERC's authority to promulgate the duty of candor regulation under Section 206 of the FPA, and finding that the Commission properly applied the regulation to statements made in investigations.⁵

According to the Commission, the market behavior duty of candor is deficient because its applicability is currently limited to entities possessing market-based rate authorization under FPA Section 205.⁶ This limitation is a remnant of the initial impetus for FERC's market behavior duty of candor, which was enacted following the early 2000s Western Energy Crisis.

B. Other Duties of Candor

The NOPR outlines over a half dozen other instances where FERC's existing regulations or other federal regulations impose some form of a duty of candor on a participant's engagement with FERC. Other sources of authority for a duty of candor include:

- **Regulations prohibiting fraud.** Commission regulations state that it is unlawful, in connection with jurisdictional natural gas and electric transactions, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."⁷ These regulations do not create a general affirmative duty of disclosure, but broadly prohibit false or misleading statements in both voluntary and required communications.

- **Federal anti-fraud statutes.** Under 18 U.S.C. § 1001(a), individuals who “in any matter within the jurisdiction of the Government . . . make any materially false, fictitious, or fraudulent statement or representation” can be fined or imprisoned for up to five years. The Commission acknowledges that it falls within the scope of this statute, but expresses concern that only the Department of Justice, not FERC, has the authority to prosecute any violations thereof.
- **Rules governing statements made under oath.** FERC’s governing statutes and adopted regulations require certain submissions to be made under oath and penalty of perjury. For instance, periodic and annual reports filed under the FPA and NGA are submitted under oath. Similar oath requirements exist for written statements in investigations, certain hydroelectric filings, and testimony and evidence submitted in proceedings before Administrative Law Judges. All Commission filings also must be signed by an attorney, which constitutes a certificate that the signer knows the contents are true to the best of the signing attorney’s knowledge and belief.
- **Applications for natural gas pipeline certificates.** Commission regulations promulgated under Section 7 of the NGA require applicants for certificates of public convenience and necessity to disclose “fully and forthrightly . . . all information relevant to the application.” NGA Section 7(d) also requires that applications for certificates shall be made in writing, under oath, and containing such information as the Commission shall require.
- **Natural Gas Act market behavior rules.** Under its Section 7 authority, the Commission has implemented rules requiring sellers with market-based rate authorization to report their natural gas trades to index publishers. Alongside this reporting requirement is a duty to “provide accurate and factual information and not knowingly submit false or misleading information or omit material information to any such publisher.” The Commission has also adopted amendments to natural gas blanket sales certificates imposing a duty to be “honest and forthright” with the Commission and price reporting entities.
- **Rules for individuals appearing before the Commission.** Under the Commission’s Rules of Practice and Procedure, persons appearing before FERC or a presiding officer must conform to the standards of ethical conduct required of practitioners before U.S. Courts, including Rule 11 of the Federal Rules of Civil Procedure, which states that any submission to a Court impliedly certifies that factual or legal representations made therein contain a reasonable basis in fact or law “to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances.”

In light of the Commission’s extensive array of existing regulatory tools to enforce candor requirements in different contexts, some industry participants are questioning whether FERC needs a new duty of candor rule at all.

II. Is the Proposed Regulation an Appropriate Response?

The NOPR proposes to take FERC’s strictest existing duty of candor, which governs market behavior, and adopt it as the baseline for all communications regarding Commission-jurisdictional topics. If enacted as proposed, the new rule would impose a broadly applicable duty governing all communications with the Commission and related entities:

Any entity must provide accurate and factual information and not submit false or misleading information, or omit material information, in any

communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators, jurisdictional transmission or transportation providers, or the Electric Reliability Organization and its associated Regional Entities, where such communication relates to a matter subject to the jurisdiction of the Commission, unless the entity exercises due diligence to prevent such occurrences.

The Commission offered interpretive guidance of the proposed rule with clarifications of terminology. This guidance, however, raises several issues of concern to industry participants.

The proposed duty of candor would apply to a broad set of “entities” encompassing both organizations and individuals. The term “entity” includes not only the entity making the communication, but also all other entities responsible for the communication. The term “communication” is defined to encompass both formal and informal communications, verbal or written, made through any method. This includes communications with FERC staff, employees of other covered entities, and agents and contractors acting on behalf of covered entities. It also would apply to communications in any way related to matters subject to FERC’s jurisdiction, whether the party knows it or not. It also applies to agents, which includes not only attorneys but also accountants, consultants and others acting on behalf of the entity.

Under the proposed rule, the only defense to an alleged duty of candor violation is the exercise of due diligence by the communicating entity or its agent in “preventing” the false or misleading statement. It therefore is not enough that a party attempted to investigate the truthfulness of the information it communicated. Instead, the Commission retains discretion to determine with the benefit of hindsight whether a party exercised reasonable due diligence under the circumstances.

The Commission proposes to weigh certain factors in determining whether a party exercised due diligence, including:

- Whether a communication had to be made without sufficient time for additional diligence to be undertaken;
- The importance and materiality of the communication to the recipient;
- The duration and consistency of the communication at issue;
- Whether the communication was voluntary or required;
- Whether the communication was in response to a specific request for information or was unsolicited;
- The size and sophistication of the communicator(s); and
- The communication’s effect on the marketplace or the Commission’s regulatory responsibilities.

The Commission also states that it does not intend to penalize all potential violations of the duty of candor, especially inadvertent errors of limited impact and scope. However, the NOPR is unclear as to

whether FERC will more tangibly define the bounds of its discretion not to enforce duty of candor violations.

III. Implications for Clients

The proposed regulation is purposely broad in scope and, if adopted, would apply to an extremely broad range of communications not only with the Commission, but also with RTOs/ISOs, market monitors, NERC, and reliability entities. The proposed regulation is not constrained by materiality, noting only that it is one consideration in evaluating due diligence. Notably, it does not limit its scope to enforcement against Commission-jurisdictional entities, but purports to cover a large spectrum of entities, whether they are aware of the Commission's jurisdiction or not. It is unclear whether FERC would apply its existing penalty guidelines to enforcement of the proposed rule, which as drafted leaves broad implementation discretion to the Commission. The duty of candor proposal would overlay existing duties of candor, creating the potential for multiple violations for the same conduct.

The breadth of the term "entity" can also create a principal-agent issue: under the proposal, if a company relies upon a non-employee agent for the submission of communications to FERC or an RTO/ISO or its market monitor, the company could face liability for inaccurate statements made by the non-employee agent. Entities that interact with FERC or any jurisdictional market operators and reliability authorities should be aware of the breadth of the proposed rule, and may consider submitting comments to raise any concerns with the proposed regulations. If codified as drafted, clients would need to assess whether the information they provide to the Commission is sufficiently vetted via due diligence and likely would need to develop internal protocols to assure veracity of submissions. This is especially important where, under the rule as proposed, the duty of candor can be breached without any intent to mislead, and principals may be responsible for untruthful submissions prepared by third-party consultants and vendors. These proposals could have a significant chilling effect on the willingness of participants to provide information to FERC or others that is not required by statute or regulation.

The breadth of the rule has raised concerns among industry participants and practitioners. Interpreted broadly, even typographical errors could lead to inadvertent violation of the rule. The rule also lacks any limitation of its application only to objective information, which raises concerns for practitioners in terms of engaging in advocacy that may be deemed misleading by a reader who merely disagrees with a proposition. This is particularly true given the Commission's focus on self-reporting. Commissioner James Danly sharply dissented from the NOPR, recognizing that it "encompasses a far greater range of activities by a far greater number of speakers than the existing duty of candor and does so without standards of materiality or intent, or a clearly defined safe harbor to protect the unwary from liability."

Fortunately, the proposal is not yet a final rule, and the Commission encourages interested industry participants to submit comments on the policies proposed in the NOPR. Initial comments must be submitted by November 10, 2022. The Commission specifically seeks comment on:

- The need for a broad duty of candor rule at all;
- Whether the existing duty of candor regulations found within the Market Behavior Rules provide a reasonable foundation for a broadly applicable duty of candor;
- The Commission's authority to promulgate a broad duty of candor;
- Whether there are categories of entities or individuals that should be exempted from the duty of candor;

- The scope of communications to be covered by the rule; and
- Whether the regulation properly identifies all organizations who assist the Commission to carry out its statutory obligations and communications to whom should be subject to a duty of candor.

We continue to monitor opportunities to engage with the Commission on matters affecting clients' interests and are actively following this proceeding and other areas within the Commission's jurisdiction that may be impacted by the NOPR.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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¹ *Duty of Candor*, 180 FERC ¶ 61,052 (2022).

² For example, the NOPR observes that there is no explicit requirement of candor for communications from shippers to interstate pipelines, transmission customers to transmission utilities, and transmission utilities to RTOs.

³ 18 CFR § 35.41(b).

⁴ *Kourouma v. FERC*, 723 F.3d 274 (D.C. Cir. 2013).

⁵ *FERC v. Coaltrain Energy, L.P.*, No. 2:16-cv-732, 2018 WL 7892222 (S.D. Ohio Mar. 30, 2018).

⁶ 18 CFR § 35.36(a)(1).

⁷ 18 CFR §§ 1c.1(a)(2), 1c.2(a)(2).

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