

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Enforcement of Statutes, Orders,
Rules, and Regulations

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Docket No. PL10-4-000

COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION

The Electric Power Supply Association¹ (EPSA) respectfully submits these comments in response to the Federal Energy Regulatory Commission's (FERC or Commission) April 15, 2010 Order establishing an opportunity for public comment on the proposed Policy Statement on Penalty Guidelines (Policy Statement and Penalty Guidelines) issued in the above-captioned proceeding.² The Policy Statement represents another step forward in the Commission's ongoing development of its enforcement program since passage of the Energy Policy Act of 2005 (EPAAct 2005), which significantly expanded FERC's authority to issue civil penalties under the Federal Power Act (FPA) and the Natural Gas Act (NGA), among other things. EPSA commends the Commission for continuing its efforts to provide further transparency and consistency to the enforcement program, and to ensure the intended benefits are fully realized with regard to the Penalty Guidelines. In that spirit, EPSA urges the Commission to issue a Revised Policy Statement on Penalty Guidelines incorporating the

¹ EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally response facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

² *Enforcement of Statutes, Orders, Rules, and Regulations, Policy Statement on Penalty Guidelines*, 130 FERC ¶ 61,220, Docket No. PL10-4-000 (March 18, 2010).

suggestions and requested clarifications reflected herein in order to render a useful, applicable policy on the assessment of penalties.

I. BACKGROUND

On March 18, 2010, the Commission issued the Policy Statement with the intention of adding fairness, consistency and transparency to its civil penalty determinations in enforcement investigations. The Policy Statement's proposed Penalty Guidelines are modeled on portions of the U.S. Sentencing Guidelines, developed for use in criminal cases, "with appropriate modifications to account for Commission-specific considerations."³ Four hypothetical examples of penalty range calculations under the new guidelines are provided in the Policy Statement (for market manipulation, tariff, capacity release, and reliability standards violations).

The proposed Penalty Guidelines generate a penalty range based on the combination of: (1) a violation level, consisting of a base level that is adjusted for various seriousness factors; and (2) a culpability score, which considers an organization's past and current conduct and efforts to remedy the violation.⁴ The specific process for calculating a civil penalty range for violations under the guidelines involves a five-step process.⁵ It starts with establishing a Base Violation Level (BVL) as follows for violations: (1) of NERC reliability standards the BVL is 16; (2) involving fraud, manipulation or anti-competitive conduct the

³ Policy Statement at P 1.

⁴ Id. at P 37.

⁵ Id. at PP 38-51.

BVL is 6; and, (3) involving misrepresentations and false statements to the Commission the BVL is 18. Second, adjustments are made to the BVL based on level of harm (such as risk of loss for reliability violations) and monetary gain or loss. Third, a Base Penalty is set, which is the greater of: (1) the dollar amount listed in the Penalty Guidelines' Violation Level Penalty Table,⁶ (2) gain to the organization from violation, or (3) loss caused by the violation. Fourth, a Culpability Score is determined starting with a base score of 5 and adjusting up or down based on six culpability factors (including organization size; level of personnel involved; prior history; effective compliance and ethics program; and, self-reporting, cooperation and acceptance of responsibility). The Culpability Score corresponds to a set of "minimum and maximum multipliers" included in the Penalty Guidelines. The fifth and final step involves multiplying the Base Penalty level (Step Three) and the "minimum and maximum multipliers" (Step Four) to produce the applicable penalty range.

Of note, the Policy Statement states that application of the Penalty Guidelines is discretionary, not mandatory, so that deviations in penalties can be made to account for the specific facts and circumstances of a violation if the Penalty Guidelines produce a penalty that does not "fit" the violation.⁷ Further, the NERC Notice of Penalty (NOP) process is not modified by the Policy

⁶ Penalty Guidelines at § 1C2.2(b).

⁷ Policy Statement at P 32. ("We do not intend to depart from the Penalty Guidelines regularly, but neither will we always adhere to a rigid application of them.")

Statement, with the Policy Statement noting that FERC has decided to further review only one of the 153 NOPs that NERC has filed to date.⁸

Additionally, the Commission's Office of Enforcement (OE) staff held three workshops in April in Washington, DC, Houston and San Francisco to discuss how the Penalty Guidelines would be applied and to answer questions.

Following the workshops, the Commission issued an Order on April 15, stating FERC "has determined that the public interest would be served by affording interested entities a broader opportunity to comment on the Penalty Guidelines before issuing a final order and putting them into effect."⁹ Accordingly, the Order announced the Commission will suspend the Policy Statement and application of the Penalty Guidelines and considers the March 18 action as interim in this proceeding.

II. COMMUNICATIONS

All pleadings, correspondence and other communications concerning this proceeding should be directed to:

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⁸ Id. at P 64.

⁹ *Order Regarding Policy Statement on Penalty Guidelines*, Docket No. PL10-4-000, (April 15, 2010).

III. COMMENTS

EPSA appreciates the Commission's ongoing efforts since passage of EAct 2005 to develop its enforcement program, and in tandem with this, the Commission's recognition that it is important for regulated entities to understand what types of violations the Commission views as most important, which facilitates the industry's efforts to allocate resources to the most important compliance objectives. EPSA has been an active participant in various proceedings related to the Commission's evolving enforcement program,¹⁰ and has previously urged the Commission to provide more clarity about the levels of civil penalties it will assess.¹¹ Specifically, EPSA, along with other energy trade associations jointly advocated that the Commission should establish and make publicly available a tiered-approach similar to that used by the Nuclear Regulatory Commission (NRC) for assessing civil penalties based on the seriousness of the offense and harm to the market.¹² The Commission has previously declined to publicly adopt a particular approach, but based on

¹⁰ Comments filed on behalf of the [Energy Trade Associations), *Implementation of the Federal Energy Regulatory Commission's Enforcement Authority*, in Docket No. AD07-13-000 (filed December 16, 2007); Comments of the Electric Power Supply Association, *Implementation of the Federal Energy Regulatory Commission's Enforcement Authority*, in Docket No. AD07-13-000 (filed December 16, 2007); Comments and Request for Clarification of Final Rule of the Industry Associations, *Ex Parte Contacts and Separation of Functions and Submissions to the Commission Upon Staff Intention to Seek an Order to Show Cause*, Docket Nos. RM08-8-000 and RM08-10-000, (filed July 21, 2008); Request for rehearing and clarification of the [Energy Trade Associations], *Order Authorizing Secretary to Issue Staff's Preliminary Notice of Violations*, Docket No. PL10-2-000 (filed January 19, 2010).

¹¹ *Implementation of the Federal Energy Regulatory Commission's Enforcement Authority*, White Paper submitted on behalf of the [Energy Trade Associations] in Docket No. AD07-13-000 (November 14, 2007) at pp. 22-24.

¹² See NRC, Enforcement Policy at 20-29, available at: <http://www.nrc.gov/about-nrc/regulatory/enforcement/enforc-pol.pdf>.

experience gained post-EPAAct 2005, indicates in the Policy Statement that “[w]e now believe that it is in the public interest to advance our past use of the Sentencing Guidelines’ principles by implementing a guidelines approach patterned after the Sentencing Guidelines....”¹³

EPSC has viewed transparency in the methodology of establishing civil penalties as a critically important component of the overall enforcement program. Accordingly, EPSC believes that the Commission should provide additional detail to and explanation of the proposed Policy Statement based on comments received in this proceeding, as there remain areas of undue subjectivity with regard to application of the Penalty Guidelines.¹⁴ If this additional clarity is not provided in a revised Policy Statement, EPSC is concerned the benefits of a publicly articulated approach to assessing civil penalties may not be fully derived, and in fact, may *hinder* regulated entities’ efforts to develop robust compliance programs and willingness to self-report possible violations.

In particular, the workshops held by OE staff in April were helpful and provided insight and greater understanding regarding application of the Penalty Guidelines and EPSC recommends that this information be incorporated explicitly into the revised Policy Statement. These workshops were not transcribed and therefore not memorialized in a manner that is necessary for energy companies

¹³ Policy Statement at P 3.

¹⁴ Most notably, there are questions regarding how the FERC penalty guidelines are intended to work with NERC’s penalty matrix in both the assessment of penalties imposed by FERC in its own Section 1(b) investigations, and when FERC acts in its appellate function to review NERC penalties. These questions are of a critical nature to entities that must comply with the rules and regulations of both the FERC and NERC.

subject to the Commission's enforcement regime.¹⁵ Additionally, the presentations by OE staff, which responded to a number of questions submitted by interested entities prior to the workshops, have not been made publicly available.¹⁶ In fact, the OE staff indicated at the workshop it had received 112 questions prior to the conference, although some were duplicative. OE staff provided responses to approximately 34 pre-submitted questions, as well as numerous questions from workshop attendees. These exchanges covered every aspect of the proposed Policy Statement and Penalty Guidelines – and provided an enhanced understanding of the Commission's intent and objectives with respect to the Policy Statement. Specific concerns addressed included application of the Penalty Guidelines to the electric reliability program, Commission discretion, compliance programs, how Base Violation Levels were established, assessing culpability, self-reporting, and cooperation during an investigation. Given this, EPSA submits that it is critical that these clarifications are memorialized within an expanded and revised Policy Statement.

As discussed in more detail below, EPSA recommends that the Commission issue a revised Policy Statement to, among other things: (1) memorialize and clarify that the Penalty Guidelines are only applicable in the

¹⁵ Because the workshop was not transcribed, EPSA's references herein to OE staff's comments at the April 7 workshop held in Washington, DC are based on EPSA staff's best understanding of what was heard in discussion that day. This highlights that the useful information provided by OE staff should be memorialized in a revised Policy Statement to ensure the industry benefits from a more complete understanding of the Commission's intent and application of the Policy Statement and Penalty Guidelines.

¹⁶ At the Washington, DC workshop held on April 7, Nancy Bagot, EPSA's Vice President of Regulatory Affairs suggested to OE staff during the Question and Answer session that the Commission post the OE staff presentations since the workshop was not transcribed and in light of the beneficial information contained in the presentations.

reliability context when the Commission opens its own 1(b) enforcement investigation and would not apply when a NERC Notice of Penalty (NOP) is pending before FERC (who serves in an appellate role in its review of NOPs); (2) reconsider its use of elevated violation levels for any reliability violation; (3) provide a more robust explanation of the decision to utilize (as modified) the U.S. Sentencing Guidelines (USSG), which were developed for use in the criminal context, and why approaches used by other federal agencies, such as the NRC, are not suitable; (4) adopt (and modify to the FERC context) the U.S. Sentencing Commission's recently proposed amendments to the USSG related to effective compliance programs which, among other things, allows cooperation credit for an effective compliance program, even if high-level personnel are involved, subject to Congressional approval; (5) clarify that in applying discretion under the Penalty Guidelines, the Commission and its staff will be guided by the principle, as outlined in the Policy Statement on Compliance, that "[a]chieving compliance, not assessing penalties, is the central goal of our enforcement efforts," (6) affirm that civil penalties will not generally be assessed for minor violations but are reserved for cases with material harm or risk of harm and intentional or willful violations; and, (7) multiple violations that are similar in nature will be handled as a single violation for purposes of applying the guidelines.

A. Clarifications Specific To The Electric Reliability Program

As a general matter, ensuring reliability is a top priority and core function for the electric sector as a whole, and therefore the industry places significant emphasis and resources on compliance with the reliability standards and other

related rules and requirements. While EPSA appreciates the Commission's interest in addressing in the proposed Policy Statement the specific types of violations of Commission rules and regulations that may be subject to a Section 1(b) investigation, many of EPSA's members share the significant concerns that have been expressed by some in the electric sector, including at the April workshops and in all comments filed to date in this proceeding,¹⁷ regarding the applicability of the Penalty Guidelines to the electric reliability program. Specifically, there are concerns that adopting this second set of penalty guidelines, in addition to the NERC Sanction Guidelines, will create confusion and inconsistency, and signals dramatic increases in penalties for reliability violations, including for minor violations. Further, there are concerns that the proposed Penalty Guidelines would impose liability on utilities for outage costs (based on "loss of load" and "risk of loss" language)¹⁸ and that this places additional and unacceptable risk on system operators. In addition, many are concerned that the elevated levels of penalties the Commission has proposed for reliability violations are unwarranted and counterproductive, and could be utilized to usurp NERC's own Sanction Guidelines as approved by the Commission.

It should be noted that in responding to the reliability concerns at the Washington, DC-based workshop, OE staff stated there have not been any enforcement Section 1(b) investigations stemming from minor reliability

¹⁷ See Comments of the National Association of Regulatory Utility Commissioners (filed April 19, 2010), Comments of the Empire District Electric Company (filed May 27, 2010), and Comments of Pacific Northwest Generating Cooperative (filed June 7, 2010).

¹⁸ Policy Statement at 29 and Penalty Guidelines at §1A1.1, Application Notes, Item 3(h), and §2A1.1 (pp. 49-52).

violations, as the intent is to deal with those at the NERC and Regional Entity levels. OE Director Norman Bay stated “there is only one set of reliability standards” and that is what regulated entities should focus on. Staff also reiterated the view that they serve in an appellate or review role for NERC NOPs filed at the FERC, and the Policy Statement does not change the NOP process.

Given the significant weight and resources allocated to reliability within the electric sector, EPSA urges the Commission to give serious attention to the comments received by various entities in this proceeding on the issues highlighted above, which warrant full consideration by the Commission with an eye toward adjusting the revised policy statement accordingly based on these concerns and suggested modifications. Further, EPSA notes that NERC currently has an evaluation underway of its FERC-approved Sanction Guidelines, which provides objective criteria for imposition of penalties through a detailed set of Violation Risk Factors (VRFs) and Violation Severity Levels (VSLs).¹⁹ If the Commission makes a final determination to apply the penalty guidelines to the electric reliability program, EPSA submits the revised policy statement should include consideration of the NERC experience and the results of the evaluation that NERC currently has underway given that the Sanction Guidelines take into account reliability fundamentals and have merit in the reliability compliance context.

¹⁹ NERC is currently working to improve the Violation Risk Factors associated with its Sanction Guidelines based on the experience gained to date in implementing the reliability enforcement program. The Improved Violation Risk Factor Proposal is available here: http://www.nerc.com/docs/standards/sar/Improved_VRF_Definitions_2010March22.pdf.

To emphasize the separation and differences between the two processes, EPSA also recommends that the Commission memorialize and further clarify in a revised Policy Statement that: (1) the Penalty Guidelines are only applicable in the reliability context when the Commission opens its own 1(b) enforcement investigation and would not apply when a NERC Notice of Penalty (NOP) is pending before FERC (who serves in an appellate role in its review of NOPs); (2) affirm that civil penalties will not generally be assessed for minor violations but are reserved for cases with material harm or risk of harm and intentional or willful violations; and, (3) incorporate information provided from the April workshops specific to application of the Penalty Guidelines to the electric reliability program.

B. Other Requested Clarifications

At the April 7 workshop in Washington, DC, OE Director Bay emphasized the guidelines are intended to strongly incent compliance and said the “clear and quantifiable takeaways” for organizations to minimize penalties are: (1) to develop a robust compliance plan and create a culture of compliance (noting that a compliance program can reduce a company’s culpability score by three points,²⁰ which in turn can reduce its penalty range amount by approximately 40 percent); (2) ensure no Senior Management involvement in violations; and, (3) to self-report if a violation is found, and if this results in an investigation, to cooperate and settle without going to trial. (Self-reporting, cooperation, and acceptance of responsibility can reduce the culpability score for a company by

²⁰ Penalty Guidelines at § 1C2.3(f)(1).

four points,²¹ thereby reducing a base penalty amount by up to 80 percent.) Further, OE Director Bay said the penalty guidelines are not designed to give OE a “bigger, badder hammer,” does not reduce the Commission’s discretion, for example, to determine whether to open an investigation or close an inquiry without further action, and importantly, does not trump the EPCRA 2005 statutory cap of \$1 million per day per violation, as the Commission cannot contravene statutes. EPSCA believes these remarks are very useful for industry and signals the emphasis the Commission places on development of an effective compliance program to avoid violations. This is consistent with past Commission pronouncements on expectations for industry with regard to enforcement and compliance. However, this should be indicated more clearly within the Policy Statement to reflect the Commission’s continued focus on the goal of incenting compliance by industry. Accordingly, EPSCA requests that the Commission clarify in a revised Policy Statement that in applying discretion under the Penalty Guidelines, the Commission and its staff will be guided by the principle, as outlined in the Policy Statement on Compliance, that “[a]chieving compliance, not assessing penalties, is the central goal of our enforcement efforts.”²²

OE Special Counsel Max Minzner further emphasized at the April 7 workshop that the US Sentencing Guidelines, as adapted, were utilized due to the long history of and body of experience surrounding their application; that

²¹ Penalty Guidelines at § 1C2.3(g).

²² *Compliance with Statutes, Regulations, and Orders*, 125 FERC ¶ 61,053 at P 1 (October 16, 2008).

penalties can be dramatically reduced (if not eliminated) through settlement, full cooperation, and self-reporting – combined with an effective compliance plan; failure to detect violations does not mean there is not an effective compliance program; the level of penalties is not expected to be significantly altered under the guidelines; and, reiterated that FERC is unlikely to open enforcement cases involving little or no risk of harm. Again, these insights on interpretation and application of the Penalty Guidelines are beneficial and should be incorporated into a revised Policy Statement. EPSA believes the Commission should expand upon its explanation of the decision to utilize (as modified) the US Sentencing Guidelines, which were developed for use in the criminal context, and why approaches used by other federal agencies, such as the NRC approach are not suitable, given concerns that most violations in the FERC context are the result of human error and mostly unintentional.

With respect to the US Sentencing Guidelines, EPSA notes that the US Sentencing Commission has recently proposed amendments to become effective November 1, 2010.²³ Included in the proposed amendments are additional “application notes” for Section 8C2.5(f)(3)(C) on Compliance and Ethics programs. Specifically, the provision encourages direct reporting to the board by responsible compliance personnel by allowing an organization with such a structure to benefit from a three level mitigation of the culpability score, even if high-level personnel are involved in the violation. EPSA requests that the

²³ Proposed Amendments to the USSG were sent to Congress on April 29, 2010, and published in the Federal Register on April 30, 2010 to become effective November 1, 2010, unless Congress rejects the proposed changes. The proposed USSG amendments are available here: http://www.ussc.gov/FEDREG/20100511_Federal_Register_Notice.pdf.

Commission incorporate this provision (as modified for the FERC context) into the penalty guidelines at Section 1C2.3.(f).

Additionally given the statements above, the Commission should reconsider its use of elevated violation levels for any reliability violation. The Commission has not adequately supported its decision to start the violation levels at 16 for any reliability violation, in contrast to the level six for fraud, anti-competitive conduct and other rule, tariff and order violations. EPSA's members are concerned that in the context of the Commission's and NERC's evolving reliability program, the extraordinarily high potential penalty levels will create counterproductive incentives that lead away from responsible self-evaluation and self-reports by utilities.

In addition, EPSA urges the Commission to more clearly affirm in the Policy Statement that civil penalties will not generally be assessed for minor violations but are reserved for cases with material harm or risk of harm and intentional or willful violations. The Penalty Guidelines do not allow for a calculation of zero, so there is no way to avoid a civil penalty under the Penalty Guidelines other than departing from them, which the Commission has indicated will occur only in limited circumstances.²⁴ EPSA believes such a clarification would better align with the Commission's prior Policy Statement on Compliance, where the Commission stated it would waive penalties under appropriate circumstances in the case of a strong compliance program. EPSA also believes this is consistent with discussion at the April 7 workshop. Finally, the Policy Statement is silent on how the Penalty Guidelines will apply to multiple violations

²⁴ Policy Statement at P 32.

that are similar in nature. EPSA requests that the Commission include an explicit statement that violations falling within the same general category (i.e., different types of reliability violations or different types of OATT violations) will be handled as a single violation for purposes of applying the Penalty Guidelines.

IV. CONCLUSION

Wherefore, EPSA respectfully requests that the Commission issue a revised Policy Statement on Penalty Guidelines incorporating the recommendations and clarifications requested herein.

Respectfully Submitted,



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June 14, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the Comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., June 14, 2010.



Nancy Bagot, VP of Regulatory Affairs