UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Enforcement of Statutes, Orders, Rules, and Regulations	Docket No. PL10-4-000

COMMENTS OF
TRANSMISSION ACCESS POLICY STUDY GROUP

Pursuant to the Commission's April 15, 2010, "Order Regarding Policy Statement on Penalty Guidelines,"[1] the Transmission Access Policy Study Group ("TAPS") submits its comments on the Commission's March 18, 2010, "Policy Statement on Penalty Guidelines."[2] TAPS appreciates the opportunity to comment on the Policy Statement, and generally agrees with the comments submitted by the American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), and the National Rural Electric Cooperative Association ("NRECA")[3] and with much of the comments submitted by the Edison Electric Institute ("EEI").[4] TAPS focuses here on points that are not covered elsewhere or that merit separate emphasis:

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1 Enforcement of Statutes, Orders, Rules, and Regulations, 131 FERC ¶ 61,040 (2010).

2 Enforcement of Statutes, Orders, Rules, and Regulations, 130 FERC ¶ 61,220 (2010) ("Policy Statement").

3 Comments of the American Public Power Association, the Large Public Power Council, and the National Rural Electric Cooperative Association, Enforcement of Statutes, Orders, Rules, and Regulations, Docket No. PL10-4-000 (June 14, 2010) ("APPA/LPPC/NRECA Comments").

4 Comments of the Edison Electric Institute, Enforcement of Statutes, Orders, Rules, and Regulations, Docket No. PL10-4-000 (June 14, 2010) ("EEI Comments").

1. The Commission should rescind the guidelines as applied to violations of reliability standards and should focus its review of NERC Notices of Penalty on whether NERC has properly applied its existing, Commission-approved sanction guidelines.[5]

   a. If the Commission does not rescind the new penalty guidelines as to reliability violations, it should at least (1) reduce the base violation level and resulting penalty floor for reliability violations, and (2) eliminate the new guidelines' use of loss of load as a penalty-increasing factor.

   b. If the Commission does not eliminate the guidelines' use of loss of load as a penalty-increasing factor, it should (1) clarify how loss of load will be valued, (2) exclude on-system load from the valuation, and (3) explain how causation issues will be addressed.[6]

2. To the extent that the Commission retains a penalty guideline approach like that set forth in the Policy Statement, it must provide expressly for downward adjustments of penalties (both within the range and potentially below the range produced by the guidelines) based on the size, financial wherewithal, and structure of an organization. Specifically, the Commission should provide expressly that, in assessing penalties within the guideline range and in determining whether to assess a penalty below the bottom of the range, the Commission will take into account:

   a. an organization's financial resources;

   b. the burden that the fine will impose upon the organization or other affected entities, including the organization's ratepayers;

   c. the size of the organization and any measure taken by the organization to discipline any officer, director, employee, or agent of the organization responsible for the offense and to prevent a recurrence of such an offense; and

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[5] If the Commission believes that the Commission-approved NERC guidelines are insufficient, it should initiate a formal process to change them under FPA Section 215(f), 16 U.S.C. § 824*o*(f).

[6] TAPS also supports EEI's other proposed changes to the guidelines for reliability violation penalties, including reshaping of the penalty enhancements, the proposed changes to the culpability scoring mechanisms, and the suggestion that the Commission use NERC's violation risk factors to guide risk of harm determinations under any guidelines the Commission may adopt, *provided that* the Commission also examines—as NERC does under its sanction guidelines, *see* NERC sanction guidelines § 4.2.1, *infra* n.11—"the specific circumstances of the violator to determine if the violation of the requirement in question actually produced the degree of risk or harm anticipated by the Violation Risk Factor."

d. entity structure (e.g., for-profit versus non-profit), including whether the organization is a public entity, whether members, customers, or other beneficiaries of the organization, other than shareholders, are direct victims of the offense, and whether the organization can pass on to consumers or others the expense of the fine.

3. The Commission should clarify or revise certain other aspects of the guidelines' implementation.[7]

I. INTERESTS OF TAPS

TAPS is a continuing, informal association of municipal utilities, municipal joint action agencies, electric cooperatives, an investor-owned utility, and other supporters, in more than thirty states, promoting open, non-discriminatory transmission access.[8] TAPS members are entirely or predominantly transmission dependent, relying on competitors' transmission systems to gain access to wholesale power markets in which they are active participants. TAPS members have an interest in the outcome of this proceeding as customers of public utilities affected by the Policy Statement. TAPS members also have an interest in the outcome of this proceeding to the extent that they are potential recipients of penalties under the guidelines.

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[7] Specifically, TAPS asks the Commission (a) to clarify Enforcement Staff's continuing prosecutorial discretion to close self-reports and investigations without penalty (even where a violation has occurred) and to reach settlements at levels lower than the minimum guideline amounts; (b) to clarify that operational penalties paid under a public utility's tariff count as diminishing the pecuniary gain/loss associated with a tariff violation; (c) to unbundle the elements that can reduce an organization's culpability score; and (d) to provide a separate credit for remediation of an offense.

[8] TAPS is chaired by Roy Thilly, CEO of WPPI Energy ("WPPI"). Current members of the TAPS Executive Committee include, in addition to WPPI, representatives of: American Municipal Power, Inc.; Blue Ridge Power Agency; Clarksdale Public Utilities; Connecticut Municipal Electric Energy Cooperative; ElectriCities of North Carolina, Inc.; Florida Municipal Power Agency; Illinois Municipal Electric Agency; Indiana Municipal Power Agency; Madison Gas & Electric; Missouri Public Utility Alliance; Missouri River Energy Services; NMPP Energy; Northern California Power Agency; Oklahoma Municipal Power Authority; and Southern Minnesota Municipal Power Agency.

II. COMMUNICATIONS

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III. COMMENTS

A. The Commission should rescind the Policy Statement as applied to reliability violations or at least revise it substantially.

TAPS supports "add[ing] greater fairness, consistency, and transparency to [the Commission's] enforcement program," which the Commission has described as the goal of the penalty guidelines.[9] But for reasons explained below and outlined by EEI, APPA, LPPC, and NRECA, adopting penalty guidelines based on the United States Sentencing Guidelines for criminal activity is the wrong approach, particularly with respect to penalties for reliability violations. Proceeding down that path will yield *less* fairness, consistency, and transparency than if the Commission had simply continued the policies that were already in place. It also will increase consumer costs without materially improving (and, in fact, while potentially harming) system reliability. These results run

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9 Policy Statement, P 2.

counter to the Commission's previously expressed goal of "[a]chieving compliance, not assessing penalties."[10]

1. The Commission should not promulgate a second set of penalty guidelines for reliability violations already covered by the FERC-approved NERC sanction guidelines.

With respect to reliability violations, there is *already* a set of Commission-approved penalty guidelines that have worked well to date.[11] The Commission should not adopt a second, more draconian set of penalty guidelines that could be applied to the very same conduct that triggers penalties under an existing, Commission-approved penalty regime.[12] The Policy Statement articulates no reason for departing from the existing NERC sanction guidelines; indeed it claims *not* to be departing from that regime at the same time that it promulgates competing guidelines that may be applied, in uncertain circumstances, to an uncertain degree, to supersede the penalties imposed through application of NERC's existing sanction guidelines. The Policy Statement's approach cannot be reconciled with the Commission's past statements regarding its

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[10] Compliance with Statutes, Regulations, and Orders, 125 FERC ¶ 61,058, P 1 (2008).

[11] NERC Rules of Procedure, Appendix 4B, Sanction Guidelines of the North American Electric Reliability Corporation (effective January 15, 2008) (available at http://www.nerc.com/files/Appendix4B_Sanctions_Guidelines_Effective_20080115.pdf) ("NERC sanction guidelines").

[12] *See* Policy Statement, P 64 ("The North American Electric Reliability Corporation (NERC), acting as the Electric Reliability Organization, and Regional Entities (RE) impose penalties for violations of Commission-approved, mandatory Reliability Standards using penalty guidelines that employ a Base Penalty Amount Table."); NERC Sanction Guidelines, *supra* n.11, Appendix A (Base Penalty Amount Table) (providing base penalty levels from $1,000 for the lowest risk and a lowest severity violation to $1,000,000 for the highest risk and highest severity violation). The Commission approved the NERC sanction guidelines in *North American Electric Reliability Corp.*, 118 FERC ¶ 61,030, *order on clarification and reh'g*, 119 FERC ¶ 61,046 (2007). The Commission also has approved, separately, the Violation Risk Factors that NERC uses in applying its guidelines. *E.g.*, *N. Am. Elec. Reliability Corp.*, 119 FERC ¶ 61,145 (2007).

review of NERC-imposed penalties, with the statutory scheme, or with the idea of promoting certainty and predictability in enforcement matters.

While the Commission has the authority to review NERC Notices of Penalty and also has independent authority to levy penalties, the Commission has not previously suggested that it might review NERC Notices of Penalty with an entirely different penalty framework in mind than the existing, Commission-approved NERC sanction guidelines. The Commission's earlier statements have suggested that its review of NERC Notices of Penalty would focus on whether NERC had applied its sanction guidelines properly under the facts of a given case consistent with the standards of FPA § 215.[13] Specifically, the Commission stated that "[w]hen reviewing a notice of penalty . . . , [it would] conduct a *de novo* review of the record of the proceeding below to ascertain whether the record contains adequate evidence that the proposed penalty determination accords with" the requirement that penalties '"bear a reasonable relation to the seriousness of the violation and shall take into consideration the efforts of [the registered entity] to remedy the violation in a timely manner.'"[14] In doing so, the Commission said (*id.* P 11), it would evaluate Notices using the factors contained in the NERC sanction guidelines, in part to ensure consistency in the application of those factors:

> In determining whether to review a notice of penalty (which will occur prior to receiving an application for review), we would look first to the apparent relative

[13] *See* Statement of Administrative Policy on Processing Reliability Notices of Penalty and Order Revising Statement in Order No. 672, Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, 123 FERC ¶ 61,046, P 8 (2008) ("Notice of Penalty Policy Order") ("[I]f the Commission moves to review a proposed penalty, it may review the amount or type of the proposed penalty, as well as any determinations underlying it, such as the existence of one or more violations of a Commission-approved Reliability Standard.").

[14] Notice of Penalty Policy Order, P 9 (citation omitted).

> seriousness of the violation at issue in the notice of penalty. For example, we would evaluate the seriousness of a violation by the combination of violation risk factor and violation severity level that NERC has assigned and that we have approved for particular requirements of the Reliability Standards implicated in the notice of penalty. We also will analyze notices of penalty to ascertain the potential risk to the reliability of the Bulk-Power System, as well as any actual harm, presented by their particular fact patterns. The more serious a violation described in a notice of penalty appears to be, the more likely it is that we would review the proposed penalty. In addition, the Commission retains the authority to review notices of penalty on its own motion to ensure that penalties are applied in a reasonably consistent manner, or to improve compliance with Reliability Standards and thereby increase the reliability of the Bulk-Power System.

(Citations omitted.)

The Policy Statement's suggestion that the Commission might review NERC Notices using significantly different criteria or a different matrix with much higher penalty levels—based on the United States Sentencing Guidelines for criminal convictions—will diminish the very certainty and predictability that the Commission says it is attempting to promote. The Policy Statement states (P 64) that:

> [W]hile we do not anticipate applying the Penalty Guidelines when we look at most notices of penalty that we receive, for an out-of-ordinary notice of penalty describing a serious violation we may consider the results of applying the Penalty Guidelines—but these results would not be determinative of our decision to proceed with a further review.

This passage offers no real insight, however, into the circumstances that will trigger Commission review or how the new penalty guidelines will affect the initiation and substance of such reviews. Which violations are "serious" ones to which the Commission "may consider the results of applying the Penalty Guidelines"? Are all

Notices dealing with "serious violation[s]" inherently out-of-[the]-ordinary? If not, what makes a Notice "out-of-ordinary"? What factors will the Commission employ in deciding whether to "consider the results of applying the Penalty Guidelines"? And what role will that consideration play if it is not determinative?

TAPS is concerned that a divergence of penalties calculated under the Policy Statement and penalties imposed by NERC applying the NERC sanction guidelines could itself become the basis for deciding that a Notice is "out-of-ordinary," warranting review. That would be inappropriate. To the extent that the Commission takes issue with the NERC sanction guidelines' sufficiency to fulfill the relevant statutory commands, rather than with NERC's *application* of those guidelines in a particular case, the Commission must follow the Congressionally-mandated path for changing NERC's rules. 16 U.S.C. § 824*o*(f).[15] It may not ignore or over-ride the Commission-approved NERC rules by applying new, and much more severe penalty guidelines under the guise of reviewing NERC Notices of Penalty.[16]

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[15] FPA Section 215(f) provides that "[t]he Commission, upon its own motion or complaint, may propose a change to the rules of the ERO[, which] proposed rule change shall take effect upon a finding by the Commission, after notice and opportunity for comment, that the change is just, reasonable, not unduly discriminatory or preferential, is in the public interest, and satisfies the requirements of subsection (c) of this section."

[16] The Commission may be concerned that, if FERC were to initiate an investigation of potential reliability violations under Part 1b of its regulations, there would be no applicable guidelines to guide the calculation of penalties. But while the NERC sanction guidelines may not govern Part 1b reliability investigations of their own force, the Commission could choose to be guided by them in conducting such investigations. TAPS believes that would be appropriate because the NERC sanction guidelines have been approved by the Commission and because adopting them for purposes of Part 1b investigations would maintain consistency between the complementary investigative mechanisms applicable to reliability violations.

2. The new penalty guidelines for reliability violations are arbitrary, vague, and produce unreasonably high penalties—especially as applied to small entities.

Putting aside the confusion caused by promulgating a second set of penalty guidelines for reliability violations, the Policy Statement errs in adopting reliability-violation penalties based on the United States Sentencing Commission's guidelines for sentencing criminal convicts. Sentencing Guidelines developed to calibrate punishment for individuals or organizations that have been convicted of crimes—those whom a jury has found guilty beyond a reasonable doubt of criminal statutes with *mens rea* requirements—are the wrong starting point for a regulatory civil penalty enforcement regime.[17] That is particularly true for electric reliability matters, where (a) there are thousands of requirements, ranging from crucial system-operations requirements to less immediately important record-keeping requirements, (b) covered entities include organizations with vastly different levels of expertise, sophistication, and resources, (c) system-operation decisions frequently must be made in minutes or seconds or are made automatically by relay settings designed to protect the broader grid, and (d) violations may be unintentional, with difficult-to-predict consequences.

The Policy Statement also provides no justification for assigning a base violation level of 16 to reliability violations, either in comparison to past penalties for such violations (assessed under the NERC sanction guidelines, for example), in comparison to

[17] The FPA's and Natural Gas Act's civil penalty provisions each require the Commission to consider the nature and seriousness of the relevant violation. FPA § 215(e)(6), 16 U.S.C. § 824*o*(e)(6); FPA § 316A(b), 16 U.S.C. § 825o-1(b); NGA § 22, 15 U.S.C. 717t-1(c). These requirements necessitate some attempt to reflect not only the potential consequences of a violation but also the state of mind involved in it. In the criminal context, *mens rea* requirements are among the substantive elements that prosecutors must establish beyond a reasonable doubt to obtain a conviction in the first place. In the electric reliability context, violations generally are strict-liability offenses, triggering a need not present in the criminal context to calibrate penalties in light of the actor's mental state.

other types of violations penalized under the Policy Statement such as market manipulation or fraud, or to the criminal offenses to which the U.S. Sentencing Guidelines apply that level. The Policy Statement's assignment to reliability violations—including unintentional ones—of a base violation level that is nearly three times that assigned to intentional market manipulation or fraud is unreasonable.

The Policy Statement's approach to penalizing reliability violations also will harm the smallest violators disproportionately. That occurs because: (a) the Policy Statement's "higher-of" structure creates a penalty floor that applies even in cases where the violation results in neither pecuniary gain to the organization nor pecuniary loss resulting from the violation; (b) the penalty floor is driven by the choice of a base violation level of 16 for reliability violations, establishing an unreasonably high floor for reliability-violation penalties; and (c) any penalty floor—particularly such a high one—will impact small entities more than larger ones. The discrimination against small entities is exacerbated by the interaction of the Policy Statement's penalty floor with the statutory civil penalty cap. The penalty floor establishes minimum penalty levels, which are more likely to be applied to small entities and lower-level violations, while the statutory cap holds down the maximum penalties for violations with greater impacts, which are more likely to result from the actions of larger entities. Such compression makes it less likely that penalties constrained by the floor and the cap will be proportionate to the seriousness of the offense, as required by the statute. Together, the statutory cap and proportionality requirement argue strongly for reducing the penalty floor for reliability violations by decreasing their base violation level.

As a result of the guidelines' higher-of structure and the base violation level for reliability violations, the *minimum* penalty for such violations (putting aside culpability-score modifiers) will be $175,000. If an organization's culpability score remains at the starting point of 5—that is, if it is adjusted neither up nor down—the lowest possible penalty range for a reliability violation becomes $175,000 to $350,000. Remarkably, that range is for violations (including unintentional ones) that involve only a low risk of minor harm and little if any pecuniary gain or loss. Record-keeping violations would be one example.[18] Penalties at such levels would be substantially higher than most penalties assessed by NERC and accepted by the Commission to date, and the Policy Statement does not come close to justifying such a high penalty floor for small scale, unintentional reliability violations with a low risk of harm to the bulk power system. Such high minimum penalties are likely to be disproportionate to the types of offense to which they apply, *regardless* of entity size,[19] but the problem is much worse as applied to small entities, for whom penalties at such high floor levels can represent a significant financial hardship.

Moreover, violation levels and associated penalty amounts increase substantially with increasing risk or potential violation severity. Moving up one category with respect to either risk or potential harm adds three points,[20] yielding a violation level of 19 and a corresponding penalty range between $500,000 and $1 million for a violation with

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[18] Policy Statement, Guidelines § 2A1.1, commentary, example (1)(A) (citing an example of low risk of minor harm).

[19] In contrast, the corresponding penalty-guideline floor for market manipulation violations—which, by definition, must be knowing or reckless—is just $5,000 to $10,000.

[20] *See* Policy Statement, Guidelines § 2A1.1(b)(1)(B) ("If the violation created either a moderate risk of minor harm OR a low risk of substantial harm, add 3.").

neither pecuniary gain nor loss, assuming no culpability-score adjustment. Moving up two categories in total—*i.e.*, high risk of minor harm or moderate risk of substantial harm, which are the Policy Statement's two examples involving "small utilities," *see* Policy Statement, Guidelines § 2A1.1, illustrative examples (C.1) and (C.2)—yields a violation level of 21 and a penalty range between $910,000 and $1.8 million for a violation with neither pecuniary gain nor loss, assuming no culpability-score adjustment.

These penalty floors are unreasonably high, particularly as applied to small entities that are least able to bear them but most likely to have penalties dictated by the floor.[21] Data supplied by one TAPS member shows 2009 power supply costs of about $5 million for municipal systems with peak load in the 15-20 MW range and about $11-14 million for municipal systems with peak load in the 35 to 40 MW range. Another TAPS member provided data for a 40 MW system with an annual power supply cost of $10.6 million. A single, $1 million penalty levied against a small system for a comparatively minor reliability violation producing neither pecuniary gain nor loss would increase that system's power supply costs by 10 to 20 percent for the year. Moreover, as non-profit entities, municipal electric systems have no means to bear such penalties other than passing them on to customers.

As explained below, the Policy Statement fails to incorporate any meaningful adjustment for—or even consideration of—the size and financial resources of an entity to be penalized. In contrast, the Commission-approved NERC sanction guidelines, which

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[21] Small entities' violations are unlikely to lead to pecuniary gain or loss exceeding the amounts associated with these violation levels. Consequently, small entities' penalties are more likely to be dictated by the Commission's choice of a base violation level for reliability violations.

have produced much lower penalty levels, do provide for consideration of those factors.[22] Thus, if the Commission uses its new, high-floor, no-calibration-for-small-entities guidelines as a point of comparison in deciding whether to review NERC Notices of Penalty, the Commission will review penalties imposed on small entities—which have less impact on the bulk power system—far more frequently than it reviews penalties imposed on larger entities. That result would be counter-intuitive, unreasonable, and discriminatory.

3. If the Commission retains the penalty guidelines for reliability violations, it should not calculate penalties based on the pecuniary value of lost load.

If reliability violations result in load shedding (no matter how proximate or attenuated the causation), penalties multiply rapidly under the Policy Statement, quickly reaching into the tens of millions depending on the method used to calculate the value of lost load (or of the load that should have been shed to prevent greater risk to the bulk power system).[23] The hypothetical set forth in paragraph 56 of the Policy Statement assumes a value of $15 million for the loss of load to 20,000 customers for seven hours, but does not explain how that value was derived. Loss of load values of such a magnitude are almost guaranteed to drive the penalty calculations for any violation that

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[22] *See* http://www.nerc.com/filez/enforcement/index.html (listing NERC enforcement actions and penalties).

[23] *See* Policy Statement, Guidelines, § 1A1.1, Application Notes 3(h).

involves a loss of load.[24] Assuming no adjustment to the organization's starting-point culpability score, the resulting penalty range for such a violation would be $15 million to $30 million for a single loss-of-load event. Again, if the Commission uses the difference between Policy Statement penalties and NERC guideline penalties as a basis for determining when to review a Notice, the Policy Statement's use of the pecuniary value of lost load would all but guarantee Commission review of every Notice involving loss of load—particularly any such Notice involving a small entity. These results are neither consistent with the statute nor the product of reasoned decision-making.

Basing penalty levels on a pecuniary valuation of loss of load is likely to have adverse, unintended consequences, including (a) system gold-plating to reduce the chances that load will be dropped because of reliability violations and (b) degraded operational decision-making. System operators should be focused exclusively on how best to operate the system in accordance with applicable reliability standards. If controlled load shedding is a proper operational response to conditions facing the system operator in a given moment, the system operator should proceed to shed the load without hesitation. The operator should not have to worry about whether the decision to shed

[24] In the hypothetical set out at paragraph 56 of the Policy Statement, the base penalty to which the organization's culpability score is applied was $15 million—an amount driven by the posited valuation for the loss of load. It is illuminating to compare that amount to the Violation Level Penalty Table set out at § 1C2.2(b) of the guidelines to see what level of adjustment would have to be applied to the 16-point base violation level to produce a $15 million base penalty. The table shows that a 16-point adjustment (for a total of 32 points) would be needed and would lead to a base penalty of $17.5 million. But a 16-point adjustment is the maximum available adjustment for reliability violations, reserved for violations involving a "high risk of extreme harm" as could occur "as a result of multiple violations … that are similar to the causes of the 2003 Northeast blackout." Policy Statement, Guidelines, § 2A1.1, commentary, example (H). The hypothetical described in paragraph 56 did not come close to that level. The degree of disparity between the penalty driven by the loss of load valuation and that which would be calculated using the (already-inflated) base violation level raises serious questions about the reasonableness of the Commission's approach to calculating and basing penalties on loss of load valuations.

load could increase his or her employer's penalty exposure if the underlying conditions to which the operator is responding were caused by the employer's reliability violation. Nor should the operator have to weigh the potential penalty consequences of shedding load preemptively to protect the bulk power system or risking greater, uncontrolled loss of load. We agree with EEI that injecting large financial penalty considerations into reliability-related system operations decisions will reduce reliability instead of enhancing it.

In addition, we note that basing civil penalty amounts on pecuniary valuations of lost load is out of step with the thrust of FPA Section 215. The Commission's authority over the reliability of the bulk power system under Section 215 is limited by the statute. It extends to the promulgation and enforcement of "reliability standard[s]," which means requirements "to provide for reliable operation of the bulk-power system." 16 U.S.C. § 824*o*(a)(3). In contrast, FPA § 215(i)(2), 16 U.S.C. § 824*o*(i)(2), denies the Commission authority "to set and enforce compliance with standards for adequacy … of electric facilities or services." Reliable operations and adequacy of service are not the same thing. "'[R]eliable operation' means operating the elements of the bulk-power system … so that instability, *uncontrolled separation, or cascading failures … will not occur*." *Id.* § 824*o*(a)(4) (emphasis added). When a reliability violation leads to controlled load shedding to preserve system stability, that result is not a failure to ensure reliable operation of the bulk-power system; it is a failure to ensure adequacy of service. To impose massive civil penalties for the service-adequacy consequences of a reliability violations usurps the role of the States in determining whether utilities should be financially responsible for losses of load.

The Policy Statement also is alarmingly vague as to how the Commission intends to apply this aspect of the guidelines. The Commission does not explain how it intends to calculate the value of lost load. But that is far from the only problem. The Policy Statement also includes no effort to wrestle with the complicated questions of causation that will arise; nor does it provide any clear step in the penalty-calculation process where such questions should be addressed. Outages rarely result directly from a single reliability violation. More frequently they result from the interaction of multiple factors, often involving action or inaction by more than one entity. Outages may result because (1) a transmission owner fails to fulfill its vegetation-management obligations, (2) a tree contacts a transmission line, (3) downstream protective devices are set improperly, (4) operational protocols are not followed, (5) facilities trip, and (6) other facilities do not perform as required under relevant reliability standards to prevent an outage or restore service.

In such situations, thorny causation questions arise. For example, an entity whose reliability violation impairs the system's ability to prevent an outage or to restore service quickly in step (6) may argue that *no* outage would have occurred as a result of its violation standing alone—that each upstream reliability violation was a but-for cause that it could not foresee and for which it should not be held responsible. How would the Commission apply the Policy Statement in such cases? Would it refrain from assessing penalties based on a pecuniary valuation of loss of load in such cases, on ground that none of the violations was fully responsible for the load shedding? Would it allocate the value of the lost load among the multiple violations and violators and, if so, how? Would it base penalties for each of the violations on the full pecuniary value of the lost load—which would be a clear and inappropriate instance of double counting?

It is easy to think of additional hypotheticals raising similarly difficult questions of causation and foreseeability. For example, reliability violations may be such that no outage would result during ordinary system conditions or under typical planning contingencies but the system's ability to withstand extraordinary events is compromised. Will outages resulting from the combination of a reliability violation and an extraordinary event (say, a once-every-hundred-years ice storm) be considered to be "reasonably foreseeable"? To be clear, we are not suggesting that the Commission was bound to anticipate and answer every such question in its Policy Statement. But the likelihood of encountering such difficult questions raises serious questions about the wisdom of basing civil penalties for reliability violations on pecuniary valuations of lost load. In any case, the Commission cannot claim to provide the industry with enforcement certainty while it holds out the potential for draconian outage-related fines but fails to deal with such complicated questions.

For the foregoing reasons, TAPS urges the Commission to abandon its proposed use of a pecuniary value for lost load in the guideline penalty calculations. If the Commission declines to do so, it should at least revise the Policy Statement to focus only on *externalized* losses borne by other entities and their customers. To the extent that an entity's reliability violation leads to involuntary outages among its own customers, both the entity and its customers will have already suffered the direct consequences of the entity's violation. To add harsh civil penalties on top of such consequences is to pour pounds of salt into an open wound—for no particular reason. Utilities already have substantial incentives to attempt to avoid involuntary outages on their own systems; civil penalties are not needed to provide deterrence.

The U.S. Sentencing Guidelines recognize such considerations. Section 8C4.8 of the Guidelines states that:

> If the members or beneficiaries, other than shareholders, of the organization are direct victims of the offense, a downward departure may be warranted. If the members or beneficiaries of an organization are direct victims of the offense, imposing a fine upon the organization may increase the burden upon the victims of the offense without achieving a deterrent effect. In such cases, a fine may not be appropriate. For example, departure may be appropriate if a labor union is convicted of embezzlement of pension funds.

The Policy Statement provides no explanation for the omission of this provision from its penalty guidelines. As explained below, the Commission should take account of organization structure in *all* circumstances in determining an appropriate penalty level. But in this specific context, the principle—that one should not impose penalties that further injure those who already have suffered the direct consequences of a violation—justifies excluding the value of involuntarily shed, on-system load from any pecuniary valuation to be used in penalty calculations.

B. If the Commission retains a guideline approach, it must tailor penalties based on the size, organizational structure, and financial resources of the entity being penalized.

If the Commission retains its proposed guideline approach to calculating civil penalties, it must revise the guidelines to tailor penalties based on the size, financial resources, and organizational structure of the entity being penalized. That is particularly (but not exclusively) true with respect to reliability violations, where penalized entities may be extremely small organizations.

In suggesting that the guidelines be revised to consider organizations' size, financial resources, and structure, we note that both the guidelines and the Commission's existing policy statements already provide for the disgorgement of unjust profits. As such, there should be no fear that reducing penalties for small entities will allow violators to keep ill-gotten gains or otherwise to benefit from their violations. On the contrary, accounting for organization-specific factors is necessary to prevent the guidelines from producing unreasonable and discriminatory penalties.

In this industry, organizations' size and financial resources vary tremendously—from small local utilities with a handful of employees operating out of the town clerk's office to massive, multinational corporations. The guidelines take little account of such differences, however. While the guidelines allow reductions of penalties that are so severe that they threaten an organization's continued existence,[25] they make no attempt to adjust for the relative burden that a given penalty would impose on different organizations. Simply put, a \$100,000 or \$1 million penalty imposed on a small entity is a far harsher and more burdensome punishment than the same penalty imposed on a large entity.

The Policy Statement accounts for an entity's size and financial resources only in very limited respects. Organization size is an explicit factor in only two adjustments made in developing a final penalty range, and those adjustments will not be relevant in all cases. Under the Policy Statement, organization size affects (a) the magnitude of the addition to an entity's culpability score arising from the involvement of high-level

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[25] Policy Statement, Guidelines § 1C3.2.

personnel or substantial-authority personnel and (b) the applicability of the culpability-score reduction for an effective compliance plan where high-level personnel or substantial-authority personnel were involved in a violation. *See generally* Policy Statement, Guidelines § 1C2.3(b), (f).

Where high-level or substantial-authority personnel were not involved, an organization's size and financial resources appears to have *no* impact on the calculation of a final penalty range. In such cases, the only explicit consideration given to such factors is the Commission's statement that it may depart from the guidelines in situations where an organization is unable to pay the penalty or where payment of the penalty would impair the organization's ability to disgorge unjust profits. Although the Commission does not attempt to define what would constitute inability to pay the penalty or disgorgement, Section 1C3.2 of the guidelines states that "the reduction under this subsection will not be more than necessary to avoid substantially jeopardizing the continued viability of the organization." That is not a sufficient adjustment, however. A small entity may be disproportionately burdened by a penalty even if that penalty does not jeopardize its continued viability.

During the April 7 workshop, Enforcement Staff suggested that the guidelines implicitly account for organization size because size is correlated with the quantitative measures of risk, loss, or gain that drive penalty calculations under the guidelines. In general, Enforcement Staff suggested, a small organization's impacts on the system will be smaller than those of a larger organization. That is generally true, but such correlations are imperfect, and the decision to establish penalty floors—which apply in situations where no upward adjustment occurs due to the risk, loss, or gain associated with a violation—breaks any such correlation for small entities whose violations produce little impact. As explained above, those penalty floors can produce very substantial penalties to be imposed on very small utilities. A $175,000 penalty floor for a single, documentary reliability violation may not affect the operations of a large public utility, but it could significantly affect the budget (and rates) of a small one.

The failure to account explicitly for such dynamics is not consistent with Federal sentencing practices even in the criminal context from which the guidelines were drawn. Under Federal law, the sentences produced by the Sentencing Guidelines are not mandatory. *United States v. Booker*, 543 U.S. 220 (2005). Federal law sets forth factors for courts to use in both applying the guidelines and considering when to depart from them. Unlike the Commission's Policy Statement, Federal law expressly incorporates into that analysis considerations regarding a defendant's financial resources and other relevant facts, as well as the relative impact of a given sentence on a particular defendant.

For example, 18 U.S.C. § 3553(a) requires courts to impose sentences that are "sufficient, but not greater than necessary" to reflect the seriousness of the offense, afford adequate deterrence, protect the public against further crimes of the defendant, and provide the defendant with needed educational or vocational training or other correctional treatment in the most effective manner. Imposing a sentence that is "sufficient, but not greater than necessary" to accomplish those purposes—especially deterrence—requires an inquiry into the circumstances and resources of a particular defendant. Indeed, Section 3553(a) goes on to require that courts, "in determining the particular sentence to be imposed, shall consider—(1) the nature and circumstances of the offense *and the history and characteristics of the defendant*" (emphasis added). Even more clearly, when it comes to sentences involving fines, Federal law requires courts to consider "in addition to the factors set forth in section 3553(a):"

> (1) the defendant's income, earning capacity, and financial resources;
>
> (2) the burden that the fine will impose upon the defendant, any person who is financially dependent on the defendant, or any other person (including a government) that would be responsible for the welfare of any person financially dependent on the defendant, relative to the burden that alternative punishments would impose; [and] …
>
> (8) if the defendant is an organization, the size of the organization and any measure taken by the organization to discipline any officer, director, employee, or agent of the organization responsible for the offense and to prevent a recurrence of such an offense.

18 U.S.C. § 3572(a).

The U.S. Sentencing Guidelines likewise take such issues into account. In determining the amount of a fine within the applicable range, the Sentencing Guidelines instruct courts to consider (*inter alia*) "the need for the sentence to … afford *adequate* deterrence, …" and "any factor listed in 18 U.S.C. § 3572(a)," including the three factors listed immediately above. U.S.S.G. §§ 8C2.8(a)(1), (10) (emphasis added).[26] The Policy Statement fails to explain why it omitted these provisions when it promulgated penalty guidelines ostensibly based on the Sentencing Guidelines.

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[26] Similarly, the Sentencing Guidelines instruct that "[i]f [an] organization has paid or has agreed to pay remedial costs arising from the offense that greatly exceed the gain that the organization received from the offense, a downward departure [below the guidelines range] may be warranted." U.S.S.G. § 8C4.9. The Sentencing Guidelines explain that "[i]n such a case, a substantial fine may not be necessary in order to achieve adequate punishment and deterrence." *Id.*

The Commission-approved NERC sanction guidelines likewise take violators' size and financial resources into account. Section 3.11 of those sanction guidelines provide that:

> **3.11 Relation of the Penalty to the Seriousness of the Violation and Violator's Ability to Pay**
>
> As discussed in Section 3.8, above, penalties levied for the violation of a reliability standard shall bear a reasonable relation to the seriousness of the violation. *The seriousness of a given violation by a given violator shall be assessed by review of the applicability of the Violation Risk Factors associated with the violation to the characteristics of the violator's operation or power system. Size is a characteristic of a violator's operation or system.* The size of the violator can be considered in the assessment but shall not be the only characteristic considered. Where size is considered in such a review the facts relating to the violation in question will be reviewed such that the "actual" size of the violator is properly discerned and appropriately considered; the following are provided as illustrative examples:
>
> • If the violator belongs to a generation and transmission cooperative or joint-action agency, size will be attributed to the particular violator, rather than to that generation and transmission cooperative or joint-action agency.
>
> • If the violator constitutes part of a corporate family the size of the violator will be attributed to that violator alone, in the absence of any facts indicating involvement of the whole corporation or corporate affiliates of the violator.
>
> • If the violator is an entity established solely as a shell to register as subject to one or more Reliability Standards the size of the entity will be disregarded in favor of consideration of the size of parent entity or any affiliates that NERC or the regional entity deems involved and constituting the "actual" size of the violator.
>
> *At the request of the violator, NERC or the regional entity may review the penalty in light of the violator's financial ability to pay the penalty. Financial ability shall include both the financial strength of the entity as well as its structure (e.g., for-profit versus non-profit).* Where

> penalties are reduced or eliminated NERC or the regional entity shall consider non-monetary sanctions or remedial action as alternatives or substitutes to the penalty, pursuant to Sections 3.17, 3.18 and 3.19, below, of this document.

(Emphasis added) (footnote omitted). Additionally, entity size may factor into determinations regarding the applicability of a Violation Risk Factor.[27] And the NERC sanction guidelines take a comparatively flexible approach to assessing an entity's ability to pay, including giving express recognition to the effects of organizational structure.[28]

The NERC sanction guidelines thus provide independent consideration, first, to entity size in determining the seriousness of a violation and, second, to a relatively nuanced assessment of an entity's ability to pay, in light of "both the financial strength of the entity as well as its structure (*e.g.*, for-profit versus non-profit)." *Id.* § 3.11. The Policy Statement takes little explicit account of either factor and includes no explanation for its failure to do so. In the Sentencing Guidelines context, courts have found the failure to assess "[a] defendant's financial resources and the burden that a fine will impose on it" to be reversible error, *e.g.*, *United States v. Patient Transfer Serv., Inc.*, 413 F.3d 734, 745-46 (8th Cir. 2005), and other Federal agencies have taken entity-specific

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[27] *See* NERC sanction guidelines § 4.2.1 ("NERC or the regional entity may consider the specific circumstances of the violator to determine if the violation of the requirement in question actually produced the degree of risk or harm anticipated by the Violation Risk Factor" and, if not, NERC or the regional entity may adjust the Base Penalty Amount).

[28] *See id.* § 4.4.1, n.12 (contemplating impacts of not-for-profit status and other similar organizational features on entities' ability to pay); *see also* Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, Order No. 672, 71 Fed. Reg. 8662, 8716 (Feb. 17, 2006), FERC Stats. & Regs. ¶ 31,204, P 634 (2006), *corrected*, 71 Fed. Reg. 11,505 (Mar. 8, 2006), *on reh'g*, Order No. 672-A, 71 Fed. Reg. 19,814 (Apr. 18, 2006), FERC Stats. & Regs. ¶ 31,212 (2006), *modified*, 73 Fed. Reg. 21,814 (Apr. 23, 2008), 123 FERC ¶ 61,046 (2008) ("The ERO or Regional Entity determining whether to impose a penalty on an RTO or ISO may consider the entity's unique characteristics … in determining an appropriate and effective sanction.").

characteristics into account in establishing fine or forfeiture levels to apply in enforcement proceedings.[29]

The Commission should revise its Policy Statement to take account of such issues meaningfully and expressly. Specifically, if the Commission does not rescind the guidelines with respect to reliability violations, it should lower the penalty floor for such violations by reducing the base violation level and should ensure that entity size is considered in assessing adjustments for violation risk and severity, in accordance with the NERC sanction guidelines (*e.g.* §§ 3.11 and 4.2.1). The Commission also should revise the Policy Statement more generally to provide that, in assessing penalties within the range and in determining whether to assess a penalty below the lower end of the guideline penalty range, the Commission will take into account:

> (1) an organization's financial resources;
>
> (2) the burden that the fine will impose upon the organization or other affected entities, including ratepayers; and
>
> (3) the size of the organization and any measure taken by the organization to discipline any officer, director,

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[29] For example, after the D.C. Circuit vacated an early attempt to promulgate penalty guidelines by means of a policy statement, *United States Tel. Ass'n. v. FCC*, 28 F.3d 1232 (D.C. Cir. 1994), the Federal Communications Commission reissued the guidelines after notice and comment procedures. In doing so, it addressed issues regarding the disparate impacts of a given penalty on different organizations. Because it could not "conclude that the prospect of a $10,000 forfeiture for a particular offense will have the same deterrent effect on a small computer vendor, a moderately-sized radio common carrier, and a $10 billion per year local telephone company or interexchange carrier," the FCC indicated that it would apply its guidelines in a manner that "assess[ed] the forfeiture amount in light of all relevant facts." In re The Commission's Forfeiture Policy Statement and Amendment of Section 1.80 of the Rules to Incorporate the Forfeiture Guidelines, 12 FCC Rcd. 17087, 17098 (July 28, 1997). Similarly, the Environmental Protection Agency adjusts penalties under its Clean Air Act, Mobile Source Civil Penalty Policy to "reflect the company's size." EPA, Mobile Source Civil Penalty Policy, at 20 (2009) (http://www.epa.gov/compliance/resources/policies/civil/caa/mobile/vehicleengine-penalty-policy.pdf). The EPA indicates that the adjustment should "typically be calculated on the basis of the company's net worth (corporations) or net assets (partnerships or sole proprietorships)," although "[t]here may be instances where business size is more appropriately determined on some other basis (*e.g.*, gross revenues, number of employees, etc.)."

> employee, or agent of the organization responsible for the offense and to prevent a recurrence of such an offense.

The same conclusion applies with respect to the details of an entity's organizational structure. Not all entities—even those of the same size—are similarly situated with respect to how penalties of a given magnitude will affect them, their customers, or the public. A number of entities in the electric industry—such as municipal systems and cooperatives—are non-profit and/or non-shareholder organizations. This organizational structure may affect the light in which an entity's actions are viewed and in which the nature or seriousness of a violation is assessed.[30] It also may affect the impact of a given penalty on the organization and other entities. Organizational structure therefore is a factor that should be assessed expressly in considering whether to impose a penalty.

As with considerations regarding entity size and financial resources, the Policy Statement's failure to address such matters departs without apparent reason from the

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[30] For example, in Order No. 697 the Commission observed that:

> Even if an electric cooperative is not statutorily exempted from our regulation under Part II of the FPA, we conclude that a waiver of § 35.39 is appropriate. . . . [A]s the Commission has previously stated in many market-based rate orders over the years, where a cooperative is involved, the cooperative's members are both the ratepayers and the shareholders. Any profits earned by the cooperative will [i]nure to the benefit of the cooperative's ratepayers. Therefore, we have found that there is no potential danger of shifting benefits from the ratepayers to the shareholders.

Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Order No. 697, 72 Fed. Reg. 39,904, 39,966 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, P 526 (2007), *clarified*, 72 Fed. Reg. 72,239 (Dec. 20, 2007), 121 FERC ¶ 61,260 (2007), *on reh'g*, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), FERC Stats. & Regs. ¶ 31,268 (2008), *clarified*, 124 FERC ¶ 61,055 (2008), *on reh'g*, Order No. 697-B, 73 Fed. Reg. 79,610 (Dec. 30, 2008), FERC Stats. & Regs. ¶ 31,285 (2008), *on reh'g and clarification*, Order No. 697-C, 74 Fed. Reg. 30,924 (June 29, 2009), FERC Stats. & Regs. ¶ 31,291 (2009), *corrected*, 128 FERC ¶ 61,014 (2009), *clarified*, Order No. 697-D, 75 Fed. Reg. 14,342 (Mar. 25, 2010), FERC Stats. & Regs. ¶ 31,305, *clarified*, 131 FERC ¶ 61,021 (2010), *reh'g granted*, Docket No. RM04-7-009 (June 8, 2010), eLibrary No. 20100608-3021, *petition for review filed sub nom. Mont. Consumer Counsel v. FERC*, No. 08-71827 (9th Cir. May 1, 2008).

Federal law and Sentencing Guidelines on which the Commission purports to rely, as well as from the NERC sanction guidelines. Section 3572(a)(7) of Title 18 requires courts to consider, in determining whether to impose a fine and the amount of the fine, "whether the defendant can pass on to consumers or other persons the expense of the fine." Likewise, the Sentencing Guidelines identify two possible, related bases for downward departure from the guidelines. Under the Sentencing Guidelines, a downward departure may be warranted (a) "if the organization is a public entity," U.S.S.G. § 8C4.7, or (b) "[i]f the members or beneficiaries, other than shareholders, of the organization are direct victims of the offense," *id.* § 8C4.8.[31] Finally, and as noted above, the Commission-approved NERC sanction guidelines expressly permit NERC to consider "entity structure (*e.g.*, for-profit versus non-profit)" in the course of assessing a penalized entity's financial ability to pay. The Commission has identified no reason for omitting such provisions when it promulgated penalty guidelines derived from the Sentencing Guidelines. The Commission should revise the Policy Statement to include such considerations in setting penalties within the range and determining when to depart from the guidelines.

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[31] The latter adjustment may be particularly important where reliability-violation penalties are driven by pecuniary valuations of load shed on the system of the entity that committed the violation, as discussed above.

C. The Commission should affirm Enforcement Staff's continuing prosecutorial discretion to refrain from seeking penalties or to reach settlements at penalty levels below those produced by the guidelines.

As the Policy Statement itself observes (P 11), Enforcement Staff closed most self-reports received between 2005 and 2007 without further action, and sought civil penalties in only a fraction of the completed investigations that found violations. The Policy Statement does not expressly preserve or endorse this approach, but it should do so. TAPS is concerned that—unless the implication is negated—the inclusion of a limited credit for self-reporting will be read to mean that the submission of a self-report now goes only toward affecting the magnitude of a penalty and not toward determining whether any penalty is warranted.

TAPS is also concerned that the inclusion of a specified, limited credit for reaching settlements (and thus avoiding a trial-type hearing) could be read to suggest that Staff no longer may reach settlements without penalties or with penalties lower than the levels produced by the penalty guidelines as adjusted by the settlement credit. That interpretation would be inappropriate, and TAPS urges the Commission to reject it. Even with a settlement credit, which appropriately reflects the saving of Commission resources that otherwise would be expended in trial-type hearings, the Policy Statement lacks any other mechanism—besides the exercise of Staff's discretion to settle without penalties or below the guideline penalty levels—to account for litigation risk with regard to establishing the underlying violation. That is another relic of the Commission's decision to derive the Policy Statement from criminal sentencing guidelines that apply *after* a conviction has been obtained. But in this context, where Staff may be applying the guidelines in the absence of an admitted or adjudicated violation, refusing to acknowledge the existence of litigation risk with respect to the underlying violation would create major disincentives to settle. The Commission should clarify that Enforcement Staff will retain the prosecutorial discretion to close cases without seeking penalties (even where a violation has been self-reported or found in an investigation) and to reach settlements providing for penalties below the penalty range produced by the guidelines.

D. The Commission should clarify that operational penalties paid under a public utility's tariff reduce the pecuniary gain or loss resulting from a violation and may justify a decision not to seek any civil penalty.

The new guidelines' Application Notes (§ 2B1.1) state that measures of "loss" will be reduced by (among other things) "[t]he money returned, and the fair market value of the property returned and the services rendered, by the entity or other persons acting jointly with the entity, to the victim before the violation was detected." *See* Policy Statement at 55. That provision does not appear to cover operational penalties that a tariff customer may pay to a public utility under the public utility's tariff, once the customer's violation is detected. In prior issuances, Enforcement Staff has indicated that the payment of such tariff penalties is a factor taken into account in deciding whether any enforcement action is warranted.[32] The Commission should clarify that the Guidelines Policy Statement was not intended to alter staff's practice in that regard. The Commission also should clarify that tariff penalty amounts already paid will be deducted from measures of "loss" used in calculating civil penalties under the guidelines.

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[32] *See* FERC, 2009 Report on Enforcement at 10 ("Because Company has already paid these penalties to its transmission provider, staff determined that the self-report should be closed with no further action.").

E. The Commission should unbundle various elements that can reduce an organization's culpability score.

As EEI argues, the Commission should unbundle the culpability-score credits for self-reporting, having an effective compliance program, cooperating with a Commission investigation, and settling without need for a trial-type hearing. EEI is correct that these are analytically distinct steps, *each* of which the Commission should encourage on its own, and that bundling them together can diminish the incentives that the guidelines are attempting to establish. For example, tying the credit for self-reporting to a subjective assessment of whether the entity then cooperated "fully" with a subsequent investigation means that an entity must decide whether to bring a potential violation to the Commission's attention (and incur risks in doing so) without assurance that it will receive credit for doing so. Unbundling the credits will provide the proper incentives at each step of the process.

F. The Commission should provide credit for remediation.

We also agree with EEI that the Commission should provide separate credit for remediation, which is a distinct factor mentioned in the statute. 16 U.S.C. § 825*o*-1(b) ("In determining the amount of a proposed penalty, the Commission shall take into consideration . . . the seriousness of the violation and the efforts of such person to remedy the violation in a timely manner."). Consistent with this requirement, prior policy statement explained that "[t]he Commission will weigh the response of a company to misconduct it discovers in determining whether civil penalty reduction is appropriate." Compliance with Statutes, Regulations, and Orders, *supra* n.10, P 21. EEI recommends that remediation lead to the selection of a penalty at the bottom of the range. *See* EEI Comments § II.E.5. An alternative approach would be to further reduce an organization's culpability score if it takes timely and effective steps to end the violation and prevent its recurrence. Either way, a remediation adjustment is necessary to give effect to the statutory language and to align the Commission's penalty policy with its stated goal of "[a]chieving compliance, not assessing penalties." Compliance with Statutes, Regulations, and Orders, *supra* n.10, P 1.

IV. CONCLUSIONS

For the foregoing reasons, the Commission should rescind the guidelines with respect to penalties for reliability violations. To the extent the Commission leaves the guidelines in place, it must clarify and revise them as set forth above. Most critically, the Commission must provide expressly for the adjustment of penalties within the range and the assessment of penalties below the range produced by the guidelines, based on the size, financial resources, and organizational structure of penalized entities.

Respectfully submitted,

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