SUTHERLAND

LEGAL ALERT

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FERC Issues Penalty Guidelines

The Federal Energy Regulatory Commission (FERC) yesterday issued new Penalty Guidelines that it will use to determine civil penalties for violations of the statutes that FERC administers and its rules, regulations and orders thereunder. In an accompanying Policy Statement, FERC stated that the Penalty Guidelines are designed to promote greater consistency, transparency, and fairness in the determination of civil penalties. The Penalty Guidelines will apply to all future violations and any pending investigation where FERC's Enforcement staff and the organization have not yet entered into settlement negotiations. The Penalty Guidelines are the latest effort by FERC to ensure "firm but fair" enforcement of federal energy laws and requirements, and to provide the clarity sought by many in the energy industry concerning the determination of monetary penalties. Whether the Penalty Guidelines meet those objectives remains to be seen.

Background

The Penalty Guidelines build on the initiatives undertaken by FERC since the passage of the Energy Policy Act of 2005 (EPAct 2005) to provide guidance on FERC's enforcement authority. EPAct 2005 enhanced FERC's enforcement powers by providing FERC civil penalty authority over all provisions of the Federal Power Act (FPA) Part II and the Natural Gas Act (NGA) and any rule or order issued pursuant to those Acts. In addition, EPAct 2005 increased the maximum civil penalty FERC can assess for a violation of the NGA, the Natural Gas Power Act of 1978, and the FPA Part II to up to $1 million per day, per violation. This was a significant increase over the prior minimum penalties which ranged from $5,500 to $11,000 per day under the applicable Acts. Previously, FERC issued two Policy Statements on Enforcement to provide guidance on how it would implement its expanded authority and assign penalties. The Penalty Guidelines, which are modeled on portions of the United States Sentencing Guidelines, represent a significant new step because FERC is now moving to a guideline approach to assessing penalties rather than relying on unquantified factors.

Calculation of Civil Penalties

The Penalty Guidelines follow a 5-step approach to generate a penalty range based on the combination of a violation level, consisting of a base level that is adjusted for various factors relating to the seriousness of the violation; and a culpability score, which factors in an organization's past and current conduct and remedial efforts and which is further used to adjust the violation level to determine the ultimate penalty range. Application of the Penalty Guidelines thus will produce a numeric "score" for the violation; the higher the score, the higher the potential range of monetary penalties. Importantly, the Penalty Guidelines do not affect FERC's practice of requiring the disgorgement of unjust profits resulting from violations.

The 5-step approach for determining a penalty range is as follows:

1. Base Violation Level

The Base Violation Level will be one of three levels, depending on the type of violation. Violations of the Reliability Standards for the Bulk Electric System of North America will carry a base

Violation Level of 16; violations involving fraud, manipulation or anti-competitive conduct and violations of rules, tariffs, and orders will carry a Base Violation Level of 6; and violations involving misrepresentations and false statements to FERC will carry a Base Violation Level of 18.

2. Adjustments

Next, FERC can make certain adjustments for each type of violation. For example, the Base Violation Level of a violation of the Reliability Standards might be adjusted if there was no risk of harm to the Bulk Electric System. Similarly, the Base Violation Level for violations involving fraud, manipulation, or anti-competitive conduct and violations of rules, tariffs, and orders contains adjustments for monetary gain or loss caused by the violation. The adjustment factors are listed in Chapter Two of the Penalty Guidelines.

Once the adjustment factors are applied to the Base Violation Level, the result is a final Violation Level. The Violation Level Corresponds to a specific dollar penalty amount listed in Chapter One of the Penalty Guidelines.

3. Base Penalty

The base penalty is calculated by determining the greater of 1) the dollar amount associated with the Violation Level (as noted in Step 2 above), 2) the pecuniary gain to the organization from the violation, or 3) the pecuniary loss from the violation caused by the organization.

4. Culpability Score

Each entity will be assigned a Culpability Score of 5, which will then be adjusted based on the following six considerations:

- The penalty will be adjusted upward when high-level personnel of the organization participated in, condoned, or were willfully ignorant of the violation. The size of the adjustment will depend on the size of the organization.
- The penalty will be adjusted upward where the organization has a prior history of committing violations. The size of the adjustment will depend on how long ago the prior violation occurred.
- The penalty will be adjusted upward if the violation violated a judicial or FERC order or injunction.
- The penalty will be adjusted upward if the organization obstructed justice, encouraged the obstruction of justice, or knew of such obstruction and failed to take reasonable steps to prevent it.
- The penalty will be adjusted downward for certain compliance and ethics measures the organization has in place, including an active participation of senior management, effective preventive measures, prompt detection and cessation of violations and voluntary reporting of violations, and remediation of the violations.
- The penalty will be adjusted downward for self-reporting, cooperation, and acceptance of responsibility for the violation.

The final Culpability Score corresponds to a set of “Minimum and Maximum Multipliers” that are listed in the Penalty Guidelines.

5. Multiplication of Base Penalty by Minimum and Maximum Multipliers

Finally, the Base Penalty (from Step 3) is multiplied by the Minimum and Maximum Multipliers (from Step 4) to produce the applicable penalty range.

FERC emphasized that although the Penalty Guidelines will generally be applied to determine civil penalties, it will retain some flexibility to depart from them in appropriate cases to accommodate unique circumstances. In addition, there are certain exceptions to the application of the Penalty Guidelines. For example, civil penalties for natural persons will be determined on individual facts and circumstances rather than the Penalty Guidelines. FERC will similarly use discretion to determine penalties in cases involving multiple types of violations rather than simply applying the Penalty Guidelines. Moreover, if the minimum guideline penalty is greater than FERC’s statutory penalty authority, the guideline penalty will be reduced to the maximum authorized penalty. FERC will also reduce the penalties when the organization is not able to pay the minimum penalty and to the extent the guideline penalty would impair the organization’s ability to disgorge profits.

Notably, FERC stated it will generally follow prior procedures for determining whether to review a Notice of Penalty filed by the North American Electric Reliability Corporation (NERC) for violations of the Reliability Standards rather than strictly applying the Penalty Guidelines. FERC stated that it anticipates only occasionally considering the results of applying the Penalty Guidelines for an extraordinary Notice of Penalty; and even then the Penalty Guidelines will not be determinative of FERC’s decision whether to proceed with further review.

Potential Impacts

The Penalty Guidelines represent a significant new step in the evolution of FERC’s enforcement program. They are designed to create a more consistent and transparent approach to penalty assessments. To the extent the Penalty Guidelines fulfill FERC’s expectations, they may serve as a useful tool for entities to assess their liability exposure and to ensure FERC is applying penalties uniformly. The Penalty Guidelines may even provide a basis to challenge penalties in the event they provide evidence of inconsistent penalty assessments.

Regulated entities should keep in mind that, although the Penalty Guidelines are intended to provide for consistency and transparency, FERC has retained a significant degree of discretion by not making the Penalty Guidelines mandatory and by reserving the right to depart from the guidelines when it deems it appropriate. The base penalty range could be quite large, and FERC has significant flexibility to determine what penalty within (or outside) each range will apply. Such discretion may result in further uncertainty in this area. It also is unclear whether application of the new Penalty Guidelines will result in the imposition of monetary penalties in more enforcement cases. FERC has indicated that it will hold a technical conference after one year’s experience to assess the use of the Penalty Guidelines; that conference likely will provide further insight into whether the Penalty Guidelines are being applied consistently.

One message provided by the Penalty Guidelines that is clear at this time is FERC’s continued emphasis on encouraging entities to develop a strong culture of compliance. Whereas in the past, FERC frequently stated it was applying mitigating credit for compliance measures, the Penalty Guidelines assign specific degrees of credit which could significantly reduce a penalty. This should motivate entities which have not already undertaken compliance measures to make that investment because it could provide dividends in terms of quantifiable mitigating credit in the future – as well as preventing violations in the first instance.

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If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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