

MEMORANDUM

Date: May 25, 2010

To: The Commission
(Meeting of June 3, 2010)

From: Elizabeth M. McQuillan, Public Utilities Counsel IV
Bishu Chatterjee, Public Utilities Regulatory Analyst V

Subject: Authorization to File Comments Regarding Policy Statement on
Penalty Guidelines; FERC Docket No. PL10-4-000

I. REQUEST FOR AUTHORIZATION

Staff seeks approval to file comments in this proceeding regarding the Policy Statement on Penalty Guidelines, 130 FERC P 61,220 (2010)¹ (“Penalty Guidelines”) issued by the Federal Energy Regulatory Commission (FERC). In the Energy Policy Act of 2005 (“EPAct 2005”), Congress expanded the FERC’s civil penalty authority to cover all provisions of Part II of the Federal Power Act, and related rules and regulations, and also increased the maximum civil penalty to \$1,000,000 per day, per violation.² Previously, FERC declined to adopt a guidelines approach, but FERC now believes that it is in the public interest to do so.³ FERC states that the Penalty Guidelines, which it modeled on portions of the United States Sentencing Guidelines (“U.S. Sentencing Guidelines”)⁴ for the criminal conduct of organizations, will promote greater consistency, and will providemore notice and certainty.⁵ The Penalty Guidelines apply to organizations, and FERC states it will continue to assess civil penalties for natural persons based on the individual acts and circumstances.⁶

¹ 2010 FERC LEXIS 471.

² 16 U.S.C. § 825o-1(b).

³ 130 FERC 61,220 at PP 26-35.

⁴ *Id.* at P 1; *see* United States Sentencing Commission, Guidelines Manual, available at <http://www.ussc.gov/guidelin.htm>.

⁵ 130 FERC 61,220 at PP 27-30.

⁶ *Id.* at P 59.

Staff's proposed comments do not challenge the Penalty Guidelines generally, but are limited to specific considerations: (1) the lack of any compliance and ethics program or the lack of an "effective" program should be considered as an upward adjustment in determining an organization's "culpability" score; (2) the definition of an "effective" compliance and ethics program should specifically reference record retention and electronic recordkeeping policies; (3) clarification of the circumstances allowing FERC to reduce a penalty below the guidelines if the organization is unable to pay; (4) separate acts of misconduct should constitute a separate "violation"; and (5) certain enhancements for violations involving fraud, anti-competitive conduct and other FERC rule, tariff and order violations should be cumulative.

II. OVERVIEW

16 U.S.C. § 825o-1 provides:

(a) Violations. It shall be unlawful for any person to violate any provision of part II [[16 USCS §§ 824](#) et seq.] or any rule or order issued under any such provision.

(b) Civil penalties. Any person who violates any provision of part II [[16 USCS §§ 824](#) et seq.] or any provision of any rule or order thereunder shall be subject to a civil penalty of not more than \$ 1,000,000 for each day that such violation continues. Such penalty shall be assessed by the Commission, after notice and opportunity for public hearing, in accordance with the same provisions as are applicable under section 31(d) [[16 USCS § 823b\(d\)](#)] in the case of civil penalties assessed under section 31 [[16 USCS § 823b](#)]. 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.

On March 18, 2010, FERC issued its Penalty Guidelines. In an April 15, 2010 order, FERC determined that broader comment should be afforded before issuing a final order, and invited comments within 60 days.⁷

Generally, like the U.S. Sentencing Guidelines, the Penalty Guidelines generate a penalty range based on a 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.⁸

Determination of a penalty range under the Penalty Guidelines is broken down into five steps:

⁷ 131 FERC P 61,040 (2010).

⁸ 130 FERC 61,220 at P 37.

- Step One: Identify the base violation level.
- Step Two: Adjustments. These account for particular circumstances specific to the violation, and may increase the base violation level. For example, there are specific base violation levels for certain types of violations, including manipulation anti-competitive conduct, violation of reliability standards, and misrepresentations to FERC.
- Step Three: Base Penalty. The base penalty is the greater of the base penalty corresponding to the violation level, the pecuniary gain to the organization based on the violation, or the pecuniary loss from the violation caused by the organization.
- Step Four: Culpability Score. The culpability score starts with a base score of five and is then adjusted upward or downward depending on six separate considerations.
- Step Five: Multiplication of Base Penalty by Minimum and Maximum Multipliers.

If the minimum penalty is more than the maximum penalty authorized by statute (\$1,000,000 per day, per violation), then the guideline penalty will be reduced to the maximum allowed by statute.⁹ Further, the Penalty Guidelines provide that the penalties will not affect FERC's practice of requiring disgorgement of unjust profits when there is "identifiable pecuniary gain," plus interest.¹⁰ Finally, FERC emphasizes that the Penalty Guidelines are discretionary, not mandatory.¹¹

III. PROPOSED COMMENTS

A. The Mitigating Effect of Compliance and Ethics Programs

Under the Penalty Guidelines, an "effective" compliance and ethics program allows FERC to reduce an organization's culpability score by three points to reflect the importance that FERC places on such programs.¹² However, the Penalty Guidelines do not address the lack of any compliance program, or an ineffective compliance program.

⁹ *Id.* at P 61.

¹⁰ *Id.* at P 57.

¹¹ *Id.* at PP 19, 27, 58.

¹² *Id.* at P 48.

The U.S. Sentencing Guidelines specifically include the lack of an effective compliance program as a relevant consideration in determining whether to impose a penalty.¹³

The Penalty Guidelines should provide for an upwards adjustment for the failure to have any program or an “effective” program. The lack of any program should allow a five-point addition to the culpability score, and the lack of an “effective” program should allow a three-point addition, commensurate with the reduction for an “effective” program.

Monitoring market activity for manipulation and other misconduct is increasingly difficult. If FERC’s purpose is deterrence through the implementation of effective compliance and ethics programs, then the lack of a program or an ineffective compliance program should increase an organization’s culpability score. This is even more important given that the Penalty Guidelines allow an organization, if it fully cooperates with an investigation, to reduce its culpability score by five points.¹⁴ Thus, an organization with no program or an ineffective program, but which fully cooperates after the fact, could have the minimum culpability score. Such a result does not promote the policy objectives of self-regulation and deterrence.

B. The Definition of an Effective Compliance and Ethics Program

Section 1B2.1 of the Penalty Guidelines contains a general description of the requirements of an effective compliance and ethics program.¹⁵ FERC should address in its Application Notes the importance of record retention and electronic recordkeeping, which are essential to self-regulation and enforcement.

C. Inability to Pay

Section 1C3.2(b) allows for a reduction of a penalty if FERC “finds that the organization is not able and, even with the use of a reasonable installment schedule, is not likely to become able to pay the minimum penalty under the Penalty Guidelines.”¹⁶ However, the reduction is limited to not more than “necessary to avoid substantially jeopardizing the continued viability of the organization.”¹⁷ The Application Note further states: “For purposes of this section, an organization is not able to pay the minimum penalty if, even

¹³ U.S. Sentencing Guidelines, § 8C2.8(a)(11).

¹⁴ 130 FERC 61,220 at P 39.

¹⁵ § 1B2.1; 2010 FERC LEXIS 471, at * 69-79.

¹⁶ *Id.* at *94.

¹⁷ *Id.* at *94-95.

with an installment schedule, the payment of that penalty would substantially jeopardize the existence of the corporation.”¹⁸

While the U.S. Sentencing Guidelines have a similar guideline,¹⁹ FERC’s guideline would benefit from clarification. Otherwise, the message may be that a penalty will not be imposed because a culpable organization is “too big too fail,” even though the organization had insufficient capitalization or risk management protocols and engaged in extensive and egregious misconduct. Further, FERC also should emphasize that the inability to pay will not preclude FERC from taking other enforcement action, including, for example, limitation or revocation of market-based rate authority.

D. Clarification of What Constitutes a Violation

The penalties in the U.S. Sentencing Guidelines and the Penalty Guidelines are based on a “violation.” Clarification of what constitutes a “violation” is necessary to further the purposes of fairness, notice and consistency. Section 1C2.1(b) states that for multiple violations falling under different guidelines (e.g., involving both anti-competitive conduct and violations of reliability standards), the Commission will determine the appropriate penalty on a case-by-case basis.²⁰

In “Example Two: Tariff Violation,”²¹ FERC discusses particular misconduct – favorable sales to an affiliate – that occurred repeatedly for almost a full year. While there is an upwards adjustment to the base violation level for the duration of the misconduct, this Example apparently treats these separate acts of misconduct as a single violation simply because they violate the same rule. Multiple violations falling under the same guideline should be considered separate violations, and not a single violation that occurred over an extended period of time.

E. Enhancements Under Section 2B1.1(b) (2) Should Be Cumulative

Section 2B1.1(b)(2) provides for enhancements for violations involving certain volumes of electricity or gas and also for the duration of the violation for fraud, anti-competitive conduct and other rule, tariff and order violations.²² These enhancements should be cumulative or FERC should clarify its reasoning why only the greatest of the enhancements applies if more than one applies.

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¹⁸ *Id.* at * 94.

¹⁹ U.S. Sentencing Guidelines, § 8C3.3.

²⁰ 2010 FERC LEXIS 471, at * 79.

²¹ 130 FERC 61,220 at P 54.

²² 2010 FERC LEXIS 471, at *103.