

ALERTS AND UPDATES

FERC Improves Enforcement Program with Policy Statement on Penalty Guidelines

March 19, 2010

On March 18, 2010, the Federal Energy Regulatory Commission (Commission) acted to enhance its Enforcement program by issuing a *Policy Statement on Penalty Guidelines* for its civil penalty determinations (Penalty Guidelines or 2010 Policy Statement).¹ This guidance is the latest in a line of policy statements and initiatives the Commission has implemented since passage of the Energy Policy Act of 2005 (EPAAct 2005), in an effort to increase fairness, consistency and transparency in its Enforcement program. These discretionary Penalty Guidelines are modelled on portions of the U.S. Sentencing Commission's Sentencing Guidelines (Sentencing Guidelines), as tailored to Commission-specific considerations. The Commission will generate a penalty range based on the combination of: (1) a violation level, consisting of a base violation level and dollar amount commensurate with the type of violation, adjusted for various factors; and (2) a culpability score, which considers an organization's past and current conduct and efforts to remedy the violation. The Penalty Guidelines will apply to all future violations and any pending investigation where the Commission's Enforcement staff has not entered into settlement negotiations.

The Commission's Office of Enforcement has a new director, Norman Bay, and other new key senior leadership. The *Policy Statement on Penalty Guidelines* is likely to be the first major step in the refinement, expansion and shift in focus of the Commission's Enforcement program.

Sentencing Guidelines

For over two decades, federal courts have used the Sentencing Guidelines to determine sentences and fines in federal criminal cases. The Sentencing Guidelines are designed to provide certainty and fairness by avoiding unjustified disparity among offenders with similar characteristics, while permitting enough flexibility to account for applicable aggravating and mitigating factors; furthermore, by providing a predictable sentence, they operate as a deterrent to misconduct. Since nationwide implementation of the Sentencing Guidelines in January 1989, federal judges have sentenced more than one million defendants under the Sentencing Guidelines. Certain federal agencies follow the Sentencing Guidelines in structuring their own penalty regimes.

The section of the Sentencing Guidelines that applies to organizations involves a two-step process to determine the fine range that an organization will be required to pay after being sentenced for a crime: (1) the calculation of a *base fine*, which is the greater of the gain to the organization, the loss caused by the conduct, or a predetermined amount that is generated by the offense level; and (2) an analysis of the organization's culpability, to produce a *multiplier range* for the base fine, considering factors, such as prior history of violations, high-level management involvement in the offense, self-reporting and responsibility, the existence of an effective compliance program and cooperation with government authorities. The multiplier and the base fine are then combined to calculate a *fine range* for the conduct. Imposing a sentence generated by the Sentencing Guidelines is not mandatory, and the Sentencing Guidelines provide a departure process, whereby a judge may impose a sentence higher or lower than the range.

EPAAct 2005 and Enforcement

The Commission uses various enforcement tools to police the electric, natural gas, hydroelectric and oil-pipeline industries that are within its jurisdiction. The Commission can require compliance plans and disgorgement of unjust profits; it can condition, suspend or revoke market-based rate authority, certificate or blanket certificate authority; it can refer matters to the U.S. Department of Justice (DOJ) for criminal prosecution, and can impose civil penalties. With the passage of EPAAct 2005, the Commission received a significant enhancement to its Enforcement program, in that EPAAct 2005 expanded the Commission's civil penalty authority under the Federal Power Act (FPA) and the Natural Gas Act (NGA), and raised the maximum civil penalty to \$1 million per day, per violation, for any violation of the Natural Gas Policy Act, the NGA or Part II of the FPA. EPAAct 2005 also required the Commission to consider certain factors—such as the seriousness of a violation and remediation measures taken—in determining the amount of a particular penalty.

In its first *Policy Statement on Enforcement* following the expansion of authority under EPAAct 2005 (2005 Policy Statement), the Commission described factors that it would consider in determining appropriate penalties under its enhanced penalty authority. The Commission noted the statutorily mandated considerations under EPAAct 2005, indicating that the "first touchstone" for its determination would be the seriousness of the violation, followed by a review of the efforts made by the company to remedy the violation in a timely manner. The Commission also considered the enforcement policies of other federal agencies, and although it declined at the time to adopt a guidelines approach like that used by the DOJ (which follows the U.S. Sentencing Guidelines), the Commission appeared to be heavily influenced by the practices of the DOJ and the Sentencing Guidelines, in deciding which factors would guide the Commission's own penalty analyses.

Between 2005 and the end of 2007, all of the post-EPAAct 2005 investigations resulting in civil penalties were resolved by settlement between Enforcement staff and the subject companies. The Commission issued 12 orders approving these settlements. The civil penalties ranged from \$300,000 to \$10 million, and reflected a wide variety in the type and seriousness of the violations at issue. In some of these cases, disgorgement or other monetary remedies were imposed, and all but three of the settlements also required compliance plans designed to prevent reoccurrence of the violations.

In 2008, the Commission issued a *Revised Policy Statement* (2008 Policy Statement) to provide industry with a fuller picture of the Enforcement staff's investigative process and the factors considered to determine whether a penalty is warranted and the amount of such penalty. The Commission reinforced that the two most-important factors are seriousness of the offense and the strength of an organization's commitment to compliance. In the 2008 Policy Statement, the Commission once again was influenced by the factors enumerated in the Sentencing Guidelines; nevertheless, the Commission continued to decline various suggestions that it adopt a penalty guidelines approach like that used by the DOJ.

2010 Policy Statement

In the 2010 Policy Statement, the Commission indicated that it now believes that the advantages of a penalty "guidelines approach" outweigh the disadvantages, and that it has gained sufficient experience to employ a guidelines approach patterned after the Sentencing Guidelines in determining civil penalties. The Commission underscored that the new Penalty Guidelines would continue to use many of the factors previously considered by the Commission in determining civil penalties, but would do so in a more focused manner by assigning those factors specific and transparent weights.

The Commission noted that the guidelines approach promotes greater transparency by providing notice to organizations as to how the Commission will determine civil penalties, which is likely to add to organizations' confidence in the fairness and consistency of the Commission's Enforcement program; will avoid confusion in the industry regarding the bases of penalties; and will provide organizations a greater understanding of the types of violations the Commission views as most important—which, in turn, may lead to more robust and effective compliance.

The Commission also noted that while a guidelines approach may provide less flexibility and discretion than a more generalized approach, the departure mechanism permits consideration of unique or exceptional factors that might arise in a case, and the Penalty Guidelines' various modifications of the Sentencing Guidelines would account for recurring Commission-specific considerations that have arisen since EPAAct 2005.

The Penalty Guidelines

Like the Sentencing Guidelines, the Commission's 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. Generating a final penalty range can be broken down into five discrete steps:

Step One: Base Violation Level

The "base violation level" is identified based on the type of violation, whether it is a violation of the Reliability Standards for the Bulk Electric System of North America; a violation involving fraud, manipulation or anti-competitive conduct; a violation of rules, tariffs or orders; or a violation involving misrepresentations and false statements to the Commission.

Step Two: Adjustments

Next, any appropriate adjustments are applied to account for circumstances that are specific to the type of violation at issue (e.g., adjustments based on the risk of harm or loss, actual harm or loss, and duration thereof; interference with the administration of justice or spoliation of records). These adjustments are applied to the base violation level from Step One, thus generating a final "violation level" that corresponds to a specific dollar amount listed in the Penalty Guidelines.

Step Three: Base Penalty

A "base penalty" is calculated by determining the greater of: (1) the dollar amount determined in Step Two, (2) the pecuniary gain to the organization from the violation or (3) the pecuniary loss from the violation caused by the organization.

Step Four: Culpability Score

An organization's "culpability score" starts with a base score, adjusted upward or downward depending on six separate considerations:

- Whether high-level personnel of the organization or unit of the organization within which the violation occurred participated in, condoned or were willfully ignorant of the violation, and whether tolerance of the violation by substantial authority personnel was pervasive throughout the organization or unit of the organization within which the violation occurred. (This factor is tied to the size of the organization and the unit of the organization within which the violation occurred.)
- Whether the organization has a prior history of committing violations.
- Whether the violation violated a judicial or Commission order or injunction directed at the organization by the Commission or other federal and state enforcement agencies that adjudicate similar types of matters as the Commission.
- Whether the organization obstructed justice, or encouraged obstruction of justice, during the investigation or resolution of the violation.
- Whether the violation occurred despite the existence of an effective compliance and ethics program at the time of the violation.
- Whether any self-reporting, cooperation and acceptance of responsibility has been indicated.

The final "culpability score" corresponds to a set of "minimum and maximum multipliers" listed in the Penalty Guidelines.

Step Five: Multiplication of Base Penalty by Minimum and Maximum Multipliers

The final step involves multiplying the "base penalty" amount from Step Three by the "minimum and maximum multipliers" from Step Four to produce the applicable penalty range. (For example, a case involving a base penalty of \$1 million and "minimum and maximum multipliers" of 0.80 and 1.60 would generate a penalty range of \$800,000 to \$1,600,000.)

The Policy Statement provides examples of how the Penalty Guidelines would be applied under different scenarios, including a market manipulation, a tariff violation, a capacity release violation and a violation of reliability standards.

The Commission recognizes the considerable interest in the 2010 Policy Statement and Penalty Guidelines, and thus, the Office of Enforcement has been directed to conduct workshops in the near future to explain the Penalty Guidelines in greater

detail and respond to questions from interested parties. Any organization subject to the Commission's jurisdiction should be aware of the specifics of the Penalty Guidelines so that they may serve as both a guide and as a possible deterrent.

About Duane Morris

At the core of Duane Morris' Energy practice are attorneys who have spent their entire careers working within the industry, some holding leadership positions with federal and local energy commissions before joining Duane Morris and focusing their efforts on understanding and anticipating energy policies and laws for clients. One of our attorneys, Sheila Slocum Hollis, was the FERC Office of Enforcement's first director, establishing the office, its policies and procedures. Other attorneys at the firm have also served in various capacities at FERC.

For Further Information

If you have questions about this *Alert*, please contact [Sheila Slocum Hollis](#) or [Jennifer D. Cook](#) in our [Washington, D.C. office](#), any other [members](#) of the [Energy, Environment and Resources Practice Group](#) or the attorney in the firm with whom you are regularly in contact.

Note

1. *Enforcement of Statutes, Orders, Rules, and Regulations*, 130 FERC ¶ 61,220 (2010).