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LEGAL ALERT

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FERC Provides Guidance on Reliability Penalties

In a March 17, 2011 order, the Federal Energy Regulatory Commission (FERC) affirmed the proposed penalty initially filed by the North American Electric Reliability Corporation (NERC) in the first case in which FERC initiated its formal review process. In doing so, FERC also offered additional guidance to NERC and the regulated community regarding the development of penalties for violations of the mandatory NERC Reliability Standards.

Background

In the March 17 order in FERC Docket No. NP10-18-000 (134 FERC ¶ 61,209) (March 17 Order), FERC addressed a proposed penalty assessed against Turlock Irrigation District (Turlock) for alleged violations of certain Reliability Standards, including the vegetation management Standard (FAC-003). The violations arose from a transmission facility outage in August 2007 that resulted in the loss of 270 MW of firm load in the service areas of Turlock and a neighboring electric utility. Following an investigation by the Western Electricity Coordinating Council (WECC), the Regional Entity with enforcement authority in Turlock's region, Turlock agreed to pay an $80,000 penalty. NERC approved the settlement and penalty amount, and filed them with FERC for approval.

FERC reviewed NERC's submission and sought additional data from NERC concerning the circumstances of the outage and Turlock's mitigation plans to remedy the violation. In a February 26, 2010 order, FERC formally initiated review of the Turlock penalty, suggesting that the penalty amount may not have been high enough in light of the loss of firm load and the size of other penalties assessed against other entities for violations of the FAC-003 Reliability Standard.

FERC's Order

In the March 17 Order, FERC affirmed the $80,000 penalty. FERC agreed with NERC and industry commenters that transmission operators like Turlock must be able to shed load at times to maintain the reliability of their transmission systems, and that shedding load alone is not inherently a Reliability Standard violation. However, FERC cautioned that the penalty for a violation resulting in load shedding should take into account the lost load because of the more serious risk involved. In this case, FERC found that "unnecessary loss of customer load as a consequence of a Reliability Standard violation is serious, and serves to increase the severity of the underlying violation." Still, FERC emphasized the "particular circumstances" of this case, including the fact that the violations occurred shortly after the Reliability Standards became mandatory and enforceable.

The March 17 Order also addressed the applicability of several mitigation factors. Specifically, FERC emphasized that a self-report will not serve as a mitigating factor where the regulated entity has a duty to report a potential violation; in this case, Turlock was entitled to no credit for self-reporting the outage and loss of load because the EOP-004 Reliability Standard requires the reporting of a disturbance such as shedding load. FERC rejected Turlock's contention that it should get credit for self-reporting because it had reported the disturbance to the WECC operations staff as required, but also self-reported the incident to the WECC enforcement staff. Turlock's cooperation and lack of concealment of information were not considered mitigating factors because Turlock provided the level of cooperation and information expected of regulated entities.

FERC also explained, in reviewing the size and nature of a registered entity as a mitigating factor, that size should not be measured “solely by the number of transmission lines” or interconnections. Rather, size is determined by “looking at multiple factors, which might vary depending on the particular circumstances,” and could include for example the number of employees, annual revenue, profits and budget, and corporate structure of the registered entity. Ultimately, however, the “size and nature” of the entity will not generally be considered as the most important factor in FERC’s review of a penalty.

FERC also rejected “human error” as a mitigating factor because treating human error as a mitigating factor would remove an incentive for compliance. Rather, monetary penalties for violations resulting from human error will encourage registered entities to develop and implement effective training and compliance programs to prevent human error in the first place.

Finally, in addition to approving the monetary penalty, FERC directed WECC to perform spot checks to ensure Turlock’s compliance with its vegetation management plan and with the requirements of other relevant Reliability Standards.

Implications

The March 17 Order reaffirms that load shedding pursuant to a Reliability Standard is not in itself a violation. However, the March 17 Order makes equally clear that the decision to shed load may factor into a penalty assessment for the underlying violation. Specifically, if load shedding results from a violation of a Reliability Standard, the “penalty for the violation should take into account the lost load because the violation created a more serious risk or result than a similar violation that did not necessitate load shedding.” Indeed, the March 17 Order explained that, although the NERC Sanction Guidelines do not expressly identify loss of load as a potentially aggravating factor in the determination of monetary penalties, nonetheless it may be considered by NERC and the Regional Entities as an “appropriate penalty adjustment factor.” The quantity of lost load thus will be considered in evaluating the seriousness of a violation, even if no “actual harm” (such as damages, injuries, or fatalities) resulted from the Reliability Standard violation.

In the March 17 Order, FERC sought to allay industry’s concerns that its order initiating review of the proposed penalty would have a “chilling effect” on system operators seeking to prevent loss or damage to the system. Whether FERC has adequately addressed those concerns remains to be seen. Because it will not always be clear to system operators whether a violation has occurred (and thus whether shedding load will result in higher penalties), FERC’s discussion in the March 17 Order may not fully avoid the potential “chilling effect.” In many ways, perhaps all that system operators can do in the wake of the March 17 Order is establish and implement sound load shedding procedures, along with sufficient training, based on their individual systems and circumstances.

Registered entities may also find that efforts to cooperate with regulators and self-report violations will not have the same mitigating effect during the penalty assessment process. FERC outlined in the March 17 Order its expectations regarding compliance efforts – simply adhering to the requirements as specified in the Reliability Standards does not serve to mitigate a penalty assessment because FERC, NERC and the Regional Entities expect this level of compliance. More is expected of registered entities to warrant mitigation credit.

Finally, FERC directed NERC and the Regional Entities to clearly describe, in future penalty filings involving loss of load resulting from a violation, relevant system conditions and whether and how the unnecessary loss of load led to or required changes in these conditions. The March 17 Order also raised concerns with the sufficiency of the record initially filed by NERC, and cautioned NERC to submit "complete and accurate" penalty filings. In contrast with recent efforts by NERC to streamline penalty filings, one possible result of FERC's admonition will be that registered entities facing penalties can expect heightened investigation and documentation by NERC and the Regional Entities to produce a more thorough record.

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If you have questions about 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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