



March 26, 2010

## FERC Issues Policy Statement on Penalty Guidelines

On March 18, 2010, the Federal Energy Regulatory Commission (FERC) issued a policy statement regarding the assessment of civil penalties<sup>1</sup> on business organizations pursuant to the civil penalty authority granted by the Energy Policy Act of 2005 (EPAAct 2005).<sup>2</sup> According to FERC, it adopted the Penalty Guidelines (which are modeled on portions of the United States Sentencing Guidelines<sup>3</sup> with appropriate modifications to account for FERC-specific considerations) to add greater fairness, consistency, and transparency to its civil penalty determinations for organizations. Under the Penalty Guidelines, FERC will determine a penalty range based on the combination of: (1) the Violation Level, consisting of a Base Violation Level for the type of offense that is adjusted for various seriousness factors; and (2) the Culpability Score, which considers an organization's past and current conduct and efforts to remedy the violation. The Penalty Guidelines are discretionary, and FERC retains the discretion to depart from the guidelines where necessary or appropriate.

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### I. Background

EPAAct 2005 authorizes FERC to assess civil penalties of up to \$1 million per violation, per day for any violation of the Natural Gas Act (NGA),<sup>4</sup> the Natural Gas Policy Act of 1978 (NGPA),<sup>5</sup> or Part II of the Federal Power Act (FPA),<sup>6</sup> or any FERC rule, regulation, or order thereunder. These provisions all direct FERC, in determining the amount of the civil penalty, to consider the nature and seriousness of the offense and any efforts to remedy the violation.

FERC has issued a number of policy statements providing guidance regarding its enforcement policies and the criteria that it considers in assessing civil penalties.<sup>7</sup> FERC had previously rejected requests to adopt a penalty guidelines approach like that taken by the Sentencing Guidelines, but explicitly left open the possibility that it would do so after it developed "more experience in reviewing matters involving its enforcement authority."<sup>8</sup>



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### II. Penalty Guidelines

#### A. Five-Step Process for Determining Civil Penalties

Under the Penalty Guidelines, FERC will follow the following five-step process to calculate the range of civil penalties it may assess: (1) determination of the Base Violation Level based on the substantive standard violated; (2) adjustments to the Base Violation Level based on the seriousness of the offense; (3) determination of the Base Penalty; (4) determination of the Culpability Score, based on the organization's past and current conduct and efforts to remedy the violation; and (5) multiplication of the Base Penalty by the Minimum and Maximum Multipliers. FERC provides hypothetical examples of how the Penalty Guidelines would be applied to calculate the civil penalty for market manipulation, a tariff violation, a capacity release violation, and a violation of a reliability standard.

##### 1. Step One: Base Violation Level

Step One consists of determining the Base Violation Level, which depends on the type of violation: (1) violations of electric reliability standards; (2) fraud, manipulation or anticompetitive conduct or other rule, tariff, or order violations; or (3) violations involving misrepresentation and false statements to FERC.

##### 2. Step Two: Adjustments to Base Violation Level

In Step Two, FERC will adjust the Base Violation Level to reflect the seriousness of the offense. For reliability standard violations, the Violation Level is adjusted for the risk of harm or loss resulting from the violations. Tariff violations or violations involving market manipulation, *et al.* are adjusted for the actual harm or loss, the duration of the violations, the volume of natural gas or power involved, and for whether the conduct involved a serious threat to market transparency. For violations involving misrepresentation and/or false statements, adjustments are made based on whether there was obstruction of justice or spoliation of records or if the violation was otherwise extensive in scope, planning, or preparation. The adjustments made to the Base Violation Level result in the final Violation Level, with corresponding penalty amounts ranging from \$5,000 to \$72,500,000.

##### 3. Step Three: Base Penalty

In Step Three, FERC establishes the Base Penalty, which is the greater of the following: (1) the dollar amount corresponding to the Violation Level; (2) the dollar value of the pecuniary gain from the violation; or (3) the dollar amount of the pecuniary loss from the violation caused by the organization.

##### 4. Step Four: Culpability Score

In Step Four, FERC determines the Culpability Score. FERC begins with a base score that is adjusted upwards or downwards based on the following six considerations:



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- whether senior management participated in, condoned or was willfully ignorant of the violation (upwards);
- whether the organization has a prior history of violations (upwards);
- whether the violation violated an order or injunction issued by a court, FERC, or another state or federal regulatory agency that adjudicates similar types of matters as FERC (upwards);
- whether the organization obstructed justice, or encouraged the obstruction of justice, during the investigation or resolution of the violation (upwards);
- whether the violation occurred despite the existence of an effective compliance and ethics program (downwards); and
- whether the organization self-reported the violations, cooperated in the investigation thereof, and/or accepted responsibility for the violations (downwards).

The final Culpability Score is used to determine the corresponding Minimum and Maximum Multipliers.

### **5. Step Five: Calculation of Penalty Range**

In Step Five, FERC determines the range of civil penalties to be assessed by multiplying the Base Penalty determined in Step Three by the Minimum and Maximum Culpability Multipliers from Step Four. The resulting penalty range will be wide because the Maximum Multiplier ranges from two to four times greater than the Minimum Multiplier (depending on the Culpability Score). FERC will exercise its discretion to decide, within that range, what civil penalty to assess.

#### **B. Applicability of Penalty Guidelines**

The Penalty Guidelines apply only to an organization, which is defined as any entity other than a natural person. The Penalty Guidelines are effective immediately and will apply to all future violations and any pending investigation where the FERC's Enforcement Staff has not entered into settlement negotiations. With respect to violations of North American Electric Reliability Corporation (NERC) reliability standards, FERC explained that, while it does not anticipate applying the Penalty Guidelines to most notices of penalty, "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."<sup>9</sup>

FERC further noted that the civil penalties assessed will be in addition to any required disgorgement of unjust profits, and that, in cases involving an identifiable pecuniary gain from a violation, FERC will continue to require disgorgement for the full amount of the gain, plus interest. FERC may also reduce the civil penalty calculated under the guidelines to the extent that payment of the civil penalty would impair the organization's ability to disgorge profits.



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### C. Penalty Guidelines are Discretionary

The Penalty Guidelines are discretionary, not mandatory, and FERC explicitly retains the discretion to depart from the Penalty Guidelines where appropriate based on specific facts and circumstances. In addition, FERC will reduce a penalty calculated under the Penalty Guidelines to the extent the resulting civil penalty exceeds the statutory maximum of \$1 million per violation, per day.

### III. Next Steps

FERC will hold a technical conference on the Penalty Guidelines on April 7, 2010. One year after the implementation of the guidelines, FERC Enforcement Staff will conduct another technical conference to discuss how they have been applied and to permit comments and questions from industry participants.

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*This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice.*

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<sup>1</sup> *Enforcement of Statutes, Orders, Rules, and Regulations*, 130 FERC ¶ 61,220 (2010) (Penalty Policy Statement). The FERC Penalty Guidelines (Penalty Guidelines) are attached to the Penalty Policy Statement.

<sup>2</sup> Pub. L. No. 109-58, 119 Stat. 594 (2005).

<sup>3</sup> United States Sentencing Commission, Guidelines Manual (Sentencing Guidelines). According to FERC, the Penalty Guidelines generally follow the methodologies used by the Environmental Protection Agency, the Occupational Safety and Health Administration, the Nuclear Regulatory Commission, and the Federal Communications Commission.

<sup>4</sup> EPA Act 2005 § 314(b)(1) (*adding* NGA § 22, 15 U.S.C. § 717t-1).

<sup>5</sup> *Id.* § 314(b)(2) (*amending* NGPA § 504(b)(6)(A), 15 U.S.C. § 3414(b)(6)(A)).

<sup>6</sup> *Id.* § 1284(e)(1) (*amending* FPA § 316A, 16 U.S.C. § 825o-1).

<sup>7</sup> *See, e.g., Enforcement of Statutes, Orders, Rules, and Regulations*, 113 FERC ¶ 61,068 (2005); *Enforcement of Statutes, Regulations and Orders*, 123 FERC ¶ 61,156 (2008) (Revised Enforcement Policy Statement); *Compliance with Statutes, Regulations, and Orders*, 125 FERC ¶ 61,058 (2008). Apart from the adoption of the Sentencing Guidelines' approach to calculating civil penalties, FERC gave no indication that the Penalty Policy Statement would replace or supersede its previous policy statements on enforcement or compliance.

<sup>8</sup> Revised Enforcement Policy Statement at P 53.

<sup>9</sup> Penalty Policy Statement at P 64.