



FERC Issues Order Affirming Proposed Penalty and Providing Guidance in Future Reviews of Penalties

On March 17, 2011, the Federal Energy Regulatory Commission (“FERC” or the “Commission”) issued an order (the “March 17 Order”) on review of a Notice of Penalty (“NOP”) in which it affirmed the North American Electric Reliability Corporation’s (“NERC’s”) proposed \$80,000 penalty against Turlock Irrigation District (“Turlock”). The Turlock NOP, submitted by NERC on November 13, 2009, was the first that the Commission chose to review. Typically, each NOP filed by NERC becomes effective by operation of law upon the expiration of the applicable thirty (30) day period following the filing in the absence of an application for review of a penalty or a review by the Commission on its own motion. Upon such a review, the FERC may affirm, set aside, or modify the penalty or remand the matter to the NERC.

The Turlock NOP addressed eight (8) violations of reliability standards, the most serious being a violation of FAC-003-1, Requirement 2. On February 26, 2010, the Commission issued an order initiating the review of the proposed penalty on the grounds that it appeared “insufficient” given that the violation of FAC-003-1, Requirement 2 resulted in an outage causing the loss of firm load on the Bulk Power System (“BPS”). The Commission was especially concerned that penalties for

prior violations of the same standard ranged from \$0 to \$250,000, none of which involved loss of load. NERC, and Turlock’s regional entity the Western Electricity Coordinating Council, vigorously defended the proposed \$80,000 penalty, arguing that a penalty that substantially exceeds that which is supported by the record in accordance with the NERC Sanction Guidelines is not a good use of resources, becomes unduly punitive and may signal to the industry that litigation, rather than prompt resolution, should be pursued.

In the March 17 Order, the Commission affirmed the \$80,000 proposed penalty. The FERC placed significant importance on the fact that the alleged violation occurred within several weeks after FAC-003-1 became effective and mandatory in the United States. In addition to approving the proposed penalty, the Commission provided guidance to the industry on “factors that could affect future reviews of penalty amounts.” These factors include:

- **Load Shedding.** FERC explains that while load shedding is not, alone, a violation (and may be necessary or required by reliability standards), if load shedding *results* from a reliability standard violation, the penalty assessed for the violation should account for the lost load because the viola-

tion created a more serious risk or result than a similar violation that did not necessitate load shedding.

- **A Registered Entity's Efforts after an Alleged Violation.** If a registered entity undertakes "significantly enhanced efforts" in response to its violation of a reliability standard, the Commission may consider it a factor in determining the penalty amount.
- **Size and Nature of a Registered Entity.** The size and nature of a registered entity is a factor that NERC or a Regional Entity may consider when calculating a penalty. The Commission measures size by looking at "multiple factors." Some cited examples include: the number of employees, annual revenue, profits and financial status.
- **Cooperation Versus Self-Reporting.** FERC clarified that when a registered entity notifies a Regional Entity of a potential violation through a report required more quickly by another standard than by the standard that the registered entity may have violated, self-reporting will not be considered

a mitigating factor when assessing a penalty amount. Subsequent cooperation by the registered entity may be considered as a separate mitigating factor in the penalty determination.

- **Human Error.** The Commission will not consider "human error" as a mitigating factor in determining a penalty. FERC believes that such consideration would remove an important incentive for compliance with the reliability standards.

It remains to be seen whether the March 17 Order provides sufficient guidance to prevent a "chilling" effect on a system operator's willingness to shed load for fear of risking a higher penalty. Moreover, it also remains unclear how the NERC will respond to the Commission's guidance that NERC file a complete and accurate record for each notice of penalty, in light of the NERC's transition to a more abbreviated format. Registered entities might expect NERC and Regional Entities to conduct more thorough investigations of potential violations that present a moderate to high risk to the BPS.

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