



JONES DAY
COMMENTARY

FERC'S NEW PENALTY GUIDELINES: WHAT'S THE BOTTOM LINE?

In its March 18, 2010, Policy Statement on Penalty Guidelines (“Guidelines”),¹ the Federal Energy Regulatory Commission (“FERC”) proposed a dramatic change to the way it calculates penalties for violations of the statutes and regulations it administers, shifting from a largely opaque approach to a more open and transparent one. Before the Guidelines, a company had to look to past public settlements and attempt to “read the tea leaves” to determine its possible financial exposure when it uncovered a perceived violation and presented it to FERC Enforcement. The Guidelines, instead, provide a detailed roadmap, enabling a company to conduct a critical analysis of its particular factual situation and to calculate its resulting financial exposure using the Guidelines’ prescriptive, formulaic approach.

FERC Enforcement Staff recently concluded workshops in Washington, Houston, and San Francisco, where it walked through the application of the Guidelines and responded to industry questions and comments. At the Washington Guidelines workshop, Enforcement Director Norman Bay emphasized that “enforcement is not a game of ‘gotcha’” and that, with the Guidelines, companies have Enforcement Staff’s “playbook” for determining penalties, which they should use to determine exactly which factors Enforcement Staff will consider and how much weight such factors will be given.

Initially, FERC had planned to place the Guidelines into effect immediately. After completing the workshops, however, FERC delayed the use of the Guidelines, stating that the March 18 issuance would be treated as “interim,” and invited industry to file written comments on the Guidelines by June 14, 2010.²

¹ *Enforcement of Statutes, Orders, Rules, and Regulations*, Policy Statement on Penalty Guidelines, 130 FERC ¶ 61,220 (2010).

² *Enforcement of Statutes, Orders, Rules, and Regulations*, Order Regarding Policy Statement on Penalty Guidelines, 131 FERC ¶ 61,040 (2010).

Our purpose here is not to summarize the Guidelines. Instead, we present an all-inclusive, one-page flowchart, intended to assist companies in understanding and applying the Guidelines' methodology to their specific situations. Further, should industry participants wish to comment on the Guidelines, the flowchart provides a helpful mechanism for identifying elements that may merit comment. We also underscore below some key points raised at the workshops that form the basis of the Guidelines and FERC's going-forward Enforcement regime.

CALCULATING PENALTIES UNDER THE GUIDELINES: JONES DAY'S PENALTY CALCULATION FLOWCHART

The Guidelines establish objective criteria that Enforcement Staff will use to determine the level of civil penalties that FERC will impose, and to ensure that penalties are transparent. Should an Enforcement Staff investigation result in the imposition of a penalty, the Guidelines will be used to generate a penalty range based on a five-step process: (1) identify the base violation level, (2) determine what, if any, adjustments should be made to the base violation level, (3) determine the base penalty, (4) determine the culpability score, and finally, (5) determine the penalty range. Although these five steps are easy to understand in the abstract, working through the underlying adjustment factors and calculations is complicated and time-consuming. To help, we have developed the attached flowchart, which reduces the Guidelines' penalty metrics to a single (11"x17") page. To analyze the potential penalty exposure associated with a particular factual situation, begin with the flowchart's Step One and work through the various steps in succession.

Importantly, at the Washington, D.C. Guidelines workshop, Director Bay made clear that even with the Guidelines in place, FERC Enforcement staff retains its "prosecutorial discretion" and the corresponding ability to close a preliminary inquiry into a minor violation with no investigation or remedial action required. Thus, self-reports relating to lesser violations will not necessarily result in any penalty or public notice, even in circumstances where the penalty metric would indicate that a penalty is warranted.

KEYS TO EFFECTIVE COMPLIANCE: IMPLEMENTATION OF AN EFFECTIVE COMPLIANCE PROGRAM, "TONE AT THE TOP," AND SELF-REPORTING

As FERC's Enforcement regime has taken shape since the Commission's civil penalty authority was significantly strengthened under the Energy Policy Act of 2005, there has been little doubt that an essential component of an effective compliance program is the support of senior management. The Guidelines emphasize this principle, as well as the importance of self-reporting whenever a violation is uncovered. Director Bay highlighted three takeaways for companies under the new Guidelines.

First, companies should "develop a robust compliance program and create a culture of compliance." Although that recommendation is consistent with the Commission's previous enforcement policy pronouncements, Director Bay noted in the context of the new Guidelines that a compliance program can reduce a company's culpability score by three points, which in turn can reduce its penalty range amount by approximately 40 percent.

Second, companies must make sure that senior management is “part of the solution, not part of the problem.” Director Bay stressed that “high level and substantial authority personnel need to foster a culture of compliance” and “should never be a party to a violation.”

Third, if a company finds a violation, it should self-report. If the self-report results in an investigation, the company should cooperate. And if Enforcement Staff seeks penalties, the company, to obtain additional credit, should resolve the matter without going to trial. Self-reporting, cooperation, and acceptance of responsibility can reduce the culpability score for a company by four points, thus reducing a base penalty amount by up to 80 percent.

CONCLUSION

In the Compliance and Enforcement world, easy answers are often hard to come by. The Guidelines represent FERC’s effort to prescribe, and thus enable a company to predict, the potential penalty exposure a company may face when it finds itself in the difficult situation of having identified an actual or potential lapse of compliance. One thing that is easy to see, though, is that the development of a robust compliance program is critical. There can be little doubt that the time to think about compliance is long before a violation. An effective compliance program is, of course, important to help a company avoid violations. But, it is equally important to ensure that any violation that slips through the cracks results in as small a penalty as possible. Without a focused effort up front, at an early stage, by compliance personnel, the legal team, and all levels of management (with particular emphasis on senior management), a company will leave itself at greater risk of financial harm if it faces a FERC review of a violation.

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