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**COMMENTS OF TRANSMISSION ACCESS POLICY STUDY GROUP ON POSTING OF PROPOSED CHANGES TO SANCTION GUIDELINES, APPENDIX 4B TO NERC RULES OF PROCEDURE, DATED MAY 20, 2020**

TAPS appreciates the opportunity to comment on NERC's proposed changes to the Sanction Guidelines, Appendix 4B to the NERC Rules of Procedure ("ROP"), dated May 20, 2020[1]. TAPS supports the increased transparency NERC proposes to provide in response to FERC's January 23, 2020, Order on Five-Year Performance Assessment.[2] Some of the proposed changes, however, raise concerns, as detailed below.

# I. FFT AND COMPLIANCE EXCEPTIONS

TAPS supports NERC's proposal to add to the Sanction Guidelines a statement that instances of noncompliance and violations processed through the Find, Fix, Track, and Report ("FFT") and Compliance Exception processes are not subject to monetary or nonmonetary sanctions. Proposed Sanction Guidelines § 2.1. It is appropriate that the FERC-approved treatment of Compliance Exceptions and FFT noncompliance be reflected in the Sanction Guidelines.

# II. VIOLATOR SIZE, SERIOUSNESS OF THE VIOLATION, AND ABILITY TO PAY

The currently effective Sanction Guidelines state,[3] as a single "basic principle,"[4] that consideration of both the seriousness of the violation (of which entity size may be a component) and ability to pay is intended to:

> (i) promote that violators are penalized or sanctioned commensurate with the risk or effect that their specific violation of the Reliability Standards had or is having on the reliability of the Bulk Power System while also (ii) mitigating overly burdensome Penalties to less consequential or financially-limited entities concurrent with (iii) promoting that no Penalty is inconsequential to the violator to whom it is assessed. Consideration of these factors is intended to result in Penalties levied for violations of Reliability Standards bearing a reasonable relationship to the seriousness of the violation while also addressing the violators' ability to pay the Penalties that are assessed.

[1] NERC Rules of Procedure, Appendix 4B, Sanction Guidelines of the North American Electric Reliability Corporation (May 20, 2020) ("Proposed Sanction Guidelines").

[2] *N. Am. Elec. Reliability Corp.*, 170 FERC ¶ 61,029 (2020) ("Five-Year Assessment Order").

[3] NERC Rules of Procedure, Appendix 4B, Sanction Guidelines of the North American Electric Reliability Corporation (July 1, 2014) ("Current Sanction Guidelines").

[4] Current Sanction Guidelines § 2, generally.

Current Sanction Guidelines § 2.6. NERC proposes to delete Section 2.6, replacing it with a new Section 2.4, "Reasonable Relationship to Seriousness of the Violation," which would provide, in part, that:

> The application of these Sanction Guidelines is intended to result in monetary and non-monetary sanctions that bear a reasonable relation to the seriousness of the violation(s) while also reflecting consideration of the other factors specified in these Sanction Guidelines.
>
> NERC or the Regional Entity considers the entity's size, the risk of the violation, and compliance history as key factors in the development of monetary and non-monetary sanctions in order to ensure that those sanctions are consequential enough such that violators do not consider the imposition of monetary and/or non-monetary sanctions to be an economic choice or cost of doing business.

Proposed Sanction Guidelines § 2.4. This formulation entirely drops the existing Section 2.6 goal of mitigating overly burdensome penalties to smaller entities. It thus appears that under this "General Principle[]," entity size can only *increase* penalties; there is no recognition of the fact that a sanction that would be appropriate for an entity of average size may have a disproportionate impact on a small entity.

NERC proposes to relocate the first two goals—sanctions commensurate with risk, and mitigation of "overly burdensome Penalties to less consequential or financially-limited entities"—to Proposed Sanction Guidelines § 3.4.4, Entity's Financial Ability to Pay, one of the final adjustments to the monetary sanction. That extensively revised subsection would provide, in part, that:

> At the written request of the entity, NERC or the Regional Entity will review the monetary sanction determined above in light of relevant, verifiable information that the entity provides regarding its financial ability to pay. Financial ability shall include the financial strength of the entity as well as its financial structure (e.g., for-profit versus non-profit). NERC or the Regional Entity may consider the entity's inherent characteristics, such as but not limited to: its size, financial structure, and ownership structure. Consideration of an entity's size, financial structure, and ownership structure is intended to (i) promote that entities are sanctioned commensurate with the risk or impact that a specific violation of the Reliability Standards had or is having on the reliability of the Bulk Power System while also (ii) mitigating the potential of overly burdensome monetary sanctions to less consequential or financially-limited entities.

Proposed Sanction Guidelines § 3.4.4 (footnote omitted). This text would appear to allow for consideration of an entity's size and financial structure, independent of the seriousness of the violation, in setting a penalty, albeit only at the entity's written request. But it is undermined by NERC's other proposed changes to that subsection, shown here in redline format:

> At the conclusion of this review, NERC or the Regional Entity may:
>
> 1. Reduce the ~~Penalty~~monetary sanction to an amount that NERC or the Regional Entity deems that the ~~violator~~entity has the financial ability to pay~~, or~~ **if the entity is not likely to become able to pay the proposed monetary sanction with the use of a reasonable installment schedule**;
>
> 2. **Extend the period over which the monetary sanction must be paid using a reasonable installment schedule**;
>
> 3.Excuse the ~~Penalty~~monetary sanction amount payable~~,~~; or
>
> 4.Sustain the ~~Penalty~~monetary sanction amount determined ~~in Step 2~~above.
>
> If NERC or the Regional Entity reduces the monetary sanction, **such reduction will not be more than necessary to avoid substantially jeopardizing the continued viability of the organization**. If NERC or the Regional Entity reduces or excuses the ~~Penalty~~monetary sanction, NERC or the Regional Entity shall consider the assessment of appropriate non-monetary sanction(s) as a substitute or an alternative for the ~~Penalty~~monetary sanction amount otherwise considered appropriate.

(Emphasis added). In other words, NERC or the Regional Entity would prefer the use of an installment schedule to reduction of a penalty; and they would *only* reduce a penalty enough to avoid "*substantially* jeopardizing the continued viability of the organization." (*Id*., emphasis added). But where a small entity and an average-sized entity have identical violations, if they face identical penalties, the average-sized entity may feel some pain while the small entity's continued viability is put at moderate (but not substantial) risk. NERC's proposal would undermine the Sanction Guidelines' currently stated intent of mitigating the impact of overly burdensome penalties on small entities by drastically raising the bar as to what constitutes a "burden." These significant new constraints on the consideration of entity size and ability to pay represent a substantive change to the existing, FERC-approved language—one which is not required by FERC's NERC's Five-Year Assessment Order.

TAPS recognizes that NERC's proposed changes are consistent with FERC's own 2010 Revised Policy Statement on Penalty Guidelines.[5] But the fact that FERC developed guidelines ten years

[5] *Enforcement of Statutes, Orders, Rules, & Regulations*, 132 FERC ¶ 61,216 (2010).

ago for its *own* enforcement actions that differ from the Sanction Guidelines it approved for NERC is not sufficient reason for NERC now to adopt FERC's significantly more punitive approach. To TAPS's knowledge, there has been no indication that FERC wishes for NERC to adopt FERC's Penalty Guidelines, in whole or in part. And as FERC noted in the Revised Policy Statement on Penalty Guidelines,[6] while it retains discretion to enforce any reliability violation, FERC in fact uses its direct enforcement authority only with respect to the most serious of reliability violations, where a more punitive approach may be more appropriate.

## III. CONSISTENCY

NERC's proposed revisions would remove any reference to the need for consistent application of the Sanction Guidelines. The currently effective Sanction Guidelines state that:

> NERC shall oversee the Regional Entities' application of the Sanction Guidelines to ensure that Regional Entities achieve acceptable levels of consistency. *NERC's oversight will ensure that there is acceptable similarity in the degree and type of sanction for violations constituting comparable levels of threat to reliability of the Bulk Power System.*

Current Sanction Guidelines § 1 (emphasis added). NERC proposes to delete the second, italicized sentence, and revise the first, as follows:

> NERC shall oversee the Regional Entities' application of the Sanction Guidelines to ensure that Regional Entities achieve acceptable levels of consistency <u>in the degree, type, and amount of sanction for violations compared to the level of threat to reliability of the Bulk Power System</u>.

Proposed Sanction Guidelines § 1 (emphasis added). The meaning of the underlined text is unclear, but appears based on the phrase "compared to the level of threat to reliability of the Bulk Power System" to be a repetition of the exhortation found elsewhere in the Sanction Guidelines that penalties are meant to bear a reasonable relationship to the seriousness of the violation. This is related to, but distinct from, the principle that similar violations (taking into account all of the factors recognized by the Sanction Guidelines) should receive similar treatment. NERC also proposes[7] to delete the only other reference to consistent application of the Sanction Guidelines:

> Adhering to the above steps will insure that the determination of any Penalty for any violation will produce output that can be directly compared (i.e. without influence of any Penalty limitations or restrictions applicable in certain jurisdictions) with the Penalty determined for any other violation, thus assisting the efforts of NERC and others to ensure that these Sanction Guidelines are uniformly applied and that there is an acceptable level of consistency in their application across North America.

[6] *Id*. PP 88-89.

[7] Proposed Sanction Guidelines at 8.

Current Sanction Guidelines § 2.15. The Compliance Monitoring and Enforcement Program (Appendix 4C to the ROP, "CMEP") states that "NERC will work to achieve consistency in the application of the *Sanction Guidelines* by Regional Entities by direct oversight and review of Penalties and sanctions." CMEP § 5.0. NERC has not proposed to delete that text from the CMEP, nor does TAPS believe it should do so. But there should be a clear statement of the goal of consistent application of the Sanction Guidelines *in* the Sanction Guidelines. These proposed deletions should not be accepted.[8]

# IV. SELF-REPORTING AND SELF-CERTIFICATION

## *A. Identification of a previously self-reported violation in a subsequent compliance engagement*

The existing Sanction Guidelines state that:

> If a Self-Report or a Self-Certification submitted by the violator accurately identifies a violation of a Reliability Standard, an identification of the same violation in a subsequent Compliance Audit or Spot Check will not subject the violator to an escalated Penalty as a result of the Compliance Audit or Spot Check process unless the severity of the violation is found to be greater than reported by the violator in the Self-Report or Self-Certification.

Current Sanction Guidelines § 3.3.3. NERC proposes, without explanation, to delete that language. Proposed Sanction Guidelines § 3.3.8. This is a substantive change, and one which should not be adopted. While the CMEP requires a Preliminary Screen that weeds out potential noncompliance if it is "known" that the noncompliance is "a duplicate of a Possible Violation or Alleged Violation that is currently being processed,"[9] that CMEP text is not an adequate substitute for the text NERC proposes to delete from the Sanction Guidelines. The Sanction Guidelines language at issue makes clear that a registered entity does not lose self-reporting credit based on an auditor's subsequent "identification" of the identical violation during a compliance engagement, so long as the violation was reported accurately. This clarification with respect to the application of the Sanction Guidelines belongs in the Sanction Guidelines. Furthermore, it is not clear that the CMEP's Preliminary Screen would prevent application of a new or escalated penalty where the self-reported violation was treated as a Compliance Exception, given that a Compliance Exception never becomes a Possible or Alleged Violation. By the same token, if a self-reported violation is still being processed at the time that the violation is (re)identified by Regional Entity staff, it may not yet have been designated as a Possible or Alleged Violation; in this situation, self-reporting credit is still appropriate. The existing prohibition should be retained.

[8] To the extent that NERC's proposed deletions are driven by a perceived inconsistency between the two statements, the language of proposed Section 1 could be revised to mirror the second, clearer statement of the principle: "NERC's oversight will ensure that ~~there is acceptable similarity in the degree and type of sanction for violations constituting comparable levels of threat to reliability of the Bulk Power System~~ these Sanction Guidelines are uniformly applied and that there is an acceptable level of consistency in their application across North America."

[9] CMEP § 3.8.

### *B. Notification of upcoming compliance monitoring engagement*

NERC proposes to add conditions on the use of self-reporting as a mitigating factor, including a requirement that the self-report have been submitted "prior to detection via a compliance monitoring engagement by NERC or the Regional Entity or intervention by NERC or the Regional Entity via a notification of an upcoming compliance monitoring engagement or Self-Certification . . .." Proposed Sanction Guidelines § 3.3.8. (NERC-proposed new text underlined). TAPS is aware that the proposed limitation on self-reports during the lead-up to a compliance engagement is generally consistent with existing practice, and that the existing practice was developed in response to a FERC order. But the proposed language is overbroad and excessively prescriptive; it should be revised. The FERC order at issue, on rehearing of a review of a Notice of Penalty involving Turlock Irrigation District,[10] stated that "[s]elf-reporting credit is not warranted . . . when a registered entity . . . reports facts *after the commencement* of a compliance audit, spot check, or other compliance process."[11] It thus appears, as a preliminary matter, that the "deadline" for submitting self-reports should be the date that a compliance engagement begins, not the date that the registered entity is notified of the compliance engagement.

In addition to being broader than necessary for compliance with the Turlock Order, the proposed language is a blunt instrument that may result in inappropriate denials of self-reporting credit. The Turlock Order made clear that the Commission "[did] not intend [its] position to diminish NERC or the Regional Entities' flexibility in applying NERC's Sanction Guidelines to determine appropriate mitigating factors. . . . . *NERC and the Regional Entities should consider the timing of a self-disclosure of a violation and whether or when they could have detected the violation prior to such disclosures*."[12] The italicized language should be added to the Sanction Guidelines. If an entity promptly[13] self-reports an incident of potential noncompliance sooner than the Regional Entity might have detected it, or if the Regional Entity might have missed the noncompliance entirely, self-reporting credit is appropriate, even if the self-report occurs during an audit.

In addition, TAPS understands that in at least some Regions, the denial of self-reporting credit during the lead-up to a compliance engagement currently extends only to violations of requirements that are in-scope for that compliance engagement. This is a reasonable approach, and is consistent with FERC's statement in the Turlock Order that "the primary principle underlying mitigation of a penalty for a self-report is that, but for the self-report, the violation could otherwise go undetected by the regulator, at least for a significant period of time":[14] a violation that is not in the scope of a compliance engagement is not significantly more likely to be detected during the compliance engagement than it would be at any other time.

[10] *N. Am. Elec. Reliability Corp.*, 139 FERC ¶ 61,248 (2012) ("Turlock Order").

[11] *Id*. P 32 (emphasis added).

[12] *Id*. P 37 (emphasis added).

[13] As would be required by NERC's other proposed addition to Proposed § 3.3.8.

[14] Turlock Order P 35.

Finally, the proposed language is too vague. For example, what constitutes "notification" of a scheduled compliance audit? Is it the notification issued to the registered entity at least ninety days prior to the commencement of the audit, pursuant to Section 3.1.1 of the CMEP? Or is it the notification of the next year's audit schedule issued prior to October 1 each year, pursuant to Section 3.1.2 of the CMEP?[15] Does the restriction end when the compliance engagement ends? If a violation that occurred prior to or during a compliance engagement is detected and promptly self-reported following the compliance engagement, is self-reporting credit available? It should not be the case that each compliance engagement renders the registered entity's entire pre-compliance engagement history off-limits for self-reporting credit. The Sanction Guidelines should only limit self-reporting credit *during* a compliance engagement (an unambiguous time period that is consistent with the Turlock Order), and should only do so with respect to the requirements within the scope of that compliance engagement; and following the conclusion of a compliance engagement, self-reporting credit should be available for violations that occurred before or during the compliance engagement.

## V. FREQUENCY AND DURATION OF VIOLATIONS

The currently effective Sanction Guidelines include paragraphs describing how penalties are calculated in the case of (a) violations that are cumulative over time, and (b) periodically monitored discrete violations. Current Sanction Guidelines § 2.16. The use of "alternative Penalty frequency or duration" is also discussed in Section 3 of the Current Sanction Guidelines. This language was added to the Sanction Guidelines in response to a FERC order.[16] NERC's only explanation of these proposed deletions is a statement that it is "[d]eleting . . .most of [Section] 2.16 to remove extraneous language and/or concepts that are no longer used."[17] Particularly in light of the FERC directives involved, this explanation is insufficient. If it is NERC's position that these "concepts . . . are no longer used," i.e., that there are no longer any requirements for which violations are cumulative over time or which are periodically monitored, and so the FERC-required language is no longer necessary, NERC must justify that position. If, on the other hand, such requirements *do* still exist, NERC must retain in the Sanction Guidelines the explanations of how it calculates monetary sanctions with respect to violations of those requirements.

## VI. "ASSESSED RISK" AND "VIOLATION DURATION"

NERC proposes to add two new factors to its calculation of the base penalty amount: "Assessed Risk" (which can multiply the base amount by up to a factor of eight) and "Violation Duration"

[15] Either option would result in every registered entity being ineligible for self-reporting credit for at least three months out of every audit cycle—a significantly longer time period than apparently contemplated by the Turlock Order.

[16] *See N. Am. Elec. Reliability Corp.*, 121 FERC ¶ 61,033, PP 6-15 (2007) ("October 2007 Order") (explaining background for new language and accepting it subject to certain additional changes, which are reflected in the currently effective Sanction Guidelines) (note that the Section 3.21 referred to in the October 2007 Order corresponds to Section 2.16 of the currently effective Sanction Guidelines, while the Section 4 referenced in the Order is now Section 3).

[17] Proposed Revisions to Appendix 4B of the NERC Rules of Procedure, Sanction Guidelines at 2, https://www.nerc.com/FilingsOrders/us/RuleOfProcedureDL/Summary%20of%20Proposed%20Revisions%20to%20Appendix%204B%20of%20the%20ROP.pdf ("Summary of Proposed Changes").

(which can increase the base amount by up to 500%).[18] Proposed Sanction Guidelines § 3.2. NERC explains[19] that this addition is in compliance with Paragraph 82 of the Five-Year Assessment Order. But that paragraph appears to direct NERC to provide clarity about how it considers these and other factors; FERC does not state that the existing Sanction Guidelines fail to capture any of the factors listed. Before adding these proposed additional factors to the Sanction Guidelines, NERC should consider, and explain, whether the factors laid out in its existing Sanction Guidelines already encompass risk and/or violation duration. The description of "Assessed Risk," in particular, appears similar in substance to the discussion of "Applicability of the Violation Risk Factor" in Section 3.2.1 of the Current Sanction Guidelines. Particularly given NERC's proposed clarification that Violation Risk Factors and Violation Severity Levels may be adjusted with respect to particular violations, it is not clear why assessed risk should be a separate factor with the potential for an eightfold penalty increase.

## VII. APPENDIX A

The proposed table of penalty adjustments in Appendix A is inconsistent and should be revised and clarified; specifically, some adjustments are given as multipliers (*see, e.g.*, Assessed Risk, Range "1 to 8," which "[m]ultiplies the monetary sanction amount derived above by 1 to 8"), while others are "increases" (*see, e.g.*, Violation Duration, Range "0 to 5," "[i]ncreases the monetary sanction amount derived above by 0% to 500%) or "reductions" (*see, e.g.*, Internal Compliance Program, Range "0 to 0.4," "[r]educes Base Monetary Sanction Amount by 0% to 40%"). This inconsistency introduces an unnecessary, added layer of complexity; there is no reason why every item could not be framed as a multiplier. In other words, in the examples cited above, Violation Duration should have a range of 1 to 6, since the intent is evidently to multiply the base amount by 1 (an increase of 0%) to 6 (an increase of 500%); and Internal Compliance Program should have a range of 0.6 to 1, since a reduction of between 0% and 40% amounts to multiplying the base sanction by 0.6 to 1.

[18] Proposed Sanction Guidelines, App. A. *See* Section VIII, *infra*, for discussion of inconsistency in descriptions of factors.

[19] Summary of Proposed Changes at 1.