A MODEST PROPOSAL FOR REFORMS OF THE FERC'S RELIABILITY AND ENFORCEMENT PROGRAMS

*John S. Moot**

Synopsis: The Energy Policy Act of 2005 (EPAct 2005) gave the Federal Energy Regulatory Commission (FERC) more effective tools to protect the public interest, including broad authority over electric reliability and enhanced enforcement powers. These tools have been used consistently and aggressively, but they remain a work in progress. This article considers the continuing implementation challenges in two areas: the electric reliability program and the assessment of civil penalties in enforcement proceedings. With respect to electric reliability, the article recommends certain reforms that could enhance the ability of the program to produce timely standards on priority matters. With respect to enforcement, the article recommends certain reforms that could better align civil penalties with corporate culpability.

* Partner, Skadden, Arps, Slate, Meagher & Flom LLP. Mr. Moot represents regulated entities in both reliability and enforcement matters and was the FERC's General Counsel or Chief of Staff at the time (2005-2008) when certain orders issued herein were issued. The views expressed herein are solely those of the author. The author would like to thank James Danly for his research in support of this article.

I. INTRODUCTION

The Energy Policy Act of 2005 (EPAct 2005) gave the Federal Energy Regulatory Commission (FERC or "the Commission") more effective tools to protect the public interest, including broad authority over electric reliability and enhanced enforcement powers. These tools have been used consistently and aggressively, but they remain a work in progress. This article considers the continuing implementation challenges in two areas: the electric reliability program and the assessment of civil penalties in enforcement proceedings. Although these two areas differ substantively, they each require difficult balancing acts. For the reliability program, it is the balance between preserving the benefits of a stakeholder-driven standards development process and ensuring that this process produces timely results that enhance reliability. For the enforcement program, it is the balance between aggressively enforcing the law and tailoring civil penalties to recognize that violations often do not involve intentional or reckless conduct.

This article recommends modest reforms in both areas. With respect to electric reliability, the article recommends certain reforms that could enhance the ability of the program to produce timely standards on priority matters. With respect to enforcement, the article recommends certain reforms that could better align civil penalties with corporate culpability.

A. The Electric Reliability Program

The electric reliability program hit somewhat of a low point at the March 2010 FERC open meeting when the Commission issued multiple orders that were critical of the standards development process.[1] Since that time, the tenor of the discourse has, with some exceptions, improved and the Commission has shown increased flexibility in resolving several contested rulemaking proceedings. Despite these gains, there remains a fundamental debate regarding whether the existing standards development process can produce strong standards on a timely basis to address the most difficult reliability questions. FERC officials have often questioned whether this "ANSI" process[2] is at the

1. March 2010 Meeting Summaries (FERC issued March 18, 2010).

2. "ANSI" refers to the American National Standards Institute accreditation of the NERC's Rules of Procedure that apply to the standards development process. These rules are set forth in Appendix 3A, Reliability Standards Development Procedure, of the Rules of Procedure. NERC, RULES OF PROCEDURE, APP. 3A (2012).

heart of the problem, whereas the North American Electric Reliability Corporation (NERC) and the industry have defended it as a valuable and indispensable part of the program. There also remain questions regarding whether the FERC routinely oversteps its bounds in reviewing proposed standards by failing to give "due weight" to NERC's technical expertise. There are new flashpoints on the horizon that may again create tensions between the FERC and the NERC over this issue.

Perhaps unwisely, this article wades into these contentious and recurring debates. With respect to the FERC's role, I continue to believe that the FERC should gradually elevate its role to focus on broad policy objectives and defer[3] more frequently to the NERC in the implementation of those objectives.[4] In the last two years, the FERC has made progress in this regard by engaging the NERC and the industry in a continuing dialogue regarding reliability priorities. It has also issued important orders that clarify the standards for the deference it will provide to the NERC.[5] These standards are generally sound in the abstract, but there remain nagging questions regarding whether deference is provided more in word than in deed.

The FERC's processes for reviewing proposed standards have also gradually improved, but could be improved further.[6] The FERC institutes a lengthy rulemaking for most reliability standards that can add up to two years to the process despite the fact that many standards are unopposed. This process can also be unpredictable, with the FERC sometimes sending the industry back to the drawing board after years of work on a revised standard. This article suggests that the FERC look for ways to streamline its processes and make them more predictable. This article recommends that the Commission consider a modest change to the role that the FERC's technical staff plays in the standards development process.

Turning to the role of the NERC and the industry, this article also addresses the question of whether the ANSI process is the problem or an indispensable part of the solution.[7] This article concludes that the answer lies somewhere in between. The frequent criticism of ANSI's multiple process layers—e.g., appointing drafting teams, allowing participation by interested persons, circulating draft standards for comment, responding to such comments, revising the standards, and voting on the standards—are somewhat overblown. It is true that the process could be streamlined, but the core objectives behind these process layers mirror the due process protections available in the FERC and other agency proceedings—namely, adequate notice to interested persons and the requirement that the agency take into account, and respond to, legitimate comments by interested persons.

The more difficult question posed by ANSI concerns the super-majority voting requirement.[8] This requirement has many benefits, including ensuring broad consensus, simplifying the FERC's review process, avoiding protracted

3. This article uses the term "deference" as a shorthand for the statutory term "due weight."
4. John S. Moot, *When Should the FERC Defer to the NERC?*, 31 ENERGY L.J. 317, 318 (2010).
5. *See infra* Section II.A.1.
6. *See infra* Section II.A.2.
7. *See infra* Section II.B.
8. *See infra* Section II.B.2.b.

litigation in the courts, and facilitating compliance. On the other hand, it can also produce delays or deadlocks in approving standards on difficult issues. To address this downside, one solution would be to reduce the voting threshold for approving a standard. This reform could shorten process at the front-end, but this article suggests that this change would simply shift time at the back end by making the FERC's review process more contentious. This article therefore urges consideration of another option—namely, adding a "circuit breaker" if consensus cannot be reached. Specifically, this article suggests giving the NERC enhanced authority to step in if the ANSI process fails to resolve a priority matter within a reasonable period of time. The authority would be patterned after its current authority under NERC Rule of Procedure 321 to respond to a governmental directive.[9]

This article also recognizes that the continuing debates over the effectiveness of the ANSI process present mixed questions of procedure and results. Although I conclude that, for the most part, the core requirements of ANSI are sound, I am the first to concede that any process will ultimately be judged by its results. The process must produce strong reliability standards on a timely basis or it will ultimately be replaced or reformed by Congress or, to the extent it has authority to do so, the FERC.[10]

B. Enforcement

Shifting gears to enforcement, it has been two years since the FERC adopted Penalty Guidelines to "add greater fairness, consistency, and transparency to [its] enforcement program."[11] At the time the Penalty Guidelines were proposed, there was significant criticism of the FERC's decision to use a "criminal" model patterned after the federal sentencing guidelines for organizations.[12] The FERC responded by improving the Penalty Guidelines in several important respects, but rejected the notion that it was "criminalizing" FERC enforcement, finding that the FERC's

> ability to impose significant monetary penalties . . . [for] regulatory violations that do not require proof of intent or recklessness is *not* a function of using the Sentencing Guidelines as a model for our Penalty Guidelines . . . [but rather] a Congressional determination that persons and organizations that violate the statutes we administer can be subjected to civil penalties of up to $1 million per day per violation.[13]

The Commission was correct to find that there is nothing inherently "criminal" in penalty schedules as opposed to case-by-case penalty determinations, but in the two years since the Commission adopted the Penalty Guidelines it has become increasingly clear that the distinctions between civil and criminal law matter very much in how the FERC's Guidelines are *applied*.

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9. NERC, RULES OF PROCEDURE, § 321 (2012).

10. The history of other self-regulatory organizations, particularly those regulated by the Securities Exchange Commission (SEC), shows that whenever the self-regulatory process is said to have failed with respect to a major issue, power has moved upward toward the federal agency and away from the industry. Moot, *supra* note 4, at 324-26.

11. *Revised Policy Statement on Penalty Guidelines*, 132 F.E.R.C. ¶ 61,216 at P 2 (2010) [hereinafter *Revised Penalty Guidelines*].

12. U. S. SENTENCING GUIDELINES MANUAL ch. 8, Sentencing of Organizations (2010).

13. *Revised Penalty Guidelines*, *supra* note 11, at PP 15, 17 (2010).

In particular, the Penalty Guidelines fail to adequately distinguish between cases in which the violation was knowing or reckless and the more benign (and more common) case where the company misinterpreted Commission rules or made unintentional compliance mistakes. In the latter cases, the Penalty Guidelines can often produce harsh results that are difficult to square with notions of fairness or corporate culpability. This is the result of several factors, particularly the fact that the culpability score has no mitigating factor directly related to intent.[14] This is understandable for criminal sentencing, with its higher burden of proof and higher standards regarding intent or recklessness, but far less so for a civil regulatory regime.

This article suggests there are several potential ways to address this concern. Some of the reforms could be implemented without amending the Penalty Guidelines, such as more frequent departures from the Penalty Guidelines or interpreting them in a way that expands the category of cases that would receive compliance program credit. Alternatively, the Commission could consider reforms that would add a specific mitigation credit directly related to cases that involve no intentional or reckless conduct. It could also consider adding a transparency credit that would serve as an indirect proxy for intent. This article also addresses a related but distinct concern associated with disgorgement of profits and recommends that the Commission adjust its policy so that disgorgement is not presumed to be "full" in all cases, but rather is subject to equitable considerations that are similar to those considered in the analogous context of refunds.

II. REFORMS TO THE PROCESS FOR DEVELOPING AND APPROVING ELECTRIC RELIABILITY STANDARDS

A. The FERC's Role: The Standard of Review and the Process for Review

This section will address (i) the FERC's standard for whether (and when) to defer to the technical expertise of the NERC; and (ii) the FERC's processes for reviewing those proposed standards.

1. The FERC Standard for Review of Proposed Reliability Rules

A central debate triggered by the March 2010 orders was whether the FERC was giving little weight to the technical expertise of the NERC. Two of the major rulemakings that arose out of the open meeting have now served as a vehicle to answer that question to some degree. Each are discussed below, along with some thoughts on what the standards adopted therein mean for future cases and a discussion of two pending rulemakings that are potential new flashpoints on the horizon.

a. Order No. 743 (BES Definition) and Order No. 733 (Relay Loadability): A Clearer Articulation of the FERC's Standard of Review

The rulemaking proceedings regarding the Bulk Electric System (BES) definition and the relay loadability standard provided the FERC the opportunity

14. *Id.* at PP 12, 16.

to more clearly articulate its standard of review of the NERC's proposed standards. In both instances, the Commission articulated a clearer standard on when it would defer to the technical expertise of the NERC and its industry volunteers, including when it would allow greater flexibility in responding to FERC directives issued under section 215(d)(5).[15] However, the two rulemakings also left open the recurring question of what technical justification must be provided by the NERC to receive such deference.

The first case where the FERC demonstrated a more flexible posture on the content of reliability standards concerned the definition of the BES. At the March 2010 meeting, the Commission had proposed, on its own initiative motion, to define the BES with a bright line test of 100 kV and above, and to require Commission approval of any exception to that bright-line test.[16] This proposal was met with widespread criticism and the FERC made two important adjustments to its proposal in Order No. 743.[17] First, the FERC held that, although it continued to believe that a bright-line 100 kV threshold was the "best way" to address its concerns, the FERC made clear that "NERC may propose a different solution that is as effective as, or superior to, the Commission's proposed approach in addressing the Commission's technical and other concerns so as to ensure that all necessary facilities are included within the scope of the definition."[18] The FERC also stated that

> [i]f the ERO decides to propose an alternative approach, it must explain in detail, and with a technical record sufficient enough for the Commission to make an informed decision, how its alternative addresses each of the Commission's concerns in a manner that is as effective as, or more effective than, the Commission's identified solution.[19]

The FERC went even further on rehearing,

> emphasiz[ing] that Order No. 743 did not mandate or direct NERC to adopt a 100 kV bright-line threshold [but rather] directed NERC to *undertake the process* of revising the bulk electric system definition to address the Commission's concerns and about the broad discretion the current definition grants to Regional Entities to modify the definition without Commission or ERO oversight, and provided a *suggested solution*.[20]

The Commission also adopted a more light-handed approach to the exemption process for facilities that operated at 100 kV and above. The FERC had initially proposed a fairly intrusive review process that one could view as micromanaging the NERC's role in considering the exemptions.[21] The Commission changed course on rehearing, finding that allowing the NERC to develop its own "exemption process should provide interested stakeholders an opportunity to participate in the development of the process" and "result in a

15. Federal Power Act § 215(d)(5), 16 U.S.C. § 824*o* (2012).

16. Notice of Proposed Rulemaking, *Revision to Elec. Reliability Org. Definition of Bulk Elec. Sys.*, 130 F.E.R.C. ¶ 61,204 (2010), 75 Fed. Reg. 14,097 (2010) [hereinafter NOPR *Revision to Reliability BES Definition*].

17. Order No. 743, *Revision to Elec. Reliability Org. Definition of Bulk Elec. Sys.*, 133 F.E.R.C. ¶ 61,150 (2010), 75 Fed. Reg. 72,909 (2010) [hereinafter Order No. 743], Order No. 743-A, *Order on Rehearing*, 134 F.E.R.C. ¶ 61,210 (2011) [hereinafter Order 743-A].

18. Order No. 743, *supra* note 17, at P 16.

19. *Id.* at P 31.

20. Order No. 743-A, *supra* note 17, at P 20 (emphasis added).

21. *Id.* at P 5.

process with practical application that is less burdensome than the NOPR proposal."[22]

The second rulemaking that posed similar issues of deference and flexibility involved the FERC's review of PRC-23-001 on "relay loadability" in Order No. 733.[23] The core technical issue was how "to ensure that the relays reliably detect and protect the electric network from all fault conditions, but do not limit transmission loadability or interfere with system operators' ability to protect system reliability."[24] The issue was particularly important because relay performance was one factor in the 2003 Blackout.[25]

The heart of the dispute when the FERC reviewed the standard in Order No. 733 was whether facilities operating at below 200 kV should be covered by the standard and, if so, in what manner.[26] The NERC had proposed a standard that would exempt those facilities unless they were deemed "critical" to reliability by system planners.[27] The FERC's NOPR had proposed to reject this "add in" approach because the FERC "expects a comprehensive review to identify *nearly every* 100 kV-200 kV facility as a critical facility."[28] The NOPR therefore

> proposed to direct the ERO to adopt a 'rule out' approach to applicability; that is, to modify PRC-023-1 so that it applies to relay settings on all 100 kV-200 kV facilities, with the possibility of case-by-case exceptions for facilities that are not critical to the reliability of the bulk electric system and demonstrably would not result in cascading outages, instability, uncontrolled separation, violation of facility ratings, or interruption of firm transmission service.[29]

There were also sharp disputes over whether the standard should apply only to steady state relay loadability or also to stable power swings, with the Commission concluding it should be the latter.[30]

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22. Order No. 743, *supra* note 17, at P 112; Order 743-A, *supra* note 17, at P 71.

23. Order No. 733, *Transmission Relay Loadability Standard*, 130 F.E.R.C. ¶ 61,221 (2010), 75 Fed. Reg. 16,913 (2010) [hereinafter Order No. 733].

24. *Id.* at P 1.

25. *Id.* at P 3.

> (Following the August 2003 blackout that affected parts of the Midwest and Northeast United States, and Ontario, Canada, NERC and the U.S.-Canada Power System Outage Task Force (Task Force) concluded that a substantial number of transmission lines disconnected during the blackout when load-responsive phase-protection backup distance and phase relays operated unnecessarily, i.e. under non-fault conditions. Although these relays operated according to their settings, the Task Force determined that the operation of these relays for non-fault conditions contributed to cascading outages at the start of the blackout and accelerated the geographic spread of the cascade.);

Order No. 733-A, *Order on Rehearing*, 134 F.E.R.C. ¶ 61,127 (2011) [hereinafter Order No. 733-A], Order No. 733-B, *Order on Reconsideration and Clarification*, 136 F.E.R.C. ¶ 61,185 (2011) [hereinafter Order No. 733-B].

26. Order No. 733-A, *supra* note 25, at PP 16, 50 n.67, Order No. 733-B, *supra* note 25, at P 4 (noting that proposed standard was intended to address Recommendation 21A of the 2003 Blackout Report, which recommended evaluating whether to cover facilities operating at 115 kV and 138 kV).

27. Order No. 733, *supra* note 23, at PP 6, 11, 20.

28. *Id.* at P 24 (emphasis added).

29. *Id.*

30. Order No. 733-B, *supra* note 25, at P 10

> (Rather than ordering the ERO to modify PRC-023-1 to address stable power swings, Order No. 733 directed the ERO to develop a new Reliability Standard that requires the use of protective relay systems that can differentiate between faults and stable power swings and, when necessary, phase-out relays that cannot meet this requirement.).

The FERC's NOPR was "unanimously opposed" by commenters, which argued that the "rule out" approach was "unnecessary, extremely costly, and potentially detrimental to reliability."[31] Similar to its approach to the BES Definition, the Commission reversed course in the Final Rule, finding that our "concerns about the 'add in' approach can be addressed by directing the ERO to modify Requirement R3 of the Reliability Standard to specify a comprehensive and rigorous test that all planning coordinators must use to identify all critical facilities."[32] The Commission cautioned, however, that this change in approach would not necessarily produce a significant change in *result* "because both approaches should ultimately result in the same list of critical facilities."[33] Not surprisingly, this rather large caveat did not quell the enormous protests that had accompanied the NOPR and so rehearing petitions ensued.[34] Again to its credit, the Commission adjusted course on rehearing, holding that,

> while the ERO is required to develop a test that will identify all facilities that must be made subject to the Reliability Standard in order for the Standard to achieve its purpose, and while we require that test to include some specific elements to provide assurance of its utility, the ERO may propose to comply with this requirement in a different manner than in the specific way set forth by the Commission, provided that the ERO can show that its alternative addresses the Commission's concern in an equally efficient and effective manner.[35]

Even with these concessions, however, the industry was not satisfied—no doubt fearing the Commission might reject anything but its preferred approach on compliance.[36] There thus ensued the most targeted debate on rehearing that had yet occurred over the scope of the Commission's jurisdiction. The heart of the debate shifted from the one at issue in Order No. 743 (the BES definition)—i.e., whether the Commission's *directive* under section 215(d)(5) was too restrictive—to the threshold question of whether the Commission had erred in issuing the directive *in the first instance* and, in particular, its failure to defer to the ERO's determination that certain matters need not be addressed in the standard (e.g., stable power swings).[37] The Commission denied rehearing and clarification on this issue,[38] but did so with an important concession (albeit an implicit one). The Commission did not explicitly quarrel with the notion that deference is owed both to the ERO's determination as to what to include in a

31. Order No. 733, *supra* note 23, at P 30.

32. Order No. 733-A, *supra* note 25, at P 15.

33. *Id.* at P 15 n.21.

34. *Id.* at P 9 (The central legal arguments on rehearing were that (i) the Commission had failed to defer to the technical expertise of the ERO, as required by section 215(d)(2), by failing to approve its approach and, instead, substituting its own view of the lessons learned from the 2003 Blackout Report, and (ii) then compounded this error by adopting a directive under section 215(d)(5) that is "so prescriptive that it denies the ERO the ability to exercise its technical discretion.").

35. *Id.* at P 13.

36. *Cf.* Moot, *supra* note 4, at 319 ("Deference must also be real and not simply a bunch of words on paper. Given the complexity of the issues, the FERC can always, if it so chooses, chide the NERC for failing to provide more explanation, consider more alternatives, or provide more technical foundation for its proposals.").

37. Order No. 733-B, *supra* note 25, at P 25

> (According to EEI/NRECA, a proposed Reliability Standard is the product of the ERO's technical judgment with respect to both what it contains and what it omits. With this premise, any directive addressing the context of the proposed Standard must overcome the obligation to accord due weight to the ERO's technical judgment.).

38. *Id.* at P 27.

standard and what to omit from that standard. Rather, it grounded its decision on an alleged failure to *adequately explain* the omission at issue, finding:

> EEI/NRECA argue that an *unexplained* omission is an exercise of the ERO's technical expertise and thus entitled to due weight. We disagree, and find that it is unreasonable to read the statute as requiring the Commission to give due weight to an omission *when there is no evidence in the record to explain that omission*. Without such evidence, the Commission would have no basis for evaluating the reasoning behind the omission or for determining whether the omission prevented the proposed Reliability Standard from satisfying the statutory standard of review. Thus, the Commission must give due weight to an omission when the ERO explains the technical basis behind the omission in an initial filing, response to a Commission data request, supplemental filing, comments on a notice of proposed rulemaking, or other filing in the record. We do not read section 215(d)(2) as requiring the Commission to give due weight to an *unexplained omission*. . . .[39]

The FERC's effort to articulate a more flexible standard thus ended on a decidedly more sour note in Order No. 733 than in Order No. 743. These differences are important and will be addressed in the next section.

b. Orders No. 733 and 743 Illustrate that the Standard for Deference is Easier to Articulate than it is to Apply

Order Nos. 733 and 743 represent important but different pillars in the FERC's evolution to a clearer standard of review. In both cases, the Commission addressed difficult and important reliability issues and, in both instances, moved from a highly prescriptive initial directive under section 215(d)(5) to a more flexible one on rehearing. In Order No. 743, the Commission reaffirmed its prior commitment in Order No. 693 to provide flexibility to the NERC in implementing the FERC's directives.[40] Although this was an important policy reaffirmation, perhaps the more important debate occurred in Order No. 733-B. There, the FERC provided its most detailed explanation to date regarding when the NERC will be deemed to have provided an "adequate explanation" for its position.[41] This is a particularly pivotal issue because it determines whether the NERC should receive deference in the first instance that would avoid the need for any directives.[42]

Both sides were right to a certain degree in Order No. 733-B. The industry was correct to demand that the FERC provide true deference to the ERO, not deference in word only. It was also right to insist on deference as to the *scope* of a standard, which necessarily includes deference to decisions on issues that

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39. *Id.* at P 29 (emphasis added).

40. Order No. 743, *supra* note 17, at PP 1, 35.

41. Order No. 733-B, *supra* note 25, at P 33.

42. The Commission is required to give "due weight" to the NERC's technical expertise when it submits a proposed reliability standard to the FERC. 16 U.S.C. § 824*o*(d)(2). If, pursuant to that standard, the Commission defers to the NERC's technical expertise and approves the proposed standard, it is less likely, all other things equal, to issue directives under section 215(d)(5) to modify the standard on a prospective basis. *Id.* § 824*o*(d)(5). That being said, the FERC has often done both at the same time since Order No. 693 was adopted—i.e., both deferring to NERC's expertise that the proposed standard is superior to the existing standard (or no standard at all), but nonetheless issuing a directive that requires further improvements on a prospective basis. Order No. 693, *Mandatory Reliability Standards for the Bulk-Power System*, FERC Docket No. RM06-16-000 at PP 29, 34 (2007) [hereinafter Order 693].

might *not* be covered by the standard.[43] However, the FERC was also correct to find that any such determination by the NERC on the scope of a standard be *adequately explained*.[44] And therein lies the problem: the recurring quandary over how much explanation is "adequate" to trigger deference and whether the FERC will ever defer to an explanation that supports a position with which it disagrees.

The FERC confronts a similar quandary when its decisions are reviewed in court. The standards for judicial review of agency action are well settled, but even a well explained agency order can be reversed if the panel reviewing it does not agree that the agency's explanations are "rational"—which inescapably involves subjective judgments regarding the *substance* of the decision being reviewed. Not surprisingly, there is scholarship questioning whether judicial standards of review—no matter how well designed—can ever be applied in a truly neutral fashion.[45]

The debate over deference in the reliability arena is further complicated by often unstated assumptions regarding the nature of reliability regulation itself. One view is that it is a highly technical area where there tends to be one right engineering answer to every important problem. An alternative view is that, although the field is indeed highly technical, many important reliability issues present difficult tradeoffs to which there are no single right answers. These can involve, for example, trade-offs between the desire to improve reliability and the objective of not incurring unnecessary costs on behalf of consumers. They can also involve trade-offs between the desire to draft standards with sufficient specificity to be enforceable and the need to provide implementation flexibility that recognizes the wide diversity of registered entities.

The choice between these characterizations of reliability regulation necessarily affects one's view of the deference question. The author believes the latter view—i.e., that reliability regulation often requires difficult trade-offs—is the more realistic one,[46] but, whichever view is correct, my more fundamental concern is that the recurring tension over the appropriate level of deference will never be resolved (or at least narrowed) unless there is an open and transparent debate over *why* deference is appropriate in the first instance. One cannot decide whether deference is appropriate in a given case without first understanding why deference is a good (or bad) thing in general.

For example, the industry has often argued that deference is appropriate because the NERC, working with industry volunteers, has "more" expertise than

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43. Moot, *supra* note 4, at 318 ("This issue is also closely related to the first issue because each time the FERC orders a standard modified under section 215(d)(5), it has essentially chosen not to defer to the NERC's determination that the standard was acceptable as written.").

44. *Id.* at 319 ("If the NERC provides a rational explanation for a proposed standard, the FERC should approve it without proposed modifications - even if the FERC would have reached a different result considering the matter de novo.").

45. *See, e.g.*, Thomas J. Miles and Cass R. Sunstein, *The Real World of Arbitrariness Review*, 75 U. CHI. L. REV. 761 (2008) (examining empirical data on whether *Chevron* deference is applied differently depending on the political views of the reviewing panel); J. HARVEY WILKERSON III, COSMIC CONSTITUTIONAL THEORY: WHY AMERICANS ARE LOSING THEIR INALIENABLE RIGHT TO SELF-GOVERNANCE (Oxford Univ. Press 2012) (critiquing main theories of Constitutional interpretation, including original intent and process theory, as insufficiently vague to constrain judicial lawmaking).

46. Moot, *supra* note 4, at 319 ("There is no single, perfect solution to most problems in the real world.").

does the FERC. That, of course, is true: the industry has far more engineers and more practical experience than the FERC staff. This rationale therefore provides a sound theoretical argument for deference, but it may carry less weight with the FERC itself because it suggests that the FERC's staff may simply be "wrong" when it raises objections to certain industry-sponsored solutions. By contrast, the FERC, as an institution, is more likely to defer to an industry-supported solution when the case can be made that the solution involves difficult trade-offs that have been adequately balanced through an open and transparent process. For example, this is the primary reason the FERC defers to ISOs or RTOs on questions involving transmission cost allocation or market design—despite the fact that many economists would argue that there are often "right" and "wrong" answers to many of those questions (particularly as they relate to market design).[47]

c. Future Challenges: BES and Vegetation Management

There are two important reliability standards pending for approval that will again raise important questions of deference and thereby potentially renew conflicts between the FERC and the NERC in this area. The first involves the revisions to the BES definition required by Order No. 743;[48] the second involves the changes to the vegetation management standard, FAC-003-002, required by Order No. 693.[49] The two proposals have several things in common, including that they respond to the Commission's directives to strengthen the existing standard (or definition) on an important issue and both involve certain, highly technical judgments that are critical to grid reliability.

In the case of the revised BES definition, the Commission recently issued a notice of proposed rulemaking that would approve the NERC's proposal regarding the "bright line" test associated with facilities 100kV and above.[50] Importantly, the FERC proposed to approve an important exception to this bright line test for certain "local area network" facilities.[51] The exception is limited in several critical respects, including when (i) power only flows into the local network, but not out of the local network, and (ii) the total capacity of all non-retail generation within such network is 75 MVA.[52] These limitations were designed, in part, to address the Commission's longstanding concern that "some

47. *See, e.g.*, Order No. 1000, *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, 136 F.E.R.C. ¶ 61,051 at P 604 (2011) ("We adopt the use of cost allocation principles because we do not want to prescribe a uniform method of cost allocation for new regional and interregional transmission facilities for every transmission planning region. To the contrary, we recognize that regional differences may warrant distinctions in cost allocation methods among transmission planning regions."); *PJM Interconnection LLC*, 117 F.E.R.C. ¶ 61,331 at P 5 (2007) (approving market design for PJM capacity markets based and giving significant weight to broad stakeholder support).

48. Notice of Proposed Rulemaking, *Revisions to Elec. Reliability Org. Definition of Bulk Elec. Sys. and Rules of Procedure*, 139 F.E.R.C. ¶ 61,247 (2012), 77 Fed. Reg. 39,857 (July 5, 2012) [hereinafter BES NOPR].

49. Petition of NERC for Approval of Interpretations to Reliability Standard FAC-003-2, FERC Docket No. RM12-4-000 (Dec. 21, 2011).

50. BES NOPR, *supra* note 48, at P 1.

51. *Id.* at PP 25-26.

52. Petition of NERC for Approval of a Revised Definition of the "Bulk Electric System," at 14, Docket No. RM12-6-000 (Jan. 25, 2012).

regional definitions of bulk electric system exclude facilities below 230 kV and transmission lines that serve Washington, DC and New York City."[53]

However, the BES definition is not out of the woods yet. The NOPR poses numerous technical questions regarding how the BES definition and its exceptions would apply to particular electrical configurations. Importantly, the Commission warned that the answers to these questions would influence whether it ultimately approves the proposal without conditions. The FERC cautioned that,

> [a]lthough we propose to approve the definition in this rulemaking, the responses to our questions are also intended to guide the Commission as to whether other action may be necessary, for example, directing NERC to develop a further modification to the core definition, inclusions or exclusions pursuant to section 215(d)(5) of the FPA.[54]

It therefore remains unclear whether the BES definition will be approved without the types of additional directives under section 215(d)(5) that have proven contentious in the past.

The revised vegetation management standard may face a more promising future, although the ultimate outcome is not yet clear. In Order No. 693, the Commission approved the proposed vegetation management standard, but criticized the standard for measuring appropriate clearances between trees and conductors, finding that "use of IEEE clearance provision as a basis for minimum clearance prior to the next tree trimming as a Requirement in vegetation management is not appropriate for safety and reliability reasons."[55] Nearly five years later, the NERC responded with a revised standard that, *inter alia*, adopted new criteria for determining such clearances based on the "Gallet Equation."[56] The FERC's Office of Electric Reliability immediately commissioned a study by an arm of the Department of Energy (DOE) to assess whether this criteria was technically sound. After several months, the DOE laboratory issued a report that was highly critical of using the Gallet Equation for tree clearances, finding "there is no evidence that the statistics relating tower design parameters are useable with trees."[57] The industry immediately responded by urging the FERC to change the way its staff participates in the standards development process to avoid similar problems in the future.[58] The process issues raised by the pending FAC-003-2 standard are discussed immediately below.

Despite the concerns raised by the DOE laboratory report, in October 2012 the Commission issued a Notice of Proposed Rulemaking that proposed to

53. NOPR *Revision to Reliability BES Definition*, *supra* note 16, at P 6.

54. BES NOPR, *supra* note 48, at P 49.

55. Order No. 693, *supra* note 42, at P 731.

56. Petition of NERC for Approval of Interpretations to Reliability Standard FAC-003-2, *supra* note 49, at 5.

57. H. KIRKHAM, APPLICABILITY OF THE "GALLET EQUATION" TO THE VEGETATION CLEARANCES OF NERC RELIABILITY STANDARD FAC-003-2 iv (Pac. Nw. Nat'l Lab. Mar. 2012).

58. Comments of Edison Electric Institute, American Public Power Association, National Rural Electric Cooperatives Association, and Electric Power Supply Association, FERC Docket No. RM12-4-000 (May 23, 2012).

approve NERC's proposed standard, subject to certain conditions.[59] The Commission found that the proposed standard was superior to the existing standard in certain important respects, such as expanding its application to critical facilities operating at below 200 kV.[60] With respect to the concerns raised by the DOE laboratory report, the FERC found that, based on the supplemental information provided by the NERC in response to the report, "the application of the Gallet equation appears to be one reasonable method to calculate [minimum vegetation clearance distance (MVCD)] values."[61] The FERC cautioned, however, that its decision in this regard was "based on our understanding, which is drawn directly from NERC's statements in its petition, that transmission operators will manage vegetation to distances *beyond the MVCD* to ensure no encroachment into the MVCD."[62] The FERC also highlighted a statement by the NERC that such clearances would need to be "well away from the spark-over zone."[63] It is unclear whether these caveats (or the other conditions in the proposed rule) will prove controversial, such as by raising compliance concerns regarding what constitutes "beyond" or "well away" from the spark-over zone. Yet, even so, the proposed rule appears to represent a significant effort by the FERC to defer to the NERC's technical expertise on an important and highly technical issue—even where NERC's determination has been questioned by an independent source.

These two important standards are also notable in that they highlight the two different cases for deference discussed in the prior section. The debate over the revised vegetation management standard is closer to a pure engineering debate as to whether the Gallet Equation is the "right" or "wrong" method to measure clearances between conductors and trees. By contrast, the BES definition presents more complex issues of balancing the need for a generic national definition with the need for flexibility to address differences that arise in each region (or each system). They therefore present a good vehicle to elevate the debate over *why* deference is appropriate (or not) in the first instance, which, in my view, is a predicate to determining *whether* it should be granted in any particular case.

2. The FERC's Processes for Reviewing Proposed Reliability Standards

The FERC has been correct to question whether the ANSI process is the optimal process for developing proposed reliability standards and to urge continuing improvements to that process. However, the FERC's own processes for reviewing reliability standards may merit a second look. Since the adoption EPAct 2005, the FERC has used a traditional rulemaking approach to review most proposed reliability standards.[64] Under this approach, the NERC submits a

59. Notice of Proposed Rulemaking, *Revisions to Reliability Standard for Transmission Vegetation Management*, 141 F.E.R.C. ¶ 61,046 (2012).

60. *Id.* at P 57.

61. *Id.* at P 71.

62. *Id.* at P 70 (emphasis added).

63. *Id.* at P 69.

64. Notice of Proposed Rulemaking, *Mandatory Requirements for the Bulk Power System*, 117 F.E.R.C. ¶ 61,084 at P 41 (2006) ("While we anticipate that the Commission would address through the rulemaking process most, if not all, new Reliability Standards proposed by NERC, certain modifications may be appropriately addressed by order.").

proposed reliability standard and the standard is not "noticed" for public comment (as in an adjudication). Rather, the FERC staff undertakes an internal evaluation of the proposal and then, once the Commission has decided on a potential course of action, it issues a notice of proposed rulemaking that proposes to approve the standard, remand it, or approve it with directives for subsequent modifications.[65] The Commission then receives and reviews comments on its NOPR and issues a final rule responding to any such comments and making adjustments, as appropriate, to its initial proposal.

This procedural approach was strongly supported by all industry groups at the time the first reliability standards were considered in Order No. 693, and it has two primary benefits. First, it provides significant benefits in terms of openness (i.e., no *ex parte* restrictions) and, second, it provides the opportunity for interested persons to respond to any of the FERC's concerns as expressed in the NOPR. However, the process also has costs in terms of both delay and uncertainty. The FERC rulemakings normally take one to two years to complete and reliability rulemakings have proved to be no exception. For example, the rulemaking proceeding on relay loadability discussed above took nearly two years to complete and nearly one year just to issue a notice of proposed rulemaking. The process is longer if rehearing orders are considered. Similar time periods have been required for more significant interpretations of reliability standards (e.g., nearly two years to review an interpretation of the transmission planning standard, TPL-002-0, R1.3.10).[66] A similar lengthy process can be expected for the BES definition and vegetation management rulemakings. This lengthy process also can produce unpredictable results, with the FERC often sending the NERC back to the drawing board to significantly revamp the standard pursuant to section 215(d)(5).[67]

There is something wrong with this picture. Although the FERC's current process tracks its approach in other rulemakings, the FERC has a more difficult task in rulemakings where it initiates the proposed reforms, including identifying the subject area that merits reform, drafting from scratch an initial proposal, parsing through thousands of pages of comments, and then issuing a final rule that responds adequately to comments and adjusts the initial proposal as appropriate. By contrast, the NERC's proposed standards represent the culmination, not the beginning, of an open process in which similar tasks have already been performed, including drafting an initial proposal, posting it for comment by all affected stakeholders, responding to those comments, and modifying the proposal as necessary to improve it. Equally important, and for the same reasons, most proposed reliability standards are unopposed at the FERC or receive only minor comments. Although the ANSI process is not without flaw (as discussed in the next section), one major benefit is that the FERC receives proposals that are widely supported by all industry groups and, indeed, the FERC has even discouraged entities from raising objections for the first time once a standard is filed with the FERC.[68]

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65. *See, e.g.*, Order No. 693, *supra* note 42, at P 184.

66. Order No. 754, *Interpretation of Transmission Reliability Planning Standard*, 136 F.E.R.C. ¶ 61,186 (2011) [hereinafter Order No. 754].

67. Federal Power Act § 215(d)(5), 16 U.S.C. § 824*o*(d)(5).

68. Order No. 693, *supra* note 42, at P 188.

I would therefore suggest that reforms to the current process be considered. There is admittedly no simple solution. For example, it would be unrealistic and mistaken to argue that the FERC should act swiftly to approve all standards submitted to it. The Commission has an important duty in reviewing reliability standards and that duty cannot be discharged with a rubber stamp. Rather, the Commission and its staff must exercise care in reviewing the NERC's standards, particularly the most important ones, and this requires determining whether there is sufficient information to support them, and whether there are significant problems that could be addressed prospectively through a section 215(d)(5) directive. Moreover, the agency's workload in this area continues to grow, making it more challenging, not less, to increase the speed and predictability with which proposed standards are reviewed.

With these large caveats in mind, one option that could make the process more efficient and predictable is to change the way the FERC's technical staff participates in the standards development process. Currently, the agency's staff participates actively but informally during the standards development process by monitoring the drafting of standards and providing oral comments to the drafting teams where appropriate. This approach probably makes sense for most standards development projects, but on a few of the highest priority standards a more formalized process may make sense. The recent examples of the BES definition and vegetation management standard illustrate the need to consider such a process. In both instances, an important standard (or definition) was developed after a lengthy and open process, but the end result still created important questions that had not, in the view of the Commission or its staff, been adequately answered. Answering these questions may add another two years to the process and, in the end, require even further revisions.

One possible reform is for the Commission's technical staff to submit written comments *during* the standards development process on some of the most important reliability standards. Such written comments could take two primary forms. The could: (i) address the *merits* of the proposed standard, raising technical objections or concerns, or (ii) alternatively, provide comments on the *record* being developed to ensure that the Commission has adequate information when the standard is filed for review. This latter approach—focusing on the record, not the merits—would be closer to Commission staff's traditional role in assisting jurisdictional companies with "pre filing" meetings. In this context, staff tend to focus on the issues that need to be addressed in the filing, as opposed to offering opinions on the merits of whatever is being proposed. Using the vegetation management standard as an example, the Commission staff could have provided written comments providing guidance on the record necessary to show that the equation can be applied to tree clearances, which might have avoided the perceived need for an independent study to complete the record.

To be sure, the Commission staff ordinarily does not issue written comments in other areas of Commission regulation, except in the rare case when the Commission requests that it issue a "white paper" for comment.[69] Rather, the staff's normal role is to advise the Commission behind the scenes, a posture

69. *See, e.g.*, FERC, STAFF WHITE PAPER: WHOLESALE POWER MARKET PLATFORM, Docket No. RM01-12-000 (Apr. 28, 2003).

that has several benefits, including protecting the staff from public criticism, and reflecting the reality that the Commission speaks only through its orders, not through its staff. However, reliability is somewhat different in three important respects: (i) the subject matter is more technical than most areas of FERC regulation, thereby increasing the importance of the technical advice of agency staff;[70] (ii) the standards development process is open and transparent, and therefore provides a forum to consider staff comments; and (iii) there are significant costs associated with disapproval of a standard by the FERC because the FERC has no authority to rewrite a standard, but rather sends the industry back to the drawing board if it is dissatisfied.

Given these factors, it would seem worthwhile to consider a way in which staff can provide written technical comments on standards before they arrive at the Commission if it has significant concerns regarding a proposal that is working its way through the standards development process. Of course, for this proposal to have benefits, the NERC and the industry would have to give significant weight to the views of staff, such as modifying the proposal to address staff's concerns or, at a minimum, providing a complete record to address them.

B. The Role of NERC and Industry: Can the Self-Regulatory Model Be Strengthened?

1. Diagnosing "the Problem"

The FERC has long been suspicious of the ANSI process from the moment Congress gave it the authority to regulate reliability matters in EPAct 2005. These concerns have traditionally fallen into two categories: (i) the process is too slow, and (ii) it tends to produce standards that are watered down.

With respect to the first, Order No. 672 cautioned that, although "the ANSI-certified process would ensure openness and balance the interests of stakeholders . . ., we are concerned about the time it may take to develop a Reliability Standard under the ANSI-certified process."[71] The Commission repeated this concern when certifying the NERC as the ERO, but noted that the NERC had indicated in its application that the ANSI process could produce standards within a year or so in most instances.[72] In its order on the three-year performance review of the NERC, the Commission again reiterated these concerns, finding that the standards development process was taking even longer than initially projected by the NERC.[73] However, the FERC stated that "we are

70. Perhaps the most comparable area of technical rigor is the infrastructure siting process where, notably, staff has arguably more delegated authority than in any other area. *See generally* 18 C.F.R. § 375.308 (2012) (setting forth a broad range of delegations to the Director, Office of Energy Projects).

71. Order No. 672, *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, FERC Docket No. RM05-30-000 at P 269 (2006) [hereinafter Order No. 672].

72. *North Am. Elec. Reliability Corp.*, 116 F.E.R.C. ¶ 61,062 at P 252 (2006) [hereinafter ERO Certification Order] ("NERC's application indicates that, under its proposed ANSI-accredited regular process a Reliability Standard may be developed in as little as four months or up to 12 to 15 months for a more complex standard.").

73. *North Am. Elec. Reliability Corp.*, 132 F.E.R.C. ¶ 61,217 at P 81 (2010) [hereinafter Order on Three-Year Assessment]

encouraged by the multiple action items that NERC intends to implement or has already implemented to improve the time required to develop Reliability Standards."[74] Subsequently, in approving those reforms, the Commission stated that it "agrees with NERC that improvements to the procedures, including added flexibility over the timing of new projects, informal stakeholder feedback, and a formal comment opportunity during the ballot period will provide for more efficient Reliability Standard processes."[75]

The FERC's second concern has been that the super-majority voting requirement (i.e., the need for a 67% vote of the ballot pool to approve a standard) can produce weaker standards that necessary to protect the grid. In Order No. 672, the Commission stated that "[t]he proposed Reliability Standard must not simply reflect a compromise in the ERO's Reliability Standard development process based on the least effective North American practice—the so-called 'lowest common denominator'—if such practice does not adequately protect Bulk-Power System reliability."[76] The Commission repeated this concern in certifying the NERC as the ERO and added the further caution that "[w]e are concerned that some process participants may support only those Reliability Standards that validate their current practices."[77] The Commission reiterated this concern again in its Order on NERC's three-year assessment.[78]

In the same vein, the Commission has expressed concern that NERC have the independent capability and expertise to assess the quality of the standards being drafted by industry volunteers and voted on by the registered ballot body:

> [T]he Commission expects that NERC should have or acquire the necessary high level of internal technical expertise to further the development and improve the quality of proposed Reliability Standards. *Utilization of industry technical expertise does not discharge the ERO of its obligation to ensure Reliability Standards are developed that are responsive to the Commission's orders and provide for reliable operation of the Bulk-Power System*. NERC anticipates over 35 Reliability Standards development projects and needs to be technically fluent about all of these projects to ensure that the development of the standards and NERC's subsequent approval or remand are based on its own technical expertise in addition to that of the industry's used to help draft the standards.[79]

Although the FERC later clarified that it was not expecting the NERC to override the ANSI process, the FERC nonetheless repeated its expectation that the NERC's "responsibilities . . . cannot be successfully carried out unless the

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(In its application for certification as the ERO, NERC indicated that under its usual ANSI-accredited process in effect at the time, a Reliability Standard may be developed in as little as four months, or up to 12 to 15 months for a more complex Standard. However, the NERC analysis submitted in this docket indicates that, in practice, it has taken considerably longer, an average processing time of 21.7 months, to develop Reliability Standards.).

74. *Id.* at P 82.

75. *North Am. Elec. Reliability Corp.*, 132 F.E.R.C. ¶ 61,200 at P 7 (2010).

76. Order No. 672, *supra* note 71, at P 329.

77. ERO Certification Order, *supra* note 72, at P 240.

78. Order on Three-Year Assessment, *supra* note 73, at P 74 ("We . . . remain concerned about the ability of the NERC Reliability Standards Development Process to develop high quality Reliability Standards that not only protect, but improve, the reliable operation of the Bulk-Power System.").

79. *North Am. Elec. Reliability Corp.*, 125 F.E.R.C. ¶ 61,056 at PP 24-25 (2008) (emphasis added).

NERC Reliability Standards Program has a sufficiently 'deep' staff of personnel with the requisite expertise."[80]

2. Potential Reforms of the Self-Regulatory Model

The NERC and the industry have not been complacent in the face of the FERC's concerns regarding the ANSI process. The process reforms adopted in 2010 were significant and, since that time, the NERC and the industry have continued to evaluate further reforms. In late 2011, the NERC organized the Standards Process Improvement Group (SPIG) to evaluate changes that could improve prioritization of standards developments projects and accelerate the process for considering them.[81] The SPIG recommended retaining ANSI accreditation, but adopted several improvements to "[l]imit [the] application of requirements that can hinder progress," such as "bundl[ing] responses to comments, . . . post[ing a] draft standard for informal comment period . . . but not be required to respond to comments, . . . [and] promot[ing] an automated system for managing comments."[82] More significantly, the SPIG recommended the creation of a Reliability Issues Steering Committee (RISC) that reports directly to the Board of Trustees and is expected to play a key role in prioritizing standards projects and ensuring that timelines are met.[83]

Are these reforms sufficient or should further reforms be considered? The answer turns on one's perspective. If one believes the existing process has systemic flaws, the recent reforms will be viewed as only tinkering at the margins. If, however, one believes the process is generally sound, the reforms should be given a chance to work. The author falls somewhere in the middle. I believe the existing process has significant value and should generally be retained and improved, but nonetheless that one other reform should be considered.

a. The ANSI Process: Is it the Problem or a Necessary Part of the Solution?

The FERC has long been skeptical of the ANSI process, whereas the NERC and the industry have long defended it. In assessing this debate, it is important to break the problem into two pieces: (i) whether there is "too much process" generally (e.g., the multiple steps for nominating, drafting, commenting on, and voting on standards); and (ii) whether the super-majority voting requirement should be retained.

With respect to the first issue—i.e., whether is "too much process"—I would suggest that, although the process should be streamlined as much as possible, the basic steps built into the process are generally sound. Most of them are designed to provide due process to affected persons and, in that regard, are not significantly different in substance (albeit different in form) than the FERC's own procedures for ensuring that interested parties receive due process. They

80. *North Am. Elec. Reliability Corp.*, 126 F.E.R.C. ¶ 61,021 at P 13 (2009).

81. NERC, MEMBER REPRESENTATIVES COMM. & STANDARDS PROCESS INPUT GRP., RECOMMENDATIONS TO IMPROVE THE NERC STANDARDS DEVELOPMENT PROCESS 1 (Apr. 2012) [hereinafter SPIG REPORT].

82. *Id.* at 4, 14.

83. *Id.* at 6.

include, *inter alia*, the requirement that: (i) the process be "open to all persons who are directly and materially affected by the activity in question," (ii) decisionmaking "shall not be dominated by any single interest category, individual or organization," and (iii) "[p]rompt consideration shall be given to the written views and objections of all participants."[84] It is hard to argue that these are protections that should be eliminated.[85]

That being said, there is an important difference between sound processes and achieving results. For example, the checks and balances inherent in the United States' system of government are often viewed as sound, but that does not mean they should be used as an excuse for failing to pass legislation that addresses critical national problems. The same is true of the self-regulatory model for reliability regulation. It has real benefits and can succeed over time, but lawmakers will rightly question its legitimacy if important standards continue to take five years to be developed and, even then, deadlocks remain on some of them. Indeed, self-regulatory models have tended to cede authority to the federal government when they have been perceived as failing to address important problems.[86]

This leads me to the second prong of the debate—whether super-majority voting should be retained. Both sides of this debate have merit. On the one hand, the requirement ensures that the standards are broadly supported and this has social utility beyond the quaint notion that compromise is good in matters of politics and policy. The social utility comes from the fact that consensus streamlines and simplifies the FERC's review process, ensures that new standards are not tied up in the courts (which infects so many agency regulations today), and facilitates compliance. On the other hand, the super-majority voting requirement has costs. By way of comparison, consider the need for sixty votes in the United States Senate to pass important legislation: the requirement encourages consensus, but also increases the possibility of for deadlock. The potential "deadlock" in the reliability area is not political, but the costs, in terms of extended delays (or, as the FERC has suggested is possible, watering down the content of new standards to gain super-majority approval), are nonetheless real.

Is there a middle ground that retains the consensus requirement but reduces the prospect that it will create delays? I would suggest there are two basic options in this regard. The first is to reduce the voting requirement to a lower threshold (e.g., 50%). This reform could accelerate the process at the front end, but I would recommend against it because it would simply add more time at the back end by making the FERC review process more contentious. Delays at the back end are particularly problematic because the FERC's authority is limited to

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84. AMERICAN NAT'L STANDARDS INST., ANSI ESSENTIAL REQUIREMENTS: DUE PROCESS REQUIREMENTS FOR AMERICAN NATIONAL STANDARDS 4 (Jan. 2012). *See also* NERC RULES OF PROCEDURE, § 304 (2012) *and* NERC STANDARDS PROCESS MANUAL, APPENDIX 3A at 3-4 (2012) (repeating essential requirements for ANSI accreditation).

85. It is worth noting that the National Technology Transfer and Advancement Act of 1995 (NTTAA) directed federal executive agencies, subject to certain exceptions, "to use technical standards that are developed or adopted by voluntary consensus standards bodies." National Technology Transfer and Advancement Act of 1995, H.R. 2196, 104th Cong. § 12 (1995) (enacted).

86. Moot, *supra* note 4, at 324-26 (discussing other self-regulatory models where Congress gradually gave more authority to federal agencies to draft rules in the first instance).

approving or remanding a standard (or directing prospective changes), not rewriting a standard to address concerns that were not resolved in the standards development process. The second option is to give the NERC greater authority to break a deadlock and thereby provide stronger incentives for the industry to reach consensus in the first instance. I turn to this option immediately below.

b. Strengthening the NERC's Authority to Break a Voting Deadlock

The NERC's traditional role in the standards development process has been two-fold. The first role involves NERC staff, which acts primarily as facilitator of the process. The NERC's "Reliability Standards staff works to ensure the integrity of the Reliability Standards processes and consistency of quality and completeness of the Reliability Standards" and also "facilitates all steps in the development of Reliability Standards, definitions, Variances, Interpretations and associated implementation plans."[87] The second role involves the Board of Trustees, which has the ultimate authority to approve any standard that is approved by the ballot pool.[88] However, similar to the FERC's authority, the Board of Trustees can only "adopt or reject a Reliability Standard and its implementation plan, but shall not modify a proposed Reliability Standard."[89] Unlike the FERC's authority, however, the Board's role is defined by the NERC Rules of Procedure, not section 215 of the EPAct of 2005.

The role expected of the NERC has slowly evolved since the implementation of EPAct 2005. In 2010, the NERC added section 321 to its Rules of Procedure to address the situation where a ballot pool is unable to respond to a FERC directive (either because it disagrees with that directive or cannot muster the necessary votes).[90] This section—adopted in response to a FERC order expressing frustration with the ballot pool's ability to defeat a FERC directive[91]—provides the Board of Trustees the authority to approve a standard that receives only 60% approval by the ballot pool (rather than two-thirds majority) and, even more significantly, to draft and approve a standard on its own if the ballot pool fails to approve a standard responsive to the FERC's directive.[92] In addition, the FERC has raised expectations (as noted above)[93] for the role of the NERC's staff, finding that it should "ensure that [reliability standards] . . . are based on its own technical expertise in addition to that of the industry's used to help draft the standards."[94]

Consistent with this evolving role for the NERC, I would suggest that, rather than eliminate or dilute the super-majority voting requirement, the better solution would be to give the NERC Board of Trustees greater authority to prevent or remedy breakdowns in the process. The SPIG reforms take a significant step in this direction by creating a committee (the RISC) that reports directly to the Board and has authority to establish timelines for the development

87. NERC STANDARDS PROCESS MANUAL, APP. 3A, at 9 (2012).

88. NERC RULES OF PROCEDURE § 308 (2012).

89. NERC STANDARDS PROCESS MANUAL, APP. 3A, at 20.

90. NERC RULES OF PROCEDURE § 321.

91. *North Am. Elec. Reliability Corp.*, 130 F.E.R.C. ¶ 61,203 at P 3 (2010).

92. NERC RULES OF PROCEDURE § 321(4).

93. *See supra* Section II.B.1.

94. *North Am. Elec. Reliability Corp.* 125 F.E.R.C. ¶ 61,056 at PP 24-25 (2008).

of standards and otherwise assure that the most important projects receive prioritization.[95] This type of reform helps to prevent breakdowns in the standards development process. However, because those breakdowns remain possible on difficult issues—e.g., reforming BAL-003-0 to address frequency response, which implicates difficult questions of allocating responsibility among various functional areas—it is therefore worth considering whether additional reforms are appropriate.

One option would be to expand the authority of the NERC Board of Trustees under section 321 of the Rules of Procedure to other high-priority matters that the ballot pool has been unable to resolve. To preserve the integrity of the ANSI process, the reform could be limited in several important respects, such as limiting it to (i) matters deemed by the Board and RISC to be of the highest priority, and (ii) only where the drafting teams and ballot pools have had sufficient time to resolve the matter, but have failed to do so. For example, if a significant new reliability threat emerged, the Board and RISC could establish a timeline for the related standards development project to be concluded and, if it was not completed by that time, the Board's authority under section 321 (or a close analog) would be triggered, empowering the Board to propose a standard on its own.

There may be concerns by some in the industry over this proposal, but, in my view, it could strengthen the self-regulatory model, rather than weaken it. For the self-regulatory model to be effective over the long term, it must be able to address the most difficult and highest priority reliability issues *on its own initiative*, not simply in response to a governmental directive. Yet the Board of Trustees currently has section 321 authority only when necessary to respond to a FERC directive, which casts its role as reactive, not proactive and independent.[96] This means that, if the RISC and the Board of Trustees identify a new issue as high priority on their initiative, but the ballot pool does not approve a standard to address it, the process will have failed unless the FERC steps in and issues a directive, thereby empowering the Board to act under section 321 (albeit after multiple additional stages of process). Admittedly, there may well be other less intrusive ways to strengthen the self-regulatory model, but this is certainly one reform that should be considered.

III. ENFORCEMENT PROGRAM REFORMS: ALIGNING CIVIL PENALTIES WITH CORPORATE CULPABILITY AND MODIFYING THE FULL DISGORGEMENT POLICY

When the FERC began imposing significant penalties after EPAct 2005 on a case-by-case basis, there were concerns that the FERC was punishing acts that were not intentional violations of the law, but rather compliance mistakes or good faith mistaken interpretations of the rules. When the FERC in 2010 decided to adopt the Criminal Sentencing Guidelines for Organizations as the model for calculating civil penalties, these concerns had a clear forum in which to be voiced. The concerns were further heightened by the large fines emanating from the penalty schedules adopted by the Proposed Penalty Guidelines. For example, the industry complained to the FERC that "using the Sentencing

95. SPIG REPORT, *supra* note 81, at 8.

96. NERC RULES OF PROCEDURE § 321 (2012) ("Special Rule to Address Certain Regulatory Directives").

Guidelines as a model for the Commission's assessment of penalties is inappropriate because violations in the civil regulatory context are often unintentional, narrowly focused errors arising from complex and obscure regulations, whereas the Sentencing Guidelines focus on intentional or reckless behavior."[97]

In response to industry criticism, the FERC made many laudable improvements to its proposed Penalty Guidelines, but held its ground on this point, finding that:

> The Commission does not agree that our use of the Sentencing Guidelines' analytical structure reflects a failure to appreciate distinctions between criminal and civil law. There is nothing inherently "criminal" in the Sentencing Guidelines, just as there is nothing inherently "civil" or "regulatory" about the Penalty Guidelines. Neither the Sentencing Guidelines nor the Penalty Guidelines create or define prohibited conduct. Each is simply an analytical tool designed to provide objectivity, consistency, and transparency in penalty determinations. The prohibited conduct is supplied by statutes, rules, and regulations that exist independent of the guidelines.
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> ***
>
> The Commission's ability to impose significant monetary penalties under the Penalty Guidelines for statutory and regulatory violations that do not require proof of intent or recklessness is *not* a function of using the Sentencing Guidelines as a model for our Penalty Guidelines. Rather, it is a result of a Congressional determination that persons and organizations that violate the statutes we administer can be subjected to civil penalties of up to $1 million per day per violation.[98]

The FERC's response on this issue was correct as far as it went. There is indeed nothing inherently criminal in using penalty "schedules," as opposed to case-by-case determinations, to assess corporate liability for civil law violations. Indeed, the electric industry itself adopted a penalty matrix (i.e., violation risk factors and severity levels) to calculate fines for reliability violations. It is a separate matter, however, whether the *content* of any such penalty guidelines fairly distinguishes between intentional and reckless conduct, on the one hand, and errors and mistakes made without intent to violate the law, on the other. This distinction is of less concern for the Criminal Sentencing Guidelines because the criminal law imposes a higher standard of proof and typically requires a finding of intent or recklessness.[99] It is a significant concern, however, in the context of a civil penalty regime that attaches liability for most violations without a finding of intentional or reckless behavior.

As explained below, this problem is a real one in the context of the FERC's Penalty Guidelines because of the way in which the base penalty and culpability score are calculated. To address the problem, the article offers several potential solutions. The article then concludes with a section discussing a distinct but related issue concerning the disgorgement of profits.

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97. *Revised Penalty Guidelines*, *supra* note 11, at P 11.

98. *Id.* at PP 15, 17.

99. For a detailed discussion, in both the majority opinion and dissent, of the presumption of *mens rea* in interpreting federal criminal statutes, see United States v. Burwell, No. 06-3070, 2012 WL 3140196 (D.C. Cir. Aug. 3, 2012).

A. Ambiguity, Inadvertent Mistakes, and the FERC's Penalty Guidelines

1. Distinguishing Intentional or Reckless Conduct from Inadvertent Mistakes or Mistaken Interpretations

The civil penalty amounts set forth in the FERC's Penalty Guidelines generally rest on the premise that penalties should bear a reasonable relationship to the harm caused by the violation. For tariff violations and market manipulation, the FERC uses the monetary gain or loss associated with the violations as the metric to set the "base penalty."[100] For reliability violations, the FERC uses the risk of harm (or loss of load) as the metric to set the base penalty.[101] This philosophy of assessing civil penalties in relationship to the harm caused by the violation is hard to quarrel with as a general proposition,[102] but implementation of that philosophy matters very much.

The problem with the FERC's implementation of this approach is that two similar violations can produce precisely the same harm—and hence receive precisely the same base penalty—but implicate very differing levels of corporate culpability, with one being caused by intentional or reckless conduct and the other being the result of human error or a mistaken rule interpretation. This problem is compounded by the fact that the "multipliers" used to calculate civil penalties can be quite large.[103] For example, for tariff violations and market manipulation, there is a "floor" that ensures the civil penalty can be no lower than the amount of the gain or loss (and, as discussed below, any gain must be relinquished as well); and, on top of this floor, the base violation level calculations can increase the penalty from two to four times this level; and then, finally, the culpability score imposes another multiplier that, even for the "base" score, can then double that amount (and, to be fair, can reduce it significantly depending on the score).[104]

A hypothetical example may help to illustrate this multiplier effect. Assume that an electric or natural gas company violated its open access transmission tariff based on a good faith, but mistaken, interpretation of a particular provision in that tariff. Assume further that this violation allowed the transmission provider to earn $200,000 in revenue over the course of one year. How would the Penalty Guidelines treat this company? The following provides the range of total fine using the base culpability score:

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100. *Revised Penalty Guidelines*, *supra* note 11, § 2B1.1.

101. *Id.* at P 4.

102. That being said, it is noteworthy that the level of base penalties assessed for various types of violations was left unexplained. Although the Commission did a commendable job explaining why it was adopting a fixed penalty schedule approach and grounding that approach in measures of harm, there was no explanation of why any particular penalty level was required to deter or punish any particular violation. To be fair, the prior case-by-case approach had done no better in explaining why any particular penalty level was required for any particular violation, but that approach had inherent flexibility (some would say too much) to account for ambiguity in the range of factors being applied.

103. *Revised Penalty Guidelines*, *supra* note 11, § 1C2.4.

104. *See generally id.* at Part C.

Step	***Input***	***Result***
Base Penalty	Violation Level 24[105]	$2.1 million
Penalty Multiplier	Base Culpability Score 5	1.0—2.0 multiplier
Penalty Range	(Steps 1 x 2)	$2.1-$4.2 million

Is this a fair result? The answer depends on one's perspective, but I would suggest the answer is no. It seems hard to justify a civil penalty range that is ten to twenty times the level of harm involved for conduct that was neither intentional nor reckless. To be sure, the eye-popping numbers in this example are affected significantly by the duration adder of six points, but that is not an extreme assumption on these facts. The duration of a violation will tend to be longer, all other things equal, in cases where the company believes it is following the law because such a company will neither change nor self-report conduct that it believes is lawful. Even if this adder is removed, the penalty range is $350,000 to $700,000—i.e., ranging as high as three times the amount of the gain involved.

The only way to mitigate this harsh result is through the culpability score. However because the mitigating factors that drive that score were taken from the criminal context, they do not directly consider whether the violation occurred due to intentional or reckless conduct or a good faith misinterpretation of the rules. They are thus of little comfort to the company in our hypothetical. The only factor that comes close to addressing this issue is the element of compliance program credit that requires a company to have a generic procedure whereby employees can seek "guidance regarding actual or potential violations without fear of retaliation."[106] This element, however, is directed at avoiding deterrence of whistleblowers, rather than our situation (which is far more common) of a company struggling to interpret the FERC regulations in good faith.

The other mitigation credits are of no more help in addressing the issue. The self-reporting credit of two points is unlikely available in our hypothetical because, when a company believes it is following the law, it is highly unlikely to self-report itself.[107] With respect to the remaining credits for settlement and cooperation, these might be available depending on the facts, but the point here is that those credits, laudable as they may be, are available to *all* companies—including those that knowingly violated the law—and thus do not serve as a vehicle to distinguish between intentional and unintentional violations.

Worse yet, cases involving ambiguities not only have limited opportunities for mitigation credit, but can often trigger the *escalator* for "senior management involvement." This can occur where senior management was consulted on the compliance question at issue. This conduct—vetting difficult questions with

105. This figure of twenty-four is the sum of a base violation level of six, a loss adder of twelve because the gain is $200,000, and a duration adder of six. The figure also assumes that the "gain" controls here because the loss is either the same amount or too difficult to quantify.

106. *Revised Penalty Guidelines, supra* note 11, § 1B2.1.

107. *Id*. at P 145. The exception might be instances where a significant portion of the industry was interpreting a tariff provision the same way, but it later became apparent that the Commission and its Office of Enforcement had a different view, leading companies to self-report after an initial settlement order identifying the conduct had been issued.

senior management—should be encouraged, not discouraged by the Penalty Guidelines. But the fact remains that the Penalty Guidelines provide the Office of Enforcement discretion to apply that escalator in cases where the company believed it was complying with the law, but the Commission later disagreed.[108]

This leaves only departures from the Guidelines as a means to avoid an unnecessarily harsh penalty in our hypothetical. Here too, however, that is an unsatisfying answer because departures are intended to be the exception,[109] not the rule. Thus, departures would be a fine answer if our fact pattern was unusual, but the evidence suggests it is not. From a review of the enforcement settlements entered into since EPAct 2005, a minority of cases have involved allegations of intentional or reckless action.[110]

There is one final possibility, namely that no prosecution is brought by the Office of Enforcement of the company in our hypothetical. For example, prior to the adoption of the Penalty Guidelines, the Commission had responded to industry concerns regarding ambiguity in Order No. 693 with the following statement:

> [M]any tariffs on file with the Commission do not specify every compliance detail, but rather provide some level of discretion as necessary to carry out a particular act. This does not mean the tariffs are unenforceable; rather, it means that, if a dispute arises over compliance and there is a legitimate ambiguity regarding a particular fact or circumstance, that ambiguity can be taken into account in the exercise of the Commission's enforcement discretion.[111]

Not surprisingly, the issue arose again in the debate over the Penalty Guidelines and, not surprisingly, the Commission gave the same answer, finding that "[o]ur position on this issue has not changed since Order No. 693."[112]

There are two ways to interpret these statements. On the one hand, the Commission may have been indicating that it will decline to prosecute a case whenever the standard or tariff at issue is ambiguous. That would be a commendable approach and, indeed, one that is compelled, depending on the presence of certain factors, by the "fair notice" doctrine. As recently described by the Supreme Court:

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108. *Id.* at P 122.

109. *Policy Statement on Penalty Guidelines*, 130 F.E.R.C. ¶ 61,220 at P 32 (2010) ("We do not intend to depart from the Penalty Guidelines regularly, but neither will we always adhere to a rigid application of them.").

110. These cases include the market manipulation cases and a few other cases involve tariff violations. All market manipulation cases require a finding of *scienter*, which is defined to include intentional or reckless conduct. Order No. 670, *Prohibition of Energy Market Manipulation*, 114 F.E.R.C. ¶ 61,047 at PP 52-54 (2006). By contrast, in the vast majority of cases involving tariff or reliability violations, including those that carried the most significant civil penalties, the Commission has not made findings of intentional or reckless conduct. *See, e.g.*, *Florida Blackout*, 129 F.E.R.C. ¶ 61,016 at PP 18, 20 (2009) (approving civil penalty of $25 million, but specifically finding that the company's actions were not intentional or fraudulent); *In re SCANA Corp.*, 118 F.E.R.C. ¶ 61,028 (2007) (approving civil penalty of $9 million and finding that one employee sought to conceal his behavior, but not finding the company to have engaged in intentional or reckless conduct). There are, however, exceptions to this general rule. *See, e.g.*, *In re Constellation New Energy—Gas Division, LLC*, 122 F.E.R.C. ¶ 61,220 at P 9 (2008) (approving civil penalty of $5 million for tariff violations and finding that "CNE-G's actions as a replacement shipper were deliberate and resulted in shielding the capacity that was released to CNE-G from competitive bidding").

111. Order No. 693, *supra* note 42, at P 275.

112. *Revised Penalty Guidelines*, *supra* note 11, at P 30.

> A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required. See *Connally* v. *General Constr. Co.*, 269 U. S. 385, 391 (1926) ("[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law"); *Papachristou* v. *Jacksonville*, 405 U. S. 156, 162 (1972) ("Living under a rule of law entails various suppositions, one of which is that '[all persons] are entitled to be informed as to what the State commands or forbids'" (quoting *Lanzetta* v. New *Jersey*, 306 U. S. 451, 453 (1939) (alteration in original))). This requirement of clarity in regulation is essential to the protections provided by the Due Process Clause of the Fifth Amendment. See *United States* v. *Williams*, 553 U. S. 285, 304 (2008). It requires the invalidation of laws that are impermissibly vague.[113]

There is also a second way in which the Commission's statement could be interpreted, namely as signaling that, even if an ambiguity did not rise to the level of triggering the fair notice doctrine, the Commission would take that ambiguity into account in fashioning a civil penalty. If that was the intent, it is again a laudable one but not one that is particularly easy to accommodate under the Penalty Guidelines. They simply do not address ambiguity in any direct manner. This is one reason why I believe some level of reform is necessary, as described immediately below.

2. Potential Reforms to Better Align Civil Penalties with Corporate Culpability

There are several ways—admittedly, none of which is perfect—to address the problem of potentially harsh fines for companies that acted in good faith, but nonetheless violated the law due to either mistaken interpretations of the law or to compliance errors that did not rise to the level of recklessness. I identify four of them here.

The first approach would be for the Commission to grant more frequent departures from the Penalty Guidelines in circumstances where the target company did not intentionally violate the law or act recklessly. This approach has the upside of tailoring the result to the individual circumstances of each case, but has the downside of failing to address the issue in a more systemic way. As indicated, the problem identified here is a recurring one, not an isolated one. There are also practical problems with this approach. Most companies do not relish multi-year litigation with the Commission and would prefer to settle on reasonable terms and put the matter behind them. For these companies, the harsh results produced by the Guidelines tilt the playing field against them because they must depend on the Office of Enforcement to recommend departures rather than grounding their arguments, in the context of settlement negotiations, in the plain words of the Penalty Guidelines.

The second approach would provide greater flexibility in how the compliance program credits are awarded. The eight factors relevant to providing this credit are both sound and well-established,[114] but the way in which they are described makes them less useful in addressing the issue of concern here. Specifically, the elements of a successful compliance program are described in generic fashion and thus provide guidance on evaluating whether the overall

113. Fed. Commc'n Comm'n v. Fox Television Stations, Inc., 132 S. Ct. 2307, 2317 (2012).

114. *Revised Penalty Guidelines*, *supra* note 11, § 1C2.3.

program is a sound one, rather evaluating the reasons why any particular violation may have occurred. Thus, a company could have a less than effective overall program, but a particular violation may have been unrelated to any deficiencies in that program—e.g., because it was the result of a good faith misapplication of a FERC rule or tariff. In theory, however, the Office of Enforcement could apply the compliance program credit in a more flexible manner to achieve the more fundamental goal of that credit, which is to align civil penalties to corporate culpability. This would give the Office of Enforcement discretion to award some compliance credit for a company that acted in good faith, but nonetheless was deemed to have violated the law.

Third, the Commission could address the problem more directly by amending the Penalty Guidelines to add a mitigation credit to the culpability score for companies that did not knowingly or recklessly violate the law. The benefit of this approach would be that it directly addresses the issue of culpability. The downside of this approach is that measuring "intent," in the context of corporate culpability, is no simple task. That being said, the Commission could provide a nonexclusive list of factors that it would consider, including whether the violation was the result of human error, inadvertence, or a good faith but mistaken interpretation of the rules. The reality that these factors may be difficult to assess in some cases does not mean that they should not be considered at all. Indeed, the Commission routinely considers this question in applying its market manipulation rules, which require a finding of *scienter* (which is defined to include intentional or reckless conduct).[115]

Finally, the Commission could adopt an alternative reform to address the issue indirectly through a credit to the culpability score for conduct that was transparent to the public. The downside of this approach is that it does not address intent directly, but it nonetheless would have certain benefits. First, transparency can be a reasonable proxy for lack of intent because companies that intend to violate the law rarely seek to publicize their actions. Second, the economic literature supports calculating corporate penalties based in part on to the probability of detection—i.e., with lower penalties for violations that are more easily detected and higher ones for conduct that is concealed or very difficult to detect.[116] Consequently, the more transparent an act, the lower the penalty needed to deter it, all else equal. Finally, this approach would be consistent with the Commission's policies in so many areas that encourage transparency.

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115. Order No. 670, *Prohibition of Energy Market Manipulation*, 114 F.E.R.C. ¶ 61,047 at PP 52-54 (2006).

116. Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 834 (1994) ("Crime is deterred efficiently . . . if the corporation is held strictly liable for all its crimes, subject to a fine equal to the social cost of crime divided by the probability of detection (H/p), because this forces the corporation to internalize the social cost of its criminal activity."); Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 875-56 (2007) ("Following deterrence theory, which provides an economic justification for corporate criminal liability, prosecutors should seek to impose an optimal punishment based on the harm and the probability of detection of the malfeasance."). *See also* John T. Byam, *The Economic Inefficiency of Corporate Criminal Liability*, 73 J. CRIM. L. & CRIMINOLOGY 582, 598 (1982); *See generally* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON., no. 2, (Mar. – Apr. 1968) at 169, 193, 195 (punishment for crime should be through fines determined by the social cost of the crime).

B. Equitable Discretion in Considering the Disgorgement Remedy

A related but distinct issue concerning corporate culpability relates to disgorgement. "Disgorgement involves relinquishing profits illegally obtained, and such profits are distributed to those who were harmed by the violations."[117] The FERC's general policy is that disgorgement must be "full"—i.e., the total amount of the "profits illegally obtained" are returned, not a portion of them. As described in the Penalty Guidelines, "[i]n the case of pecuniary gain as a result of the violation, the Commission enters a disgorgement order for the *full amount* of the gain plus interest."[118]

This is a sensible policy in the abstract. It is reasonable to argue that, as a general rule, a company that violated the law should not profit therefrom. But the real world is often more complicated. For example, regulated companies do not always profit from violations because their revenues (net margins) from transactions are generally flowed back to ratepayers. In that situation, disgorgement could operate as a penalty, for example, if the company was required to flow back disgorgement to one set of customers (i.e., those that were "harmed") but could not, because of the rule against retroactive ratemaking, recover those costs from its other customers. It is therefore worth considering whether the FERC should change its policy and award full disgorgement only where that is the appropriate equitable remedy, rather than as a matter of course without regard to the facts and circumstances.

The case law suggests that such a change is merited. Disgorgement is an equitable remedy, not a punitive one,[119] and, in that respect, is closely analogous to the policy on refunds. In those cases, the Commission and the courts have required a weighing of the relevant factors, not an iron-clad rule that refunds are always appropriate. For example, in rejecting a request for refunds in *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator Corp. and the California Power Exchange Corp.*, the Commission explained:

> While SMUD suggests that PNM's refund obligation is statutory in nature, there is no statutory obligation to pay refunds. Rather, refunds are at the discretion *of the Commission*. . . . Courts have long held that the breadth of the Commission's "discretion is, if anything, at zenith" when it is "fashioning [] remedies and sanctions, including enforcement and voluntary compliance programs in order to arrive at maximum effectuation of Congressional objectives."[120]

117. *Revised Penalty Guidelines*, *supra* note 11, at P 216; *see also id.* § 1B1.1 (disgorgement equals "pecuniary gain"); *Policy Statement on Enforcement*, 113 F.E.R.C. ¶ 61,068 at P 19 (2005) ("The purpose of disgorgement is to nullify the value of gains acquired through misconduct."); *Order Revising Market Based Rate Tariffs and Authorizations*, 114 F.E.R.C. ¶ 61,165 at P 33 (2006) ("The purpose of disgorgement . . . is to remedy unjust enrichment."); *and Energy Transfer Partners*, 130 F.E.R.C. ¶ 63,018 at P 104 (2010) (In other words, "[t]he primary purpose of disgorgement is not to refund others for losses suffered, but rather to 'deprive the wrongdoer of his ill-gotten gain.'" (quoting Zacharias v. SEC, 569 F.3d 458, 471 (D.C. Cir. 2009)).

118. *Revised Penalty Guidelines*, *supra* note 11, § 1B1.1(a) (emphasis added).

119. *Id.* at P 216 (disgorgement is not imposed for "punitive" purposes); *Zacharias*, 569 F.3d at 471 ("Our disgorgement cases uniformly hold that an 'order to disgorge is not a punitive measure; it is intended primarily to prevent unjust enrichment.'" (citations omitted)).

120. *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs. into Markets Operated by the Ca. Indep. Sys. Operator Corp. and the Ca. Power Exch. Corp.*, 131 F.E.R.C. ¶ 61,082 at P 42 n.85 (2010) (citations omitted).

Similarly, the courts and Commission have held that, because "customer refunds are a form of equitable relief, akin to restitution . . . the general rule is that agencies should order restitution only when money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it."[121] Thus, "[i]n determining whether to order refunds, the Commission *must* balance equity considerations and determine what is just and reasonable, and also determine whether an alternate remedy is more appropriate."[122] This policy applies not only to refunds in the context of rate proceedings, but also instances where a regulated entity is found to have violated its tariff.[123]

Consistent with these precedents, I would suggest that the Commission consider more closely aligning its policy on disgorgement with its policy on refunds. The collision of the two policies is most obvious—and, from a policy perspective, unacceptable—where no refund would be required if a violation was found in a section 206 complaint, but "full" disgorgement would be required if the violation was found in a section 1b investigation. There is no rational basis for such divergent outcomes. And the problem becomes even more severe in a regulated setting because disgorgement is sometimes not recoverable in rates due to the prohibition on retroactive ratemaking—thereby making it effectively a form of civil penalty. For example, as the Commission observed in *Black Oak Energy, L.L.C. v. PJM Interconnection, L.L.C.*, where the tariff violation involves a misallocation of revenues, "ordering refunds in such a case would be unfair because it would result in a loss of revenue from the reallocation when the utility would not have the opportunity to file a new rate case to recover those revenues."[124] The Commission should therefore consider modifying its policy on full disgorgement to more closely align it with its policy on refunds in electric rate matters.

IV. CONCLUSION

The Commission has done a commendable job implementing EPAct 2005 and its efforts are ongoing in many areas of regulation. This article recommends that the Commission consider further changes in two areas (electric reliability

121. *Midwest Indep. Transmission Sys. Operator*, 117 F.E.R.C. ¶ 61,113 at P 94 (2006) [hereinafter *MISO*] (quoting Towns of Concord, Norwood, and Wellesley v. FERC, 955 F.2d 67, 75 (D.C. Cir. 1992)).

122. *Niagara Mohawk Power Corp. v. N.Y. Indep. Sys. Operator*, 110 F.E.R.C. ¶ 61,244 at P 64 [hereinafter *NiMo*] (emphasis added), *reh'g denied*, 113 F.E.R.C. ¶ 61,155 (2005), *aff'd sub nom*. Consol. Edison of N.Y. v. FERC, 510 F.3d 333 (D.C. Cir. 2007).

123. *See, e.g.*, *MISO*, *supra* note 121, at PP 94-95 (declining to order refunds despite finding that MISO violated its own tariff); *NiMo*, *supra* note 122, at P 64 (declining refunds despite finding that NYISO violated its tariff); Opinion No. 415, *Entergy Services, Inc.*, 80 F.E.R.C. ¶ 61,197 (1997) (denying refunds despite finding that Entergy violated the System Agreement). *See also* Koch Gateway Pipeline Co. v. FERC, 136 F.3d 810, 816 (D.C. Cir. 1998) (finding that a gas pipeline violated its tariff, but holding that the Commission abused its discretion in ordering refunds).

124. *Black Oak Energy, L.L.C. v. PJM Interconnection, L.L.C.*, 136 F.E.R.C. ¶ 61,040 at P 26 (2011); *accord Louisiana Public Serv. Comm'n v. Entergy Servs., Inc.*, 135 F.E.R.C. ¶ 61,218 at P 23 (2011)

> (When a case involves a company over collecting revenues to which it was not entitled, the Commission generally holds that the excess revenues should be refunded to customers. By contrast, in a case where the company collected the proper level of revenues, but it is later determined that those revenues should have been allocated differently, the Commission traditionally has declined to order refunds.).

and enforcement) and that the NERC consider one change as well. These proposed changes are modest in scope, but can nonetheless make a contribution to the successful implementation of EPAct 2005.