

**ATTACHMENT 4A**

**ERO SANCTIONS GUIDELINES  
(APPENDIX 4B TO THE RULES OF PROCEDURE)**

**CLEAN VERSION**

**Sanction Guidelines  
of the  
North American  
Electric Reliability Corporation**

**March 12, 2007**

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## **1. Preamble and Overview**

The North American Electric Reliability Corporation, as the electric reliability organization (ERO), and regional entities to whom NERC has delegated authority (hereinafter referred to collectively as “regional entities” or individually as a “regional entity”) shall determine and may levy monetary penalties and non-monetary sanctions and remedial actions against owners, operators, and users of the bulk power system for violations of the requirements of NERC Reliability Standards (“reliability standards”) approved by the Federal Energy Regulatory Commission (FERC) and applicable authorities in Canada and/or Mexico. This document sets out the processes and principles to be followed, and factors that will be considered when determining penalties, sanctions, or remedial actions for violations. Collectively these processes, principles and factors are NERC’s penalties, sanctions, and remedial action guidelines.

NERC and the regional entities will exclusively follow the directives, principles and processes in these Sanction Guidelines when determining penalties, sanctions, or remedial action for a violation. However, adjustment factors are also provided to afford NERC or the regional entity the flexibility needed to accommodate the facts surrounding each violation. In this manner, rigid prescription of specific penalty formulae can be avoided at the same time that appropriate limitations on the degree of discretion and flexibility available to address each violation on its merits is maintained. The outcome will be remedies that are commensurate and fair compared to the reliability impact of the violation and to remedies levied for similar violations, yet appropriately reflective of any unique facts and circumstances regarding the specific violation and violator.

The adjustment factors established in this document are generally consistent with those listed in the FERC Policy Statement on Enforcement issued on October 20, 2005. However, discussion of the factors presented in this document is not exhaustive as other facets of these factors, or other additional factors not discussed herein, may also be considered to determine a given penalty, sanction, or remedial action, as NERC or the regional entity deems appropriate under the circumstances.

Regional entities shall follow these guidelines to determine penalties, sanctions, or remedial actions. NERC shall oversee the regional entities’ application of the guidelines to ensure that acceptable levels of consistency are achieved. NERC’s oversight will also ensure comparable outcomes; i.e. that there is acceptable similarity in the degree and type of sanction for violations constituting comparable levels of threat to reliability of the bulk power system. In order to facilitate this oversight, regional entities’ reporting to NERC of penalties and sanctions they have determined will be thorough and in sufficient detail that NERC can understand and reasonably replicate the outcomes reached; NERC may develop reporting requirements or a standard reporting form for use by the regional entities for this purpose, as NERC deems necessary or appropriate.

As experience is gained by NERC and the regional entities through the use and application of these guidelines, NERC will review the guidelines and may modify them as NERC deems appropriate or necessary. Authority delegated by NERC to the regional entities with respect to penalties, sanctions, or remedial actions does not include the authority to modify these guidelines.

Any revision to this document or to the principles and factors identified or addressed within it must first be approved by the NERC board, then by FERC, appropriate authorities in Canada or appropriate authorities in Mexico prior to becoming effective and applicable within the United States or these authorities’ respective jurisdictions.

## **2. Document Scope and Exclusions**

This document identifies and discusses the processes and principles to be followed, and factors that will be considered to determine penalties, sanctions, or remedial actions for violations of the reliability standards.

This document notes but does not otherwise address the progression of actions and steps that NERC or the regional entity will follow to process a violation from its initial incoming status upon discovery as a probable violation, through to its possible final determination as a post-appeal confirmed violation. This is set out in NERC's Rules of Procedure Section 400 and applicable regional entity program documents.

This document notes but does not otherwise address how an alleged violation is reviewed in order to confirm or dispel it. NERC's process and requirements for this are set out in the NERC Rules of Procedure Section 400. Regional entities will undertake such reviews either using the processes and requirements set out in the Rules of Procedure or using their own documented process that has been reviewed and approved by NERC as meeting the requirements for such a process.

This document notes but does not otherwise address the processes and procedural steps by which a violation can be appealed, or by which a penalty, sanction, or remedial action determined and levied for a violation can be appealed. These are set out in NERC's Rules of Procedure Section 400 and applicable regional entity program documents.

Section 403 paragraph 18 of NERC's Rules of Procedure provides for the possibility of settlements within NERC or regional entity compliance enforcement programs. This document makes reference to settlements to but does not address them further.

### **3. Basic Principles**

The following paragraphs identify and discuss the basic principles underpinning why and how NERC and the regional entities will determine penalties, sanctions, and remedial actions for violations of the requirements of the reliability standards.

The principles are unique and complimentary; the order in which they are presented does not set or indicate order of precedence.

#### **3.1 Necessary Element of NERC Compliance Program**

Primary objectives of NERC as the ERO include the promotion and enforcement of compliance with the reliability standards by owners, operators, and users of the bulk power system; standards made mandatory by duly-authorized legislative bodies in the U.S and Canada, and designed to maintain and promote the reliability of the two countries' shared power grids. Consistent with these objectives, NERC and the regional entities will monitor and act to verify compliance with standards' requirements; however, beyond monitoring and acting only to verify compliance, NERC and the regional entities will also hold bulk power system owners, operators, and users — or their delegates — accountable for confirmed compliance violations. This accountability will include determination and the possible levying of penalties, sanctions, or remedial actions.

Penalties, sanctions, and remedial actions are valid and necessary mechanisms to NERC and the regional entities for the enforcement and promotion of compliance to the reliability standards, in part because they can:

- a. promote compliance behavior;
- b. provide deterrence to future incidents, actions or situations of noncompliance by the violator or others;
- c. implement actions that will promptly correct behavior;
- d. disgorge benefits that may or may have accrued to a violator as a consequence of violating;
- e. visit upon a violator some portion of any damage their violation may or may have visited upon others.

Accordingly, the determination and potential levying of appropriate penalties, sanctions, or remedial actions by NERC or the regional entity upon those responsible for violations shall be a required step within the NERC and regional entity compliance enforcement programs.

#### **3.2 Settlement of Compliance Violations**

NERC and the regional entities shall maintain the reliability of the bulk power system by enforcing compliance with NERC and regional entity reliability standards. NERC and regional entity compliance enforcements programs will lay out how NERC and the regional entities will do this. In particular and by necessity, elements of these programs regarding the confirmation of violations, the determination and levying of penalties, sanctions, or remedial actions, and appeals are rigid and legalistic in form and nature in order to respect the basic tenets of due process and natural justice inherent within United States and Canadian justice systems, respectively, upon which they are being based. However, absolute adherence to the compliance programs, to the exclusion of other options, may not be the most appropriate, efficient or desirable means by which to achieve the end goal in all circumstances, to all entities party to a violation.

As set out in the NERC Rules of Procedure Section 403 paragraph 18, violations of the reliability standards may be dealt with through settlements reached between NERC, regional entity and the entity or entities to whom a potential, alleged, or confirmed violation is attributed to by NERC or the regional entity. Any provisions made within a settlement regarding penalties, sanctions, or remedial actions can supersede any corresponding penalties, sanctions that would otherwise be determined pursuant to these guidelines.

### **3.3 Settlement Request**

At any point in the determination and levying of a penalty, sanction, or remedial action pursuant to these guidelines, any entity found in or being investigated for a violation may request a settlement; at no point within the processes and procedures, etc, described by these guidelines is the option of settlement not available.

### **3.4 Settlement Effect on Continuation of Determination of Penalties, Sanctions, or Remedial Actions**

Until a settlement is finalized or parties to that settlement agree otherwise, NERC or the regional entity may continue activities and actions towards the determination and levying of a penalty, sanction, or remedial action that would otherwise be applicable pursuant to these guidelines, or that will be applicable if the settlement is not finalized.

### **3.5 Timing of Determination of Penalty, Sanction or Remedial Action**

All alleged violations will be reviewed by NERC or the regional entity with the outcome that either the violation will be confirmed or the violation will be dispelled.

The penalty, sanction, or other remedial action for a violation will be determined when an alleged violation is affirmed.

At any time during confirmation review, hearing, or appeals NERC or the regional entity may determine that remedial action is warranted by the subject entity of the review, hearing, or appeals. NERC or the regional entity may direct that such remedial actions be undertaken by the subject entity at any time, including prior to confirmation of a violation, and without regulatory approval.

### **3.6 Determining Party**

The determination of penalty, sanction or other remedial action for a violation will generally be undertaken by the same entity undertaking the confirmation review of that violation.

### **3.7 No Influence of Penalty, Sanction or Remedial Action upon Violation Confirmation Process**

The penalty, sanction, or remedial action determined for a violation will not influence the outcome of the regional entity' or NERC's confirmation review of the violation. In particular, if the determination of penalty, sanction, or remedial action for a probable violation is being undertaken by the same entity undertaking the confirmation review, the entity will insure that there is sufficient separation, in such terms as time, process, personnel or the like, to preclude that the penalty, sanction, or remedial action determined influences the outcome of the confirmation review.

### **3.8 Reasonable Relationship to Violation**

Penalties, sanctions, and remedial actions levied or applied for the violation of a reliability standard shall bear a reasonable relation to the seriousness of the violation while also reflecting consideration of the factors that these guidelines direct to take into account. In the United States, the legislation establishing mandatory enforceable reliability standards and the ERO requires that "Any penalty imposed ... shall; (A) bear a reasonable relation to the seriousness of the violation; and (B) take into consideration the efforts of the user, owner, or operator to remedy the violation in a timely manner<sup>1</sup>.

### **3.9 Use and Facets of Factors to Determine Penalties**

Penalties levied for a given violation will be based on all facts and other information relevant to the incident or situation. To that end, these guidelines include factors which NERC and the regional entities will consider while determining the penalty or sanction to be levied.

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<sup>1</sup> H.R.6, Energy Policy Act of 2005, Section 215, Paragraph e, subparagraph 6.

NERC considers, and these guidelines direct, that the presence of some factors within a violation aggravates the seriousness of that violation and should cause an increase or expansion of the penalty to be levied. Conversely, the presence of some other factors mitigates that seriousness and should cause a decrease or reduction of the penalty to be levied. Also, some factors may mitigate or aggravate, and should have commensurate impact. NERC considers, and these guidelines direct, that the absence of an aggravating or mitigating factor will have no impact, as opposed to a mitigating or aggravating impact, respectively, to a penalty.

This document presents many of the relevant facets of the factors included in these guidelines. However, additional facets of these factors, or additional factors not discussed herein, may also be considered to determine a given penalty, sanction, or remedial action, as NERC or the regional entity deems appropriate under the circumstances. Where additional factors or facets are used they will be identified and their use will be justified. The effect of using these factors or facets on the penalty, sanction, or remedial action determined will also be fully and clearly disclosed.

### **3.10 Multiple Violations**

A violation is a failure or inadequacy to meet a requirement of a reliability standard by a party responsible to comply with that requirement.

The failure or inadequacy of a violator to comply may involve more than one standard or several requirements of a single standard; as such, multiple individual violations may be in play when penalties, sanctions, or remedial actions for an incident or situation of noncompliance are being determined.

Strictly speaking, NERC or the regional entity can determine and levy a separate penalty or sanction, or direct remedial action, upon a violator for each individual violation. However, in instances of multiple violations related to a single act or common incidence of noncompliance, NERC or the regional entity will generally determine and issue a single aggregate penalty, sanction, or remedial action directive bearing reasonable relationship to the aggregate of the related violations. The penalty, sanction, or remedial action will not be that determined individually for the least serious of the violations; it will generally be at least as large or expansive as what would be called for individually for the most serious of the violations.

Some entities may be registered as being responsible for more than one function (e.g., transmission owner, transmission operator, balancing authority, generation operator), and a single requirement in some reliability standards may apply to the responsible entity for several functions. Where several functions are performed by the same entity, a violation will be assessed against the entity, not against each function.

### **3.11 Relation of the Penalty to the Seriousness of the Violation and Violator's Ability to Pay**

As discussed in Section 3.8, above, penalties levied for the violation of a reliability standard shall bear a reasonable relation to the seriousness of the violation. The seriousness of a given violation by a given violator shall be assessed by review of the applicability of the Violation Risk Factors<sup>2</sup> associated with the violation to the characteristics of the violator's operation or power system. Size is a characteristic of a violator's operation or system. The size of the violator can be considered in the assessment but shall not be the only characteristic considered. Where size is considered in such a review the facts relating to the violation in question will be reviewed such that the "actual" size of the violator is properly discerned and appropriately considered; the following are provided as illustrative examples:

- If the violator belongs to a generation and transmission cooperative or joint-action agency, size will be attributed to the particular violator, rather than to that generation and transmission cooperative or joint-action agency.

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<sup>2</sup> See Section 4 Part 4.11 for a discussion of these factors

- If the violator constitutes part of a corporate family the size of the violator will be attributed to that violator alone, in the absence of any facts indicating involvement of the whole corporation or corporate affiliates of the violator.
- If the violator is an entity established solely as a shell to register as subject to one or more Reliability Standards the size of the entity will be disregarded in favor of consideration of the size of parent entity or any affiliates that NERC or the regional entity deems involved and constituting the “actual” size of the violator.

At the request of the violator, NERC or the regional entity may review the penalty in light of the violator’s financial ability to pay the penalty. Financial ability shall include both the financial strength of the entity as well as its structure (e.g., for-profit versus non-profit). Where penalties are reduced or eliminated NERC or the regional entity shall consider non-monetary sanctions or remedial action as alternatives or substitutes to the penalty, pursuant to Sections 3.17, 3.18 and 3.19, below, of this document.

The above actions will: (i) promote that violators are penalized or sanctioned commensurate with the risk or effect that their specific violation of the reliability standards had or is having to the reliability of the bulk power system while also; (ii) mitigating overly burdensome penalties to less consequential or financially-limited entities concurrent with; (iii) promoting that no penalty is inconsequential to the violator to whom it is assessed. This will promote that penalties levied for violations of reliability standards bear a reasonable relation to the seriousness of the violation while also addressing violators’ ability to pay the penalties they are assessed.

### **3.12 Violation Time Horizon**

Reliability standards involving longer and broader time horizons, such as long-term planning activities, may have a lesser immediate impact and pose less immediate risk to the reliability of the bulk power system than standards addressing shorter and narrower timeframes, such as entities’ conduct in real time. Similarly, standards involving longer and broader time horizons typically will provide a longer time period over which to discover and remedy a violation when compared to standards addressing more immediate activities such as next-day planning, same-day operations or real-time operations. Using a time horizon element in the determination of penalties for violations provides for recognition of the “more immediate” nature — and hence higher risk — of the threat of some violations as opposed to the lesser-risk “future threat if not corrected” nature of other violations.

Penalties levied for the violation of a reliability standard shall consider the time horizon of the standard violated; violations of standards involving more immediate or real-time activities will generally incur larger penalties than violations of standards with longer or broader horizons.

Time horizons inherent in reliability standard requirements are not reflected in their assigned Violation Risk Factors or Violation Severity Levels<sup>3</sup>. Accordingly, the time horizon element of a violation will be considered when determining the Base Penalty Amount<sup>4</sup> for the violation.

The time horizon considered and its impact on the selection of the Base Penalty Amount for the violation will be decided upon by NERC or the regional entity based upon judgment and the facts of the violation. The rationale for the time horizon used and its impact on the setting of the Base Penalty Amount will be documented by NERC or the regional entity and provided within the Notice of Penalty issued for the violation.

### **3.13 Extenuating Circumstances**

In unique extenuating circumstances, such as significant natural disasters, penalties may be significantly reduced or eliminated.

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<sup>3</sup> See Section 4 Part 4.11 for a discussion of these factors.

<sup>4</sup> See Section 4 Part 4.2

### **3.14 Concealment or Intentional Violation**

Penalties levied for the violation of a reliability standard shall always take into consideration any attempt by a violator to conceal the violation from NERC or the regional entity, or any intentional violation incurred for purposes other than a demonstrably good faith effort to avoid a significant and greater threat to the immediate reliability of the bulk power system.

### **3.15 Economic Choice to Violate**

Owners, operators, and users of the bulk power system may be presented with situations or circumstances where compliance with the reliability standards preclude or reduce an economic gain that could be realized by violating the standards. Penalties shall be sufficient to assure that entities responsible for complying with reliability standards do not find it attractive to make economic choices that cause or unduly risk violations to reliability standards, or risk or cause incidents resulting from violations of the reliability standards. Penalties levied to violators who have made such a choice shall reflect this aspect of the violation.

### **3.16 No Influence by Outcome of Economic Choice to Violate**

Economic choices to violate are generally made for the violator's own potential gain, but making such a choice does not always result in all potential gains being realized or may result in damage or loss. However, irrespective of the outcome to the entity making an economic choice to violate, such decisions risk others' reliability, commonly without either their knowledge or consent. Penalties levied to violators making an economic choice to violate shall reflect only that the choice was made at all; the lack of or reduced magnitude of any actual benefit received, or any damage suffered, by the violator as a consequence of making this choice will have no influence on the determination of the penalty to be levied.

### **3.17 Non-Monetary Sanctions or Remedial Actions**

Enforcement actions taken by NERC or a regional entity are not limited to monetary penalties; at the discretion of NERC or the regional entity, sanctions or remedial actions may also be applied and can include limitations on activities, functions, operations, or other appropriate sanctions, including the establishment of a reliability watch list composed of major violators.

### **3.18 Non-Exclusiveness of Monetary Penalties or Non-Monetary Sanctions**

A non-monetary sanction may be imposed either in lieu of or in addition to a monetary penalty imposed for the same confirmed violation, and vice versa. Imposition of a monetary penalty or non-monetary sanction for a violation does not preclude the imposition of the other as long as, in combination, the aggregate penalty continues to bear a reasonable relation to the seriousness of the violation.

### **3.19 Monetization of the Value of Sanctions**

A significant element of NERC's oversight of penalties, sanctions, and remedial action determined and levied by regional entities is ensuring acceptable similarity in the degree and type of sanction for violations constituting comparable levels of threat to the reliability of the bulk power system. It is also a requirement and a commitment of NERC and its designees that penalties, sanctions, or remedial actions levied or applied for the violation of a reliability standard bear reasonable relation to the seriousness of the violation. Specifically with respect to penalties and sanctions, it is intuitive that it will be easier, more objective, and more transparent to monitor and test for acceptable similarity if (monetary) penalties or monetized values of sanctions determined for violations are used as the primary basis of comparison, versus comparisons made on the basis of other (non-monetized) considerations. Similarly, there will be strong intuitiveness and transparency, particularly to those interested but not strongly familiar with the power industry, that the seriousness of a violation has been reasonably addressed if the consequences for it to the violator are determined and can be expressed clearly and quantifiably in monetary terms.

Penalties determined and levied by NERC or regional entities will by definition be valued in monetary terms: U.S or Canadian dollars. It will be the preference of NERC that (non-monetary) sanctions imposed either in lieu of or in addition to a penalty include disclosure of the monetary value that the sanctions represent to the violator. It is intuitive that defensible monetary values for those sanctions will be most easily determined if the penalty for the violation pursuant to these guidelines is first determined and then the sanctions to be levied are introduced and justified as appropriate alternatives to that penalty or additions to a lesser penalty. However, sanctions may be determined directly (e.g. without first determining a penalty amount) and monetized using other methods.

NERC does not have a preference between penalties and sanctions for violations. The preference expressed here will support ensuring comparability of outcomes regarding application of these guidelines and the promotion of reasonable relationship between the seriousness of a violation and the sanctions, or penalties and sanctions, levied for it.

### **3.20 Maximum Limitations on Penalties**

Penalties are direct, monetary judgments levied against a violator by NERC or the regional entity for the violation of requirements of the reliability standards. In contrast, sanctions will impose limitations or restrictions of some kind that may result in economic or other impacts to the violator, and remedial actions are directives by NERC or a regional entity to the violator regarding the correction of conditions, practices or any other relevant action or activity underlying the noncompliance(s) involved.

***In the United States, the Federal Power Act allows for the imposition of civil penalties of up to \$1,000,000 per day per violation.*** NERC and the regional entities draw their authority to levy penalties from the Federal Power Act; accordingly this figure is and can be understood as the maximum monetary penalty that NERC or regional entities are authorized to levy. However, as this legislation also requires that “[a]ny penalty imposed ... shall; (A) bear a reasonable relation to the seriousness of the violation; and (B) take into consideration the efforts of the user, owner, or operator to remedy the violation in a timely manner<sup>5</sup>” ***entities required to comply with the reliability standards must also understand that NERC and the regional entities will be obligated to assess penalties amounts up to and including the maximum amount for violations where warranted pursuant to these guidelines.***

In Canadian jurisdictions the maximum monetary penalty potentially assessable for a reliability standard violation is significantly less than the amount allowed in the United States under the Federal Power Act. Also, legislation presently governing some Canadian jurisdictions does not accommodate the levying of such a penalty under some circumstances, may not accommodate the levying of such a penalty for all violations, or does not accommodate the levying of any monetary penalties.

When a penalty may be levied, or proposed to regulatory authorities with jurisdiction to be levied, the following steps will be followed:

- a. NERC or the regional entity will initially disregard the penalty limitations of the regulatory authorities with jurisdiction, and determine what the penalties or sanctions would be pursuant to these sanction guidelines only.
- b. NERC or the regional entity will review the maximum penalty allowed by the regulatory authorities with jurisdiction.
- c. NERC or the regional entity will set the actual penalty to be levied, or proposed to the regulatory authorities with jurisdiction to be levied, as the lesser of that determined pursuant to these guidelines and the maximum penalty or sanction allowed by the regulatory authorities.

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<sup>5</sup> H.R.6, Energy Policy Act of 2005, Section 215, Paragraph e, subparagraph 6.

- d. If the lesser penalty is the maximum penalty allowed by the regulatory authorities, the notice of penalty or similar document issued by NERC or the regional entity regarding the violation will also list the penalty that was determined pursuant to these guidelines.

Adhering to the above steps will insure that the result of the determination of any penalty for any violation will produce output that can be directly compared (i.e. without influence of local authorities' penalty limitations or restrictions) with the penalty determined for any other violation, assisting efforts of NERC and others to ensure that these guidelines are uniformly applied and that there is an acceptable level of consistency in the application of these sanction guidelines across North America. Regulatory authorities with jurisdiction may also find such information useful for their determination of the appropriateness of any penalty or sanction proposed to them to be levied. Similarly, policy and legislative bodies may find such information of value to the review or development of arrangements addressing such matters.

## **4. Determination of Monetary Penalties**

The following describes the steps that NERC or the regional entity will follow to determine the monetary penalty for a violation<sup>6</sup>. The determination of non-monetary sanctions is discussed in Section 5 of this document; Section 6 discusses remedial action.

- Step 1. The Base Penalty Amount for the violation will be set as discussed in Sections 4.1 and 4.2, below.
- Step 2. The Base Penalty Amount set in Step 1 will be reviewed pursuant to Section 4.3, below. This will result in the Adjusted Penalty Amount.
- Step 3. The Adjusted Penalty Amount determined in Step 2 may be reviewed in light of the violator's financial ability to pay the penalty. Also, where applicable NERC or the regional entity will reconfirm that the penalty set will disgorge unjust profits or economic benefits associated with an economic choice to violate<sup>7</sup>. At the conclusion of this review the Final Penalty Amount will be set.

Penalties shall be assessed on a per violation basis and are subject to assessment on a "per day in violation" basis where (i) NERC or the regional entity deems it appropriate to do so and (ii) the nature of the reliability standards requirement(s) violated supports doing so, in particular the time period and duration, the nature and the severity of the risk posed to the bulk power system by the violation(s),

Figures listed in the Base Penalty Amount Table are germane to the determination of penalties on both a simple per occurrence basis and as the basis for the determination of an appropriate "per day in violation" amounts as warranted by NERC or the Regional Entity and supported by the nature of the reliability standards requirement(s) violated and the characteristics of the violation(s) as discussed above,

### **4.1 Initial Value Range of the Base Penalty Amount**

NERC or the regional entity will determine an initial value range for the Base Penalty Amount by considering two factors regarding the violation: the Violation Risk Factor (VRF) of the requirement violated and the Violation Severity Level (VSL) assessed for the violation. Using the Base Penalty Amount Table provided in Appendix A NERC or the regional entity will look up the initial value range for the Base Penalty Amount by finding the intersection of the violation's VRF and VSL on the table<sup>8</sup>.

#### **4.1.1 Violation Risk Factor**

Each requirement set out within NERC's reliability standards has been assigned a Violation Risk Factor (VRF) through the NERC reliability standards development process. The factors have been defined and approved through the standards development process and are assigned to requirements to provide clear, concise and comparative association between the violation of a requirement and the expected or potential impact of the violation to the reliability of the bulk power system. One of three defined levels of risk is assigned to each standards requirement: Lower Risk Factor, or; Medium Risk Factor, or; High Risk Factor. Definitions of the factors can be found in appropriate standards development process documentation.

#### **4.1.2 Violation Severity Level**

Violation severity levels (VSLs) are defined measurements of the degree to which a violator violated a requirement of a reliability standard. Whereas violation risk factors are determined

<sup>6</sup> The text in this section discusses the determination of a single penalty for an individual violation; however, the process laid out is also applicable to determining the individual penalties, or a single aggregate penalty, for multiple violations that are associated with each other as discussed in Section 3 Part 3.1 of this document.

<sup>7</sup> Reference: Section 3 Parts 3.15 and 3.16.

<sup>8</sup> As discussed in Section 3 Part 3.1 of this document where there is more than one violation in play, but the violations are sufficiently associated, NERC or the regional entity may set a single initial value range that is appropriate in light of the individual VRF/VSL combinations of the violations.

pre-violation and indicate the relative potential impacts that violations of each standard could pose to the reliability of the bulk power system, the violation severity level is assessed post-violation and is an indicator of how severely the violator actually violated the standard(s) requirement(s) in question.

These guidelines utilize the violation severity levels that have been established<sup>9</sup> by NERC for requirements of the reliability standards. Up to four levels can be defined for each requirement; the levels have been designated as: Lower, Moderate, High, and Severe.

#### **4.2 Setting of the Base Penalty Amount**

NERC or the regional entity will set the Base Penalty Amount for the violation. The Base Penalty Amount set for the violation may be set at the highest figure of the initial value range determined pursuant to Section 4.1, above. However, NERC or the regional entity may set the Base Penalty Amount at or below the lowest figure of the initial value range in light of two specific circumstances regarding the violation and the violator, specifically:

- a. The applicability of the Violation Risk Factor of the violation to the specific circumstances<sup>10</sup> of violator.
- b. Whether this is an inconsequential first violation by the violator of the reliability standard(s) in question.

As noted in Section 3.12 NERC or the regional entity will consider the time horizon involved with the violation when setting the Base Penalty Amount for the violation. As also noted in Section 3.12 this consideration will be documented for inclusion in the Notice of Penalty issued for the violation.

The penalty amount resulting from the this review will be the Base Penalty Amount that is used as the basis for further adjustment pursuant to the factors discussed in the next section (4.3) of this document.

##### **4.2.1 Applicability of the Violation Risk Factor**

Violation Risk Factors are assigned to standards' requirements as indicators of the expected risk or harm to the bulk power system posed by the violation of a requirement by a typical or median entity that is required to comply. NERC or the regional entity may consider the specific circumstances of the violator to determine if the violation of the requirement in question actually produced the degree of risk or harm anticipated by the Violation Risk Factor. If that expected risk or harm was not or would not have been produced, NERC or the regional entity may set the Base Penalty Amount to a value it (i) deems appropriate and (ii) is within the initial value range set above pursuant to Section 4.1.

##### **4.2.2 First Violation**

If the actual or foreseen impact of the violation is judged to be inconsequential by NERC or the regional entity and the violation is the first incidence of violation of the requirement in question by the violator, NERC or the regional entity may at its discretion: (i) set the Base Penalty Amount to a value it deems appropriate within the initial value range set above pursuant to Section 4.1, or (ii) excuse the penalty for the violation (i.e. set the Base Penalty Amount to 0\$).

This relief will generally not be afforded to the violator if NERC or the regional entity determines that the violator has a poor compliance record; e.g. the circumstances discussed in Section 4.3.1 have been an aggravating factor in one or more previous penalties assessed to the violator.

<sup>9</sup> Assignment of these levels is scheduled to be complete by the end of 2006.

<sup>10</sup> The circumstances of the violator will include but not be limited to, as appropriate: the violator's aggregate and net load; interconnections characteristics such as voltage class and transfer ratings;

This relief will not be available for consideration in instances where the violator has concealed or attempted to conceal the violation, failed or refused to comply with compliance directives from NERC or the regional entity, or intentionally violated for purposes other than a demonstrably good faith effort to avoid a significant and greater threat to the immediate reliability of the bulk power system.

### **4.3 Application of Adjustment Factors**

Adjustment factors provide the opportunity to NERC or the regional entity to adjust the base penalty to reflect the specific facts and circumstances material to each violation and violator.

These guidelines recognize and require that, as a minimum, NERC or the regional entity consider the following:

- a. Repetitive violations and the violator's compliance history
- b. Failure of the violator to comply with compliance directives
- c. Self-disclosure and voluntary corrective action by the violator
- d. Degree and quality of cooperation by the violator in the violation investigation and in any remedial action directed for the violation
- e. The presence and quality of the violator's compliance program quality
- f. Any attempt by the violator to conceal the violation
- g. Intentional violations
- h. Extenuating circumstances

Two documents issued by United States regulatory agencies will be instructive to NERC and the regional entities when they are determining penalties for violations of the reliability standards: the FERC's Policy Statement on Enforcement issued on October 20, 2005 under Docket No. PL06-00, and; U.S Securities and Exchange Commission (SEC) Release No. 44969 under the Securities and Exchange Act of 1934, issued on October 23 2001, also concurrently issued by the SEC as Release No. 1470 under Accounting and Auditing Enforcement.

NERC or the regional may also consider other additional factors it deems appropriate under the circumstances as long as their use is clearly identified and adequately justified. The effect of using these factors will also be fully and clearly disclosed.

#### **4.3.1 Repetitive Violations and Compliance History**

A bulleted point under Paragraph 20 of the FERC Policy Statement on Enforcement highlights repeat offenses by a violator. If a violator has had repetitive infractions of the same or a closely-related reliability standard requirement, particularly within a time frame defined within the standard(s) or deemed appropriate by NERC or the regional entity in the absence of the standard(s) defining the time frame, NERC or the regional entity shall consider some increase to the penalty.

The term "violation reset time period" of a standards requirement may be defined or implied within a given standard to describe the period of time generally required for a violator to continue operations without incidence of further violation(s) of the Reliability Standards, particularly of the initial or a similar standard violated, in order to avoid or minimize consideration of the violator's previous violation history for sanctioning purposes in the event of a subsequent violation(s). NERC and the Regional Entities shall exercise appropriate judgment and discretion in this regard as warranted, particularly where no reset time period is specifically set within the standard violated. Repeat violations within violation reset time periods are aggravating factors in the determination of sanctioning. Accordingly, a violation

history of no violations will produce no mitigation of the penalty otherwise determined; a violation history of infrequent minor violations of lesser risk requirements assessed lower violation severity levels may result in small or no increase; a history of more frequent violations or previous violations of higher risk requirements assessed more severe violation severity levels will generally incur commensurately larger increases.

#### **4.3.2 Failure to Comply with Compliance Directives**

If the violator has violated reliability standard requirements notwithstanding having received related compliance directives, such as for remedial action from NERC or the regional entity, NERC or the regional entity shall consider some increase to the penalty.

#### **4.3.3 Self-Disclosure and Voluntary Corrective Action**

NERC or the regional entity shall consider whether a violator self-disclosed the violation prior to detection or intervention by NERC or the regional entity, and any action undertaken by the violator to correct the situation. NERC or the regional entity will be instructed in their consideration of these factors by the text of Paragraphs 24 and 25 of the FERC Policy Statement on Enforcement. As they deem warranted, NERC or the regional entity may reduce the violator's penalty consistent with the cited sections of the FERC policy.

#### **4.3.4 Degree and Quality of Cooperation in Violation Investigation and Remedial Action**

NERC or the regional entity shall consider the degree and quality of the violator's cooperation with NERC or the regional entity in the investigation of the violation and any remedial action arising from it. NERC or the regional entity will be instructed in making their determination on this by the text of Paragraphs 26 and 27 of the FERC Policy Statement on Enforcement. NERC or the regional entity may adjust the violator's penalty as they deem warranted commensurate with the cited sections of the FERC policy statement. This may result in an increase, a decrease or no change to the penalty.

#### **4.3.5 Presence and Quality of Compliance Program**

NERC or the regional entity shall consider the presence and quality of the violator's compliance program. NERC or the regional entity will be instructed in making their determination on this factor by the text of Paragraphs 22 and 23 of the FERC Policy Statement on Enforcement. As they deem warranted, NERC or the regional entity may reduce the violator's penalty consistent with the cited sections of the FERC policy. Consistent with the FERC policy NERC or the regional entity may not increase a violator's penalty specifically on the grounds that the violator has no program or a poor quality program.

#### **4.3.6 Violation Concealment**

Two bulleted points under Paragraph 20 of the FERC Policy Statement on Enforcement highlight misrepresentation of material facts and resistance or impediment to inquiry of a violation. When determining a penalty NERC or the regional entity shall consider any concealment or attempt to conceal the violation, or information needed to investigate the violation, on the part of the violator. If the violator concealed or attempted to conceal, some significant increase to the penalty shall be considered; doubling of the penalty otherwise determined is suggested. Conduct of this nature on more than one occasion regarding one violation, or with respect to more than one violation, should incur an even larger increase to the penalty otherwise determined.

#### **4.3.7 Intentional Violation**

Another bulleted point under Paragraph 20 of the FERC Policy Statement on Enforcement highlights offenses as willful action by a violator. When determining a penalty NERC or the regional entity shall consider if the violator intentionally violated without just cause; i.e., for purposes other than a demonstrably good faith effort to avoid a significant and greater threat

to the immediate reliability of the bulk power system. If the violator engaged in such conduct, some significant increase to the penalty shall be considered; doubling of the penalty otherwise determined is suggested. If conduct of this nature has been detected on more than one occasion, NERC or the regional entity should assess an even larger increase to the penalty otherwise determined.

NERC or the regional entity will consider violations attributable to an economic choice to violate as intentional violations. Consistent with the FERC Policy Statement on Enforcement any penalty issued involving conduct of this manner shall as a minimum disgorge any profits or economic benefits acquired as a consequence of the behavior, whenever and to the extent that they can be determined or reasonably estimated.

#### **4.3.8 Extenuating Circumstances**

NERC or the regional entity will consider if there are extenuating circumstances regarding the violation that justify reduction or elimination of the penalty otherwise determined.

Consideration of adjusting a penalty for this factor would be inconsistent with NERC or the regional entity increasing a penalty after consideration of any other factor included in this section of these guidelines, such as intentional violation without justifiable cause or concealment or attempt to conceal.

### **4.4 Setting of the Final Penalty Amount**

The Adjusted Penalty Amount determined in Step 2 may be reviewed in light of the violator's financial ability to pay the penalty. Also, if the violation was an economic choice, NERC or the regional entity will reconfirm that the penalty set will disgorge any unjust profits or economic benefits. At the conclusion of this review the Final Penalty Amount will be set.

#### **4.4.1 Violator's Financial Ability to Pay<sup>11</sup>**

At the written request of the violator NERC or the regional entity will review the penalty determined in Step 2 in light of relevant, verifiable information that the violator provides regarding their financial ability to pay. At the conclusion of this review NERC or the regional entity may:

1. Reduce the penalty payable to an amount that NERC or the regional entity, as applicable, deems the violator has the financial ability to pay, or;
2. Excuse the penalty amount payable, or;
3. Sustain the penalty amount determined in Step 2.

Where the penalty amount has been reduced or excused, NERC or the regional entity shall consider the assessment of appropriate non-monetary sanction(s) as a substitute or an alternative for the penalty amount that has been excused or by which the penalty has been reduced.

#### **4.4.2 Reconfirmation of Disgorgement of Unjust Profit or Gain**

Notwithstanding the application of any other consideration or factor applicable to the determination of a just and reasonable penalty for the violation, if the violation in question involved an economic choice to violate NERC or the regional entity shall reconfirm that the penalty set meets the requirements set forth in Parts 3.15 and 3.16 of Section 3 of this document.

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<sup>11</sup> NERC anticipates that this will be the primary vehicle for addressing the ability to pay of "not-for-profit" and other similar organizations.

## **5. Determination of Non-Monetary Sanctions**

The imposition of sanctions is not bounded to monetary penalties. Non-Monetary sanctions applied must be applied with the objective of promoting reliability and compliance with the reliability standards. Non-monetary sanctions may include, but not be limited to, the following:

- a. Limitations on activities, functions, or operations
- b. Placing an entity on a reliability watch list composed of major violators

## **6. Remedial Action**

### **6.1 Definition and Anticipated Use**

Remedial actions are directives that may be issued to a bulk power system owner, operator, or user to resolve an alleged violation of a reliability standard by addressing conditions, practices, or any other relevant action or activity. A remedial action directive will be issued when NERC or the regional entity identifies an alleged violation of a reliability standard that must be corrected to promptly reduce the reliability threat that NERC or the regional entity has identified poses to the reliability of the bulk power system.

NERC or the regional entity will generally employ remedial action directives where they deem it necessary to clearly specify minimum corrective actions that the subject of the remedial action directive must take; additionally or alternatively a remedial action directive may clearly specify timelines within which the subject must take specified actions, complete specified tasks, or achieve specified outcomes. Also, to the extent NERC or the regional entity is authorized to do so, a remedial action directive may communicate penalties, sanctions, or further remedial actions that may be imposed should the specific remedial action directive not be complied with by those to whom it has been issued. As a rule of thumb, remedial action directives will be of use to NERC or the regional entity whenever any significant combination of specificity, clarity, or time is of the essence to address a threat to the reliability of the bulk power system brought on by lack of or inadequate compliance to the reliability standards.

### **6.2 Compliance Requirements**

In the United States, the Commission has concluded that owners, operators, or users of the bulk power system must comply with remedial action directives issued to them by NERC or a regional entity. Noncompliance with a remedial action directive may result in a substantially increased penalty or sanction.

Remedial action directives issued by NERC or the regional entity will include a deadline by which time the owner, operator, or user must complete requirements set out in the order, and by which time the entity must demonstrate compliance to the remedial action directive to NERC or the regional entity that issued it. Failure or refusal to meet the requirements or deadlines set out in a remedial action directive may itself result in further remedial action directives or significantly increased penalties or sanctions by NERC or the regional entity.

### **6.3 No Obligation to Issue**

NERC or the regional entity may, but is not obligated, to issue remedial action directives. Lack of being issued a remedial action directive does not relieve a bulk power system owner, operator, or user from any responsibilities they otherwise have to comply or maintain compliance with requirements of the reliability standards. Remedial action directives will be used by NERC or the regional entities only as they deem warranted, when they deem warranted.

### **6.4 Scope of Application**

The scope of remedial action directives issued by NERC or the regional entity will be limited to conditions, practices, or any other relevant actions or activities resulting in noncompliance, or that NERC or the regional entity considers at significant risk of becoming noncompliant, to requirements of the reliability standards. However, beyond merely directing compliance or improved compliance with standards' requirements, where NERC or the regional entity is authorized to do so, the directive may also stipulate how compliance or the improvement to compliance is to be achieved.

### **6.5 Availability**

In the United States, the Commission has interpreted the Federal Power Act to authorize the NERC or the regional entity can issue a remedial action directive prior to completion of the confirmation review of a probable violation, or prior to the determination of a penalty or sanction for that violation.

The Commission also concluded it is not necessary for NERC or the regional entity to acquire the Commission's or other regulators' approval prior to issuing remedial action directives. Accordingly, NERC or the regional entity may issue remedial action directives to entities in the United States whenever they deem it necessary or otherwise warranted to do so. Also, NERC or the regional entity may issue remedial action directives to entities in the United States regarding a violation, irrespective of whether that violation is ultimately verified or dispelled by NERC or the regional entity's investigation of the violation.

#### **6.6 No Impact on Confirmation of Violation, or Penalties or Sanctions**

Remedial action directives issued regarding a violation, in particular any costs incurred by the violator to comply with any such directive, will not be considered when reviewing whether the aggregate of any penalties and sanctions levied for that violation bear a reasonable relation to the seriousness of the violation. Also, any remedial action directives issued with respect to a violation will not influence the outcome of the confirmation review of that violation nor the determination of penalties or sanctions for that violation; ordering a violator to correct what needs correcting anyway is no grounds for dispelling a violation nor reducing or eliminating a penalty or sanction that would otherwise be determined appropriate for the violator for that violation.

#### **6.7 Types of Remedial Actions**

NERC or the regional entities may issue remedial action directives to correct compliance with NERC or regional reliability standards and reduce or eliminate threats to the reliability of the bulk power system. Examples of remedial actions include:

- a. Specifying operating or planning criteria, limits, or limitations
- b. Requiring specific system studies
- c. Defining operating practices or guidelines
- d. Requiring confirmation of data, practices, or procedures through inspection testing or other methods
- e. Requiring specific training for personnel
- f. Requiring development of specific operating plans

## Appendix A: Base Penalty Amount Table

The following lists the Base Penalty amounts corresponding to combinations of violation risk factor and violation severity factor<sup>12</sup>.

Violation Risk Factor	Violation Severity Level							
	Lower		Moderate		High		Severe	
	Range Limits		Range Limits		Range Limits		Range Limits	
	Low	High	Low	High	Low	High	Low	High
<b>Lower</b>	\$1,000	\$3,000	\$2,000	\$7,500	\$3,000	\$15,000	\$5,000	\$25,000
<b>Medium</b>	\$2,000	\$30,000	\$4,000	\$100,000	\$6,000	\$200,000	\$10,000	\$335,000
<b>High</b>	\$4,000	\$125,000	\$8,000	\$300,000	\$12,000	\$625,000	\$20,000	\$1,000,000

NOTE: This table describes the amount of penalty that could be applied for each day that a violation continues.

<sup>12</sup> Figures listed in the Base Penalty Amount Table are germane to the determination of penalties on both a simple per occurrence basis and as the basis for the determination of an appropriate “per day in violation” amounts as warranted by NERC or the Regional Entity and supported by the nature of the reliability standards requirement(s) violated and the characteristics of the violation(s).