Federal Energy Regulatory Commission
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Conference on Enforcement Policy
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Statement of
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"FERC has long had an enforcement program, but the focus of that program was changed dramatically by the Energy Policy Act of 2005, which granted us a greater role in market regulation, in preventing market manipulation and market power exercise, and in assuring bulk power system reliability. The new law also gave us stronger enforcement authority through enhanced civil penalty authority.

FERC has been exercising its new enforcement tools for two years, but the public results have been visible for only the past ten months. This conference is a good opportunity to review these results, better explain our enforcement objectives and processes, and to consider possible changes in FERC enforcement policy that could improve compliance.

My goals for this conference are, first, to restate the central rationale of FERC enforcement policy. Second, to provide greater clarity to the regulated community and the public on how we approach enforcement, including our procedures, some of which are nonpublic, our philosophy towards self reports and compliance programs, and how we determine the size of civil penalties. It is important that the regulated community and the public understand our priorities, standards and processes for enforcement. Third, to identify the importance of developing strong compliance programs and discuss proposals directed at achieving greater compliance.

The object of FERC enforcement policy is to achieve maximum compliance with regulatory requirements. We can achieve greater compliance by taking steps to strengthen the compliance programs of regulated companies, by using our penalty authority to encourage compliance, and by being clear in our regulatory requirements. Our goal is compliance, not the collection of civil penalties. However, it is sometimes necessary to impose civil penalties in order to encourage maximum compliance.

It is a personal priority for me as Chairman to strengthen compliance programs in the regulated community. Actions we can take now to strengthen compliance will pay great dividends over time.

To be clear, I do not expect perfect compliance. I would expect some level of violations will occur even with a universally strong commitment to compliance by the regulated community. However, if we can strengthen compliance programs we can reduce the number and seriousness of violations.

Many aspects of our enforcement program are new and not particularly well understood by the regulated community and the public. One of the goals of this conference is improved understanding of our enforcement philosophy, standards and processes. There are at least four areas of our enforcement policy that may not be well understood and where I think we can do a better job explaining our approach. First, our overall attitude towards the regulated community. Second, the due process that is currently afforded to subjects of investigations. Third, the value of self reporting and compliance programs. Fourth, the principal factors that govern the size of civil penalties.

Attitude Towards the Regulated Community

Chester Bowles was Administrator of the Office of Price Administration during the Second World War. That office was responsible for controlling the price of consumer goods and rationing certain goods and Bowles confronted compliance challenges. Bowles offered an interesting observation about the attitude of a regulated population towards compliance, namely that "20% of the regulated population will automatically comply with any regulation, 5% will attempt to evade it, and the remaining 75% will comply as long as they think the 5% will be caught and punished."

I have no reason to believe the dynamic we are facing at FERC is fundamentally different. If you accept that proxy, the question is what steps can FERC take to help the 95% of the regulated community that are trying to comply with our requirements, and how can we best assure the remaining 5% are caught and punished. As a general matter, I would expect to see improved compliance if our regulatory requirements are seen as fair and if they are clearly stated.

Our enforcement resources are limited, and we must exercise prosecutorial discretion. We should focus our resources on those violations that cause serious harm, on violations that entail great risk of serious harm, on violations of core regulatory requirements, and on companies with the weakest compliance programs. We should focus our enforcement resources on identifying and punishing those regulated companies that are resolved to evade our regulatory requirements, as well as sanctioning companies with weak compliance cultures. This second class may well be composed principally of companies that are largely indifferent to compliance, rather than companies bent on evasion.

Due Process Afforded to Subjects of Investigations

FERC is as committed to being fair as being firm in enforcement. Fairness means providing due process to subjects of investigations and fairly considering their arguments. Due process means many things, but includes disclosing in detail the bases for our investigation, our theory of the case, and our facts. It also includes giving subjects a fair opportunity to respond before any public action is taken.

Investigations start in a variety of ways. Sometimes an investigation begins with an anonymous hotline call, sometimes by a tip from competitors. Often, investigations start with incomplete information. In the course of an investigation, enforcement staff sometimes discovers evidence of violations. But we also shut down investigations when we are convinced that no violation occurred. Over the past two years, we have closed a number of investigations on that basis.

One of the challenges in implementing our enhanced enforcement authority is that only certain actions are public – most notably, those instances where we find a violation and assess a penalty. But there are many instances where we close a non-public investigation or accept a self-report without assessing a penalty. Those actions remain nonpublic for good reasons.

I directed the Enforcement Staff to prepare an aggregated overview of our recent history in this area to give the regulated community and the public a better picture of how often we do not impose penalties or seek other remedies. The Staff Report on Enforcement is a very

complete review. As the report shows, although we have assessed penalties in 12 cases since last year, in the large majority of cases – both self reports and investigations we initiated – there was no civil penalty.

Value of Self Reporting and Compliance Programs

I am aware there are questions about how much value FERC places on self reports. The short answer is that self-reports are very important, but they are often not enough, standing alone, to absolve the reporting company of a penalty. Rather, self-reports are better understood as an essential component of a sound compliance program, not a factor that stands alone.

For example, consider a hypothetical company that violates the law every day and is rigorous in reporting those violations every day. In my view, such a company should not be rewarded for those self-reports, but rather should be viewed as suspect for not having a sound compliance program dedicated to reducing or eliminating the incidence of violations.

It is therefore important that companies put in place strong compliance programs that have internal controls that reduce or eliminate the incidence of violations. Once such a program is in place, if a violation nonetheless occurs and is detected as part of the compliance program (such as through internal audits), the violation should be self-reported. It is the combination of a strong compliance program and self-reporting that provides a regulated company the best opportunity for avoiding a significant civil penalty, or perhaps avoiding a penalty altogether.

Having said that, there is no question that FERC values self reporting; that is demonstrated by our treatment of self reports. Self reporting results in lower penalties than would otherwise be the case; and failure to self report results in higher civil penalties. As reflected in the Report on Enforcement prepared by Staff, 79% of self reports (45 out of 57) that have been resolved were closed without payment of a civil penalty, while 21% (12 out of 57) have resulted in civil penalties - none of which have approached maximum penalty levels. In other words, four out of five times a self report is resolved without payment of a civil penalty.

As I indicated, however, even though there is value in self reporting, the value of self reporting diminishes if disconnected from efforts to improve compliance. Going forward, in my view the single most important mitigating factor should be the strength of a regulated company's commitment to compliance. Self reporting is an element of a strong compliance culture, but by itself does not suggest a commitment to compliance – a company that self reports the same violation cannot be said to have a commitment to compliance.

A strong commitment to compliance can lower what would otherwise be maximum penalties to moderate levels, or moderate penalties to no or minimal penalty levels. As I stated earlier, some incidence of violations will occur, even by regulated companies with the strongest commitment to compliance. If a regulated company with a strong compliance culture inadvertently commits a lesser violation and self reports it, they will have a strong basis to argue that there should be no penalty, particularly if there is no harm to the public. By the same token, a company with a weak compliance program that repeatedly violates the law can expect to receive a penalty, even if those violations are self-reported and even if harm to the public is small or nonexistent.

To illustrate, if two regulated companies commit identical violations, and the only distinction between the companies is the relative commitment to compliance, the proper outcome may well be that the company with the strong compliance culture pays no or minimal penalty, and the company with the weak compliance culture pays a civil penalty that may be significant.

If a company persists in a weak commitment to compliance, there are other steps we can consider in addition to higher civil penalties. We can make the company the subject of more frequent compliance audits. We could consider establishing an onsite FERC staff presence until compliance improves to acceptable levels. In an extreme case, we could require senior executives of a regulated company to appear before the Commission at an Open or Closed Meeting to discuss the company's poor compliance history.

If FERC is going to place great weight on the relative strength or weakness of a regulated company's commitment to compliance, we must accept we have a duty to identify the core elements of a strong corporate compliance program. We must be specific on what we consider the elements of a strong or weak compliance program.

Greater Clarity on the Size of Civil Penalties

We provided guidance on factors FERC would consider in the imposition of civil penalties in the October 2005 Enforcement Policy Statement. This year, we have entered into 12 settlements involving a total of $41.6 million in civil penalties. We also have resolved 45 self reports of violations without requiring the payment of any civil penalties. All the settlements we entered into this year, as well as the two show cause orders we issued last July, are consistent with the Enforcement Policy Statement.

In my view, the civil penalties imposed to date have been appropriate. They reflect an enforcement philosophy that focuses its resources on violations that cause or threaten serious harm and on violations of core regulatory requirements. They reflect an enforcement philosophy that waives civil penalties for innocent violations of lesser requirements where there is no material harm.

In particular, FERC has been reserved in imposition of maximum civil penalties. As indicated earlier, in 45 self reports, FERC imposed no civil penalties. FERC has proposed maximum penalties in only two cases, both involving alleged market manipulation, namely Amaranth and Energy Transfer Partners. In each case, maximum penalties were proposed for only one of the multiple alleged violations. In none of the 12 settlements involving the payment of civil penalties, did penalties approach maximum or near-maximum levels.

However, I accept there is a need to provide greater clarity to the regulated community and the public on when FERC is likely to impose maximum or near-maximum civil penalties, moderate penalties, and minimal or no penalties.

To be clear, I do not believe all FERC regulatory requirements are equally important, nor that all violations are equally offensive. That is borne out by our treatment of self reports where we imposed no civil penalty for innocent violation of lesser regulatory requirements. Violation of some regulatory requirements may result in maximum civil penalties, while others result in moderate, minimal or no penalties. Let me offer some perspective on the

principal factors that should govern the size of civil penalties.

As a general rule, maximum or near-maximum penalties are appropriate when serous harm was caused by the violation. Harm should be the most important consideration in determining the size of a civil penalty. That is consistent with the Enforcement Policy Statement issued two years ago.

However, in some cases maximum or near-maximum penalties may be appropriate in the absence of serious harm, but where there was serious risk of harm. For example, market manipulation is an offense that may often result in maximum penalties, even if the manipulative scheme is ultimately unsuccessful. The enforcement and civil penalty provisions of the Energy Policy Act of 2005 were inspired in large part by the market manipulation that occurred during 2000-01. Violations of certain reliability standards can also risk serious harm, such as cascading blackouts. In both situations, it may be appropriate, depending on the facts, to impose maximum or near-maximum penalties for market manipulation or serious reliability violations even in the absence of serious harm.

In my view, the most important mitigating factor in determining the size of a civil penalty should be the strength of a regulated company's commitment to compliance. If a regulated company has a strong compliance program, that argues for lesser penalties. But the reverse is also true if a company has a weak compliance culture and demonstrates an indifference towards compliance. A weak compliance culture could, in effect, become an aggravating factor if it results in repeated violations of the law. In such a situation, higher penalties would be appropriate to sanction such a weak compliance culture.

There are also situations where moderate penalties are appropriate. For example, where a violation results in lesser harm, or where the violation involves a core regulatory requirement. As I indicated, not all FERC regulatory requirements are equally important; some rules are core elements of our regulatory program. For example, network transmission service is a core element of the open access transmission tariff, and the shipper must have title rule is a core element of our gas regulatory program. Violations in these areas resulted in moderate penalties that did not approach maximum levels.

Proposals to Improve Compliance with FERC Requirements

If FERC demands compliance, we must be clear on the nature of our rules. I accept that our regulatory requirements may not always be clear, and we have a duty to clarify ambiguous requirements. As a general matter, we should not impose a civil penalty for violating a regulatory requirement that is ambiguous. If in the course of its action on an investigation the Commission clarifies our regulatory requirement for the first time, we should give the regulated community an opportunity to come into compliance with our newly clarified regulatory requirement.

We accept our responsibility to be clear in our regulatory requirements. We rescinded Market Behavior Rule 2 in part out of concern that it would be unfair to have two different sets of anti-manipulation rules. We held a technical conference on the Standards of Conduct rule last year to address concerns from the regulated community that this particular rule presented a compliance challenge. The Standards of Conduct rulemaking initiated earlier this year was intended in part to address these compliance challenges.

The desire to be clear in our regulatory requirements led us to establish the no action letter process two years ago. However, over the past two years we have received only nine no action letter requests. It is not clear to me why there have been so few requests. Perhaps the scope of no action letters is too limited. Currently, no action letters are limited to Standards of Conduct, Codes of Conduct, Market Behavior Rules, and the Anti-Manipulation Rules.

One option before the Commission is expanding the scope of no action letters to cover a broader range of FERC requirements. For example, some in the regulated community have expressed interest in expanding the scope of no action letters to include our gas capacity release rules.

We could also develop an alternative mechanism, such as interpretative letters, to address other issues, such as transactional matters under section 203 of the Federal Power Act or tariff interpretations. There is some uncertainty in application of section 203 in the wake of changes to the Federal Power Act and repeal of the Public Utility Holding Company Act of 1935. We have attempted to address that uncertainty with the orders issued by the Commission last summer, but perhaps interpretative letters could provide a useful means to further clarify our requirements.

Our goal is to achieve maximum compliance with FERC regulatory requirements. I would like to discuss a number of proposals intended to help regulated companies achieve greater compliance. As stated earlier, it is a personal priority of mine to strengthen the compliance programs of regulated companies.

I recognize that developing model corporate compliance programs can be expensive. For that reason, we can be flexible in our negotiated settlements to encourage the development of model compliance programs. For example, instead of requiring that all settlement monies be paid in the form of civil penalties to the U.S. Treasury, we could allow some settlement funds to be used to fund model compliance programs.

Normally, I would expect a settlement would involve the payment of some penalties to the U.S. Treasury. However, we might be able to achieve more long-term good by allowing a portion of settlement monies to be used to strengthen compliance. We could also consider putting some settlement monies in an escrow fund, and return funds if a regulated company avoids non-administrative violations for some period of time.

If we are to insist on strong compliance programs, we should also be willing to provide guidance to the regulated community on the key elements of such programs. We could offer that guidance in a number of ways, such as developing a staff guidance document regarding the key elements in a sound compliance program or considering requests by individual companies to audit their compliance programs. The purpose of such an audit would be to identify the weaknesses in the compliance programs of regulated companies and propose improvements. The company would be responsible for implementing any such improvements, as well as for future compliance.

By offering these ideas, I want to emphasize that we are open to changes in enforcement policy that may help the members of the regulated community that are trying to comply with our requirements avoid violations.

I would like the views of the panelists on these proposals, and would like to hear your ideas on how we can strengthen compliance.

Conclusion

In conclusion, the object of FERC enforcement policy is to achieve maximum compliance with regulatory requirements. We expect compliance, but we are also willing to help the regulated community achieve improved compliance.

In my view, the Commission has properly exercised its civil penalty authority this year. We have reserved maximum penalties for the most serious alleged violations involving serious harm. We have imposed moderate penalties for violations of core regulatory requirements. We have resolved lesser violations without imposition of civil penalties.

However, this agency is a reform agency. We are prepared to consider changes that will further the goal of achieving maximum compliance, and I have proposed a number of ideas.

I look forward to hearing the views of my colleagues and the panelists."