

Development and Implementation of Violation Risk Factors for Enforcement of Compliance with NERC Reliability Standards

Background

On April 4, 2006, NERC filed its application to become the North American electric reliability organization (ERO) with the U.S. Federal Energy Regulatory Commission (FERC), the National Energy Board of Canada, and with the Canadian provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, and Nova Scotia. Once recognized as the ERO, NERC would have the authority, working with regional entities through delegation agreements, to enforce compliance with reliability standards approved by these governmental agencies. This authority would include the ability to impose financial penalties for violations of standards.

In its application, NERC offered a set of *ERO Sanction Guidelines* in Appendix 4 to its proposed rules of procedure. The guidelines provide a baseline matrix for the determination of financial penalties. This matrix, shown in Figure 1, begins with two factors: 1) violation risk factor and 2) violation severity level (previously known as level of noncompliance). The violation risk factor is a measure of the potential adverse risk a violation of a standard would have on the reliability of the bulk power system. The violation severity level is a measure of how badly an entity missed the required performance level. The proposed guidelines describe other factors that can be considered in adjusting a financial penalty upward or downward within a defined range.

Violation Risk Factor	Violator Size & Time Horizon Limits	Violation Severity Level			
		Lower	Moderate	High	Severe
Lower	Standard Penalty	\$1,000	\$3,000	\$6,000	\$10,000
	Lower	\$1,000	\$1,000	\$1,500	\$2,000
	Upper	\$2,000	\$6,000	\$12,000	\$20,000
Medium	Standard Penalty	\$5,000	\$15,000	\$25,000	\$40,000
	Lower	\$2,000	\$3,000	\$5,000	\$8,000
	Upper	\$10,000	\$30,000	\$50,000	\$80,000
High	Standard Penalty	\$35,000	\$50,000	\$70,000	\$100,000
	Lower	\$7,000	\$10,000	\$14,000	\$20,000
	Upper	\$70,000	\$100,000	\$140,000	\$200,000

Figure 1 — Proposed ERO Penalty Matrix for Violation of Reliability Standards

Violation risk factors have not previously existed and they must now be developed. In addition to using the violation risk factors in the setting of financial penalties, the NERC Board of Trustees had requested prior to the energy legislation establishing the ERO that such factors be developed to allow the board to better understand the potential impacts of violations of various standards. The violation severity levels do exist in the current standards as “levels of noncompliance”.

New Approach to Compliance Elements in Standards

In a white paper jointly approved in October 2005 by the Standards Authorization Committee and the Compliance and Certification Committee, several changes were proposed with regard to how compliance elements are developed in support of reliability standards:

- A violation risk factor would be assigned to each requirement in every standard. The standard drafting team would apply its technical expertise to propose the risk factors. The risk factors would be subject to stakeholder comment and ballot, along with the rest of the standard, through the standard development process.
- Compliance elements that depend more on compliance enforcement expertise, including the levels of noncompliance, would be removed from the standards and developed in a separate due process within the compliance enforcement program¹.

Initial Development of Violation Risk Factors

A Standard Authorization Request (SAR) was initiated to develop the [violation risk factors](#) for the existing reliability standards. The SAR was posted for comment from February 2 to March 6, 2006. A number of the comments received on the SAR were related to how the violation risk factors would be developed. Those questions are answered here:

- A drafting team will propose a violation risk factor to be assigned to each requirement in each existing reliability standard.
- These proposed risk factors will be included in a survey form to allow stakeholders to input their own ranking for each requirement. This initial survey will be conducted from mid-April through end of May.
- In a second posting from July 1 to August 15, the drafting team will revise the risk factors based on stakeholder inputs from the first posting. The drafting team will also add risk factors for all new standards that are currently in development and expected to be presented for NERC board approval on or before November 1, 2006. Once again, stakeholders will be asked to rank the violation risk factor of each requirement using a survey form.
- In September, the drafting team will submit a final set of recommended violation risk factors for a ballot of stakeholders to be conducted in October. Stakeholders will be asked to ballot the complete initial set of violation risk factors using a single ballot.
- If approved, the risk factors will be forwarded to the NERC board on November 1, 2006, for approval and immediate filing with FERC and the applicable governmental authorities in Canada.

Proposed Implementation of Violation Risk Factors

The risk factors are proposed to become effective on January 1, 2007, or an alternative later date set by FERC and the applicable governmental authorities in Canada. NERC's ERO application includes a six-month trial period in which financial penalties would be calculated and reported, but not imposed on the violating entities. The financial penalties would be imposed after this trial period.

To aid in implementation, once the violation risk factors are approved by the stakeholders and the board, NERC staff will integrate the risk factors into the existing reliability standards using a format such as shown the following example:

R2. A Reliability Coordinator, Balancing Authority, Transmission Operator, Generator Operator or Load Serving Entity shall promptly analyze Bulk Electric System disturbances on its system or facilities. **[Violation Risk Factor — Medium]**

¹ The Compliance and Certification Committee has posted a [proposed procedure](#) for the development of compliance elements public comment.

All standard drafting teams working on standards in the future (all those standards subject to approval after November 1, 2006) will be required to develop violation risk factors as a regular part of developing the standard.